



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**



CLEAN WATER STATE REVOLVING FUND

Financial and Compliance Audit Report

For the Year Ended June 30, 2014

Justin P. Wilson, Comptroller



**Division of State Audit
Financial and Compliance Section**

DEBORAH V. LOVELESS, CPA, CGFM, CGMA
Director

EDWARD BURR, CPA, CGFM
Assistant Director

DEREK D. MARTIN, CPA, CFE, CGFM
Audit Manager

Erica Pettway, CFE
In-Charge Auditor

Hellens Cruz-Sanchez, CPA, CFE
Staff Auditor

Gerry C. Boaz, CPA, CGFM
Technical Manager

Amy Brack
Editor

Amanda Adams
Assistant Editor

Comptroller of the Treasury, Division of State Audit
Suite 1500, James K. Polk Building
505 Deaderick Street
Nashville, TN 37243-1402
(615) 401-7897

Reports are available at
www.comptroller.tn.gov/sa/AuditReportCategories.asp.

Mission Statement
The mission of the Comptroller's Office is to improve the quality of life
for all Tennesseans by making government work better.

Comptroller Website
www.comptroller.tn.gov



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

SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

March 26, 2015

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, 2014. 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,

A handwritten signature in black ink that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA
Director

15/010

Audit Report
Clean Water State Revolving Fund
For the Year Ended June 30, 2014

TABLE OF CONTENTS

	<u>Page</u>
Audit Highlights	1
Financial Section	
Independent Auditor's Report	2
Basic Financial Statements	
Statements of Net Position	4
Statements of Revenues, Expenses, and Changes in Net Position	5
Statements of Cash Flows	6
Notes to the Financial Statements	7
Internal Control, Compliance, and Other Matters	
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 <i>Government Auditing Standards</i>	10

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, 2014

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.



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

PHONE (615) 401-7897
FAX (615) 532-2765

SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

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, 2014, and June 30, 2013, 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, 2014, and June 30, 2013, 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, 2014, and June 30, 2013, 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 1, 2014, 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, CPA
Director
December 1, 2014

CLEAN WATER STATE REVOLVING FUND
Statements of Net Position
June 30, 2014, and June 30, 2013

(Expressed in Thousands)

	June 30, 2014	June 30, 2013
Assets		
Current assets:		
Cash (Note 2)	\$502,846	\$471,399
Loans receivable	21,044	22,247
Total current assets	523,890	493,646
Noncurrent assets:		
Loans receivable	341,481	350,066
Total noncurrent assets	341,481	350,066
Total assets	865,371	843,712
Liabilities		
Current liabilities:		
Payable to borrowers (Note 3)	5	7
Total current liabilities	5	7
Noncurrent liabilities:		
Customer deposits payable (Note 2)	5,358	4,894
Total noncurrent liabilities	5,358	4,894
Total liabilities	5,363	4,901
Net Position		
Unrestricted	860,008	838,811
Total net position	\$860,008	\$838,811

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, 2014, and June 30, 2013

(Expressed in Thousands)

	Year Ended June 30, 2014	Year Ended June 30, 2013
Operating Revenues		
Revenue from loans	\$ 6,854	\$ 10,205
Interest income	436	530
Total operating revenues	7,290	10,735
Operating Expenses		
Administrative expenses	1,189	1,130
Total operating expenses	1,189	1,130
Operating income	6,101	9,605
Nonoperating Revenues		
Capitalization grant	12,572	3,759
Total nonoperating revenues	12,572	3,759
Nonoperating Expenses		
Principal forgiveness (Note 5)	3,941	3,854
Total nonoperating expenses	3,941	3,854
Income before transfers	14,732	9,510
Transfers in (Note 4)	6,465	3,622
Change in net position	21,197	13,132
Net position, July 1	838,811	825,679
Net position, June 30	\$860,008	\$838,811

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, 2014, and June 30, 2013

(Expressed in Thousands)

	Year Ended June 30, 2014	Year Ended June 30, 2013
Cash Flows From Operating Activities		
Payments for interfund services	\$ (1,189)	\$ (1,130)
Net cash used by operating activities	(1,189)	(1,130)
Cash Flows From Noncapital Financing Activities		
Operating grants received	12,573	3,759
Transfers in	6,465	3,622
Net cash provided by noncapital financing activities	19,038	7,381
Cash Flows From Investing Activities		
Loans issued	(33,250)	(41,368)
Principal forgiven	(3,941)	(3,855)
Collections of loan principal	43,038	106,029
Security deposits from borrowers	463	1,076
Interest received on loans	6,854	10,205
Interest received on investments	441	537
Amounts repaid to borrowers	(7)	(885)
Net cash provided by investing activities	13,598	71,739
Net increase in cash	31,447	77,990
Cash, July 1	471,399	393,409
Cash, June 30	\$502,846	\$471,399
Reconciliation of operating income to net cash used by operating activities:		
Operating income	\$ 6,101	\$ 9,605
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(6,854)	(10,205)
Interest income	(436)	(530)
Total adjustments	(7,290)	(10,735)
Net cash used by operating activities	\$ (1,189)	\$ (1,130)

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, 2014, and June 30, 2013

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.

Change 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*,

Notes to the Financial Statements (Continued)

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, 2014, the Clean Water State Revolving fund had \$497,487,401 in the State Treasurer's pooled investment fund for operating cash purposes, and \$5,358,001 in customer security deposits in the Local Government Investment Pool. At June 30, 2013, the fund had \$466,505,117 in the State Treasurer's pooled investment fund and \$4,894,488 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's 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 Clean Water State Revolving Fund received an interfund transfer from the state's general fund to provide a state match for the federal grant to operate the program of \$6,465,170 during the year ended June 30, 2014, and \$3,621,605 during the year ended June 30, 2013.

Note 5. Principal Forgiveness

In fiscal year 2010, the Clean Water State Revolving Fund 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.

Beginning in fiscal year 2011, and continuing through present, the capitalization grant received by the Clean Water State Revolving Fund also stipulated that the state must subsidize a portion

Notes to the Financial Statements (Continued)

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.



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

PHONE (615) 401-7897
FAX (615) 532-2765

SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

**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, 2014, 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 1, 2014. 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, CPA
Director
December 1, 2014