



**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY**



**CLEAN WATER STATE REVOLVING FUND**

**Financial and Compliance Audit Report**

For the Year Ended June 30, 2017

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**Justin P. Wilson, Comptroller**



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JUSTIN P. WILSON  
*Comptroller*

JASON E. MUMPOWER  
*Chief of Staff*

February 7, 2018

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, 2017. 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  
Division of State Audit

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**Audit Report**  
**Clean Water State Revolving Fund**  
**For the Year Ended June 30, 2017**

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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, 2017

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### **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  
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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, 2017, and June 30, 2016, 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, 2017, and June 30, 2016, 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, 2017, and June 30, 2016, 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 November 30, 2017, 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  
Division of State Audit  
November 30, 2017

**CLEAN WATER STATE REVOLVING FUND**  
**Statements of Net Position**  
**June 30, 2017, and June 30, 2016**

(Expressed in Thousands)

	June 30, 2017	June 30, 2016
<b>Assets</b>		
Current assets:		
Cash (Note 2)	\$433,866	\$501,855
Loans receivable	26,301	24,990
Total current assets	460,167	526,845
Noncurrent assets:		
Loans receivable	532,262	444,736
Total noncurrent assets	532,262	444,736
Total assets	992,429	971,581
<b>Liabilities</b>		
Current liabilities:		
Payable to borrowers (Note 3)	34	14
Total current liabilities	34	14
Noncurrent liabilities:		
Customer deposits payable (Note 2)	6,871	6,293
Total noncurrent liabilities	6,871	6,293
Total liabilities	6,905	6,307
<b>Net position</b>		
Unrestricted	985,524	965,274
Total net position	\$985,524	\$965,274

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, 2017, and June 30, 2016**

(Expressed in Thousands)

	Year Ended June 30, 2017	Year Ended June 30, 2016
<b>Operating revenues</b>		
Revenue from loans	\$ 8,123	\$ 7,280
Interest income	2,372	1,197
<b>Total operating revenues</b>	<b>10,495</b>	<b>8,477</b>
<b>Operating expenses</b>		
Administrative expenses	1,065	1,094
<b>Total operating expenses</b>	<b>1,065</b>	<b>1,094</b>
<b>Operating income</b>	<b>9,430</b>	<b>7,383</b>
<b>Nonoperating revenues</b>		
Capitalization grant	7,437	51,010
<b>Total nonoperating revenues</b>	<b>7,437</b>	<b>51,010</b>
<b>Nonoperating expenses</b>		
Principal forgiveness (Note 5)	3,038	3,627
<b>Total nonoperating expenses</b>	<b>3,038</b>	<b>3,627</b>
<b>Income before transfers</b>	<b>13,829</b>	<b>54,766</b>
<b>Transfers in (Note 4)</b>	<b>6,421</b>	<b>1,428</b>
<b>Change in net position</b>	<b>20,250</b>	<b>56,194</b>
<b>Net position, July 1</b>	<b>965,274</b>	<b>909,080</b>
<b>Net position, June 30</b>	<b>\$985,524</b>	<b>\$965,274</b>

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, 2017, and June 30, 2016**

(Expressed in Thousands)

	Year Ended June 30, 2017	Year Ended June 30, 2016
<b>Cash flows from operating activities</b>		
Payments for interfund services	\$ (1,065)	\$ (1,094)
<b>Net cash used by operating activities</b>	<b>(1,065)</b>	<b>(1,094)</b>
<b>Cash flows from noncapital financing activities</b>		
Operating grants received	7,438	51,010
Transfers in	6,421	1,428
<b>Net cash provided by noncapital financing activities</b>	<b>13,859</b>	<b>52,438</b>
<b>Cash flows from investing activities</b>		
Loans issued and other disbursements to borrowers	(119,016)	(98,016)
Collections of loan principal	27,140	23,022
Security deposits from borrowers	727	936
Interest received on loans	8,123	7,281
Interest received on investments	2,406	1,210
Amounts repaid to borrowers	(163)	(5)
<b>Net cash used by investing activities</b>	<b>(80,783)</b>	<b>(65,572)</b>
Net decrease in cash	(67,989)	(14,228)
Cash, July 1	501,855	516,083
<b>Cash, June 30</b>	<b>\$433,866</b>	<b>\$501,855</b>
<b>Reconciliation of operating income to net cash used by operating activities:</b>		
Operating income	\$ 9,430	\$ 7,383
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(8,123)	(7,280)
Interest income	(2,372)	(1,197)
<b>Total adjustments</b>	<b>(10,495)</b>	<b>(8,477)</b>
<b>Net cash used by operating activities</b>	<b>\$ (1,065)</b>	<b>\$ (1,094)</b>

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, 2017, and June 30, 2016**

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**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 Tennessee's *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, regardless of the timing of related cash flows.

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.

## **Notes to the Financial Statements (Continued)**

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### **Note 2. Deposits**

At June 30, 2017, the Clean Water State Revolving Fund had \$426,993,796 in the State Treasurer's pooled investment fund for operating cash purposes, and \$6,872,059 in customer security deposits in the Local Government Investment Pool. At June 30, 2016, the fund had \$495,561,685 in the State Treasurer's pooled investment fund and \$6,293,660 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 funds are very liquid; there are no minimum amounts or lengths of time for investment, with the exception of a 24-hour notice for withdrawals exceeding \$5,000,000. The fund is not rated by a nationally recognized statistical rating organization. The fund's investments are measured at amortized cost. 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](http://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 is due to the borrowers per the loan agreements.

### **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 \$6,421,254 during the year ended June 30, 2017, and \$1,428,557 during the year ended June 30, 2016.

### **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 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

## **Notes to the Financial Statements (Continued)**

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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. Principal forgiveness is recognized on the statements of cash flows as “loans issued and other disbursements to borrowers.”



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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, 2017, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements, and have issued our report thereon dated November 30, 2017. 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  
Division of State Audit  
November 30, 2017