

Clean Water State Revolving Fund

**For the Year Ended
June 30, 2001**

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Elizabeth M. Birchett, CPA
Audit Manager

Donna Jewell, CPA
In-Charge Auditor

Michael Hampton
Sunita Khetpal
Amy Mallicote
Erick Rosa, CPA
Staff Auditors

Gerry C. Boaz, CPA
Technical Analyst

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at
www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our Web site at
www.comptroller.state.tn.us.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

**John G. Morgan
Comptroller**

February 19, 2002

The Honorable Don Sunquist, Governor
and
Members of the General Assembly
and
Members of the Tennessee Local Development Authority
State Capitol
Nashville, TN 37243
and
The Honorable Milton H. Hamilton, Jr., Commissioner
and
Members of the Wastewater Financing Board
Department of Environment and Conservation
401 Church Street, 21st Floor
Nashville, TN 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, 2001. 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,

John G. Morgan
Comptroller of the Treasury

JGM/sc
01/106

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, 2001

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.

"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) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at
www.comptroller.state.tn.us/sa/reports/index.html.

For more information about the Comptroller of the Treasury, please visit our Web site at
www.comptroller.state.tn.us.

Audit Report
Clean Water State Revolving Fund
For the Year Ended June 30, 2001

TABLE OF CONTENTS

	<u>Exhibit</u>	<u>Page</u>
INTRODUCTION		1
Post-Audit Authority		1
Background		1
Organization		1
AUDIT SCOPE		2
OBJECTIVES OF THE AUDIT		2
PRIOR AUDIT FINDINGS		3
RESULTS OF THE AUDIT		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
FINANCIAL SECTION		
Independent Auditor's Report		6
Financial Statements		8
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

Clean Water State Revolving Fund For the Year Ended June 30, 2001

INTRODUCTION

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.

BACKGROUND

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, 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.

AUDIT SCOPE

The audit was limited to the period July 1, 2000, through June 30, 2001, and was conducted in accordance with government auditing standards generally accepted in the United States of America. Financial statements are presented for the year ended June 30, 2001. 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.

OBJECTIVES OF THE AUDIT

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.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

RESULTS OF THE AUDIT

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, 2001, 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 government auditing standards generally accepted in the United States of America. 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.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

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

November 16, 2001

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, 2001, and have issued our report thereon dated November 16, 2001. As discussed in Note 4 to the financial statements, the Clean Water State Revolving Fund implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. We conducted our audit in accordance with government auditing standards generally accepted in the United States of America.

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
November 16, 2001
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.

However, we noted certain matters involving the internal control over financial reporting, which we have reported to the fund's management in separate letter.

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,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." in a cursive style.

Arthur A. Hayes, Jr., CPA,
Director

AAH/sc



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

Independent Auditor's Report

November 16, 2001

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, 2001, 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 government auditing standards generally accepted in the United States of America. 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, 2001, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable John G. Morgan
November 16, 2001
Page Two

As discussed in Note 4 to the financial statements, the Clean Water State Revolving Fund implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2001, on our consideration of the Clean Water State Revolving Fund'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.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA,
Director

AAH/sc

CLEAN WATER STATE REVOLVING FUND
BALANCE SHEET
JUNE 30, 2001

(Expressed in Thousands)

ASSETS

Current assets:

Cash (Note 2)	\$ 72,957
Loans receivable	16,090
Interest receivable on loans	<u>10</u>

Total current assets	<u>89,057</u>
----------------------	---------------

Other assets:

Loans receivable	<u>324,011</u>
------------------	----------------

Total assets	<u>\$ 413,068</u>
--------------	-------------------

LIABILITIES AND EQUITY

Liabilities:

Current liabilities:

Payable to borrowers (Note 3)	<u>\$ 3</u>
-------------------------------	-------------

Total current liabilities	<u>3</u>
---------------------------	----------

Total liabilities	<u>3</u>
-------------------	----------

Equity:

Contributed capital-federal	249,170
Contributed capital-state	61,717
Retained earnings-unreserved	<u>102,178</u>

Total equity	<u>413,065</u>
--------------	----------------

Total liabilities and equity	<u>\$ 413,068</u>
------------------------------	-------------------

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, 2001

(Expressed in Thousands)

OPERATING REVENUES

Revenue from loans	\$ 12,000
Interest income	<u>4,439</u>
Total operating revenues	<u>16,439</u>

OPERATING EXPENSE

Administrative expense	<u>1,023</u>
Total operating expense	<u>1,023</u>

Operating income	<u>15,416</u>
------------------	---------------

Nonoperating revenue

Capital contributions-federal	<u>9,000</u>
-------------------------------	--------------

Total nonoperating revenue	<u>9,000</u>
----------------------------	--------------

Net income	<u>24,416</u>
------------	---------------

Other change in equity

Equity transfer from primary government	<u>1,502</u>
---	--------------

Net change in equity	<u>25,918</u>
----------------------	---------------

Equity, July 1	<u>387,147</u>
----------------	----------------

Equity, June 30	<u>\$ 413,065</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, 2001

(Expressed in Thousands)

Cash flows from operating activities:	
Payments for interfund services	\$ (840)
Payments to suppliers for services	<u>(183)</u>
Net cash used by operating activities	<u>(1,023)</u>
Cash flows from noncapital financing activities:	
Capital contributions-federal	9,000
Equity transfers in	<u>1,502</u>
Net cash provided by noncapital financing activities	<u>10,502</u>
Cash flows from investing activities:	
Loans issued	(51,054)
Collections of loan principal	13,609
Interest received on loans	12,012
Interest received on investments	<u>4,439</u>
Net cash used by investing activities	<u>(20,994)</u>
Net decrease in cash	<u>(11,515)</u>
Cash, July 1	<u>84,472</u>
Cash, June 30	\$ <u><u>72,957</u></u>
Reconciliation of operating income to net cash used by operating activities:	
Operating income	\$ <u>15,416</u>
Adjustments to reconcile operating income to net cash used by operating activities:	
Revenue from loans	(12,000)
Interest income	<u>(4,439)</u>
Total adjustments	<u>(16,439)</u>
Net cash used by operating activities	\$ <u><u>(1,023)</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, 2001

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 has been included in the *Tennessee Comprehensive Annual Financial Report* as an enterprise fund (State Revolving Fund).

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America 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 method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

Operating revenues and expenses are distinguished from nonoperating items in the Clean Water State Revolving Fund. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The principal operation of the fund is to provide loans to local governments through a revolving loan fund established under Title VI of the Clean Water Act. Therefore, the principal operating revenues of the fund are from loans made to borrowers. The fund also recognizes interest income as an operating revenue. The fund's operating expenses are its administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Clean Water State Revolving Fund
Notes to the Financial Statements (Cont.)
June 30, 2001

Reclassifications

Effective June 30, 2001, warrants and wires payable are no longer reported on the balance sheet of the fund. The issuance of warrants and wires, rather than the subsequent acceptance or redemption through the banking system, is deemed to effectively reduce the cash balance. The July 1, 2000, cash balance has been restated to reflect this reclassification.

The Statement of Cash Flows has been prepared using the direct method of reporting cash flows. The direct method presents the cash receipts and cash disbursements of the fund for the year, including cash flows from operating activities. Operating activities are generally the cash effects of transactions and other events that enter into the determination of operating income. A reconciliation of the operating income to net cash flow from operating activities is also presented in this statement. In prior years, the Statement of Cash Flows was presented using the indirect method of reporting cash flows. Under the indirect method, the operating income is reconciled to the net cash flow from operating activities, and nonoperating cash receipts and cash disbursements are presented.

NOTE 2. DEPOSITS

The fund had \$72,956,508 in the State Treasurer's pooled investment fund at June 30, 2001. 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 State Funding Board. 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*.

Clean Water State Revolving Fund
Notes to the Financial Statements (Cont.)
June 30, 2001

NOTE 3. PAYABLE TO BORROWERS

This account represents loan principal overpayments that will be refunded to borrowers.

NOTE 4. CHANGE IN ACCOUNTING PRINCIPLE

As of July 1, 2000, GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, was implemented for the fund. Grant contributions from the federal government are considered voluntary nonexchange transactions. Prior to the implementation of GASB 33, these contributions were considered additions to contributed capital—federal on the Statement of Revenues, Expenses, and Changes in Equity. With the implementation of GASB 33, these contributions are reported as capital contributions—federal, a nonoperating revenue.