

Clean Water State Revolving Fund

**For the Year Ended
June 30, 2003**

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

December 9, 2003

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
and
Members of the Tennessee Local Development Authority
State Capitol
Nashville, Tennessee 37243
and
The Honorable Betsy Child, 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, 2003. 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/eb
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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, 2003

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

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Audit Report
Clean Water State Revolving Fund
For the Year Ended June 30, 2003

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Clean Water State Revolving Fund For the Year Ended June 30, 2003

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 their jurisdiction; pledging their 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, 2002, through June 30, 2003, and was conducted 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. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. 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*.

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.

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, 2003, 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 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. 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**

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

October 30, 2003

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, 2003, and have issued our report thereon dated October 30, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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
October 30, 2003
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,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." The signature is written in a cursive style with a large, prominent initial "A".

Arthur A. Hayes, Jr., CPA,
Director

AAH/eb



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

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Independent Auditor's Report

October 30, 2003

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

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Clean Water State Revolving Fund, an enterprise fund of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years 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 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 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Clean Water State Revolving Fund, an enterprise fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable John G. Morgan
October 30, 2003
Page Two

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 of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2003, 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/eb

CLEAN WATER STATE REVOLVING FUND
STATEMENTS OF NET ASSETS
JUNE 30, 2003, AND JUNE 30, 2002

	June 30, 2003	June 30, 2002
(Expressed in Thousands)		
ASSETS		
Current assets:		
Cash (Note 2)	\$ 144,687	\$ 103,871
Receivables		
Loans receivable	18,876	17,775
Interest receivable on loans	26	6
Total current assets	163,589	121,652
Noncurrent assets:		
Loans receivable	306,990	314,857
Total noncurrent assets	306,990	314,857
Total assets	470,579	436,509
LIABILITIES		
Current liabilities:		
Payable to borrowers (Note 3)	5	3
Total current liabilities	5	3
Total liabilities	5	3
NET ASSETS		
Restricted	470,574	436,506
Total net assets	\$ 470,574	\$ 436,506

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

CLEAN WATER STATE REVOLVING FUND
 STATEMENTS OF REVENUES, EXPENSES, AND
 CHANGES IN NET ASSETS
 FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	<u>Year Ended June 30, 2003</u>	<u>Year Ended June 30, 2002</u>
OPERATING REVENUES		
Revenue from loans	\$ 11,505	\$ 12,405
Interest income	<u>2,054</u>	<u>2,188</u>
Total operating revenues	<u>13,559</u>	<u>14,593</u>
OPERATING EXPENSES		
Administrative expense	<u>923</u>	<u>934</u>
Total operating expenses	<u>923</u>	<u>934</u>
Operating income	<u>12,636</u>	<u>13,659</u>
NONOPERATING REVENUE		
Operating grant	<u>16,285</u>	<u>4,994</u>
Total nonoperating revenue	<u>16,285</u>	<u>4,994</u>
Income before transfers	28,921	18,653
Transfers in (Note 4)	<u>5,147</u>	<u>4,788</u>
Change in net assets	34,068	23,441
Net assets, July 1	<u>436,506</u>	<u>413,065</u>
Net assets, June 30	<u>\$ 470,574</u>	<u>\$ 436,506</u>

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

CLEAN WATER STATE REVOLVING FUND
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	<u>Year Ended June 30, 2003</u>	<u>Year Ended June 30, 2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments for interfund services	\$ (912)	\$ (928)
Payments to service providers	<u>(11)</u>	<u>(6)</u>
Net cash used by operating activities	<u>(923)</u>	<u>(934)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating grants received	16,285	4,994
Transfers in	<u>5,147</u>	<u>4,788</u>
Net cash provided by noncapital financing activities	<u>21,432</u>	<u>9,782</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans issued	(27,679)	(19,371)
Collections of loan principal	34,440	26,840
Interest received on loans	11,492	12,409
Interest received on investments	<u>2,054</u>	<u>2,188</u>
Net cash provided by investing activities	<u>20,307</u>	<u>22,066</u>
Net increase in cash	40,816	30,914
Cash, July 1	<u>103,871</u>	<u>72,957</u>
Cash, June 30	<u>\$ 144,687</u>	<u>\$ 103,871</u>
Reconciliation of operating income to net cash used by operating activities:		
Operating income	\$ <u>12,636</u>	\$ <u>13,659</u>
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(11,505)	(12,405)
Interest income	<u>(2,054)</u>	<u>(2,188)</u>
Total adjustments	<u>(13,559)</u>	<u>(14,593)</u>
Net cash used by operating activities	<u>\$ (923)</u>	<u>\$ (934)</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, 2003, and June 30, 2002**

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 (Sewer Treatment Loan 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.

As of July 1, 2001, GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, was implemented for the fund. Prior to the implementation of GASB 34, transfers from the primary government to match grant contributions from the federal government were considered equity transfers on the Statement of Revenues, Expenses, and Changes in Equity. With the implementation of GASB 34, this transfer is no longer classified as an equity transfer.

In addition, equity has been reclassified into the following categories: Invested in capital assets, net of related debt; Restricted; and Unrestricted. The fund has only restricted net assets.

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.

Clean Water State Revolving Fund
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002

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 interest on 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.

Cash

This classification includes cash on hand and deposits in the pooled investment fund administered by the State Treasurer.

NOTE 2. DEPOSITS

The Clean Water State Revolving Fund had \$144,687,002 in the State Treasurer's pooled investment fund at June 30, 2003, and \$103,871,357 at June 30, 2002. The pooled investment fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements for obligations of the United States or its agencies which are fully guaranteed as to principal and interest by the United States; and in certain obligations of the State of Tennessee pursuant to Section 9-4-602(b), *Tennessee Code Annotated*. The pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*. The report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

**Clean Water State Revolving Fund
Notes to the Financial Statements (Cont.)
June 30, 2003, and June 30, 2002**

NOTE 3. PAYABLE TO BORROWERS

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

NOTE 4. INTERFUND TRANSFER

The Clean Water State Revolving Fund received an interfund transfer from the general fund of the state to provide the state match of a federal grant to operate the program of \$5,147,114 during fiscal year 2003 and \$4,788,065 during fiscal year 2002.