

**State Funding Board
Sewage Treatment Facilities Fund**

**For the Year Ended
June 30, 1997**

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February 6, 1998

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable W. R. Snodgrass
Comptroller of the Treasury
Secretary of the State Funding Board
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State Funding Board, Sewage Treatment Facilities Fund, for the year ended June 30, 1997. 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.

Very truly yours,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

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State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
State Funding Board
Sewage Treatment Facilities Fund
For the Year Ended June 30, 1997

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, and contracts; 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

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

**Audit Report
State Funding Board
Sewage Treatment Facilities Fund
For the Year Ended June 30, 1997**

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State Funding Board Sewage Treatment Facilities Fund For the Year Ended June 30, 1997

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the State Funding Board, Sewage Treatment Facilities 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.

LEGISLATIVE HISTORY

The Sewage Treatment Facilities Fund has operated since the early 1970’s through the Department of Health under the authority of Section 68-221-202, *Tennessee Code Annotated*. Chapter 521 of the Public Acts of 1970 authorized repayments of loans to be remitted to the State Funding Board. The fund provided financial assistance to local governments and utility districts for the construction of sewage treatment, solid waste recovery, and waterworks facilities. A user’s fee was authorized to generate funds for the borrowing entities to repay the loans. General obligation bonds were sold to finance the program. Although these bonds remain full faith and credit obligations of the state, they are being retired from resources of the fund. Future financing for this program will be generated by the Tennessee Local Development Authority.

ORGANIZATION

The Department of Health provided engineering expertise to determine the eligibility and priority of municipal projects for financing. The State Funding Board approved contracts for financing. The State Funding Board is composed of the Governor, who serves *ex officio* as chairman, the State Treasurer, the Secretary of State, the Commissioner of Finance and Administration, and the Comptroller of the Treasury, who serves *ex officio* as secretary.

The staff of the State Funding Board is composed of certain employees from the Division of Bond Finance, Office of the Comptroller of the Treasury.

An organization chart for the State Funding Board is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 1996, through June 30, 1997, and was conducted in accordance with generally accepted auditing standards 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, 1997, and for comparative purposes, the year ended June 30, 1996. The State Funding Board, Sewage Treatment Facilities 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*.

The audit covered allotment code 307.07-Division of Bond Finance (Fund 33).

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, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," it included tests of compliance with applicable federal laws and regulations and consideration of internal control. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and OMB Circular A-133.

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 State Funding Board, Sewage Treatment Facilities Fund's financial statements for the year ended June 30, 1997, 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 generally accepted auditing standards 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 disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the State Funding Board, Sewage Treatment Facilities Fund.

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

December 16, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the State Funding Board, Sewage Treatment Facilities Fund, as of and for the year ended June 30, 1997, and have issued our report thereon dated December 16, 1997. We conducted our audit in accordance with generally accepted auditing standards 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, and contracts, 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 herein under *Government Auditing Standards*.

The Honorable W. R. Snodgrass
December 16, 1997
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 for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/th

Independent Auditor's Report

December 16, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the State Funding Board, Sewage Treatment Facilities Fund, as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenses, and changes in retained earnings 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 generally accepted auditing standards 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Funding Board, Sewage Treatment Facilities Fund, as of June 30, 1997, and June 30, 1996, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

The Honorable W. R. Snodgrass
December 16, 1997
Page Two

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 1997, on our consideration of the fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/th

STATE FUNDING BOARD
SEWAGE TREATMENT FACILITIES FUND
BALANCE SHEETS
JUNE 30, 1997, AND JUNE 30, 1996

(Expressed in Thousands)

	<u>June 30, 1997</u>	<u>June 30, 1996</u>
<u>ASSETS</u>		
Current assets:		
Cash (Note 2)	\$ 3,753	\$ 3,788
Receivables:		
Principal due from local governments	2,880	2,825
Interest due from local governments	<u>23</u>	<u>55</u>
Total current assets	<u>6,656</u>	<u>6,668</u>
Principal due from local governments	<u>27,692</u>	<u>30,722</u>
Deferred charges	<u>133</u>	<u>143</u>
Total assets	<u>\$ 34,481</u>	<u>\$ 37,533</u>
<u>LIABILITIES AND EQUITY</u>		
Liabilities:		
Current liabilities:		
Accrued interest payable	\$ 487	\$ 626
Due to local governments (Note 3)	482	511
General obligation bonds payable, net (Note 4)	<u>2,880</u>	<u>2,825</u>
Total current liabilities	<u>3,849</u>	<u>3,962</u>
Noncurrent liabilities:		
General obligation bonds payable, net (Note 4)	<u>26,614</u>	<u>29,503</u>
Total liabilities	<u>30,463</u>	<u>33,465</u>
Equity:		
Retained earnings, unreserved	<u>4,018</u>	<u>4,068</u>
Total liabilities and equity	<u>\$ 34,481</u>	<u>\$ 37,533</u>

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

STATE FUNDING BOARD
SEWAGE TREATMENT FACILITIES FUND
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
FOR THE YEARS ENDED JUNE 30, 1997, AND JUNE 30, 1996

(Expressed in Thousands)

	<u>Year Ended June 30, 1997</u>	<u>Year Ended June 30, 1996</u>
<u>OPERATING REVENUES</u>		
Charges for services	\$ 1,341	\$ 2,007
Interest income	<u>223</u>	<u>391</u>
Total operating revenues	<u>1,564</u>	<u>2,398</u>
<u>OPERATING EXPENSES</u>		
Interest expense	1,547	2,215
Administrative expense	<u>42</u>	<u>27</u>
Total operating expenses	<u>1,589</u>	<u>2,242</u>
Operating income (loss)	(25)	156
Operating transfer to Tennessee Local Development Authority	<u>(25)</u>	<u>(25)</u>
Net income (loss)	(50)	131
Retained earnings, July 1	<u>4,068</u>	<u>3,937</u>
Retained earnings, June 30	\$ <u><u>4,018</u></u>	\$ <u><u>4,068</u></u>

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

STATE FUNDING BOARD
SEWAGE TREATMENT FACILITIES FUND
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1997, AND JUNE 30, 1996

(Expressed in Thousands)

	<u>Year Ended June 30, 1997</u>	<u>Year Ended June 30, 1996</u>
Cash flows from operating activities:		
Operating income (loss)	\$ <u>(25)</u>	\$ <u>156</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Amortization	10	-
Charges for services	(1,341)	(2,007)
Interest income	(223)	(391)
Interest expense	1,547	2,215
Increase (decrease) in due to local governments	<u>(29)</u>	<u>25</u>
Total adjustments	<u>(36)</u>	<u>(158)</u>
Net cash used by operating activities	<u>(61)</u>	<u>(2)</u>
Cash flows from noncapital financing activities:		
Proceeds from sale of bonds	-	15,273
Retirement of long-term principal	-	(18,725)
Principal payments	(2,825)	(3,775)
Interest paid	(1,695)	(2,474)
Call premiums paid	-	(280)
Bond issuance costs paid	-	(73)
Operating transfer to Tennessee Local Development Authority	<u>(25)</u>	<u>(25)</u>
Net cash used by noncapital financing activities	<u>(4,545)</u>	<u>(10,079)</u>
Cash flows from investing activities:		
Collections of loan principal	2,780	4,480
Interest received on loans	1,568	1,999
Purchases of investments	-	(18,974)
Proceeds from maturity of investments	-	18,974
Interest received on investments	<u>223</u>	<u>391</u>
Net cash provided by investing activities	<u>4,571</u>	<u>6,870</u>
Net decrease in cash	<u>(35)</u>	<u>(3,211)</u>
Cash, July 1	<u>3,788</u>	<u>6,999</u>
Cash, June 30	\$ <u><u>3,753</u></u>	\$ <u><u>3,788</u></u>
Noncash investing, capital, and financing activities:		
Bond issuance costs	\$ <u><u>-</u></u>	\$ <u><u>74</u></u>

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

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements
June 30, 1997, and June 30, 1996

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Sewage Treatment Facilities Fund was created to provide financial assistance to local governments and utility districts through the issuance of state general obligation bonds. Future financing for the program has been generated by the Tennessee Local Development Authority. Pursuant to the Governmental Accounting Standards Board's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2100, the State Funding Board, Sewage Treatment Facilities Fund, is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an enterprise fund (State Loan Program).

Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The State Funding Board, Sewage Treatment Facilities 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 basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

Bond Premiums, Issuance Costs, and Refunding Costs

Bond premiums, issuance costs, and refunding costs are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable unamortized bond premium and refunding costs. Unamortized issuance costs are reported as deferred charges.

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements (Cont.)
June 30, 1997, and June 30, 1996

NOTE 2. DEPOSITS

The fund had \$3,753,121 in the State Treasurer's pooled investment fund at June 30, 1997, and \$3,787,852 at June 30, 1996.

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, limited money market mutual funds, and obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The pooled investment fund is also authorized to enter into securities lending agreements in which U.S. government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Treasurer's pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*.

NOTE 3. DUE TO LOCAL GOVERNMENTS

This account represents loan principal overpayments and interest earnings that will be refunded to local governments.

NOTE 4. BONDS PAYABLE

Bonds payable at June 30, 1997, and June 30, 1996, are as follows (expressed in thousands):

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements (Cont.)
June 30, 1997, and June 30, 1996

	<u>June 30, 1997</u>	<u>June 30, 1996</u>
General obligation bonds, 5.0% issued March 1, 1977, due in generally decreasing amounts of principal and interest ranging from \$2.5 million in 1998 to \$.7 million in 2006	\$15,565	\$17,325
Refunding general obligation bonds, 4.6% to 5.0%, issued February 15, 1996, due in various amounts of principal and interest from \$1.8 million in 1998 to \$1.0 million in 2010 (net of unamortized premium of \$367 and deferred amount on refunding of \$253 at June 30, 1997, and net of unamortized premium of \$396 and deferred amount on refunding of \$273 at June 30, 1996)	<u>13,929</u>	<u>15,003</u>
Total bonds payable	<u>\$29,494</u>	<u>\$32,328</u>

Debt service requirements to maturity for all bonds payable at June 30, 1997, are as follows (expressed in thousands):

For the Year(s)	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
<u>Ending June 30</u>			
1998	\$ 2,880	\$1,460	\$ 4,340
1999	3,045	1,316	4,361
2000	3,195	1,164	4,359

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements (Cont.)
June 30, 1997, and June 30, 1996

2001	3,125	1,004	4,129
2002	3,280	848	4,128
2003-2010	<u>13,855</u>	<u>2,303</u>	<u>16,158</u>
 Total	 <u>\$29,380</u>	 <u>\$8,095</u>	 <u>\$37,475</u>

NOTE 5. CURRENT REFUNDING

On February 15, 1996, the State Funding Board issued \$14.9 million of General Obligation Bonds for a current refunding of \$18.7 million of outstanding 1980 General Obligation bonds, a portion of which is included as a debt of the Sewage Treatment Facilities Fund. Net proceeds of \$15.2 million, which includes an original issue premium, combined with other funds available to the Board, were used to redeem the 1980 bonds on March 1, 1996.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$.3 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2010 using the straight-line method. The refunding was completed to reduce the debt service payments over the next 14 years by \$6.5 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$3.0 million.