

**Clean Water State Revolving Fund**

**For the Year Ended  
June 30, 1999**

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March 20, 2000

The Honorable Don Sundquist, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable Milton H. Hamilton, Jr., Commissioner  
Department of Environment and Conservation  
401 Church Street, 21<sup>st</sup> Floor  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Clean Water State Revolving Fund for the year ended June 30, 1999. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director  
Division of State Audit

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State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**Clean Water State Revolving Fund**  
For the Year Ended June 30, 1999

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## AUDIT OBJECTIVES

The objectives of the audit were to consider the fund's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grants; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

## AUDIT FINDINGS

The audit report contains no findings.

## OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

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"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit  
1500 James K. Polk Building, Nashville, TN 37243-0264  
(615) 741-3697

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**Audit Report**  
**Clean Water State Revolving Fund**  
**For the Year Ended June 30, 1999**

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**TABLE OF CONTENTS**

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	<u>Exhibit</u>	<u>Page</u>
<b>INTRODUCTION</b>		1
Post-Audit Authority		1
Legislative History		1
Organization		1
<b>AUDIT SCOPE</b>		2
<b>OBJECTIVES OF THE AUDIT</b>		2
<b>RESULTS OF THE AUDIT</b>		3
Audit Conclusions		3
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>		4
<b>FINANCIAL SECTION</b>		
Independent Auditor's Report		6
Financial Statements		
Balance Sheet	A	8
Statement of Revenues, Expenses, and Changes in Equity	B	9
Statement of Cash Flows	C	10
Notes to the Financial Statements		11
Required Supplementary Information		
Year 2000 Disclosures		12

# Clean Water State Revolving Fund For the Year Ended June 30, 1999

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## INTRODUCTION

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### POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Clean Water State Revolving Fund. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

### LEGISLATIVE HISTORY

The Clean Water State Revolving Fund was created in 1987 by an act of the General Assembly, codified as Section 68-221-1004, *Tennessee Code Annotated*. The fund is intended, in coordination with state and federal assistance programs, to provide local governments and utility districts with low-cost financial assistance to improve and protect water quality and public health. The fund was established as a revolving loan fund under Title VI of the Clean Water Act of 1987, administered by the United States Environmental Protection Agency. The fund’s loans are provided to local governments, at or below market interest rates, to construct facilities whose purposes may include collection, treatment, and disposal of wastewater. Local governments pledge to repay the loan principal and interest through a variety of methods including assessing, levying, and collecting ad valorem taxes on all taxable property within its jurisdiction; pledging its full faith and credit and unlimited taxing power; fixing, levying, and collecting fees and other charges for the use of the wastewater facility; and pledging any other security deemed necessary as determined by the Tennessee Local Development Authority.

### ORGANIZATION

The Clean Water State Revolving Fund is governed by the Tennessee Local Development Authority (TLDA), the Department of Environment and Conservation’s Division of Community Assistance (the Department), and the Wastewater Financing Board (the Board). The TLDA administers the fund, adopts the rules and regulations for the fund’s administration, and deposits

all receipts from repayments of loans into the fund. The Department conducts engineering and environmental studies on the planning and design of the facilities, approves applications for facility construction, and recommends to TLDA an appropriate financing method for each facility. In the event of missed payments, the Board is empowered to effect reasonable user rate increases or to effect system efficiencies through the negotiated consolidation of certain wastewater facilities. The Board is composed of the Commissioner of Environment and Conservation; the Comptroller of the Treasury; and five members appointed by the Governor representing municipalities, utility districts, environmental interests, manufacturing interests, and minority citizens of the state. The Director of the Division of Community Assistance serves as technical secretary to the Board.

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## AUDIT SCOPE

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The audit was limited to the period July 1, 1998, through June 30, 1999, and was conducted in accordance with generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 1999. The Clean Water State Revolving Fund forms an integral part of state government and as such has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered fund 35 of the State of Tennessee Accounting and Reporting System.

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## OBJECTIVES OF THE AUDIT

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The objectives of the audit were

1. to consider the fund's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

**Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in**

administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

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## RESULTS OF THE AUDIT

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### AUDIT CONCLUSIONS

#### Internal Control

As part of the audit of the Clean Water State Revolving Fund's financial statements for the year ended June 30, 1999, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

#### Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

#### Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Clean Water State Revolving Fund's financial statements.

**Report on Compliance and on Internal Control  
Over Financial Reporting Based on an Audit of  
Financial Statements Performed in Accordance With  
*Government Auditing Standards***

December 9, 1999

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Clean Water State Revolving Fund as of and for the year ended June 30, 1999, and have issued our report thereon dated December 9, 1999. We conducted our audit in accordance with generally accepted government auditing standards.

Compliance

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

The Honorable John G. Morgan  
December 9, 1999  
Page Two

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director  
Division of State Audit

AAH/cj

## **Independent Auditor's Report**

December 9, 1999

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheet of the Clean Water State Revolving Fund as of June 30, 1999, and the related statements of revenues, expenses, and changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the fund's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with generally accepted government auditing standards. 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 financial statements referred to above present fairly, in all material respects, the financial position of the Clean Water State Revolving Fund as of June 30, 1999, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

The Honorable John G. Morgan  
December 9, 1999  
Page Three

The Year 2000 Disclosures on pages 12 and 13 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that the fund is or will become year 2000 compliant, that the fund's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the fund does business are or will become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 1999, on our consideration of the fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director  
Division of State Audit

AAH/cj

CLEAN WATER STATE REVOLVING FUND  
BALANCE SHEET  
JUNE 30, 1999

(Expressed in Thousands)

ASSETS

Current assets:

Cash (Note 2)	\$	94,902
Loans receivable		11,764
Interest receivable		3
		3

Total current assets		106,669
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Other assets:

Loans receivable		243,068
		243,068

Total assets	\$	349,737
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LIABILITIES AND EQUITY

Liabilities:

Current liabilities:

Warrants payable	\$	7
Payable to borrowers		3
		3

Total current liabilities		10
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Total liabilities		10
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Equity:

Contributed capital-Federal		233,426
Contributed capital-State		53,863
Retained earnings-unreserved		62,438
		62,438

Total equity		349,727
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Total liabilities and equity	\$	349,737
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The Notes to the Financial Statements are an integral part of this statement.

CLEAN WATER STATE REVOLVING FUND  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN EQUITY  
FOR THE YEAR ENDED JUNE 30, 1999

(Expressed in Thousands)

<u>OPERATING REVENUES</u>	
Revenue from loans	\$ 8,861
Investment income	<u>4,694</u>
Total operating revenues	<u>13,555</u>
<u>OPERATING EXPENSE</u>	
Administrative expense	<u>-</u>
Total operating expense	<u>-</u>
Operating income	<u>13,555</u>
Nonoperating revenues (expenses)	
Operating grants	816
Grant expenses	<u>(816)</u>
Total nonoperating revenues (expenses)	<u>-</u>
Net income	13,555
Other changes in equity	
Contributed capital-Federal	19,320
Equity transfer from primary government	<u>3,758</u>
Net change in equity	<u>36,633</u>
Equity, July 1	<u>313,094</u>
Equity, June 30	<u>\$ 349,727</u>

The Notes to the Financial Statements are an integral part of this statement.

CLEAN WATER STATE REVOLVING FUND  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 1999

(Expressed in Thousands)

Cash flows from operating activities:	
Operating income	\$ <u>13,555</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Revenue from loans	(8,861)
Investment income	(4,694)
Increase in payable to borrowers	<u>1</u>
Total adjustments	<u>(13,554)</u>
Net cash provided by operating activities	<u>1</u>
Cash flows from noncapital financing activities:	
Operating grants received	816
Operating grants paid	(816)
Equity transfers in	3,758
Capital contributions	<u>19,320</u>
Net cash provided by noncapital financing activities	<u>23,078</u>
Cash flows from investing activities:	
Loans issued	(39,177)
Collections of loan principal	10,929
Interest received on loans	8,868
Interest received on investments	<u>4,694</u>
Net cash used by investing activities	<u>(14,686)</u>
Net increase in cash	<u>8,393</u>
Cash, July 1	<u>86,509</u>
Cash, June 30	\$ <u><u>94,902</u></u>

The Notes to the Financial Statements are an integral part of this statement.

**Clean Water State Revolving Fund**  
**Notes to the Financial Statements**  
**June 30, 1999**

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**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Reporting Entity**

The Clean Water State Revolving Fund was created to provide local governments and utility districts with low-cost financial assistance to improve and protect water quality and public health.

Pursuant to the Governmental Accounting Standards Board's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2100, the Clean Water State Revolving Fund is part of the primary government and as such has been included in the *Tennessee Comprehensive Annual Financial Report* as an enterprise fund (Sewer Treatment Loan).

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Clean Water State Revolving Fund follows all applicable GASB pronouncements as well as applicable private-sector pronouncements issued on or before November 30, 1989.

**Measurement Focus and Basis of Accounting**

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

**NOTE 2. DEPOSITS**

The fund had \$94,901,857 in the State Treasurer's pooled investment fund at June 30, 1999. The pooled investment fund administered by the State Treasurer is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the State of Tennessee pursuant to Section 9-4-602(b), *Tennessee Code Annotated*. The pooled investment fund is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 1999.

## **Clean Water State Revolving Fund Required Supplementary Information Year 2000 Disclosures**

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The “Year 2000 Issue” (“Y2K”) arises because most computer software programs allocate two digits to the data field for “year” on the assumption that the first two digits will be “19.” Such programs will thus interpret the year 2000 as the year 1900, the year 2001 as 1901, etc. Absent reprogramming, Y2K affects both computer hardware (i.e., the embedded logic of computer chips) and computer software, and could impact both the ability to enter data into the computer programs and the ability of such programs to correctly process data. Y2K affects the computer applications and other equipment of the fund and its vendors.

The state has assessed the impact of Y2K on its computer applications. The state has completed its assessment and has determined that certain computer applications are mission-critical, certain are critical, and certain are supportive. Mission-critical computer applications are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the state from fulfilling its mission. Critical computer applications are those for which there are manual alternatives, but the state would unlikely be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer applications are those for which there are manual alternatives and the state expects to be able to perform such functions manually, if necessary.

The fund has identified two mission-critical applications. The fund relies principally upon the State of Tennessee Accounting and Reporting System (STARS) administered by the state’s Department of Finance and Administration and upon the Cash Management System administered by the Department of the Treasury. The fund’s Y2K initiatives had not resulted in the commitment of significant financial resources as of the end of the fund’s reporting period.

As of June 30, 1999, STARS and the Treasury Cash Management System had completed the validation and testing stage. In this context, validation and testing refers to the development of test data and test scripts, the running of test scripts, the review of test results, and the correction of any anomalies detected.

The state is continuing testing of its computer applications and expects the cost to be \$15.5 million. The state’s mainframe system provides the supporting computer system infrastructure upon which the state’s application systems reside and are processed. The state’s mainframe and all systems’ software have completed the validation and testing stage. The state is in the process of assessing and remediating the Y2K effect on other equipment.

The state is not presently aware of any noncompliance by its yet untested mission-critical and critical computer applications and other equipment or of any costs to achieve Y2K compliance that will have a material negative impact on the state’s operations or financial status;

**Clean Water State Revolving Fund  
Required Supplementary Information (Cont.)  
Year 2000 Disclosures**

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however, the state can give no assurance that circumstances will not change. The state has developed contingency plans for all mission-critical and critical functions.

The state's efforts to ensure Y2K compliance of its computer applications, mainframe and systems' software, desktop applications, and other equipment are not a guarantee that systems and equipment will be Y2K compliant.

The state is soliciting information from other organizations whose Y2K compliance could affect the state regarding the status of their assessment, testing, and remediation of their computer applications and other equipment. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a material negative effect on the state's operations or financial status, although no assurances can be given that circumstances will not change. The state does not have full and complete information, however, from these other organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the state's operations or financial status.