

Clean Water State Revolving Fund

**For the Year Ended
June 30, 2004**

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

Edward Burr, CPA
Assistant Director

Elizabeth M. Birchett, CPA
Audit Manager

Robyn R. Probus, CPA, CFE
In-Charge Auditor

Kimberly White
Staff Auditor

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

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

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

John G. Morgan
Comptroller

February 8, 2005

The Honorable Phil Bredesen, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and

The Honorable Betsy Child, Commissioner
and

Members of the Water and 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, 2004. 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/rrp
05/014

State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Clean Water State Revolving Fund
For the Year Ended June 30, 2004

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 grant agreements; 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.

Audit Report
Clean Water State Revolving Fund
For the Year Ended June 30, 2004

TABLE OF CONTENTS

	<u>Exhibit</u>	<u>Page</u>
INTRODUCTION		
Post-Audit Authority		1
Background		1
Organization		1
AUDIT SCOPE		2
OBJECTIVES OF THE AUDIT		2
PRIOR AUDIT FINDINGS		3
OBSERVATIONS AND COMMENTS		3
Fraud Considerations		3
RESULTS OF THE AUDIT		3
Audit Conclusions		3
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>		5
FINANCIAL SECTION		
Independent Auditor's Report		7
Financial Statements		
Statements of Net Assets	A	9
Statements of Revenues, Expenses, and Changes in Net Assets	B	10
Statements of Cash Flows	C	11
Notes to the Financial Statements		12

Clean Water State Revolving Fund For the Year Ended June 30, 2004

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 Water and 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, 2003, through June 30, 2004, 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, 2004, and for comparative purposes, the year ended June 30, 2003. 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 grant agreements;
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.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

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, 2004, 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 and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters 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
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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 Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

November 29, 2004

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, 2004, and have issued our report thereon dated November 29, 2004. 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.

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 an opinion 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 that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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.

The Honorable John G. Morgan

November 29, 2004

Page Two

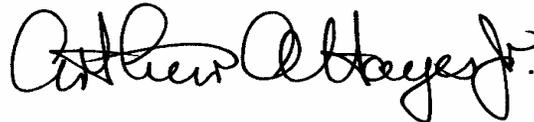
We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

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/rrp



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NASHVILLE, TENNESSEE 37243-0264
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FAX (615) 532-2765**

Independent Auditor's Report

November 29, 2004

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, 2004, and June 30, 2003, 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. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of the Tennessee Local Development Authority and the Water and Wastewater Financing Board; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; maintaining the accounting records for the Clean Water State Revolving Fund and the Tennessee Local Development Authority; and providing support staff to the Authority.

The Honorable John G. Morgan

November 29, 2004

Page Two

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, 2004, and June 30, 2003, 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 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, 2004, and June 30, 2003, 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 November 29, 2004, on our consideration of the Clean Water State Revolving Fund's internal control over financial reporting and on 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* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes, Jr.", written in a cursive style.

Arthur A. Hayes, Jr., CPA,
Director

AAH/rrp

CLEAN WATER STATE REVOLVING FUND
STATEMENTS OF NET ASSETS
JUNE 30, 2004, AND JUNE 30, 2003

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
(Expressed in Thousands)		
ASSETS		
Current assets:		
Cash (Note 2)	\$ 177,872	\$ 144,687
Receivables		
Loans receivable	18,209	18,876
Interest receivable on loans	21	26
	<u>196,102</u>	<u>163,589</u>
Total current assets		
Noncurrent assets:		
Loans receivable	315,101	306,990
	<u>315,101</u>	<u>306,990</u>
Total noncurrent assets		
Total assets	<u>511,203</u>	<u>470,579</u>
LIABILITIES		
Current liabilities:		
Payable to borrowers (Note 3)	10	5
	<u>10</u>	<u>5</u>
Total current liabilities		
Total liabilities	<u>10</u>	<u>5</u>
NET ASSETS		
Restricted	511,193	470,574
	<u>511,193</u>	<u>470,574</u>
Total net assets	<u>\$ 511,193</u>	<u>\$ 470,574</u>

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, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	<u>Year Ended June 30, 2004</u>	<u>Year Ended June 30, 2003</u>
OPERATING REVENUES		
Revenue from loans	\$ 11,525	\$ 11,505
Interest income	<u>1,717</u>	<u>2,054</u>
Total operating revenues	<u>13,242</u>	<u>13,559</u>
OPERATING EXPENSES		
Administrative expense	<u>794</u>	<u>923</u>
Total operating expenses	<u>794</u>	<u>923</u>
Operating income	<u>12,448</u>	<u>12,636</u>
NONOPERATING REVENUE		
Operating grant	<u>24,701</u>	<u>16,285</u>
Total nonoperating revenue	<u>24,701</u>	<u>16,285</u>
Income before transfers	37,149	28,921
Transfers in (Note 4)	<u>3,470</u>	<u>5,147</u>
Change in net assets	40,619	34,068
Net assets, July 1	<u>470,574</u>	<u>436,506</u>
Net assets, June 30	<u>\$ 511,193</u>	<u>\$ 470,574</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, 2004, AND JUNE 30, 2003

(Expressed in Thousands)		
	Year Ended June 30, 2004	Year Ended June 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments for interfund services	\$ (783)	\$ (912)
Payments to service providers	(11)	(11)
Net cash used by operating activities	(794)	(923)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating grants received	24,701	16,285
Transfers in	3,470	5,147
Net cash provided by noncapital financing activities	28,171	21,432
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans issued	(31,660)	(27,679)
Collections of loan principal	24,223	34,440
Interest received on loans	11,528	11,492
Interest received on investments	1,717	2,054
Net cash provided by investing activities	5,808	20,307
Net increase in cash	33,185	40,816
Cash, July 1	144,687	103,871
Cash, June 30	\$ 177,872	\$ 144,687
Reconciliation of operating income to net cash used by operating activities:		
Operating income	\$ 12,448	\$ 12,636
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(11,525)	(11,505)
Interest income	(1,717)	(2,054)
Total adjustments	(13,242)	(13,559)
Net cash used by operating activities	\$ (794)	\$ (923)

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, 2004, and June 30, 2003

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 forms an integral part of state government and as such 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.

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 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.

Clean Water State Revolving Fund
Notes to the Financial Statements (Cont.)
June 30, 2004, and June 30, 2003

Cash

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

NOTE 2. DEPOSITS

The fund had \$177,871,642 in the State Treasurer's pooled investment fund at June 30, 2004, and \$144,687,002 at June 30, 2003. The pooled investment fund administered by the State Treasurer 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 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*.

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 \$3,469,899 during fiscal year 2004 and \$5,147,114 during fiscal year 2003.