AGENDA

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
AUDIT COMMITTEE
MAY 31, 2023, 2:10 PM
CORDELL HULL BUILDING, VOLUNTEER CONFERENCE ROOM, 2ND FLOOR

1. **(Treasurer)** Call Meeting to Order

2. **(Treasurer)** Approval of the AC Meeting Minutes June 15, 2022 **(Pg. 2)** *

3. **(Michael Campbell)** Review Audit Reports Issued by Comptroller's Office

    a. Discuss TLDA Audit Report **(Pg. 5)**

    b. Discuss Clean Water State Revolving Fund Audit Report **(Pg. 25)**

4. **(Alicia West)** Review Financial Statements including Significant Accounting & Reporting Standards **(Pg. 33)**

5. **(Vena Jones)** SRF Summary of PERS Reports from EPA **(Pg. 36)**

    a. 2020 TN_SRF Drinking Water PERS Report **(Pg. 37)**

    b. 2020 TN_SRF Clean Water PERS Report **(Pg. 48)**

6. **(Sandi Thompson)** Risk Assessments Memo **(Pg. 60)**

    a. 2022 SLF Risk Assessment **(Pg. 61)**

    b. 2022 TDEC Water Resource Risk Assessment **(Pg. 72)**

7. **(Sandi Thompson)** Discuss Management's Responsibility to Prevent, Detect & Report Fraud, Waste & Abuse

8. **(Sandi Thompson)** Discuss Comptroller Hotline

9. **(Earle Pierce)** Audit Committee Responsibilities Calendar **(Pg. 80)**

10. **(Earle Pierce)** Current Internal Auditing Article **(Pg. 81)**

11. **(Treasurer)** Other Business

12. **(Treasurer)** Adjournment

* Items with an asterisk denote action required by the Audit Committee

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
AUDIT COMMITTEE MEETING MINUTES
June 15, 2022

The Tennessee Local Development Authority (TLDA) Audit Committee met on Wednesday, June 15, 2022. The meeting began at 10:59 a.m. in the State Capitol, Executive Conference room.

The following members were present:

- David H. Lillard, Jr., State Treasurer
- Mayor Gary Cordell, Coffee County Mayor (Telephonically)
- Tre Hargett, Tennessee Secretary of State
- Jim Bryson, F&A Commissioner (Present not participating)

Others present were:

- Sandra Thompson, Director, Office of State and Local Finance
- Alicia West, Program Accountant, Office of State and Local Finance
- Earle Pierce, Director of Internal Audit, TN Department of Treasury
- Adeniyi Bakare, State Revolving Fund Director, TN Department of Environment and Conservation (TDEC)

Call Meeting to Order

Treasurer Lillard called the meeting to order and asked for a roll call to determine a quorum. The results of the roll call confirmed a quorum was present for the meeting.

Roll Call: Treasurer Lillard-Present, Secretary Hargett-Present, Mayor Cordell-Present

Approval of Meeting Minutes

Treasurer Lillard presented the minutes from the June 15, 2021, TLDA Audit Committee meeting for approval. There were no other recommended changes. Treasurer Lillard motioned to accept the minutes as presented and Secretary Hargett seconded the motion. Mr. Pierce performed a roll-call vote and the motion passed unanimously.

Treasurer Lillard-Aye, Secretary Hargett-Aye, Mayor Cordell-Aye

Review Audit Reports Issued by Comptroller's Office

Treasurer Lillard noted Michael Campbell from State Audit was absent and recognized Earle Pierce, Treasury Internal Audit Director to review the audit reports for the Tennessee Local Development Authority (TLDA) and the Clean Water State Revolving Fund (CWSRF). Mr. Pierce communicated comments from Michael Campbell regarding both audits. The TLDA and CWSRF received unmodified opinions on their June 30, 2021, financial statements. No findings were noted on the audits. Mr. Campbell greatly appreciated the communication and support received from Ms. Thompson and her staff during the audit.

Review Financial Statements Including Significant Accounting and Reporting Standards

Treasurer Lillard recognized Alicia West to review the financial statements for the TLDA and the SRF programs. Ms. West presented an overview of the financial statements.

Status of Program Evaluation Reviews (PERs) from the EPA

Treasurer Lillard recognized Adeniyi Bakare, State Revolving Fund Director from TDEC to the status of the FY2021 PERS reviews from the EPA. Mr. Bakare informed the Committee the PERS reviews were still in progress at this time, and he expects the results later in 2022. Treasurer Lillard asked if the committee members had any questions. No questions were received from the Committee members.

State and Local Finance 2021 Risk Assessments

Treasurer Lillard recognized Sandi Thompson to discuss the Office of State and Local Finance (SLF) and Division of Water Resources 2021 Risk Assessments. Ms. Thompson stated the risk assessments cover risks and controls as required by the Financial Integrity Act. A memo regarding the act was included in the materials. Ms. Thompson discussed some of the testing performed to ensure controls documented in the risk assessments worked as intended.

Discuss Management's Responsibility to Prevent, Detect and Report Fraud, Waste and Abuse

Treasurer Lillard recognized Sandi Thompson to speak about management's responsibility to prevent, detect, and report fraud, waste, and abuse. Ms. Thompson stated the tone at the top is the first line of defense for preventing fraud, waste, and abuse. Ms. Thompson noted she was not aware of any instances of reported fraud, waste, or abuse within the Office of State and Local Finance. Department personnel are aware risk exists with performing their duties. Those risks are monitored and mitigated daily by SRF leadership.

Discuss Comptroller Hotline

Treasurer Lillard recognized Sandi Thompson to discuss the Comptroller's Fraud, Waste, and Abuse (FWA) Hotline. Employees and members of the community are encouraged to call the Comptroller's toll-free hot line to report any instances of suspected waste and abuse of government funds. Citizens are referred to the hotline when they have complaints.

Discuss Current Internal Audit Article

Treasurer Lillard recognized Earle Pierce to present a current article from the Institute of Internal Auditors entitled, "Tone at the Top". Mr. Pierce summarized the article with a brief discussion maintaining excellence in corporate governance. 2021 survey results revealed a decline in seven of eight categories since the start of the pandemic. Mr. Pierce discussed key takeaways on how to strengthen corporate governance outlined in the article.

Other Business

Treasurer Lillard opened the floor for any other business to be brought before the Committee. No new business was presented.

Adjournment

Secretary Hargett motioned to adjourn. Treasurer Lillard seconded the motion. A roll call vote was made to adjourn the meeting and the motion passed unanimously.

Treasurer Lillard-Aye, Secretary Hargett-Aye, Mayor Cordell-Aye
Treasurer Lillard adjourned the meeting at 11:10 a.m.

Approved:

David H. Lillard, Jr.
TLDA Audit Committee Chairman

Tennessee Comptroller of the Treasury

Jason E. Mumpower
Comptroller

November 30, 2022

Ms. Sandi Thompson, Director
Division of State Government Finance
425 Rep. John Lewis Way N.
Nashville, Tennessee 37243

Dear Ms. Thompson:

We have completed our audit fieldwork of the Tennessee Local Development Authority for the year ended June 30, 2022. We are enclosing a draft copy of the financial statements and notes to the financial statements for your information. The financial statements and notes will be included in the published audit report.

All of the enclosed and otherwise referenced materials should be considered part of our confidential working papers not open to public inspection pursuant to state law. Our sharing of this information with you is pursuant to the internal processes of the State of Tennessee and is not intended as a publication or distribution of this information outside of official government channels. Therefore, you are requested to appropriately safeguard its confidentiality and appropriately restrict its further disclosure. If you must share the information with other government officials, you are requested to attach this letter with the materials, maintain the stamped notation on the materials that the information is confidential, and further advise those other officials of their continuing responsibility to appropriately safeguard its confidentiality and appropriately restrict its further disclosure.

On behalf of my staff, I would like to thank you and your staff for your cooperation during the audit. If you have any questions about these procedures, please call Michael Campbell, the manager in charge of the audit.

Sincerely,

Katie J. Stickel

Katherine J. Stickel, CPA, CGFM, Director
Division of State Audit

Attachments

cc: The Honorable David H. Lillard, Jr., Treasurer
Mr. Earle Pierce, Audit Committee Secretary
Sharon Schmucker, Manager

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
Management's Discussion and Analysis

As management of the Tennessee Local Development Authority, we offer readers of the Authority's basic financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal years ended June 30, 2022, and June 30, 2021, with comparative data for the year ended June 30, 2020. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the Independent Auditor's Report, the audited financial statements, and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

Program Activity Highlights

The Authority's purpose is to provide loans to Local Government Units under the State Loan Programs and State Infrastructure Program. The table below summarizes this business activity.

Pursuant to Title 4, Chapter 31, *Tennessee Code Annotated*, the General Assembly of the state created the Tennessee Local Development Authority to issue bonds and notes to fund capital projects for a variety of purposes. Currently, the programs of the Authority which have made loans to borrowers in the past include:

1) the State Loan Programs providing assistance to local government units in the construction of waterworks, sewage treatment, and energy and/or solid waste recovery facilities; and

2) the State Infrastructure Program providing assistance to local government units in the construction of transportation infrastructure projects that provide public benefits by enhancing mobility or safety, promoting economic development, or increasing the quality of life and general welfare of the public.

	Local Government Units			State Infrastructure Program		
	2022	2021	2020	2022	2021	2020
Number of borrowers with outstanding loans	3	4	4	1	1	1
Total number of outstanding loans	3	4	4	1	1	1
Total amount of outstanding loans (in thousands)	$778	$1,023	$1,230	$1,306	$1,371	$1,434
Number of outstanding loans approved in fiscal year	0	0	0	0	0	0
Amount of loans approved in fiscal year (in thousands)	$0	$0	$0	$0	$0	$0

The state is not liable on any debt of the Authority, and the bonds are not a debt of the State of Tennessee. For more specific financial information on long-term debt activity, see Note 5, Debt Payable, in the notes to the financial statements.

The financial statements and the analysis provided in the remainder of this report reflect the financial results of this activity.

Debt Administration

The Authority's most long-standing program is its State Loan Program. To date, the State Loan Program has only been utilized to make loans for the construction of water and sewer projects. A financial analysis is conducted for each loan applicant to be funded through the State Loan Program before the application is approved by the Authority. Each local government unit must demonstrate that it has enacted rates and charges sufficient to repay the debt, as well as to fund operations, maintenance, and depreciation. The Authority also compares state-shared taxes, which are pledged by the local government unit, in relation to projected debt service. The Authority is authorized to intercept these state-shared taxes, should the government unit fail to timely repay its loan. The balance of any deficit would be secured by the debt service reserve fund and the statutory reserve fund. The statutory reserve fund is a set aside amount in the fund from appropriations of the State's General Assembly from 1985 to 1987, intended to ensure payment of debt service on debt issued for any purpose under the State Loan Program.

During its construction phase, a project in the State Loan Program is typically funded with the proceeds from the issuance of Bond Anticipation Notes. As projects reach completion, and the amount of dollars expended is evaluated to assure an appropriate economy of scale to sell bonds, the Authority may fix the interest rate for the term of the projects by issuing long-term debt. Interest rates on the State Loan Program facilities long-term fixed-rate debt range from a low of 4% to a high of 4.375%. By pooling the financing of the capital projects, management believes that economic efficiencies of a single large borrowing administered by one agency are achieved. The creditworthiness of both large and small local government units is blended into one credit resulting in a lower cost of borrowing to most participants.

At June 30, 2022, the Authority's State Loan Program was rated AA by Standard & Poor's Rating Group (S&P) and AA by Fitch Ratings. In general, rating reports include comments about the Authority's ongoing commitment to conservative practices, as well as sound legal provisions, strong state oversight, and an ample debt service reserve as strengths of the credit. Rating agencies also note that added strengths of the credit of the program are the underlying credit quality of the local governments receiving loans, the responsibility of the localities to repay loans, and the Authority's history of never needing to intercept state-shared taxes or tap the statutory reserve fund.

The State Infrastructure Fund was created in 2009 with the transfer of the existing state infrastructure bank which had been under the administration of the Tennessee Department of Transportation (TDOT). The following sources can be used to provide additional capitalization to the fund: appropriations from the State's General Assembly; federal funds apportioned and available to the State and approved by TDOT; contributions, donations, and grants from the federal government or other governmental units or private entities; and principal and interest repayments from the borrowers. The Authority reviews each loan application to determine the borrower's capability to assure sufficient revenues to operate and maintain the project for its useful life and to repay the loan. The borrower may pledge its state-shared taxes, its full faith and credit and unlimited taxing power, or other security as the Authority deems appropriate. No debt may be issued to provide loans to borrowers from the State Infrastructure Fund. The Authority is charged with the responsibilities of approving loan applications and administering the loans. The Authority has received and approved one loan application from the fund.

Overview of the Financial Statements

The Authority is a discretely presented component unit of the State of Tennessee and uses proprietary fund accounting. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting and the flow of economic resources measurement focus. This basis recognizes revenues when earned and expenses at the time liabilities are incurred, regardless of when cash is received or paid. Using the economic resources measurement focus, a reader is presented information that allows them to determine the transactions and events that have increased or decreased the total economic resources for the period.

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements are comprised of two components: 1) the financial statements and 2) notes to the financial statements. The financial statements consist of the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. The Statement of Net Position reports the Authority's overall financial position at June 30, the end of each fiscal year presented. The Statement of Revenues, Expenses and Changes in Net Position reports the results of operations for the year. The Statement of Cash Flows summarizes the inflows and outflows of cash throughout the fiscal year. These statements are supplemented by notes to the financial statements, which provide information essential to the reader's understanding of the financial statements. In addition to the financial statements and notes, this report also contains supplementary information containing financial statement information at the program level.

Financial Analysis of the Authority

Standard indicators of financial success are not applicable to the Authority. The financial goal of the Authority is to provide borrowers with timely access to the capital markets at the lowest possible cost and to make creditworthy loans. There have been no incidents which required the Authority to refuse a loan application due to the inability to obtain capital funding. Also, the Authority has never had to use the intercept of state-shared taxes, nor has it had to draw from the debt service reserve fund or the statutory reserve fund to pay debt service.

The following is a discussion highlighting certain elements of the Authority's financial statements.

Statements of Net Position Summary
(in thousands of dollars)

	2022	2021	2020
Current assets	$17,164	$16,507	$15,993
Restricted assets	273	272	348
Other assets	1,787	2,101	2,377
Total assets	19,224	18,880	18,718
Deferred outflows of resources	-	-	26
Current liabilities	366	358	455
Noncurrent liabilities	794	1,023	1,258
Total liabilities	1,160	1,381	1,713
Net position (unrestricted)	$18,064	$17,499	$17,031

Note: The Authority owns no capital assets.

For the years ended June 30, 2022; June 30, 2021; and June 30, 2020, the largest component of the total asset balance is the cash balance. Loans receivable (both current and noncurrent) totaled $2,083,768 at June 30, 2022; $2,394,055 at June 30, 2021; and $2,663,403 at June 30, 2020. Restricted assets represent the debt service reserve fund. Other assets decreased from 2021 to 2022 and 2020 to 2021 as no new loans were made and payments were received on existing loans receivable. The Authority's liabilities consist mostly of the outstanding portion of its bonds payable. No bonds have been issued since 2006. Bonds payable continues to decrease as bond payments are made. No Revenue Bond Anticipation Notes were issued during any of the three years presented. The Authority has not received any loan applications in the current fiscal year and has no plans to issue debt in the immediate future. In the current market, communities who have previously utilized the program have identified other funding opportunities that better suit their needs at this time.

Statements of Revenues, Expenses, and Changes in Net Position Summary
(in thousands of dollars)

	2022	2021	2020
Operating Revenues			
Revenue from loans	$82	$84	$100
Administrative fees collected	651	583	503
Interest income	35	13	247
Total operating revenues	768	680	850
Operating Expenses			
Interest expense	49	69	90
Subsidy to borrowers	1	1	7
Administrative expenses	153	142	155
Total operating expenses	203	212	252
Operating income	565	468	598
Increase in Net Position	$565	$468	$598

The Authority's operating expenses are supported by revenue received from the borrowers as a one-time cost of issuance expense not to exceed 2% at the time of permanent financing, interest on loans, and income on investments. In addition, the Authority has oversight and approval duties related to loans made from the Clean Water and Drinking Water State Revolving fund (SRF) programs. In 2010, the Authority was given statutory authority to charge the SRF borrowers a fee for the administration of the loans. Therefore, subsequent loans approved are charged an eight-basis point (0.08%) fee on the outstanding balance of the loan over its life. These administrative fees are recognized by the Authority as operating revenue. Operating expenses include interest expense on outstanding debt and administrative expenses of the program. A portion of investment earnings will be returned to borrowers as a subsidy to borrowers upon bond maturity.

Revenue to the Authority increased from 2021 to 2022 and decreased from 2020 to 2021. Interest income increased from 2021 to 2022 as market interest rates increased. A decline in market interest rates caused a decline in interest income from 2020 to 2021. Administrative fees related to the SRF loan programs increased during the periods shown. Revenue from loans of the Authority is declining as the state loan program winds down. All the Authority's loans are structured such that the borrowers make level debt service payments for the life of the loan, meaning that over time as the borrowers' principal portion of the payment increases, the interest portion of the payment decreases. Because no new loans have been made, as the existing loans approach maturity, the interest revenue will trend downward. The Authority's total operating expenses decreased from 2021 to 2022 as well as from 2020 to 2021. Unless new loans are made, operating expenses are expected to trend downward.

COVID-19

COVID-19 is not expected to have a significant impact on the Authority's state loan program. Borrowers that experience financial difficulties can be referred to the state's utilities boards which supports municipalities, counties, treatment authorities, water, and wastewater public utilities that operate water and sewer enterprises by ensuring that they are financially self-supporting. Additionally, loans are secured by a pledge of system revenues and are further secured by a pledge of borrower's state-shared taxes, a security deposit equal to maximum annual debt service, and a statutory reserve fund. Therefore, sufficient funds are available to meet debt service requirements on the bonds in the event of a loan default.

Contacting the Authority's Management Team

This discussion and analysis is designed to provide our citizens, local government units, community providers, investors, and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Division of State Government Finance, State of Tennessee, Cordell Hull Building, 425 Rep. John Lewis Way N., Nashville, Tennessee 37243-3400 or visit our website at http://www.comptroller.tn.gov/sl/.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
Statements of Net Position
June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	June 30, 2022	June 30, 2021
Assets		
Current assets:		
Cash (Note 2)	$16,867	$16,214
Receivables:		
Loans receivable	297	293
Total current assets	17,164	16,507
Noncurrent assets:		
Restricted cash (Notes 2 and 3)	273	272
Loans receivable	1,787	2,101
Total noncurrent assets	2,060	2,373
Total assets	19,224	18,880
Liabilities		
Current liabilities:		
Accrued interest payable	14	17
Payable to borrowers (Note 4)	122	121
Revenue bonds payable (Note 5)	230	220
Total current liabilities	366	358
Noncurrent liabilities:		
Revenue bonds payable, net (Note 5)	794	1,023
Total noncurrent liabilities	794	1,023
Total liabilities	1,160	1,381
Net position		
Unrestricted (Note 6)	18,064	17,499
Total net position	$18,064	$17,499

The notes to the financial statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	Year Ended June 30, 2022	Year Ended June 30, 2021
Operating revenues		
Revenue from loans	$ 82	$ 84
Administrative fees collected	651	583
Interest income	35	13
Total operating revenues	768	680
Operating expenses		
Interest expense	49	69
Subsidy to borrowers	1	1
Administrative expenses	153	142
Total operating expenses	203	212
Operating income	565	468
Net position		
Net position, July 1	17,499	17,031
Net position, June 30	$18,064	$17,499

The notes to the financial statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
Statements of Cash Flows
For the Years Ended June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	Year Ended June 30, 2022	Year Ended June 30, 2021
Cash flows from operating activities		
Payments to service providers	$ (153)	$ (142)
Net cash used by operating activities	(153)	(142)
Cash flows from noncapital financing activities		
Principal payments	(220)	(285)
Interest paid	(52)	(63)
Net cash used by noncapital financing activities	(272)	(348)
Cash flows from investing activities		
Collections of loan principal	311	269
Interest received on loans	82	84
Administrative revenue	651	583
Interest received on pooled investment fund	35	13
Amounts repaid to borrowers	-	(27)
Net cash provided by investing activities	1,079	922
Net increase in cash	654	432
Cash, July 1	16,486	16,054
Cash, June 30	$17,140	$16,486
Reconciliation of operating income to net cash used by operating activities:		
Operating income	$ 565	$ 468
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(82)	(84)
Interest income	(35)	(13)
Interest expense	49	69
Subsidy to borrowers	1	1
Administrative revenue from borrowers	(651)	(583)
Total adjustments	(718)	(610)
Net cash used by operating activities	$ (153)	$ (142)

The notes to the financial statements are an integral part of this statement.

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The Tennessee Local Development Authority was created to provide financial assistance to local governments through the issuance of revenue bonds or notes. The Authority has also issued bonds to assist nonprofit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities.

The Authority is a component unit of the State of Tennessee and is a separate legal entity. In accordance with the Governmental Accounting Standards Board's (GASB) Statement 14, *The Financial Reporting Entity*, as amended, the Authority is discretely presented in Tennessee's *Annual Comprehensive Financial Report* because the Authority's board consists of state officials which include the Governor, the Secretary of State, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Finance and Administration, a State Senate appointee, and a State House appointee. The Governor serves as chairman, and the Secretary of State serves as vice chairman. The Comptroller of the Treasury serves as secretary. The Director of the Division of State Government Finance serves as the assistant secretary; the Division of State Government Finance provides administrative and financial services to the Authority. Therefore, the state has the ability to affect the day-to-day operations of the Authority.

The Authority does not have any employees. The members serve without salary but are entitled to reimbursement for their actual and necessary expenses incurred in the performance of their official duty.

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 basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

The Tennessee Local Development Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The Authority's principal operation is to provide loans to local governments through the issuance of revenue bonds or notes. Therefore, the principal operating revenues of the Authority are from interest on loans made to borrowers. The Authority also recognizes income on investments as operating revenue. The Authority's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, arbitrage, and 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 State Pooled Investment Fund administered by the State Treasurer.

Bond Discounts, Bond Premiums, and Issuance Costs

Bond discounts and premiums 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 discounts and premiums. Bond issuance costs are expensed when incurred.

Note 2. Deposits

Under the general bond resolution of the Tennessee Local Development Authority, the funds of the Authority are to be held and invested by the State Treasurer.

The Authority does not utilize its own bank accounts but has cash on deposit for its operating cash purposes in the State Pooled Investment Fund (SPIF) administered by the State Treasurer. The Authority had $17,140,513 in the pooled investment fund at June 30, 2022, and $16,486,822 at June 30, 2021. 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. The fund is not rated by a nationally recognized statistical rating organization. The fund's investments are measured at amortized cost. The pooled investment fund's investment policy and required risks disclosures are presented in the SPIF financial statements and notes, which are available on the state's website at https://treasury.tn.gov/Explore-Your-TN-Treasury/About-the-Treasury/Department-Reports

Note 3. Restricted Assets

The general bond resolution of the Authority requires that the principal of each bond issue include an amount equal to one year's debt service requirement and that such amount be placed in special trust accounts with the trustee. The required debt service reserve was $273,090 at June 30, 2022, and $271,890 at June 30, 2021.

Note 4. Payable to Borrowers

This account represents interest earnings on restricted assets and loan principal that is being held until the bonds mature and then will be refunded to borrowers.

Note 5. Debt Payable

Revenue Bonds

Bonds payable at June 30, 2022, and June 30, 2021, were as follows (expressed in thousands):

	June 30, 2022	June 30, 2021
2006 Series B at interest rates from 4% to 4.375% maturing to 2029 (original par-$37,415)	1,030	1,250
Total par amount of bonds payable	1,030	1,250
Less unamortized discount	(6)	(7)
Net bonds payable	$ 1,024	$ 1,243

Debt service requirements to maturity of the revenue bonds payable at June 30, 2022, were as follows (expressed in thousands):

For the Year(s) Ending June 30	Principal	Interest	Total
2023	$ 230	$ 43	$ 273
2024	240	34	274
2025	245	24	269
2026	260	13	273
2027	15	2	17
2028–2029	40	3	43
Total	$1,030	$119	$1,149

Changes in long-term debt payable for the year ended June 30, 2022, were as follows (expressed in thousands):

	Balance July 1, 2021	Additions	Deletions	Balance June 30, 2022	Amounts Due Within One Year
Revenue bonds payable	$ 1,250	$ -	$ 220	$ 1,030	$ 230
Less: unamortized bond discount	(7)	-	(1)	(6)	-
Total bonds payable	$ 1,243	$ -	$ 219	$ 1,024	$ 230

Changes in long-term debt payable for the year ended June 30, 2020, are as follows (expressed in thousands):

	Balance July 1, 2021	Additions	Deletions	Balance June 30, 2021	Amounts Due Within One Year
Revenue bonds payable	$ 1,535	$ -	$ 285	$ 1,250	$ 220
Less: unamortized bond discount	(8)	-	(1)	(7)	-
Add: unamortized bond premium	16	-	16	-	-
Total bonds payable	$ 1,543	$ -	$ 300	$ 1,243	$ 220

Events of Default

Debt under the Tennessee Local Development Authority State Loan Program is secured by monthly payments of principal and interest made by local governments in accordance with the loan agreements. Under these loan agreements, local governments agree to levy fees, rates, or charges for services provided by the project and/or ad valorem taxes sufficient to pay debt service requirements. Additional security includes a pledge of state-shared taxes, a debt service reserve, and a statutory reserve.

Upon event of default, the General Bond Resolution empowers the trustee to institute any action or proceedings of law or equity for the collection of all payments due and unpaid under a loan agreement and to require the Authority to withhold state-shared taxes to the extent permitted by law and the terms of the loan agreement. In the event a local government should fail to make a timely and full payment with respect to the loan agreement, the Secretary or Assistant Secretary to the Authority will notify the Commissioner of Finance and Administration (the Commissioner) that the local government has failed to pay loan repayments due and payable with respect to a project and pursuant to the loan agreement and request the Commissioner to notify the local government of the default. The Commissioner shall deliver written notice by certified mail to the local government of such failure within 5 days of such failure. In the event the local government unit fails to remit the required payment or payments within 60 days of receipt of such notice, the Commissioner shall, without further authorization, withhold such sum or part of such sum from the state-shared taxes to make the local government current with respect to the unpaid loan. The balance of any deficit would be secured first by the debt service reserve and then the statutory reserve.

Upon the event of default of principal and interest due on bonds or notes, the Authority shall notify the trustee of such event and the corrective action, if any, the Authority intends to take. Upon the occurrence of an event of default of which the trustee has actual knowledge and at all times thereafter while such default shall continue, the trustee shall become vested with all the estate, property, rights, trusts, duties, and obligations of the trustee and shall take possession or supervision over the funds and account created under the General Bond Resolution and collect and receive all revenues and other monies in the same manner as the Authority and shall act in place of the Authority in the exercise of all rights and duties. The trustee shall give written notice by mail to all the registered holders of the bonds within 60 days after having obtained actual knowledge of default. Upon the occurrence and continuance of an event of default, the trustee (1) for and on behalf of the holders of the bonds, shall have the same rights which are possessed by the bondholders; (2) shall be authorized to proceed, in its own name and as trustee of an express trust; (3) may pursue any available remedy by action at law or suit in equity to enforce the payment of principal and interest and premium, if any, on the bonds; (4) may file such proofs of claim and other papers or documents as may be necessary; and (5) may, and upon written request of the holders of the bonds of not less than a majority in principal amount of the bonds then outstanding shall proceed to protect and enforce all rights of the bondholders and the trustee as permitted by the General Bond Resolution and the laws of the State of Tennessee.

Note 6. Statutory Reserve

The statutory reserve is an amount set aside in the fund intended to ensure payment of the required annual debt service (principal and interest) for municipalities in the event of a default that have insufficient state-shared taxes available to the Authority to withhold. Per review of the General Bond Resolution, it was determined that this amount should be classified as unrestricted net position. The statutory reserve was funded at $3 million from appropriations of the state’s General Assembly from 1985 to 1987. As of June 30, 2022, the statutory reserve balance was $3,314,087.

As a part of the application process, each loan applicant pledges its available state-shared taxes, giving the Authority the authorization to intercept these state-shared taxes, should the local government unit fail to repay timely its loan. An analysis is conducted to compare this state-shared tax amount to projected maximum annual debt service. The balance of any deficit would be secured first by the debt service reserve and then the statutory reserve.

Note 7. State Infrastructure Fund

The Tennessee Transportation State Infrastructure Fund was created pursuant to Section 4-31-1201, *Tennessee Code Annotated*. The State Infrastructure Program provides assistance to local government units in the construction of transportation infrastructure projects that provide public benefits by enhancing mobility or safety, promoting economic development, or increasing the quality of life and general welfare of the public. In fiscal years 2022 and 2021, no loans were approved.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY

Supplementary Schedules of Net Position - Program Level

June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	June 30, 2022			June 30, 2021		
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
Assets						
Current assets:						
Cash	$15,757	$ 1,110	$16,867	$15,198	$ 1,016	$16,214
Receivables:						
Loans receivable	232	65	297	229	64	293
Total current assets	15,989	1,175	17,164	15,427	1,080	16,507
Noncurrent assets:						
Restricted cash	273	-	273	272	-	272
Loans receivable	546	1,241	1,787	794	1,307	2,101
Total noncurrent assets	819	1,241	2,060	1,066	1,307	2,373
Total assets	16,808	2,416	19,224	16,493	2,387	18,880
Liabilities						
Current liabilities:						
Accrued interest payable	14	-	14	17	-	17
Payable to borrowers	122	-	122	121	-	121
Revenue bonds payable	230	-	230	220	-	220
Total current liabilities	366	-	366	358	-	358
Noncurrent liabilities:						
Revenue bonds payable, net	794	-	794	1,023	-	1,023
Total noncurrent liabilities	794	-	794	1,023	-	1,023
Total liabilities	1,160	-	1,160	1,381	-	1,381
Net position						
Unrestricted	15,648	2,416	18,064	15,112	2,387	17,499
Total net position	$ 15,648	$ 2,416	$18,064	$15,112	$ 2,387	$17,499

TENNESSEE LOCAL DEVELOPMENT AUTHORITY

Supplementary Schedules of Revenues, Expenses, and Changes in Net Position - Program Level

For the Years Ended June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	Year Ended June 30, 2022			Year Ended June 30, 2021		
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
Operating revenues						
Revenue from loans	$ 57	$ 25	$ 82	$ 58	$ 26	$ 84
Administrative fees collected	649	2	651	581	2	583
Interest income	33	2	35	12	1	13
Total operating revenues	739	29	768	651	29	680
Operating expenses						
Interest expense	49	-	49	69	-	69
Subsidy to borrowers	1	-	1	1	-	1
Administrative expenses	153	-	153	142	-	142
Total operating expenses	203	-	203	212	-	212
Operating income	536	29	565	439	29	468
Net position						
Net position, July 1	15,112	2,387	17,499	14,673	2,358	17,031
Net position, June 30	$15,648	$2,416	$18,064	$15,112	$2,387	$17,499

TENNESSEE LOCAL DEVELOPMENT AUTHORITY

Supplementary Schedules of Cash Flows - Program Level

For the Years Ended June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	Year Ended June 30, 2022			Year Ended June 30, 2021		
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
Cash flows from operating activities						
Payments to service providers	$ (153)	$ -	$ (153)	$ (142)	$ -	$ (142)
Net cash used by operating activities	(153)	-	(153)	(142)	-	(142)
Cash flows from noncapital financing activities						
Principal payments	(220)	-	(220)	(285)	-	(285)
Interest paid	(52)	-	(52)	(63)	-	(63)
Net cash used by noncapital financing activities	(272)	-	(272)	(348)	-	(348)
Cash flows from investing activities						
Collections of loan principal	246	65	311	206	63	269
Interest received on loans	57	25	82	58	26	84
Administrative revenue	649	2	651	581	2	583
Interest received on pooled investment fund	33	2	35	12	1	13
Amounts repaid to borrowers	-	-	-	(27)	-	(27)
Net cash provided by investing activities	985	94	1,079	830	92	922
Net increase in cash	560	94	654	340	92	432
Cash, July 1	15,470	1,016	16,486	15,130	924	16,054
Cash, June 30	$ 16,030	$ 1,110	$ 17,140	$ 15,470	$ 1,016	$ 16,486
Reconciliation of operating income to net cash used by operating activities:						
Operating income	$ 536	$ 29	$ 565	$ 439	$ 29	$ 468
Adjustments to reconcile operating income to net cash used by operating activities:						
Revenue from loans	(57)	(25)	(82)	(58)	(26)	(84)
Interest income	(33)	(2)	(35)	(12)	(1)	(13)
Interest expense	49	-	49	69	-	69
Subsidy to borrowers	1	-	1	1	-	1
Administrative revenue from borrowers	(649)	(2)	(651)	(581)	(2)	(583)
Total adjustments	(689)	(29)	(718)	(581)	(29)	(610)
Net cash used by operating activities	$ (153)	$ -	$ (153)	$ (142)	$ -	$ (142)

DRAFT

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Tennessee Comptroller of the Treasury

Jason E. Mumpower
Comptroller

November 30, 2022

Ms. Sandi Thompson, Director
Division of State Government Finance
425 Rep. John Lewis Way N.
Nashville, Tennessee 37243

Dear Ms. Thompson:

We have completed our audit fieldwork of the Clean Water State Revolving Fund for the year ended June 30, 2022. We are enclosing a draft copy of the financial statements and notes to the financial statements for your information. The financial statements and notes will be included in the published audit report.

All of the enclosed and otherwise referenced materials should be considered part of our confidential working papers not open to public inspection pursuant to state law. Our sharing of this information with you is pursuant to the internal processes of the State of Tennessee and is not intended as a publication or distribution of this information outside of official government channels. Therefore, you are requested to appropriately safeguard its confidentiality and appropriately restrict its further disclosure. If you must share the information with other government officials, you are requested to attach this letter with the materials, maintain the stamped notation on the materials that the information is confidential, and further advise those other officials of their continuing responsibility to appropriately safeguard its confidentiality and appropriately restrict its further disclosure.

On behalf of my staff, I would like to thank you and your staff for your cooperation during the audit. If you have any questions about these procedures, please call Michael Campbell, the manager in charge of the audit.

Sincerely,

Katherine J. Stickel, CPA, CGFM, Director
Division of State Audit

Attachments

cc: The Honorable David H. Lillard, Jr., Treasurer
Mr. Earle Pierce, Audit Committee Secretary
Sharon Schmucker, Manager

CLEAN WATER STATE REVOLVING FUND
Statements of Net Position
June 30, 2022, and June 30, 2021

(Expressed in Thousands)

	June 30, 2022	June 30, 2021
Assets		
Current assets:		
Cash (Note 2)	$ 370,721	$ 396,617
Loans receivable	40,874	58,508
Total current assets	411,595	455,125
Noncurrent assets:		
Loans receivable	801,411	727,401
Total noncurrent assets	801,411	727,401
Total assets	1,213,006	1,182,526
Liabilities		
Current liabilities:		
Payable to borrowers (Note 3)	8	6
Due to general fund	33	31
Total current liabilities	41	37
Noncurrent liabilities:		
Customer deposits payable (Note 2)	3,915	4,600
Total noncurrent liabilities	3,915	4,600
Total liabilities	3,956	4,637
Net position		
Unrestricted	1,209,050	1,177,889
Total net position	1,209,050	1,177,889

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, 2022, and June 30, 2021

(Expressed in Thousands)

	Year Ended June 30, 2022	Year Ended June 30, 2021
Operating revenues		
Revenue from loans	$ 9,964	$ 9,927
Interest income	796	304
Total operating revenues	10,760	10,231
Operating expenses		
Administrative expenses	1,114	1,113
Total operating expenses	1,114	1,113
Operating income	9,646	9,118
Nonoperating revenues		
Capitalization grant	19,186	18,549
Total nonoperating revenues	19,186	18,549
Nonoperating expenses		
Principal forgiveness (Note 5)	1,114	639
Total nonoperating expenses	1,114	639
Income before transfers	27,718	27,028
Transfers in (Note 4)	3,443	4,616
Change in net position	31,161	31,644
Net position, July 1	1,177,889	1,146,245
Net position, June 30	1,209,050	1,177,889

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, 2022, and June 30, 2021

(Expressed in Thousands)

	Year Ended June 30, 2022	Year Ended June 30, 2021
Cash flows from operating activities		
Payments for interfund services	$ (1,112)	$ (1,082)
Net cash used by operating activities	(1,112)	(1,082)
Cash flows from noncapital financing activities		
Operating grants received	19,186	18,549
Transfers in	3,443	4,616
Net cash provided by noncapital financing activities	22,629	23,165
Cash flows from investing activities		
Loans issued and other disbursements to borrowers	(117,703)	(169,559)
Collections of loan principal	59,474	141,446
Security deposits from borrowers	55	973
Interest received on loans	9,964	9,927
Interest received on investments	805	310
Amounts repaid to borrowers	(8)	(4,333)
Net cash used by investing activities	(47,413)	(21,236)
Net increase (decrease) in cash	(25,896)	847
Cash, July 1	396,617	395,770
Cash, June 30	$ 370,721	$ 396,617
Reconciliation of operating income to net cash used by operating activities:		
Operating income	$ 9,646	$ 9,118
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(9,964)	(9,927)
Interest income	(796)	(304)
Due to general fund	2	31
Total adjustments	(10,758)	(10,200)
Net cash used by operating activities	$ (1,112)	$ (1,082)

The notes to the financial statements are an integral part of this statement.

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. The Clean Water State Revolving Fund has been included in Tennessee's *Annual Comprehensive Financial Report* as an enterprise fund (Sewer Treatment Loan Fund). That report is posted on the state's website at https://www.tn.gov/finance/rd-doa/fa-accfin-ar.html.

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 State Pooled Investment Fund administered by the State Treasurer.

Note 2. Deposits

At June 30, 2022, the Clean Water State Revolving Fund had $366,806,102 in the State Pooled Investment Fund for operating cash purposes and $3,915,367 in customer security deposits in the Local Government Investment Pool. At June 30, 2021, the fund had $392,017,061 in the State Pooled Investment Fund and $4,600,230 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. The fund is not rated by a nationally recognized statistical rating organization. The fund's investments are measured at amortized cost. The pooled investment fund's investment policy and required risks disclosures are presented in the SPIF financial statements and notes, which are available on the state's website at https://treasury.tn.gov/Explore-Your-TN-Treasury/About-the-Treasury/Department-Reports.

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 Transfers

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 U.S. Environmental Protection Agency to fund the program. To provide a state match for the federal grant to operate the program, the Clean Water State Revolving Fund received an interfund transfer of $3,443,000 from the state's general fund during the year ended June 30, 2022, and $4,616,400 during the year ended June 30, 2021.

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 ARRA 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 that the Clean Water State Revolving Fund received 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. Principal forgiveness is recognized on the statements of cash flows as part of "loans issued and other disbursements to borrowers."

Tennessee Comptroller of the Treasury

Jason E. Mumpower
Comptroller

Fiscal Year Ending June 30, 2022

TLDA Programs

1. State Loan Program Fund: (Water/Sewer)
   - 3 borrowers
   - 3 loans outstanding
   - $1,030,000 bonds outstanding (Bonds mature 2029)

2. State Infrastructure Fund (Transportation)
   - 1 borrower
   - Collections:
     - $64,188 loan principal
     - $25,356 interest

Operating Income: $564,749
Net Position at June 30, 2022: $18,064,051
No new loans are being issued for these programs.

State Revolving Fund Loan Programs

1. Clean Water Fund
   - Disbursements
     - $117,703,045
   - Collections
     - $59,474,084 loan principal
     - $9,964,376 interest
   - Net position at June 30, 2022: $1,209,049,855

2. Drinking Water Fund
   - Disbursements
     - $12,793,402
   - Collections
     - $11,028,373 loan principal
     - $1,210,270 interest
   - Net position at June 30, 2022: $223,849,583
   - No significant changes to accounting and reporting standards.

SRF Program Summary for TLDA May 31, 2023, Audit Committee Meeting

1. EPA Region 4 SRF Program Evaluation Report - Clean Water SRF (CWSRF) Program SFY2021
   - On July 18, 2022, EPA conducted an Annual Review Opening Meeting for the DWSRF Program
   - On August 16, 2022, the review concluded with a Closing Meeting.
   - EPA identified no findings or required actions but made the following recommendations.
     - EPA requests that the state evaluate different approaches and options such as utilization of cash flow modeling and increased marketing of the SRF to decrease uncommitted balances and increase program pace. The state has reported that it is short staffed but has made efforts to improve response rates to solicitations for projects. In addition, TDEC reports a significant increase in project funding requests in FY22, estimating over $400M in need.
     - EPA recommends that the state considers maximizing the percentage of additional subsidy allowable for SRF capitalization grant awards. A state may utilize up to 30 percent of the available funds in the cap grant to provide additional subsidy to eligible recipients. The minimum subsidization requirement for each cap grant is 10 percent. Zero percent of TDEC's FY21 disbursement was for additional subsidization.

2. EPA Region 4 SRF Program Evaluation Report - Clean Water SRF (CWSRF) Program SFY2022
   - On March 13, 2023, EPA conducted an Annual Review Opening Meeting for the CWSRF Program.
   - On April 14, 2023, EPA conducted an Annual Review Closing Meeting for the DWSRF.
   - EPA identified no findings or required action.
   - We expect to receive the final PER reports for SFY22 within 60 days following the Closing Meeting.

3. EPA Region 4 SRF Program Evaluation Report - Drinking Water SRF (DWSRF) Program SFY2021
   - On July 18, 2022, EPA conducted an Annual Review Opening Meeting for the DWSRF Program

- On August 18, 2022, EPA concluded the review with a Closing Meeting
- EPA identified no findings or required actions but made the following recommendations
    - EPA recommends the state to evaluate different approaches and options such as utilization of cash flow modeling and increased marketing of the SRF to decrease uncommitted balances and increase program pace. The state has reported that it is short staffed but has made efforts to improve response rates to solicitations for projects. In addition, TDEC reports a significant increase in project funding requests in FY22, estimating over $275M in need
    - EPA recommends that the state considers maximizing the percentage of additional subsidy allowable for SRF capitalization grant awards. A state may utilize up to 49 percent of the available funds in the cap grant to provide additional subsidy to eligible recipients. The minimum subsidization requirement for each cap grant is 20 percent. 7.5 percent of TDEC's FY21 disbursement was for additional subsidization
    - EPA recommends that the state considers maximizing the percentage of additional subsidy allowable for SRF capitalization grant awards. A state may utilize up to 49 percent of the available funds in the cap grant to provide additional subsidy to eligible recipients. The minimum subsidization requirement for each cap grant is 20 percent. 7.5 percent of TDEC's FY21 disbursement was for additional subsidization.

4. EPA Region 4 SRF Program Evaluation Report SFY2022 - Drinking Water SRF (DWSRF) Program
    - On March 13, EPA conducted an Annual Review Opening Meeting for the DWSRF Program
    - On April 14, EPA conducted an Annual Review Closing Meeting for the DWSRF.
    - There were no findings or observations, but we do expect a couple recommendations.
    - We expect to receive the final PERS reports for SFY22 within 60 days following the Closing Meeting.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 4
ATLANTA FEDERAL CENTER
61 FORSYTH STREET, SW
ATLANTA, GEORGIA 30303-3104

September 19, 2022

Ms. Jennifer Dodd
Environmental Program Manager
Tennessee Department of Environment and Conservation
312 Rosa L. Parks Avenue
Nashville, TN 37242

Dear Ms. Dodd:

Enclosed are the annual program evaluation reports for Tennessee's Clean Water and Drinking Water State Revolving Fund Programs. We thank you and your staff for the time and effort to support the reviews and for your collaboration with the EPA on both programs.

Should you have any questions, please have your staff contact Mr. Christopher B. Thomas of my staff, via email at Thomas.Chris@epa.gov or by phone at (404) 562-9345.

Sincerely,

Jeaneanne M. Gettle, Director
Water Division

Enclosure (2)

U. S. ENVIRONMENTAL PROTECTION AGENCY
REGION 4
PROGRAM EVALUATION REPORT
August 15, 2022

Tennessee Drinking Water State Revolving Fund
State Fiscal Year 2021
July 1, 2020 – June 30, 2021

EXECUTIVE SUMMARY

This Program Evaluation Report (PER) reviews the performance of the Tennessee Department of Environment and Conservation's (TDEC) Drinking Water State Revolving Fund program (DWSRF) for TDEC's fiscal year (FY) 2021, which runs from July 1, 2020, to June 30, 2021. The U.S. Environmental Protection Agency (EPA) is required by 40 CFR § 35.3570 to annually assess the success of TDEC's performance of activities to determine compliance with the terms of the capitalization grant agreement. In part, the EPA utilized TDEC's FY20 DWSRF Intended Use Plan (IUP) and FY21 annual report in its review.

The EPA Federal FY20 capitalization grant provided Tennessee with $19,125,000 in drinking water assistance. This required a 20 percent state match of $3,825,000. When added to the DWSRF capitalization grant the total is $22,950,000. During FY21, TDEC made 8 new loans to local governments, committing a total of $7,171,000. One of the metrics the EPA utilizes in evaluating state programs is "pace", which is defined as cumulative amount of loans issued as a percentage of all funds available. As of June 30, 2021, the reported pace of TDEC's program was 73 percent, a decrease from TDEC's FY20 program pace of 80 percent. The national average for FY21 is 96 percent.

The Tennessee DWSRF has been administered in accordance with Section 1452 of the Safe Drinking Water Act (SDWA) as amended. The program is following all terms, schedules, provisions/assurances of the IUP, the operating agreement between TDEC and the EPA, and the conditions of the capitalization grant agreement.

SECTION I: PURPOSE AND SCOPE

The EPA Region 4 began the FY21 annual review of the Tennessee DWSRF with an opening meeting on July 18, 2022. The review concluded with a closing conference on August 15, 2022. This review process was conducted as prescribed in Section 1452 of the SDWA, 40 CFR § 35.3575 and in the Annual Review Guidance issued October 2021. The review was conducted virtually.

The purposes of the annual review are to:

1. Evaluate the success of the state's performance in achieving goals and objectives identified in the IUP, and the state's annual report;
2. Evaluate the state's compliance with regulations, operating agreement, and capitalization grant agreement;
3. Assess the financial status and performance of the fund;
4. Review the program in accordance with EPA's SRF Annual Review Guidance;
5. Review the status of resolution of prior year PER findings; and
6. Examine and follow up on any open audit findings and recommendations.

In attendance at the virtual opening conference for TDEC were Adeniyi Bakare, Felicia Freeman, and Keeyona Love. Attending from the EPA Region 4 were Johnnie Purify, Ronza Jordan, Amy Kuhs, Martha Douglas, Tracy Williams, Matthew Lagod, Brooke Pine, Mohit Varma, Rose Degner, and Monique Wyatt.

During the review period, EPA Region 4 examined project files, loan agreements, any additional supporting documents, tested financial transactions, and met with TDEC staff to better understand issues and exchange information.

At the completion of the review, a virtual exit briefing was held to review the observations made by the EPA and to clarify any outstanding issues. Attending the exit conference for TDEC were Paula Mitchell, Adeniyi Bakare, Felicia Freeman, and Keeyona Love. Attending from the EPA Region 4 were Chris Thomas, Jake Netemeyer, Amy Kuhs, Martha Douglas, Tracy Williams, Jean Ray, Matthew Lagod, Brooke Pine, Monique Wyatt, and Rose Degner.

SECTION II: COMPLIANCE REQUIREMENTS

TDEC provided the EPA with the most recent financial audit for the year ending June 30, 2021. This audit contained no findings.

TDEC's Disadvantaged Business Enterprises (DBE) goal for FY21 was 15.6 percent. TDEC's DBE participation percentage for FY21 was 10.48 percent. TDEC provides assurances that borrowers follow the six affirmative steps for DBE participation.

TDEC is in compliance with the 13 assurances stated in the grant agreement, including capacity development and operator certification requirements. These assurances have their basis in 40 CFR § 35.3550.

Based on the review, the following items describe the activities and observations of interest:

1. Assurance that the state has the authority to establish a fund and to operate the DWSRF program in accordance with the SDWA.

   Status: TDEC provided the required Attorney General certification with the grant application.

2. Assurance that the state will comply with state statutes and regulations and abide by state law.

   Status: TDEC certified this in the FY20 IUP.

3. Assurance that the state has the technical capability to operate the program.

   Status: TDEC is in compliance with this assurance.

4. Assurance that the state will accept capitalization grant funds in accordance with a payment schedule.

   Status: TDEC certified this in the FY20 IUP.

5. Assurance that the state will deposit all capitalization grant funds in the fund or set-aside account.

   Status: TDEC has deposited the capitalization grant appropriately.

6. Assurance that the state will provide an amount at least equal to 20 percent of the capitalization grant (state match) in the fund.

   Status: The FY20 capitalization grant was $19,125,000. The 20 percent state match amount of

$3,825,000 was provided through state appropriation funds.

7. Assurance that the state will deposit net bond proceeds, interest earnings and repayments into the fund.

   Status: TDEC did not leverage. All repayments and interest earnings are credited to the fund.

8. Assurance that the state will utilize Generally Accepted Accounting Principles.

   Status: TDEC has complied with this assurance.

9. Assurance that the state will have the fund and set-aside account audited annually in accordance with Generally Accepted Government Auditing Standards.

   Status: The DWSRF is audited annually. 40 CFR § 35.3570(b) states audits are due within one year after the end of the FY.

10. Assurance that the state will adopt policies and procedures to assure that borrowers have a dedicated source of revenue for repayments (or in the case of a privately-owned system, demonstrate that there is adequate security).

    Status: TDEC has complied with this assurance in loan agreements to borrowers.

11. Assurance that the state will commit and expend funds as efficiently as possible and in an expeditious and timely manner.

    Status: The overall pace percentage for TDEC is 73 percent, a decrease from TDEC's FY20 program pace of 80 percent. TDEC disbursed a total of $6,943,400 from the DWSRF in FY21.

12. Assurance that funds will be utilized in accordance with the IUP.

    Status: The annual report documents that TDEC is in compliance with this assurance.

13. Assurance that the state will provide the EPA with a Biennial Report.

    Status: TDEC has elected to provide an annual report to the EPA. The annual report for TDEC DWSRF program was received by September 30, 2021, for TDEC FY21 ending June 30, 2021. The report contained adequate and accurate information.

SECTION III: PROGRAM GOALS

TDEC has thirteen long term goals and eleven short term goals in their IUP. EPA evaluated one long-term and one short-term goal. TDEC is working toward meeting each of the goals evaluated. TDEC's status in meeting these goals is discussed in the DWSRF annual report. The goals and accomplishments reviewed for the FY21 PER, include:

Long term goal and status:

- Protect and enhance water quality in the state by ensuring the technical integrity of funded projects.

  Status: This goal is aimed at ensuring funding recipients have adequate project planning, design, and construction capabilities. It is accomplished through the continuous development of standard operation procedures, financial sufficiency processes, integration with other TDEC programs, and a new database for tracking projects. The state also achieves this goal via maintenance and award of high-ranking projects on the Project Ranking List. TDEC is pursuing marketing and outreach campaigns and has seen a 60 percent increase in solicitation response.

Short term goal and status:

- Maximize funds available through cooperation with EPA.

  Status: TDEC pursues capitalization grant allocations available and has redesigned their IUP format. The state also works with all potential borrowers that have eligible projects, including pursuing pilot projects that will lead the program to achieve the highest capitalization grant utilization rate possible.

SECTION IV: PROJECT FILES REVIEWED

Loan Reviewed	Environmental Review Determination	Loan Amount
Town of Woodbury New Water Storage Tank Project Loan Agreement Signed: 09/21/2020	Categorical Exclusion issued: 12/10/2019	Loan Amount: $800,000 Loan Term: 20-year Loan Interest Rate: 0.34% Principal Forgiveness: $160,000

Smyrna Water Meter Replacement Project Loan Agreement Signed: 01/25/2021	Categorical Exclusion issued: 12/10/2020	Loan Amount: $3,000,000 Loan Term: 20-year Loan Interest Rate: 0.68% Principal Forgiveness: $0

Both projects were eligible for DWSRF funding and followed the environmental review, Davis Bacon, American Iron and Steel, and procurement requirements.

SECTION V: ENVIRONMENTAL BENEFITS REPORTING

FY21 Loans	Public Benefit	Total Investment
8 New Loans	Improvements to public water systems promoting compliance, ensuring water supply, and protecting public health.	$6,943,400

TDEC updated the Public Water Supply Benefits Reporting (PBR) database in a timely fashion as required by the grant agreement. All necessary information about projects funded in FY21 was entered in the PBR system.

SECTION VI: ADDITIONAL SUBSIDIZATION AND POPULATION SERVED

	Assistance for Small Systems (<10,000)	Additional Subsidization Disbursed during FY21	Number of Projects that received Additional Subsidization	Minimum % of Additional Subsidization Required per Capitalization Grant
FY20 Cap Grant Disbursement Totals	$4,765,665	$886,000	1	20%
FY21 Disbursement Totals	$1,400,000	$470,000	3	20%

The terms and conditions of the grant award allow additional subsidy in the form of principal forgiveness (PF) to borrowers of the DWSRF loan program. In addition to the disadvantaged community additional subsidy assistance that must be provided as described in Section 1452(d) of the SDWA in an amount between six percent and 35 percent, an additional 14 percent of the capitalization grant must be provided as additional subsidization under the 2020 Congressional Add-Sub authority. Tennessee's FY20 and FY21 Capitalization Grants were open and making principal forgiveness disbursements at the time of this review. Region 4 will confirm the state's additional subsidy requirements were met before closing its grant.

SECTION VII: CASH DRAWS

Draw ID Number	Draw Date	Draw Amount
DT 21AS1259189	11/18/2020	$2,333.34
DT 21AS1265679	12/28/2020	$159,040.98
DT 21AS1281591	04/09/2021	$1,393,009.50
DT 21AS1262835	12/10/2020	$797.89

Four cash draws that occurred in the State's FY were reviewed. All invoices reviewed in the selection were found to be properly made for eligible DWSRF expenditures and were appropriately recorded. No improper payments were identified.

SECTION VIII: PROGRAM HIGHLIGHTS

TDEC's Focus on Source Water Protection

The SRF Local Assistance set-aside funds the development and implementation of local drinking water initiatives, including capacity development and source water protection. TDEC has used this set aside to establish a 5-year joint funding agreement with the United States Geological Survey (USGS) to implement statewide source water assessment through geographic information system analysis, groundwater level monitoring, and technical reviews of groundwater recharge areas for public water systems. This three-component project began in April 2021, creating opportunities for collaboration over the next five years between USGS and the SRF program.

SECTION IX: FINANCIAL INDICATORS

Financial Indicators Activity	2020	2021
Return on Federal Investment	130.9%	129.7%
Assistance Provided as a % of Funds Available	80%	73%
Disbursements as a % of Assistance Provided	92%	93%
Set-Aside Spending Rate	85.7%	82.2%
Uncommitted Balances	$74.3M	$115M

On the basis of our financial review, we conclude TDEC DWSRF is in sound financial condition. Note: financial indicators data provided by NIMS report.

SECTION X: SET ASIDE PERFORMANCE

Section 1452(g)(2) of the SDWA allows the DWSRF program the option of using up to 31 percent of their capitalization grant for activities that protect sources of drinking water, enhance water systems management and capacity development strategies. TDEC reserved $3,510,000, or 18.35 percent of the FY21 capitalization grant, for set-aside activities. TDEC elected to utilize the set-asides in the following manner:

Program Administration – 4 percent
Program Administration is either 4 percent of the capitalization grant, $400,000, or 1/5 percent of the current valuation of the fund (whichever the state chooses) to cover the reasonable costs of administration of the DWSRF programs. TDEC elected to take 4 percent, or $765,000, of the capitalization grant in administrative set asides, expending $285,018 in FY21.

State Program Management – 10 percent
TDEC reserved 10 percent, or $1,912,500, of the capitalization grant in set-aside funds for State Program Management, expending $675,590 in FY21. These funds provide program support for the Public Water Supervision Program which promotes the state’s drinking water goals through the Enforcement Tracking Tool, laboratory certification program, and technical services and assistance to address challenges with public water system technical capacity. The funds also support the Operator Certification program which offers certification exams to over 1,000 applicants a year.

Small System Technical Assistance – 2 percent
SDWA allows funds for technical assistance and training to help small systems build the capacity they need to provide safe drinking water. In FY21, the program reserved $382,500 for this set aside, expending $198,272 in FY21. The funds supported TDEC's partnership with the Fleming Training Center which provides training opportunities and technical assistance to small water system operators. FY21 included 136 virtual and in-person training offerings to 1,302 attendees.

Local Assistance – 15 percent
SDWA allows the local assistance set-aside to provide assistance, including technical and financial assistance, to public water systems as part of a capacity development strategy and for source water protection activities. TDEC reserved $450,000 from the local assistance set-aside for the TDEC Source Water Protection Program and the Well Head Protection Program. The program secured a 5-year joint funding agreement with the USGS to implement statewide source water assessment.

SECTION XI: FOLLOW UP ON PRIOR YEAR PROGRAM EVALUATION REPORT

- The FY20 PER included a recommendation to increase the pace of the program.

  Status: The state has continued to increase community engagement, improve project solicitation and developed a strategy to reach small and disadvantaged communities.

- The FY20 PER recommended that TDEC continue to ensure borrowers follow DBE affirmative steps and try to increase DBE participation.

  Status: In response, TDEC has revised its loan documents to include the six DBE affirmative step and the SRF reviews borrowers' submittals to ensure compliance with good faith efforts to include DBE participation.

SECTION XII: RECOMMENDATIONS

- EPA requests that the state evaluate different approaches and options such as utilization of cash flow modeling and increased marketing of the SRF to decrease uncommitted balances and increase program pace. The state has reported that it is short staffed but has made efforts to improve response rates to solicitations for projects. In addition, TDEC reports a significant increase in project funding requests in FY22, estimating over $275M in need. The EPA will continue to provide assistance where needed.

- EPA recommends that the state considers maximizing the percentage of additional subsidy allowable for SRF capitalization grant awards. A state may utilize up to 49 percent of the available funds in the cap grant to provide additional subsidy to eligible recipients. The minimum subsidization requirement for each cap grant is 20 percent. 7.5 percent of TDEC's FY21 disbursement was for additional subsidization.

SECTION XIII: FINDINGS

There are no findings.

SECTION XIV: STATEMENT OF COMPLIANCE WITH SRF ANNUAL REVIEW GUIDANCE

We have conducted an annual review of Tennessee's Drinking Water State Revolving Fund Program for FY21 in accordance with EPA's SRF Annual Review Guidance.

U. S. ENVIRONMENTAL PROTECTION AGENCY
REGION 4
PROGRAM EVALUATION REPORT
August 16, 2022

Tennessee Clean Water State Revolving Fund
State Fiscal Year 2021
July 1, 2020 – June 30, 2021

EXECUTIVE SUMMARY

This Program Evaluation Report (PER) reviews the performance of the Tennessee Department of Environment and Conservation's (TDEC) Clean Water State Revolving Fund program (CWSRF) for TDEC fiscal year (FY) 2021, which runs from July 1, 2020, to June 30, 2021. The U.S. Environmental Protection Agency (EPA) is required by 40 CFR § 35.3165 to annually assess the success of TDEC's performance of activities to determine compliance with the terms of the capitalization grant agreement. In part, the EPA utilized TDEC's FY20 CWSRF Intended Use Plan (IUP) and FY21 annual report in its review.

The EPA Federal FY21 capitalization grant provided Tennessee with $23,085,000 in clean water assistance. This required a 20 percent state match of $4,617,000. When added to the CWSRF capitalization grant the total is $27,702,000. During FY21, TDEC made eight new loans to local governments totaling $77,567,851. One of the metrics the EPA uses in evaluating state programs is "pace" which is defined as the cumulative amount of loans issued as a percentage of all funds available. As of June 30, 2021, the reported pace of TDEC's program was 94 percent, a decrease from TDEC's FY20 program pace of 98 percent. The national average for FY21 is 97 percent.

The Tennessee CWSRF has been administered in accordance with Title VI of the Clean Water Act (CWA) as amended. The program is following all terms, schedules, provisions/assurances of the IUP, the operating agreement between TDEC and the EPA and the conditions of the capitalization grant agreement.

SECTION I: PURPOSE AND SCOPE

The EPA Region 4 began the FY21 annual review of the Tennessee CWSRF with an opening meeting on July 18, 2022. The review concluded with a closing conference on August 16, 2022. The review process was conducted as prescribed in Section 606(e) of the CWA, 40 CFR § 35.3165 and in the Annual Review Guidance issued in October 2021. The review was conducted virtually.

The purposes of the annual review are to:

1. Evaluate the success of the state's performance in achieving goals and objectives identified in the IUP, and the state's annual report;

2. Evaluate the state's compliance with regulations, operating agreement, and capitalization grant agreement;

3. Assess the financial status and performance of the fund;

4. Review the program in accordance with EPA's SRF Annual Review Guidance;

5. Review the status of resolution of prior year PER findings; and

6. Examine and follow up on any open audit findings and recommendations.

In attendance at the virtual opening conference for TDEC were Adeniyi Bakare, Felicia Freeman, and Keeyona Love. Attending from the EPA Region 4 were Johnnie Purify, Ronza Jordan, Amy Kuhs, Martha Douglas, Tracy Williams, Matthew Lagod, Brooke Pine, Mohit Varma, Rose Degner, and Monique Wyatt.

During the review period, EPA Region 4 examined project files, loan agreements, any additional supporting documents, tested financial transactions, and met with TDEC staff to better understand issues and exchange information.

At the completion of the review, a virtual exit briefing was held to review the observations made by the EPA and to clarify any outstanding issues. Attending the exit conference for TDEC were Paula Mitchell, Adeniyi Bakare, and Felicia Freeman. Attending from the EPA Region 4 were Chris Thomas, Jake Netemeyer, Amy Kuhs, Martha Douglas, Tracy Williams, Jean Ray, Matthew Lagod, Brooke Pine, and Rose Degner.

SECTION II: COMPLIANCE REQUIREMENTS

TDEC provided the EPA with a financial audit for the year ending June 30, 2021. This audit contained no findings.

TDEC's Disadvantaged Business Enterprises (DBE) goal for FY21 was 15.6 percent. TDEC's DBE participation percentage for FY21 was 14.37 percent. TDEC provides assurances that borrowers follow the six affirmative steps for DBE participation.

TDEC is in compliance with the 16 assurances stated in the grant agreement. These assurances have their basis in 40 CFR § 35.3135.

Based on the review, the following items describe the activities and observations of interest:

1. Assurance that the state will accept capitalization grant funds in accordance with a payment schedule.

   Status: TDEC certified this in the FY20 IUP.

2. Assurance that the state will provide an amount at least equal to 20 percent of the capitalization grant (state match) in the fund.

   Status: The FY20 capitalization grant was $23,085,000. The 20 percent state match amount of $4,617,000 was provided through state appropriation funds.

3. Assurance that the state will make binding commitments in an amount equal to 120 percent of each quarterly grant payment within one year after receipt of each quarterly grant payment.

   Status: The state made eight loans with local governments totaling $77,567,851 in FY21. TDEC met this requirement.

4. Assurance that the state will commit and expend funds as efficiently as possible and in an expeditious and timely manner.

   Status: The overall pace percentage for TDEC is 94 percent, a decrease from TDEC's FY20 program pace of 98 percent. TDEC disbursed a total of $169,558,890 from the CWSRF in FY21.

5. Assurance that the CWSRF must be utilized solely to provide loans and other authorized forms of assistance: (a) to municipalities, inter-municipal, interstate, or state agencies for the construction of publicly owned treatment works as defined in Section 212 of the Act and that appear on the state's priority list developed pursuant to Section 216 of the Act; and (b) for implementation of a nonpoint source pollution control management program under Section 319 of the Act; and (c) for development and implementation of an estuary conservation and management plan under Section 320 of the Act.

Status: TDEC funded wastewater and stormwater projects to meet this requirement.

6. Assurance that the state will comply with state statutes and regulations and abide by state law.

   Status: TDEC certified this in the FY20 IUP.

7. Assurance that the state is required to comply and to require all recipients of funds directly made available by capitalization grants to comply with applicable federal authorities.

   Status: In the FY21 annual report, under the provisions of the operating agreement/conditions of their grant, the state certified compliance with other federal authorities.

8. Assurance that the state may draw cash when the SRF receives a request from the loan recipient, based on incurred costs.

   Status: Cash draws for the reporting period ending June 30, 2021, were made in accordance with 40 CFR § 35.3160. No improper payments were identified.

9. Assurance that the state is required to establish fiscal control and accounting procedures that are sufficient to assure proper accounting for payments received by the CWSRF, disbursements made by the CWSRF, and CWSRF balances at the beginning and end of the accounting period. The state must also agree to utilize accounting, audit and fiscal procedures conforming to generally accepted government accounting standards as these are promulgated by the Governmental Accounting Standard Board.

   Status: In the FY21 annual report, the state certified adherence to state auditing and accounting procedures, which comply with the Single Audit Act of 1984 and OMB circular A-128 by reference to the Operating Agreement.

10. Assurance that the state must agree to require recipients of CWSRF assistance to maintain project accounts in accordance with generally accepted government accounting standards as these are promulgated by the Government Accounting Standards Board.

    Status: TDEC has complied with this requirement via a condition in the loan agreement for borrowers.

11. Assurance that the state will provide an annual report to the Regional Administrator on the actual use of the funds, in accordance with Section 606(d) of the CWA.

    Status: The FY21 annual report for TDEC's CWSRF program was received by September 30, 2021, for the state FY ending June 30, 2021. The report contained adequate and accurate information regarding program implementation.

12. Assurance that the state will conduct reviews of the potential environmental impacts of all

Section 212 construction projects receiving assistance from the CWSRF, including nonpoint source pollution control Section 319 and estuary protection Section 320 projects that are also Section 212 projects. The state may elect to apply the procedures at 40 CFR Part 6, subpart E and related subparts, or apply its NEPA like SERP for conducting environmental reviews.

Status: TDEC has a NEPA-like state environmental review process (SERP) which was approved by the EPA Region 4 Regional Administrator. Two projects were reviewed for compliance with the SERP. Both reviewed projects followed the SERP and were well documented.

13. Assurance that the CWSRF will only provide assistance to projects that are consistent with any plans developed under Sections 205(j), 208, 303(e), 319 and 320 of the CWA.

    Status: TDEC is in compliance with this regulation, funding only eligible projects.

14. Assurance that the state shall submit a schedule that reflects, by quarters, the estimated disbursements from the capitalization grant for the year following the grant award date. This schedule must be developed in conformity with the procedures applicable to cash draws in 40 CFR § 35.3160 and must be sufficient to allow the EPA and the state to jointly develop and maintain a forecast of cash draws.

    Status: TDEC complied with this regulation in the FY20 IUP.

15. Assurance that the state will prepare a plan identifying the intended uses of the funds in the CWSRF and describing how those uses support the goals of the CWSRF. The IUP must be prepared annually and must be subjected to public comment and review before being submitted to the EPA. The EPA must receive the IUP prior to the award of the capitalization grant. According to Section 606(c) of the CWA, after providing the IUP for public comment and review, each state shall annually prepare a plan identifying the intended uses of the amounts (including repayments) available to its water pollution control revolving fund.

    Status: TDEC's FY20 IUP was complete and included repayments and interest earnings in the amounts available for assistance.

16. Assurance that the state will prepare a plan identifying the intended uses of the fund amounts available to its water pollution control revolving fund. Generally, based on an Office of General Counsel opinion in a January 19, 1995, a one-year time frame seems reasonable for committing repayments and other funds to projects. If all available funds are not committed to projects, then the IUP must contain a plan which details how and when the funds will be utilized.

    Status: TDEC is complying with this requirement.

SECTION III: PROGRAM GOALS

TDEC has seven long term goals and 12 short term goals in their IUP. EPA evaluated one long-term and one short-term goal. TDEC is working toward meeting each of the goals evaluated. TDEC's status in meeting these goals is discussed in the CWSRF annual report. The goals and accomplishments reviewed for the FY21 Program Evaluation Report, include:

Long term goal and status:

- Protect and enhance water quality in Tennessee by ensuring the technical integrity of funded projects.

  Status: This goal is aimed at ensuring funding recipients have adequate project planning, design, and construction capabilities. It is accomplished through the continuous development of standard operation procedures, financial sufficiency processes, integration with other TDEC programs, and a new database for tracking projects. The state also achieves this goal via maintenance and award of high-ranking projects on the project ranking list. TDEC is pursuing marketing and outreach campaigns and has seen a 60 percent increase in solicitation response.

Short term goal and status:

- Maximize funds available through cooperation with EPA.

  Status: TDEC pursues capitalization grant allocations available and has redesigned their IUP format. The state also works with all potential borrowers that have eligible projects, including pursuing pilot projects that will lead the program to achieve the highest capitalization grant utilization rate possible.

SECTION IV: PROJECT FILES REVIEWED

Loan Reviewed	Environmental Review Determination	Loan Amount
City of White House Wastewater Treatment Plant Improvements Loan Agreement Signed: 11/24/2020	Finding of No Significant Impact issued: 09/09/2020	Loan Amount: $12,448,000 Loan Term: 20-year Loan Interest Rate: 0.90% Principal Forgiveness: $0
City of Chattanooga Wastewater Treatment Plant Improvements and Inflow and Infiltration Corrections Loan Agreement Signed: 12/14/2020	Finding of No Significant Impact issued: 09/10/2020	Loan Amount: $15,000,000 Loan Term: 20-year Loan Interest Rate: 0.91% Principal Forgiveness: $0

Both projects were eligible for CWSRF funding and followed the environmental review, Davis Bacon, American Iron and Steel, and procurement requirements.

SECTION V: ENVIRONMENTAL BENEFITS REPORTING

FY21 Loans	Public Benefit	Total Investment
8 New Loans	Assistance to wastewater and nonpoint source projects improving water quality	$77,567,851

TDEC updated the Clean Water Benefits Reporting (CBR) database as required by the grant agreement in a timely fashion. All necessary information about projects funded in FY21 was entered into the CBR system.

SECTION VI: GREEN PROJECT RESERVE

FY21	Public Benefit	Total Investment
0 Projects	Green infrastructure, water or energy efficiency improvements, or other environmentally innovative activities	$0

The FY20 Capitalization Grant Terms and Conditions require the recipient to make a timely and concerted good faith solicitation for projects that address green infrastructure, water or energy efficiency improvements or other environmentally innovative activities. During the fiscal year TDEC did not have any new projects that qualified for green project subsidization but disbursed $11,327,000 from previous green project commitments.

Additionally, the recipient agrees to include in its IUP such qualified projects, or components of projects, that total an amount at least equal to 10 percent of its capitalization grant.

SECTION VII: ADDITIONAL SUBSIDIZATION AND POPULATION SERVED

	Assistance provided to Small Systems (<10,000)	Additional Subsidization Disbursed during FY	Number of Projects that received Additional Subsidization	Minimum requirement of Subsidization per Cap Grant
FY20 Disbursement Totals	$21,482,605	$1,123,300	10	10%
FY21 Disbursement Totals	$1,719,851	$0	0	10%

The terms and conditions of the grant award allow additional subsidy in the form of principal forgiveness (PF) to borrowers of the CWSRF loan program. In addition to the 30 percent additional subsidy that may be utilized at a state's discretion as described in the Water Resources Reform and Development Act, the recipient agrees to utilize 10 percent of the funds available in the FY20 capitalization grant to provide additional subsidy to eligible recipients. Tennessee's FY20 and FY21 Capitalization Grants were open and the FY20 Capitalization Grant was making principal forgiveness disbursements at the time of this review. Region 4 will confirm the state's additional subsidy requirements were met before closing its grant.

SECTION VIII: CASH DRAWS

Draw ID Number	Draw Date	Draw Amount
DT20AS1271575	02/04/2021	$35,000.00
DT 21AS1277350	03/12/2021	$127,583.33
DT 20AS1244859	08/18/2020	$1,799,540.00
DT 21AS1259788	11/20/2020	$16,106.67

Four cash draws that occurred in the state's FY were reviewed. All invoices reviewed in the selection were found to be properly made for eligible CWSRF expenditures and were appropriately recorded. No improper payments were identified.

SECTION IX: PROGRAM HIGHLIGHTS

TDEC's focus on Small and Disadvantaged Communities

The state continues to focus on offering technical assistance and training to small and disadvantaged communities. TDEC contracted with the Tennessee Association of Utility Districts (TAUD) to provide technical assistance to distressed and disadvantaged communities. The funds dedicated to this program create opportunities to develop managerial, technical, and financial capabilities in systems and assist in reducing health-based drinking water violations at no cost to the recipient community.

TDEC provides competitive and affordable loans through the CWSRF

Tennessee's SRF loan terms are offered at up to 30 years not exceeding the useful life of the project. TDEC has a comprehensive and complex methodology for determining a community's ability to pay for financing and uses this methodology to set affordable financing rates.

SECTION X: FINANCIAL INDICATORS

Financial Indicators Activity	2020	2021
Return on Federal Investment	248%	265%
Assistance Provided as a % of Funds Available	98%	94%
Disbursements as a % of Assistance Provided	81%	86%
Uncommitted Balances	$42.3M	$143M

On the basis of this financial review, EPA concludes the TDEC CWSRF is in sound financial condition. Note: financial indicators data provided in NIMS report.

SECTION XI: FOLLOW UP ON PRIOR YEAR PROGRAM EVALUATION REPORT

There were no EPA recommendations in the FY20 CWSRF PER.

SECTION XII: RECOMMENDATIONS

- EPA requests that the state evaluate different approaches and options such as utilization of cash flow modeling and increased marketing of the SRF to decrease uncommitted balances and increase program pace. The state has reported that it is short staffed but has made efforts to improve response rates to solicitations for projects. In addition, TDEC reports a significant increase in project funding requests in FY22, estimating over $400M in need. The EPA will continue to provide assistance where needed.

- EPA recommends that the state considers maximizing the percentage of additional subsidy allowable for SRF capitalization grant awards. A state may utilize up to 30 percent of the available funds in the cap grant to provide additional subsidy to eligible recipients. The minimum subsidization requirement for each cap grant is 10 percent. Zero percent of TDEC’s FY21 disbursement was for additional subsidization.

SECTION XIII: FINDINGS

There are no findings.

SECTION XIV: STATEMENT OF COMPLIANCE WITH SRF ANNUAL REVIEW GUIDANCE

EPA Region 4 has conducted an annual review of Tennessee's Clean Water State Revolving Fund Program for FY21 in accordance with EPA's SRF Annual Review Guidance.

Jason E. Mumpower
Comptroller

To:	Members of the Tennessee Local Development Authority (TLDA) Audit Committee
From:	Sandi Thompson Director, Division of State Government Finance (SGF)
Date:	May 31, 2023
Subject:	Risk Assessments

The management risk assessments for the SGF and the Division of Water Resources are attached. These annual reports address agency-wide risk management and internal control requirements of Tenn. Code Ann. § 9-18-102, known as the Tennessee Financial Integrity Act, as amended.

This code requires that each agency of state government and institution of higher education to establish and maintain internal controls, to provide reasonable assurance that:

1. Obligations and costs are in compliance with applicable law;
2. Funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and
3. Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.

To document compliance with the requirements set forth above, the code requires that each agency of state government and institution of higher education annually perform a management assessment of risk and that the internal controls discussed above be incorporated into such assessment.

The objectives of the annual risk assessment are to:

1. provide accountability for meeting program objectives;
2. promote operational efficiency and effectiveness;
3. improve reliability of financial statements;
4. strengthen compliance with laws, regulations, rules, and contracts and grant agreements; and
5. reduce the risk of financial or other asset losses due to fraud, waste, and abuse.

Please let us know if you need any additional information in this regard.

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Issue 116 | April 2023

Adjusting the Risk Appetite for Non-Financial Measures

Risk appetite — the level of risk that an organization is prepared to accept in pursuit of its objectives — is fundamental to effective governance in all organizations, and boards play a critical role in setting that appetite. But are credit and market risks and other financial factors the only issues that should be considered? Despite their name, non-financial risks can also have a significant financial impact on an organization. As companies focus on governance, risk, and compliance concerns, they should consider how non-financial risk is impacting the success of their enterprise risk management (ERM) efforts and overall risk appetite.

The sheer number of risks that fall into the non-financial category raises the chances that some may be overlooked. They may include operational, compliance, cybersecurity, reputational, environmental, employee conduct, ethical and corporate culture, public health, social justice, diversity, equity and inclusion, human rights, strategic, third-party, geopolitical, natural resources, human resources, and data integrity risk—among others. This partial list shows just how significant non-financial risks can be and makes the case for incorporating them into any discussion on risk appetite. Indeed, "non-financial risks now pose a potentially costlier threat than financial exposures," according to PwC.[1]

"Non-financial risks now pose a potentially costlier threat than financial exposures." PwC

Expecting the Unexpected

Organizations should be aware that this is an evolving area where new and unfamiliar risks should be expected to emerge. Five years ago, for example, few companies had protocols in place to deal with a potential global health crisis that would interrupt worldwide economic activity, upend supply chains, and bring some industries to a virtual halt, but the COVID-19 pandemic highlighted the need to expect the unexpected.

Even when organizations believe they have their arms around potential non-financial risks, they may not anticipate all the issues that can arise. Privacy risk, for example, seems like a well-known consideration, but it can become a problem in unexpected ways. One well-known retailer experienced reputational damage when it was reported that a parking system app used by its landlord was tracking customers' browser usage. In the uproar that ensued, the retailer argued that it was not in charge of the app, but the reputational damage was done.

The board has an important role in this effort. Regarding environmental, social and governance (ESG) issues, which encompass many common types of non-financial risk, "boards need to continuously examine and question information provided by management and recognize that ESG is an enterprise-level risk that should be viewed through the lens of strategy and operations," according to a National Association of Corporate Directors report.[2]

An Alphabet Soup

Identifying and measuring non-financial risk is an important concern, but there is little consistency in guidance on how this should be done. There is currently an alphabet soup of frameworks and standards that organizations can choose to use but no actual comprehensive requirements at the federal level in the United States and no globally embraced standards. For the moment, the available guidance covers a number of different areas, as demonstrated by the 23 non-financial measurement and reporting standards and frameworks in a list compiled by the Center for Sustainable Organizations.[3] They are categorized based on considerations such as primary constituency of interest (shareholder versus stakeholder), performance constructs of interest (risk, value creation/impact valuation, sustainability), triple bottom line considerations, and primary form of measurement (incrementalist versus context based). Organizations can choose to follow one set of guidelines, to mix and match rules from more than one, or to opt out of this type of reporting altogether. However, the latter may not be a truly viable option going forward. Internal audit can provide insights to help organizations make sense of measurement and reporting options at a time when there is increasing pressure on organizations from a wide range of stakeholders who want more information and transparency on non-financial issues, including ESG. For some of the world's largest institutional investors, "ESG has become a proxy for good risk management and long-termism, two primary concerns today," according to management consulting firm Russell Reynolds Associates.[4]

ISSB REPORTING STANDARDS

In November 2021, the IFRS Foundation trustees announced the creation of a new standard-setting board—the International Sustainability Standards Board (ISSB)—to help meet demands for high-quality, transparent, reliable, and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters.

The ISSB was tasked with developing a comprehensive global baseline of sustainability-related disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities to help them make informed decisions.

The new ISSB reporting standards addressing climate and sustainability reporting are expected to be published by the end of the second quarter of 2023.

An Evolving Regulatory Landscape

The number of disclosure regulations involving non-financial risk is growing rapidly worldwide, with European Union regulators leading the way. In the U.S., reporting regulations in two non-financial areas are on the imminent horizon. Last year, the U.S. Securities and Exchange Commission (SEC) proposed to require registrants to include specified climate-related and cybersecurity disclosures in their registration statements and periodic reports. For climate concerns, disclosures would include details on risks that could have a material impact on the business, results of operations, or financial condition, along with some climate-related financial statement metrics and disclosures on greenhouse gas emissions.[5] Regarding cybersecurity, there would be amendments to the commission's rules to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting by public companies.[6] Although the proposals are aimed at listed companies, private company stakeholders may also press for similar disclosures.

Gathering Non-Financial Risk Data

Many organizations may have some well-established procedures in place related to specific non-financial information, so it's important to understand what data is already available, especially if reporting and disclosure becomes mandatory in some areas. Companies likely have collected a great deal of data for compliance with rules set by regulatory bodies. In the U.S., examples include the Environmental Protection Agency, Occupational Safety and Health Administration, Department of Labor, Department of Commerce, and others. Risk management procedures related to COSO's internal control framework and ISO management systems may also be capturing information on non-financial issues. Internal audit can help companies assess the data on hand to identify information gaps and to avoid duplication of efforts.

About The IIA

The Institute of Internal Auditors (IIA) is a nonprofit international professional association that serves more than 230,000 global members and has awarded more than 185,000 Certified Internal Auditor (CIA) certifications worldwide. Established in 1941, The IIA is recognized throughout the world as the internal audit profession's leader in standards, certifications, education, research, and technical guidance. For more information, visit theiia.org.

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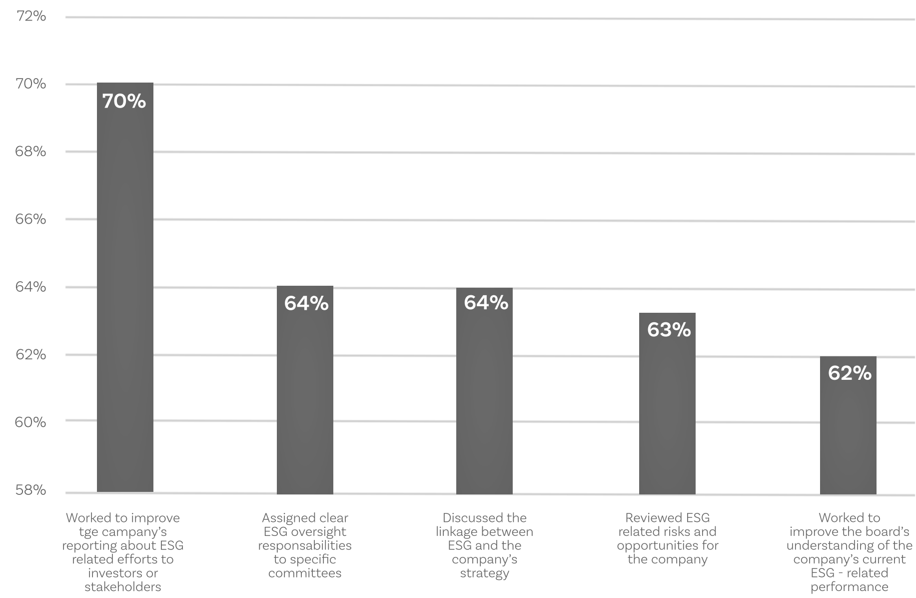
However, even though companies may already have information, it's important to be aware that, because of the lack of consistent reporting requirements for non-financial risks and lack of familiarity with this area, the processes and procedures around them may be inadequate. Controls and risk assessment procedures may be less developed in some functions than in others, or insufficient for current needs. The information may be coming from a range of areas—such as human resources, procurement, ESG, or sales—making it challenging to identify and gather. Regarding ESG, "fraud risk in this area should be top of mind for audit committees and a focal point in fraud risk assessments overseen by the audit committee," according to a Deloitte report, which noted that this risk is not governed by the same types of controls present in financial reporting processes. As a result, it may be easier to manipulate voluntarily reported data on carbon emissions or other key non-financial measures. [7]

Private companies may find their controls are lacking. There's clearly room for boards to make a difference on this front. Fourteen percent of private companies told the NACD that their boards had not focused on ESG issues over the past 12 months, compared to only 3% at public companies, which face more demands for data in this area. Only 39% of private companies said their board has reviewed ESG-related risks and opportunities for the company. [8] (See figure 1.)

Figure 1 - **Which ESG Oversight Practices Have Boards Performed in the Last 12 Months?**



Source: : 2022 NACD Board Practices and Oversight Survey—ESG: Compare and Contrast Among Public and Private Companies

Involving Internal Audit

To help leadership understand and tackle non-financial risks, internal audit leaders can use their holistic understanding of the entity's many facets—and threats-to identify risk considerations and provide advice on how best to deal with them.

Internal audit teams build their audit plans on a number of factors, among them the organization's overall risk appetite. Auditors consider the organization's financial risk limits and appetite statements, as well as considerations such as laws and regulations, organizational policies and standards, and the expectations of stakeholders-such as the board, investors, analysts, customers, employees, and business partners—as well as industry standards.

One step for boards is to see that internal audit has a chance to play a critical role in ensuring the completeness and accuracy of non-financial data. Unfortunately, many organizations are not making full use of the contribution that internal audit can make. The chief audit executive (CAE) reports to the board on ESG issues at only 11% of public companies surveyed and 8% of private companies, according to the NACD survey.

Internal audit can provide data and advice that can help mitigate and identify risks that include:

- **Impact on the business model.** Companies may find themselves facing unexpected pressure to adopt new practices that address unexpected non-financial risks.
- **Loss of competitive edge.** Non-financial risks have the potential to damage a company's market share and reputation.
- **Difficulty accessing capital or higher borrowing costs.** Investors or lenders may require greater transparency on non-financial risks than the company can offer.
- **Labor disadvantages.** A tight hiring market or lack of employee engagement could be damaging, particularly if a company appears as an unappealing place to work.
- **Social and geopolitical implications.** Companies may fail to anticipate localized social or civil unrest.

A Deep Understanding

"Risk management cannot be seen as a collection of static practices but must evolve to keep pace with rapidly changing business models," according to a McKinsey report.[9] As companies monitor and maintain risk approaches for non-financial data, internal audit can provide a deep understanding of the organization and ongoing insights in a changing and uncertain risk landscape.

QUESTIONS FOR BOARD MEMBERS

» Are non-financial risks incorporated into our organization's risk appetite?

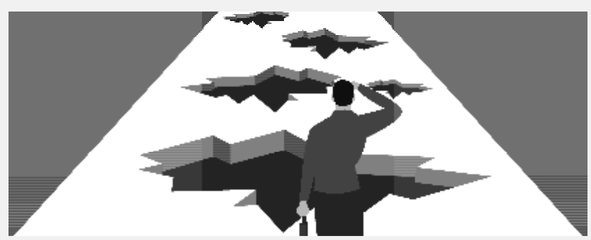
» How does our organization monitor non-financial risk?

» What controls are in place to identify, prevent or mitigate non-financial risks?

» Are these controls regularly evaluated and updated?

» Is the board receiving independent assurance from internal audit on non-financial risk measurement and oversight?

Quick Poll Question



Are non-financial risks incorporated into your organization's risk appetite?

◯ Yes

◯ No

◯ Don't Know

Visit theiia.org/Tone to answer the question and learn how others are responding.

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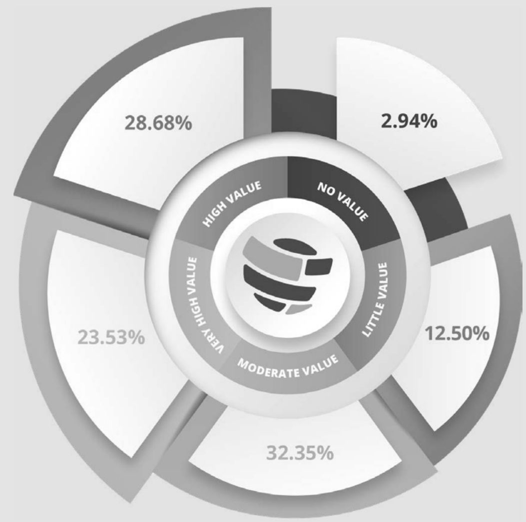
QUICK POLL RESULTS

Overall, how would you rate the value that has been created from internal audit's use of data analytics or automation at your organization?



Source: Tone at the Top December 2022 Quick Poll Survey.

[1] "Taking Control: How to Get on Top of Non-Financial Risk," Christopher Eaton and David O'Brien, PwC, March 9, 2021.

[2] 2022 NACD Board Practices and Oversight Survey—ESG: Compare and Contrast Among Public and Private Companies, NACD, 2022.

[3] https://www.sustainableorganizations.org/Non-Financial-Frameworks.pdf

[4] "ESG and Stakeholder Capitalism," Andrew Droste, Russell Reynolds Associations, published by Bloomberg Law, April 2020.

[5] "SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors," US Securities and Exchange Commission press release, March 21, 2022.

[6] "SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies," SEC press release, March 9, 2022.

[7] "Emerging Fraud Risks to Consider: ESG; On the Audit Committee's Agenda," Deloitte, July 2022.

[8] 2022 NACD Board Practices and Oversight Survey—ESG: Compare and Contrast Among Public and Private Companies, NACD, 2022.

[9] "Financial Institutions and Nonfinancial Risk: How Corporates Build Resilience," Bjorn Nilsson, Thomas Poppensieker, Sebastian Schneider, and Michael Thun, McKinsey, February 28, 2022.

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