AUDIT REPORT

Clean Water State Revolving Fund

For the Year Ended
June 30, 2013

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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February 20, 2014

The Honorable Bill Haslam, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority
The Honorable Robert Martineau, Commissioner
Department of Environment and Conservation

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Clean Water State Revolving Fund for the year ended June 30, 2013. You will note from the independent auditor's report that an unmodified 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,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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Audit Report
Clean Water State Revolving Fund
For the Year Ended June 30, 2013

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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, 2013

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.

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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority
The Honorable Robert Martineau, Commissioner
Department of Environment and Conservation

Report on the Financial Statements

We have audited the accompanying financial statements of the Clean Water State Revolving Fund, an enterprise fund of the State of Tennessee, as of and for the years ended June 30, 2013, and June 30, 2012, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. 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. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Clean Water State Revolving Fund.

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 of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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, 2013, and June 30, 2012, and the changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2013, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 13, 2013

Clean Water State Revolving Fund
Statements of Net Position
June 30, 2013, and June 30, 2012

(Expressed in Thousands)

	June 30, 2013	June 30, 2012
ASSETS		
Current assets:		
Cash (Note 2)	$471,399	$393,409
Loans receivable	22,247	28,823
Total current assets	493,646	422,232
Noncurrent assets:		
Loans receivable	350,066	408,151
Total noncurrent assets	350,066	408,151
Total assets	843,712	830,383
LIABILITIES		
Current liabilities:		
Payable to borrowers (Note 3)	7	10
Total current liabilities	7	10
Noncurrent liabilities:		
Customer deposits payable (Note 2)	4,894	4,694
Total noncurrent liabilities	4,894	4,694
Total liabilities	4,901	4,704
NET POSITION		
Unrestricted	838,811	825,679
Total net position	$838,811	$825,679

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 Position
For the Years Ended June 30, 2013, and June 30, 2012

(Expressed in Thousands)

	Year Ended June 30, 2013	Year Ended June 30, 2012
OPERATING REVENUES		
Revenue from loans	$ 10,205	$ 13,402
Interest income	530	322
Total operating revenues	10,735	13,724
OPERATING EXPENSES		
Administrative expenses	1,130	1,292
Total operating expenses	1,130	1,292
Operating income	9,605	12,432
NONOPERATING REVENUE		
Capitalization grant	3,759	29,013
Total nonoperating revenue	3,759	29,013
NONOPERATING EXPENSE		
Principal forgiveness (Note 5)	3,854	11,132
Total nonoperating expense	3,854	11,132
Income before transfers	9,510	30,313
Transfers in (Note 4)	3,622	4,417
Change in net position	13,132	34,730
Net position, July 1	825,679	790,949
Net position, June 30	$838,811	$825,679

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, 2013, and June 30, 2012

(Expressed in Thousands)

	Year Ended June 30, 2013	Year Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments for interfund services	$ (1,130)	$ (1,292)
Net cash used by operating activities	(1,130)	(1,292)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating grants received	3,759	29,013
Transfers in	3,622	4,417
Net cash provided by noncapital financing activities	7,381	33,430
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans issued	(41,368)	(49,150)
Principal forgiven	(3,855)	(11,718)
Collections of loan principal	106,029	193,448
Security deposits from borrowers	1,076	190
Interest received on loans	10,205	13,403
Interest received on investments	537	328
Amounts repaid to borrowers	(885)	(431)
Net cash provided by investing activities	71,739	146,070
Net increase in cash	77,990	178,208
Cash, July 1	393,409	215,201
Cash, June 30	$471,399	$393,409
Reconciliation of operating income to net cash used by operating activities:		
Operating income	$ 9,605	$ 12,432
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(10,205)	(13,402)
Interest income	(530)	(322)
Total adjustments	(10,735)	(13,724)
Net cash used by operating activities	$ (1,130)	$ (1,292)

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, 2013, and June 30, 2012

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 accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

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 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.

Changes in Accounting Principle

The fund implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,*

during the year ended June 30, 2013. As a result, the residual of all other elements in the fund's statement of financial position was named as net position, rather than net assets.

Note 2. Deposits

At June 30, 2013, the Clean Water State Revolving Fund had $466,505,117 in the State Treasurer's pooled investment fund for operating cash purposes and $4,894,488 in customer security deposits in the Local Government Investment Pool. At June 30, 2012, the fund had $388,715,250 in the State Treasurer's pooled investment fund and $4,693,544 in the Local Government Investment Pool. The Local Government Investment Pool is part of the pooled investment fund administered by the State Treasurer. The pooled investment fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The fund is not rated by a nationally recognized statistical rating organization. Its investment policy and required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. The report is posted on the state's website at www.treasury.tn.gov.

Note 3. Payable to Borrowers

This account represents loan principal overpayments that will be refunded to borrowers and interest earned on security deposits, which per the loan agreements is due to the borrowers.

Note 4. Interfund Transfer

Each year since the Clean Water State Revolving Fund Loan Program's inception in 1987, the state has been awarded a capitalization grant from the United States' Environmental Protection Agency to fund the program. The State of Tennessee provides a funding match. The Clean Water State Revolving Fund received an interfund transfer from the state's general fund of $3,621,605 during the year ended June 30, 2013, and $4,416,898 during the year ended June 30, 2012, to meet this matching requirement.

Note 5. Principal Forgiveness

In fiscal year 2010, the Clean Water State Revolving Fund (CWSRF) received money from the American Recovery and Reinvestment Act (ARRA) of 2009. As part of the conditions stipulated by the Act for acceptance of this money, the State Revolving Fund program granted principal forgiveness to the borrowers. Each community that received an ARRA loan was granted 40% principal forgiveness, thus only 60% of the total award was recorded as a repayable loan. Additionally, each community was limited to one ARRA loan in an amount that could not exceed $12.5 million dollars.

Beginning in fiscal year 2011, and continuing through the present, the capitalization grant received by the Clean Water State Revolving Fund also stipulated that the state must subsidize a portion of the borrower loans. Therefore, for the first time as a part of its normal operations, the fund began granting principal forgiveness as a part of the loans made from the capitalization grant. The communities to receive this subsidization are determined according to normal procedures of priority ranking used in the past to make loans.

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Independent Auditor's 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*

The Honorable Bill Haslam, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority
The Honorable Robert Martineau, Commissioner
Department of Environment and Conservation

We have audited the financial statements of the Clean Water State Revolving Fund, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements, and have issued our report thereon dated December 13, 2013. 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 of the financial statements, we considered the Clean Water State Revolving Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be

material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Clean Water State Revolving Fund's financial statements are free from material misstatement, we performed tests of its 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 13, 2013