

**Alabama Drinking Water
Finance Authority**

COMPONENT UNIT FINANCIAL STATEMENTS

For the Year Ended September 30, 2017



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Alabama Drinking Water Finance Authority
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September 30, 2017

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

We have audited the accompanying financial statements of the business-type activities and the major funds of the Alabama Drinking Water Finance Authority (the "Authority"), a component unit of the State of Alabama, as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the major funds of the Authority, as of September 30, 2017, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 4 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by *Title 2 U.S. Code of Federal Regulations Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2018 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, L.L.C.

Enterprise, Alabama

March 21, 2018

The Alabama Drinking Water Finance Authority (the Authority) was established in 1997 to provide a self-perpetuating source of low interest loans for the construction of public water treatment and distribution facilities needed to meet the public health goals of the Safe Drinking Water Act. The Authority is operated by the Alabama Department of Environmental Management who serves as agent for the Authority. The following discussion provides an overview of the financial position and results of operation for the Authority as of September 30, 2017. For more detailed information, please refer to the financial statements including the Notes to the Financial Statements.

Overview of the Financial Statements

The Authority operates as a Proprietary Fund and presents the following basic financial statements: Statement of Net Position, Statement of Activities, Statement of Net Position - Proprietary Funds, Statement of Revenues, Expenses, and Changes in Net Position - Proprietary Funds and Statement of Cash Flows - Proprietary Funds. The statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred, regardless of when cash is received or expended. Investments are reported at fair market value or amortized cost.

The Proprietary Funds statements provide financial information about the Alabama Drinking Water Finance Authority which the Alabama Department of Environmental Management operates like a business.

Statement of Net Position - Proprietary Funds - Includes all assets, liabilities, and deferred outflows of the Authority and provides a snapshot of the financial position of the Authority at the end of the fiscal year. Assets plus deferred outflows less liabilities results in net position that are restricted and used in assuring the perpetuation of the Authority. Net Position is comprised primarily of loans receivable that are not obligated to a bond issue and cash or short term investments pledged to loans that are in the process of closing.

Statement of Changes in Net Position - Proprietary Fund - Reports all additions and deductions for the fiscal year. Additions are primarily comprised of loan interest and investment income and federal awards. Deductions are mainly bond interest expense and administrative expenses. Additions minus deductions provide the change in restricted net position for the fiscal year. The change in restricted net position plus the beginning restricted net position results in the restricted net position available for the perpetuation of the Authority.

The Notes to the Financial Statements include an organizational description, a summary of significant accounting policies, information on cash and investments, loans receivable, payables to municipalities, long term debt, arbitrage, and related parties, among others.

Management's Discussion and Analysis

COMPARATIVE SUMMARY STATEMENTS

Statement of Net Position

<i>September 30,</i>	2017	2016	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	\$ 18,347,188	\$ 8,484,671	\$ 9,862,517	116%
Receivables	182,388,475	184,226,553	(1,838,078)	-1%
Investments	117,104,372	124,014,925	(6,910,553)	-6%
Unamortized items	3,794,612	3,007,165	787,447	26%
Total assets	321,634,647	319,733,314	1,901,333	1%
Deferred Outflows of Resources				
Deferred charge on refunding	1,374,225	1,562,999	(188,774)	-12%
Liabilities				
Accrued liabilities	278,981	221,383	57,598	26%
Payable to municipalities	22,643,706	31,230,935	(8,587,229)	-27%
Bonds payable, net	49,304,347	55,762,786	(6,458,439)	-12%
Total liabilities	72,227,034	87,215,104	(14,988,070)	-17%
Net position, restricted	\$ 250,781,838	\$ 234,081,209	\$ 16,700,629	7%

Statement of Activities

<i>For the year ended September 30,</i>	2017	2016	Variance	% increase (decrease)
Operating revenue	\$ 7,848,906	\$ 8,455,588	\$ (606,682)	-7%
Operating expense	3,156,869	3,655,733	(498,864)	-14%
Operating income	4,692,037	4,799,855	(107,818)	-2%
Non-operating revenue	11,408,592	11,242,113	166,479	1.5%
Intergovernmental transfers in	600,000	-	600,000	100%
Change in net position	\$ 16,700,629	\$ 16,041,968	\$ 658,661	4%

Management's Discussion and Analysis

Statement of Cash Flows

<i>For the year ended</i> <i>September 30,</i>	2017	2016	Variance	% increase (decrease)
Net cash provided by (used in) operating activities	\$ (2,077,251)	\$ 13,322,543	\$ (15,399,794)	-116%
Net cash provided by (used in) non-capital and related financing activities	11,939,768	(36,660,982)	48,600,750	133%
Net increase (decrease) in cash and cash equivalents	\$ 9,862,517	\$ (23,338,439)	\$ 33,200,956	142%

Financial Highlights

- The Authority closed 17 new loans totaling \$16,006,000.
- Net position increased \$16,700,629 mainly due to the utilization of \$15,329,820 in federal funds transferred to loan recipients.

Statement of Net Position

<i>September 30,</i>	2016	2015	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	\$ 8,484,671	\$ 31,823,110	\$ (23,338,439)	-73%
Receivables	184,226,553	186,598,610	(2,372,057)	-1%
Investments	124,014,925	80,331,625	43,683,300	54%
Unamortized items	3,007,165	3,571,790	(564,625)	-16%
Total assets	319,733,314	302,325,135	17,408,179	6%
Deferred Outflows of Resources				
Deferred charge on refunding	1,562,999	1,751,773	(188,774)	-11%
Liabilities				
Accrued liabilities	221,383	1,173,142	(951,759)	-81%
Payable to municipalities	31,230,935	24,412,067	6,818,868	28%
Bonds payable, net	55,762,786	60,452,458	(4,689,672)	-8%
Total liabilities	87,215,104	86,037,667	1,177,437	1%
Net position, restricted	\$ 234,081,209	\$ 218,039,241	\$ 16,041,968	7%

Management's Discussion and Analysis

Statement of Activities

<i>For the year ended September 30,</i>	2016	2015	Variance	% increase (decrease)
Operating revenue	\$ 8,455,588	\$ 10,152,772	\$ (1,697,184)	-17%
Operating expense	3,655,733	3,856,794	(201,061)	-5%
Operating income	4,799,855	6,295,978	(1,496,123)	-24%
Non-operating revenue	11,242,113	8,020,591	3,221,522	40%
Change in net position	\$ 16,041,968	\$ 14,316,569	\$ 1,725,399	12%

Statement of Cash Flows

<i>For the year ended September 30,</i>	2016	2015	Variance	% increase (decrease)
Net cash provided by (used in) operating activities	\$ 13,322,543	\$ 45,375,896	\$ (32,053,353)	-71%
Net cash provided by (used in) non-capital and related financing activities	(36,660,982)	(43,674,654)	7,013,672	16%
Net increase (decrease) in cash and cash equivalents	\$ (23,338,439)	\$ 1,701,242	\$ (25,039,681)	1472%

Financial Highlights

- The Authority closed 20 new loans totaling \$31,080,500.
- Net position increased \$16,041,968 mainly due to the utilization of \$16,201,374 in federal funds transferred to loan recipients.

Alabama Drinking Water Finance Authority
Statement of Net Position
September 30, 2017

	Business-type Activities
Assets	
Current assets:	
Cash and cash equivalents - restricted	\$ 18,347,188
Accrued interest receivable on investments - restricted	153,759
Accrued interest receivable on loans receivable	566,493
Current portion of loans receivable	15,945,000
Grants and other receivables	165,393
Total current assets	35,177,833
Noncurrent assets:	
Investments - restricted	117,104,372
Loans receivable, less unamortized premium of \$2,552,170	165,557,830
Principal forgiveness	3,794,612
Total noncurrent assets	286,456,814
Total assets	321,634,647
Deferred Outflows of Resources	
Deferred charge on refunding	1,374,225
Liabilities	
Current liabilities:	
Accounts payable	41,723
Current portion of revolving loan bonds	6,625,000
Accrued interest payable	177,523
Other payables	59,735
Total current liabilities	6,903,981
Long-term liabilities:	
Payables to municipalities	22,643,706
Revolving loan bonds payable	42,679,347
Total long-term liabilities	65,323,053
Total liabilities	72,227,034
Net Position	
Restricted for loans and debt service	250,781,838
Total net position	\$ 250,781,838

The accompanying notes are an integral part of these financial statements.

Alabama Drinking Water Finance Authority
Statement of Activities
For the Year Ended September 30, 2017

Functions/Programs	Expenses	Program Revenues		Net Revenue (Expense) and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	Business-type Activities
Business-type Activities:				
Drinking water loans	\$ 6,801,601	\$ 1,153,911	\$ 15,572,394	\$ 9,924,704
General Revenues				
Investment earnings				6,175,925
Intergovernmental transfers in				600,000
Total general revenues and transfers				6,775,925
Change in net position				16,700,629
Net Position - Beginning				234,081,209
Net Position - Ending				\$ 250,781,838

The accompanying notes are an integral part of these financial statements.

Alabama Drinking Water Finance Authority
Statement of Net Position
Proprietary Funds
For the Year Ended September 30, 2017

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Assets			
Current assets:			
Cash and cash equivalents - restricted	\$ 15,035,812	\$ 3,311,376	\$ 18,347,188
Accrued interest receivable on investments - restricted	153,759	-	153,759
Accrued interest receivable on loans receivable	566,493	-	566,493
Current portion of loans receivable	15,945,000	-	15,945,000
Grants and other receivables	165,393	-	165,393
Total current assets	31,866,457	3,311,376	35,177,833
Noncurrent assets:			
Investments - restricted	116,894,246	210,126	117,104,372
Loans receivable, less unamortized premium of \$2,552,170	165,557,830	-	165,557,830
Principal forgiveness	3,794,612	-	3,794,612
Total noncurrent assets	286,246,688	210,126	286,456,814
Total assets	318,113,145	3,521,502	321,634,647
Deferred Outflows of Resources			
Deferred charge on refunding	1,374,225	-	1,374,225
Liabilities			
Current liabilities:			
Accounts Payable	-	41,723	41,723
Current portion of revolving loan bonds	6,625,000	-	6,625,000
Accrued interest payable	177,523	-	177,523
Other payables	59,735	-	59,735
Total current liabilities	6,862,258	41,723	6,903,981
Long-term liabilities:			
Payables to municipalities	22,643,706	-	22,643,706
Revolving loan bonds payable	42,679,347	-	42,679,347
Total long-term liabilities	65,323,053	-	65,323,053
Total liabilities	72,185,311	41,723	72,227,034
Net Position			
Restricted for loans and debt service	\$ 247,302,059	\$ 3,479,779	\$ 250,781,838

The accompanying notes are an integral part of these financial statements.

Alabama Drinking Water Finance Authority
Statement of Revenues, Expenses and Changes in Net Position
Proprietary Funds
For the Year Ended September 30, 2017

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Operating Revenues			
Investment earnings	\$ 1,200,909	\$ 41,649	\$ 1,242,558
Interest from loan receivable	5,212,772	-	5,212,772
Bond premium accretion	239,665	-	239,665
Administrative fees	-	1,153,911	1,153,911
Total operating revenues	6,653,346	1,195,560	7,848,906
Operating Expenses			
Administration expense	1,461,706	-	1,461,706
Investment loss	78,466	56,481	134,947
Employee benefits	-	298,449	298,449
Office expense	-	103,222	103,222
Other expenses	-	328,582	328,582
Salaries	-	829,963	829,963
Total operating expenses	1,540,172	1,616,697	3,156,869
Operating income (loss)	5,113,174	(421,137)	4,692,037
Nonoperating Revenues (Expenses)			
Federal grant revenue	15,329,820	-	15,329,820
Principal forgiveness expense	(2,008,553)	-	(2,008,553)
Bond interest expense	(1,636,179)	-	(1,636,179)
State revenue	2,909	-	2,909
Net decrease in the fair value of investments	(306,813)	27,408	(279,405)
Total nonoperating revenues (expenses)	11,381,184	27,408	11,408,592
Income Before Transfers	16,494,358	(393,729)	16,100,629
Intergovernmental transfers in	600,000	-	600,000
Change in Net Position	17,094,358	(393,729)	16,700,629
Net Position - Beginning	230,207,701	3,873,508	234,081,209
Net Position - Ending	\$ 247,302,059	\$ 3,479,779	\$ 250,781,838

The accompanying notes are an integral part of these financial statements.

Alabama Drinking Water Finance Authority
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2017

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Cash Flows from Operating Activities:			
Interest and dividends received on investments	\$ 1,342,176	\$ 41,649	\$ 1,383,825
Receipts of payments from municipalities	15,539,674	-	15,539,674
Payments to employees and vendors	(76,945)	(1,531,436)	(1,608,381)
Interest received on loans receivable	4,712,655	-	4,712,655
Administration fees	(1,461,706)	1,153,911	(307,795)
Payments to municipalities	(22,194,612)	-	(22,194,612)
Net cash used in operating activities	(2,138,758)	(335,876)	(2,474,634)
Cash Flows from Non-capital and Related Financing Activities:			
Grant revenue received	15,333,693	-	15,333,693
Payments to municipalities- Principal forgiveness	(2,398,617)	-	(2,398,617)
State revenue	2,909	-	2,909
Redemption of investment securities, net	4,413,625	2,082,576	6,496,201
Principal paid on revolving loan bonds	(6,030,000)	-	(6,030,000)
Interest paid on revolving loan bonds	(1,667,035)	-	(1,667,035)
Transfers in	600,000	-	600,000
Net cash provided by non-capital and related financing activities	10,254,575	2,082,576	12,337,151
Net increase in cash and cash equivalents	8,115,817	1,746,700	9,862,517
Cash and Cash Equivalents - restricted, beginning of year	6,919,995	1,564,676	8,484,671
Cash and Cash Equivalents - restricted, end of year	\$ 15,035,812	\$ 3,311,376	\$ 18,347,188

-Continued-

The accompanying notes are an integral part of these financial statements.

Alabama Drinking Water Finance Authority
Statement of Cash Flows
Proprietary Funds (Continued)
For the Year Ended September 30, 2017

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used in) by Operating Activities:			
Operating income (loss)	\$ 5,113,174	\$ (421,137)	\$ 4,692,037
Bond premium accretion	(239,665)	-	(239,665)
Loan premium amortization	(864,524)	-	(864,524)
Investment loss	78,466	56,481	134,947
(Increase) decrease in operating assets:			
Other receivables	(76,945)	-	(76,945)
Accrued interest receivable on investments - restricted	141,267	-	141,267
Accrued interest receivable on loans receivable	(32,976)	-	(32,976)
Loans receivable and other receivables	2,270,000	-	2,270,000
Accrued arbitrage rebate	-	-	-
Increase (decrease) in operating liabilities:			
Accounts payable	-	28,780	28,780
Payables to municipalities	(8,587,229)	-	(8,587,229)
Due to WPCA	59,674	-	59,674
Net cash used in operating activities	\$ (2,138,758)	\$ (335,876)	\$ (2,474,634)

The accompanying notes are an integral part of these financial statements.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Alabama Drinking Water Finance Authority (the "Authority") have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following notes to the financial statements are an integral part of the Authority's financial statements.

Description of Organization

The Authority, a component unit of the State of Alabama, was created by the State of Alabama's Legislature in 1997 to issue revolving loan bonds and lend the bond proceeds to eligible municipalities at below market interest rates to pay for certain costs of planning, designing, acquiring or constructing certain sanitary drinking water and related facilities. The Federal Water Quality Act of 1987, as amended by the Federal Safe Drinking Water Act Amendment of 1996 (SDWA), provides for the implementation of a state revolving loan program to accept the federal capitalization grants and the required 20% state matching funds which are provided by the federal and state governments. The Alabama Department of Environmental Management (ADEM) is the recipient agency of the federal grant and has been designated by the State of Alabama to administer the revolving loan program.

The Authority does not have any full time employees. Instead, ADEM charges the Authority for time spent on revolving loan program activities by employees of ADEM, and the Authority reimburses ADEM for such costs. The charges include the salaries and benefits of the employees, as well as indirect costs allocated to the Authority based on direct salary costs. Employees charging time to the Authority are covered by the benefits of ADEM.

Basis of Accounting

The Authority is reported as a proprietary fund and uses the economic resources measurement focus and the accrual basis of accounting. The proprietary fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing loans to Alabama municipalities to finance water and sewer system upgrades. The principal operating revenues of the Authority are comprised of investment earnings, administrative fees, and interest income from loans. Operating expenses consist primarily of administrative salaries, other expenses, and interest expense on bonds. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Authority has one item that qualifies for reporting in this category, the deferred charge on refunding reported in the

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

statement of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period and so will *not* be recognized as an inflow of resources (revenue) until that time. The Authority did not have any items that qualify as deferred inflows of resources.

Budget Information

Under the Alabama Constitution, money may only be drawn from the Treasury by a legal appropriation. However, the Authority operates under a continuous appropriation because the funding of the matching funds approved by the voters contains its own appropriation authority. Therefore, the Authority's operations are not included in the State's annual budget.

Cash and Cash Equivalents

Highly liquid investments with a maturity of 90 days or less when acquired are classified as cash equivalents. Included in cash equivalents are money market funds and repurchase agreements held by the State Treasurer. Money market funds are held by a counterparty or by its trust department but not in the Authority's name. The repurchase agreements held by the State Treasurer are held in the Authority's name.

Investments

Investments are reported at fair value or amortized cost. All investment income, including changes in the fair value of investments, is recognized in the statement of revenues, expenses, and changes in net assets. Repurchase agreements are stated at cost, which approximates market value. The Authority has adopted a formal written investment policy. However, as disclosed in Note 2, investments and underlying collateral are limited to U.S. Government Securities, AAA, and Prime-1 rated investments.

Bond Discount

Bond discounts on long-term debt are amortized on the interest method over the life of the debt to which it relates.

Loans Receivable, Payables to Municipalities and Loan Premium

The Authority issues loans to eligible municipalities or their agencies (municipalities) through the purchase of the municipalities' revenue or general obligation bonds or warrants with the loan disbursements being made as the municipalities' construction expenditures are incurred. The loans

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

to municipalities are in excess of the expenditures made by the Authority. The excess of these loans receivables over the payments to municipalities is classified as a loan premium. This loan premium, which allows the Authority to recover certain costs associated with the loan, is amortized into income on the interest method over the life of the loan. The stated interest rate for these loans range from 2.20% to 3.95% and the effective interest rates range from 2.20% to 3.94%. The loans are typically repaid over a twenty-year period. The stated interest rates for these loans include a 0.75% fee charged to municipalities for administrative costs.

Payables to municipalities represent amounts committed by the Authority to fund qualifying projects conducted by the municipalities.

No provision for uncollectible accounts has been made, as all loans are current, and Management believes that all loans will be repaid according to the loan terms.

Restricted Assets

Under each bond indenture, certain funds and bank accounts are required to be established and controlled by a trustee. The accounts of the trustee funds are maintained on the cash receipts and disbursements basis and are adjusted for financial statement purposes to reflect accrued receivables and payables. Additional restricted assets are held by the State of Alabama on behalf of the Authority until the disbursement of the assets to municipalities occurs.

Capital Assets

Capital assets are recorded at cost and are being depreciated over their estimated useful lives. The estimated useful life of the Authority's capital assets is three years. Depreciation is calculated using the straight-line method. The Authority maintains a capitalization threshold of five hundred dollars. The cost of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized.

Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Authority are interest earnings on loans and investments. Due to the nature of the Authority's business, obtaining and making loans, interest which is typically nonoperating is deemed to be operating revenue. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Administrative Fees

The sole source of administrative fees is a 0.75% fee charged to municipalities on the principal amount of the loan made to the municipalities by the Authority, net of bank and trustee fees.

Grant Revenue

Grants received are recognized as nonoperating revenues in the accounting period in which they are earned and become measurable. The federal capitalization grant is awarded in the form of a letter of credit. Funds are drawn from the federal capitalization grant only after the originating expenditure to the municipality has been approved. Since expenditure is the primary factor for determining eligibility, revenue is recognized when the funds are expended.

The State appropriation is awarded to the Authority by the State legislature each year. In accordance with federal law, the appropriation must be at least 20% of the federal capitalization grant. The State's appropriation is not expended upon receipt; therefore, the State's appropriation is deferred upon receipt and recognized as revenue as a constant percentage of each federal grant draw. Such percentage is dependent on the actual appropriation (see Note 5).

Interfund Transfers

The Authority has the ability to transfer and receive funds from the Clean Water State Revolving Fund and ADEM.

Concentration of Credit Risk

All of the loans to municipalities represent receivables from municipalities located in the State of Alabama.

Net Position

The Authority's net position is divided into two components:

- *Net investment in capital assets* – This component of net position consists of the historical cost of capital assets, net of accumulated depreciation, and is reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt should also be included in this component of net position.
- *Restricted* – This component of net position consists of assets that are restricted by debt covenants, contributors, contractual provisions, or enabling legislation, reduced by liabilities related to those assets. The Authority's restricted net position as reported in the statement of net position consists of cash and investments which are restricted for loans and debt service.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Impact of Recently Issued Accounting Pronouncements

In fiscal year 2017, the Authority adopted four new statements of financial accounting standards issued by the Governmental Accounting Standards Board:

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (“GASB 74”).
- GASB Statement No. 77, *Tax Abatement Disclosures* (“GASB 77”).
- GASB Statement No. 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans* (“GASB 78”).
- GASB Statement No. 80, *Blending Requirements for Certain Component Units an amendment of GASB Statement No. 14* (“GASB 80”).

GASB 74 establishes accounting and financial reporting standards, but not funding or budgetary standards, for state and local governmental other postemployment benefit (“OPEB”) plans. The statement replaces GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and Statement No. 57, *OPEB Measurement by Agent Employers and Agent Multiple-Employer Plans*. The adoption of GASB 74 had no impact on the Authority’s financial statements.

GASB 77 defines a tax abatement and contains required disclosures about a reporting government’s own tax abatement agreements and those agreements that are entered into by other governments and that reduce the reporting government’s tax revenues. There was no impact on the Authority’s financial statements as a result of the implementation of GASB 77.

GASB 78 amends the scope and applicability of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*—and amendment of GASB Statement No. 27 to exclude pension plans provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (a) is not a state or local government pension plan, (b) is used to provide defined benefits both to employees of state or local governmental employers and to employees of employers that are not state or local governments, and (c) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). The Statement also establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above. There was no impact on the Authority’s financial statements as a result of the implementation of GASB78.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

GASB 80 amends the blending requirements for the financial statement presentation of component units of all state and local governments by providing an additional criterion. As provided for in GASB 80, a component unit should be included in the reporting entity financial statements using the blending method if the component unit is organized as a not-for-profit corporation in which the primary government is the sole corporate member as identified in the component unit's articles of incorporation or bylaws. There was no impact on the Authority's financial statements as a result of the implementation of GASB 80.

Recently Issued But Not Yet Effective

GASB has issued the following pronouncements that may affect future financial position, results of operations, cash flows, or financial presentation of the Authority upon implementation. Management has not yet evaluated the effect of implementation of these standards.

GASB Statement No.	GASB Accounting Standard	Effective Fiscal Year
75	<i>Account and Financial Reporting for Postemployment Benefits Other Than Pensions</i>	2018
81	<i>Irrevocable Split-Interest Agreements</i>	2018
83	<i>Certain Asset Retirement Obligations</i>	2019
84	<i>Fiduciary Activities</i>	2020
85	<i>Omnibus 2017</i>	2018
86	<i>Certain Debt Extinguishment Issues</i>	2018
87	<i>Leases</i>	2021

GASB Statement No. 75 ("GASB 75") establishes standards of accounting and financial reporting, but not funding or budgetary standards, for OPEB that is provided to the employees of state and local governmental employers through OPEB Plans that are administered through trusts or equivalent arrangements meeting certain criteria. This statement also establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditure. It replaces the requirements of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurement by Agent Employers and Agent Multiple-Employer Plans*. For defined benefit OPEB plans, the statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information are addressed. GASB 75 is effective for fiscal years beginning after June 15, 2017.

GASB Statement No. 81 ("GASB 81") requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. GASB 81 also provides expanded guidance for circumstances in which the government holds the assets. The requirements of GASB 81 are effective for periods beginning after December 15, 2016.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

GASB Statement No. 83 (“GASB 83”) addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in GASB 83. GASB 83 establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. GASB 83 also includes various disclosure requirements. The requirements for GASB 83 are effective for reporting periods beginning after June 15, 2018.

GASB Statement No. 84 (“GASB 84”) establishes criteria for identifying fiduciary activities of all state and local governments. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. The requirements of GASB 84 are effective for reporting periods beginning after December 15, 2018.

GASB Statement No. 85 (“GASB 85”) addresses practice issues that have been identified during implementation and application of certain GASB Statements. GASB 85 addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). The requirements of GASB 85 are effective for reporting periods beginning after June 15, 2017.

GASB Statement No. 86 (“GASB 86”) improves the consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. GASB 86 also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of GASB 86 are effective for reporting periods beginning after June 15, 2017.

The objective of GASB Statement No. 87 (“GASB 87”) is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. GASB 87 increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under GASB 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of GASB 87 are effective for reporting periods beginning after December 15, 2019.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications

During fiscal year 2017, management determined to present interest paid on revolving loan bonds in the non-capital and related financing activities section of the statements of cash flows, which was previously presented in the operating activities section, totaling \$1,667,035 and \$1,812,633 for the years ended September 30, 2017 and 2016, respectively.

NOTE 2 - CASH AND INVESTMENTS

Deposits

As of September 30, 2017, cash consisted of non-interest bearing deposits held by the State Treasurer and financial institutions in the name of the Authority. The Authority's deposits were covered by the Federal Deposit Insurance Corporation (FDIC) or by collateral held with the State Treasurer's office in the name of the State Treasurer under the Security for Alabama Funds Enhancement (SAFE) Act. Under the SAFE Act, financial institutions holding public deposits in excess of the amounts insured by the FDIC must pledge collateral to a collateral pool in the name of the State Treasurer. The State Treasurer is responsible for monitoring compliance with the collateralization and reporting requirements of the SAFE Act. If any member financial institution fails, the entire collateral pool becomes available to satisfy claims of governmental entities. If the value of the pool's collateral were inadequate to cover the loss, additional amounts would be assessed on a pro rata basis to the members of the pool. Funds deposited in accordance with the requirements of the SAFE Act are considered fully secured.

Investments

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The fair value of fixed-maturity investments fluctuates in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods. However, the Authority's intent is to hold all securities to maturity, and as such, fixed maturity investments are classified as held to maturity. Investments are classified in the following table as if they were held to maturity.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 2 - CASH AND INVESTMENTS (Continued)

As of September 30, 2017, the Authority had the following investment holdings and maturities:

	Market	Investment Maturities		
		Less than 3 years	3-6 years	Greater than 6 years
Investments:				
U.S. Treasury SLGs	\$ 7,193,850	\$ 888,550	\$ 557,010	\$ 5,748,290
U.S. Treasury Bonds/Notes	95,563,806	95,082,537	95,398	385,871
Commercial Paper	14,346,716	14,346,716	-	-
Total investments	117,104,372	\$ 110,317,803	\$ 652,408	\$ 6,134,161
Cash equivalents:				
Money Market Funds	18,347,188	N/A	N/A	N/A
Total holdings	\$ 135,451,560			

Custodial Credit Risk – Custodial credit risk is the risk that in the event of the failure of the counterparty to a transaction, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority has U.S. Government securities (bonds, notes, and slugs) totaling \$102,757,656 held in trust by either the Bank of New York, U.S. Bank, or Regions Bank in a fiduciary capacity.

These securities are bond reserve funds and are held under a trust agreement between the Authority and the trustee bank for the benefit of the bondholder and are not deemed to have significant custodial credit risk. The securities are approved by bond insurers and are held in the name of the Trustee for the bond issue for the benefit of bondholder. The Authority has custodial credit risk relative to repurchase agreements through the State Treasury whose policy requires that the underlying securities held in the counterparty's safekeeping department be in the name of the Authority.

Concentration of Credit Risk – Concentration of credit risk is the result of investing 5% or more of total investments in any one issuer. As of September 30, 2017, the Authority held investments with the following issuers that comprised 5% or more of total investment holdings, other than the U.S. Treasury.

Issuer	Investment Type	Recorded Amount	Percentage of Total Holdings
Bank Tokyo Mitsubishi	Commercial Paper	\$ 14,346,716	10.59%

Credit Risk – Credit Risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. Nationally recognized statistical rating organizations provide ratings of debt securities' quality based on a variety of factors, such as financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations. The bond indenture

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 2 - CASH AND INVESTMENTS (Continued)

agreements authorize the Authority to invest in “eligible investments.” “Eligible investments” are defined as (a) any debt securities that are direct, general obligations of the United States of America; (b) any debt securities where the payment of the principal and of interest on which is unconditionally guaranteed by the United States of America; and (c) repurchase agreements collateralized by securities of the type described in the preceding clauses (a) and (b) above with any commercial bank, of such broker/dealer subject to the Securities Investors’ Protection Corporation jurisdiction or any commercial bank if such broker/dealer or bank has an uninsured, unsecured, and unguaranteed obligation rated “Prime-1” or “A-3” or better by Moody’s Investors Service, Inc. and “A-1” or “A-” or better by Standard & Poor’s Corporation. All of the investments and cash equivalents held by the Authority for the year ended September 30, 2017 are collateralized by U.S. Government securities rated AAA or Prime-1 by Moody’s Investor Services.

The ratings of total holdings are as follows at September 30, 2017:

Moody's Ratings	Recorded Amount	Recorded Amount as a Percent of Total Holdings Value
Exempt from disclosure	\$ 102,757,656	75.86%
Aaa	18,347,188	13.55%
Prime-1	14,346,716	10.59%
	\$ 135,451,560	100.00%

Investment holdings that are exempt from disclosure consist of U.S. Treasury slugs, bonds, and notes.

NOTE 3 - FAIR VALUE MEASUREMENTS

GASB Statement No. 72, *Fair Value Measurement and Application*, enhances comparability of governmental financial statements by requiring fair value measurement for certain assets and liabilities using a consistent definition and accepted valuation techniques. The standard establishes a hierarchy of inputs used to measure fair value that prioritizes inputs in to three categories – Level 1, Level 2, and Level 3 inputs – considering the relative reliability of inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are as follows:

- Level 1 inputs are quoted (unadjusted) prices in active markets for identical financial assets or liabilities that are accessible at the measurement date;
- Level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the financial asset or liability, either directly or indirectly; and

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 3 - FAIR VALUE MEASUREMENTS (Continued)

- Level 3 inputs are unobservable inputs for the financial asset or liability.

The level in the fair value hierarchy within which a fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents the Authority's financial assets carried at fair value by level within the valuation hierarchy as of September 30, 2017:

Investment Type	Level 1	Level 2	Level 3	Total
US Treasury obligations	\$ -	\$ 7,193,850	\$ -	\$ 7,193,850
Federal agency obligations	-	95,563,806	-	95,563,806
Total investments at fair value	-	102,757,656	-	102,757,656

Investments recorded at amortized cost, such as commercial paper and money market funds, are excluded from the table above.

NOTE 4 - LOANS RECEIVABLE

Loans receivable at September 30, 2017, as discussed below, are as follows:

Completed projects	\$ 142,830,000
Projects in progress	41,225,000
	184,055,000
Less:	
Current portion loans receivable	15,945,000
Unamortized Premium	2,552,170
Loans receivable, net	\$ 165,557,830

Loans mature at various intervals. The schedule of principal payments on loans maturing in subsequent years as follows:

2018	\$ 15,945,000
2019	16,585,000
2020	15,690,000
2021	14,555,000
2022 and thereafter	121,280,000
	\$ 184,055,000

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 4 - LOANS RECEIVABLE (Continued)

As of September 30, 2017, the Authority's ten largest outstanding loans, in the aggregate, exceeded \$77 million. The outstanding balances of these loans represent approximately 42% of the total loans receivable, as follows:

Loan Recipient	Outstanding Balance
Madison 2015 Water Treatment Plant Improvemets	\$ 16,110,000
Shelby County South Water Treatment Plant	15,380,000
Warrior River Phase 1 Improvements	13,545,000
Florence AMR & Wilson Lake Intake Improvements	5,595,000
Tuscaloosa Water System Improvements	5,485,000
Birmingham Water Line Improvements and SolarBee Installation	4,865,000
Madison Water System Improvements	4,815,000
Tuscaloosa Water System Improvements	4,050,000
South Alabama Utilities Water System Improvements - AMR System	3,930,000
Shelby County South Water Treatment Plant (Supplemental)	3,700,000
	\$ 77,475,000

NOTE 5 - APPROPRIATIONS

The U. S. Environmental Protection Agency (EPA) awards ADEM capitalization funds under its annual grant agreement. During the year ended September 30, 2017, the EPA awarded ADEM capitalization funds under its annual grant agreement in the amount of \$15,740,000. During the year ended September 30, 2017, the State of Alabama did not appropriate any funds from the State General Fund to the Authority.

The federal capitalizing grants require a state appropriation of at least 20% of the awarded federal capitalization grant. In the absence of such an appropriation, the EPA allows the required match to be satisfied by using a portion of the proceeds from the revolving fund loan bonds. The Authority has chosen to use bond proceeds as the required match for the federal capitalizing grants. As of September 30, 2017, the Authority had yet to receive any state matching funds.

The amount of unused federal capitalization grants was approximately \$17,022,210 at September 30, 2017. The Authority will apply for a federal capitalization grant in 2018. Any grants in 2018 and subsequent years are subject to approval on a yearly basis.

The following summarizes the capitalization grant awarded, amounts drawn on each grant, and balances available for future loans as of September 30, 2017:

Alabama Drinking Water Finance Authority
Notes to Financial Statements

NOTE 5 - APPROPRIATIONS (Continued)

Year	Grant Amount	Draws prior to 2017	2017 Draws	Total Draws	Amount Available for Future Draws
2014	\$ 16,892,000	\$ 16,367,145	\$ 524,855	\$ 16,892,000	\$ -
2015	16,781,000	16,108,987	25,203	16,134,190	646,810
2016	15,876,000	-	15,240,600	15,240,600	635,400
2017	15,740,000	-	-	-	15,740,000
	<u>\$ 65,289,000</u>	<u>\$ 32,476,132</u>	15,790,658	<u>\$ 48,266,790</u>	<u>\$ 17,022,210</u>
Less:					
	Administrative and set-aside expenses		(456,965)		
<u>Total 2017 Draws</u>			<u>\$ 15,333,693</u>		

NOTE 6 - PAYABLES TO MUNICIPALITIES

As of September 30, 2017, the authority had \$22,643,706 in payables to municipalities. These payables represent loans on projects in progress at year end. Loan funds are advanced as work is completed on each project.

NOTE 7 - LONG-TERM DEBT

On February 1, 2012, the Authority issued Refunding Series 2012A Revolving Loan Bonds totaling \$45,210,000. The Series 2012 A Bonds include:

\$45,210,000 serial bonds commencing August 15, 2012, and due August 15, 2024, which bear interest rates ranging from 0.05% to 4.00%.

On December 1, 2013, the Authority issued Refunding Series 2013A Revolving Loan Bonds totaling \$10,035,000. The Series 2013 A Bonds include:

\$10,035,000 serial bonds commencing August 15, 2017, and due August 15, 2027, which bear interest rates ranging from 3.00% to 3.75%.

On January 1, 2015, the Authority issued Refunding Series 2015A Revolving Loan Bonds totaling \$15,720,000. The Series 2015 A Bonds include:

\$15,720,000 serial bonds commencing August 15, 2016, and due August 15, 2027, which bear interest rates ranging from 2.00% to 5.00%.

**Alabama Drinking Water Finance Authority
Notes to Financial Statements**

NOTE 7 - LONG-TERM DEBT (Continued)

All bond issues contain provisions in which the Authority may, at its option and without premium, redeem amounts equal to amounts on deposit in the Capitalized Interest Account and the Bond Proceeds Account, generally within three years of the second payment date.

All bonds are insured by a municipal bond insurance policy for the total of the principal and interest. The bond insurer (AMBAC Indemnity) will not insure payment on acceleration or the payment of any redemption, prepayment, acceleration premium or any risk other than nonpayment.

Summary of changes in long-term debt for 2017:

	Balance 10/01/16		Additions		Reductions		Balance 9/30/2017
Revolving fund loan bonds	\$ 53,415,000	\$	-	\$	6,030,000	\$	47,385,000
Add: Unamortized premiums	2,347,787		-		428,440		1,919,347
Total	\$ 55,762,787	\$	-	\$	6,458,440	\$	49,304,347

Long-term debt at September 30, 2017 is payable as follows:

	Principal		Interest		Total
2018	\$ 6,625,000	\$	1,420,184	\$	8,045,184
2019	6,835,000		1,197,134		8,032,134
2020	5,775,000		1,004,734		6,779,734
2021	5,655,000		831,484		6,486,484
2022	5,210,000		659,446		5,869,446
2023-2027	17,285,000		1,291,146		18,576,146
	47,385,000		<u>\$ 6,404,128</u>		<u>\$ 53,789,128</u>
Plus: Unamortized premium	1,919,347				
Less: Current portion	6,625,000				
Total long-term debt	\$ 42,679,347				

Summary of changes in deferred outflows related to debt for 2017:

	Balance 10/01/16		Additions		Reductions		Balance 9/30/2017
Unamortized deferred refunding costs	\$ 1,562,999	\$	-	\$	188,774	\$	1,374,225

The Authority issued the 2012A Refunding Series revolving loan bonds for the purpose of refunding the Series 1998A Bonds, the Series 2000A & B Bonds, the Series 2000C Bonds, and the Series 2002A Bonds, which had an aggregate principal balance of \$69,870,000 on February 13, 2012. The refunding resulted in an accounting loss of approximately \$2,046,205 that has been capitalized and

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 7 - LONG-TERM DEBT (Continued)

is being amortized on a straight-line basis, through 2024. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately \$23.1 million over the next 13 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately \$15.9 million. As of September 30, 2017, the unamortized deferred refunding costs totaled \$1,124,867 for the Series 1998A, 2000A & B, Series 2000C, and 2002A Bonds.

The Authority issued the 2013A Refunding Series revolving loan bonds for the purpose of refunding the Series 2003A Bonds, which had an aggregate principal balance of \$29,305,000 on December 1, 2013. The refunding resulted in an accounting loss of approximately \$230,659 that has been capitalized and is being amortized on a straight-line basis, through 2027. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately \$19.2 million over the next 14 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately \$6.7 million. As of September 30, 2017, the unamortized deferred refunding costs totaled \$166,146 for the Series 2003A Bonds.

The Authority issued the 2015A Refunding Series revolving loan bonds for the purpose of refunding the Series 2004A Bonds, which had an aggregate principal balance of \$23,345,000 on January 1, 2015. The refunding resulted in an accounting loss of approximately \$106,094 that has been capitalized and is being amortized on a straight-line basis, through 2027. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately \$7.6 million over the next 13 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately \$3.9 million. As of September 30, 2017, the unamortized deferred refunding costs totaled \$83,212 for the Series 2004A Bonds.

NOTE 8 - ARBITRAGE REBATE CALCULATIONS

In accordance with Internal Revenue Code, Section 148, and related regulations as the issuer of tax-exempt debt, the Authority obtained an arbitrage calculation during the year ended 2017. Per the calculation received, there are no amounts due to or from the Internal Revenue Service at September 30, 2017.

NOTE 9 - RELATED PARTIES

ADEM acts as an agent for the Authority and is authorized to administer the revolving loan fund program in accordance with applicable federal and state laws.

The Authority does not maintain any employees of their own. Salary expense on the Loan Fee Fund is related to services provided by the employees of ADEM, which is allocated to the Authority. As the Authority has no employees, no liability for pension costs or other post-employment benefits is recognized by the Authority.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 9 - RELATED PARTIES (Continued)

The director of ADEM is the vice president of the Authority. ADEM receives a portion of the federal capitalization grants as reimbursement for administrative costs.

NOTE 10 - PRINCIPAL FORGIVENESS

Beginning in fiscal year 2009, the capitalization funds provided to ADEM from the EPA required the recipient (ADEM) to use a portion of the funds provided by the grant to provide additional subsidization in the form of principal forgiveness, negative interest rate loans, or grants.

This amount was set at a minimum of 30%, 5.55%, 20%, 20%, 20%, 20% and 20% of total grant funds provided by the 2011 grant, 2012 grant, 2013 grant, 2014 grant, 2015 grant, 2016 grant, and 2017 grant, respectively. The principal forgiveness amount was allocated amongst qualifying projects for the municipalities. This amount is recognized as a receivable on the statement of net assets at the time a loan is issued and is included in the total amount payable to municipalities. Principal forgiveness is stated separately from the associated loans receivable as it is not required to be repaid by the municipalities. As the work is completed on these projects and the loan funds are advanced to the municipalities, a percentage of the total principal forgiveness amount is expensed in relation to the total amount paid to the respective municipalities. Principal forgiveness expense recognized during the year ended September 30, 2017 totaled \$2,008,553, leaving a remaining balance of \$3,794,612 capitalized as principal forgiveness on the statement of net position as of September 30, 2017.

NOTE 11 - SUBSEQUENT EVENTS

The Authority has evaluated subsequent events through March 21, 2018, the date the financial statements were available to be issued, and there were none to disclose.

**Alabama Drinking Water Finance Authority
Schedule of Expenditures of Federal Awards
September 30, 2017**

Federal Grantor/Pass Through Grantor/Program Title	CFDA Number	Grantor's Number	Passed through to Subrecipients	Federal Expenditures
Environment Protection Agency				
Passed through the Alabama Department of Environmental Management				
Capitalization Grants for Drinking Water State Revolving Funds	66.468	FS984472-15	\$ 772	\$ 89,220
Capitalization Grants for Drinking Water State Revolving Funds	66.468	FS984472-16	15,240,600	15,240,600
Total Drinking Water State Revolving Fund Cluster			\$ 15,241,372	15,329,820
Total Federal Expenditures				\$ 15,329,820

See accompanying notes to the schedule of expenditures of federal awards.

Alabama Drinking Water Finance Authority Notes to Schedule of Expenditures of Federal Awards

NOTE 1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the schedule) summarizes the federal expenditures of the Authority under programs of the federal government for the year ended September 30, 2017. The amounts reported as federal expenditures were obtained from the Authority's trial balance. Because the schedule presents only a selected portion of the operations of the Authority, it is not intended to and does not present the financial position, changes in net position and cash flows of the Authority.

For purposes of the schedule, federal awards include all grants, contracts, and similar agreements entered into directly with the federal government and other pass through entities. Payments received for goods or services provided as a vendor do not constitute federal awards for purposes of the schedule. The Authority has obtained Catalog of Federal Domestic Assistance (CFDA) numbers to ensure that all programs have been identified in the schedule. Federal programs with different CFDA numbers that are closely related because they share common compliance requirements are defined as a cluster by the Uniform Guidance. One cluster is separately identified in the schedule and is the following:

Drinking Water State Revolving Fund Cluster

This cluster includes awards that enable recipients to establish a revolving loan fund to assist public water systems to finance the costs of infrastructure needed to achieve or maintain compliance with the Safe Drinking Water Act requirements and provide the public health objectives of the Act. The revolving loan fund can be used to provide loans and other types of financial assistance for qualified communities, local agencies, and private entities. Funds may also be set aside for various activities that promote source water protection and enhances water systems management.

NOTE 2 - FEDERAL PASS-THROUGH FUNDS

The Authority is the sub-recipient of federal funds that have been subjected to testing and are reported as expenditures and listed as federal pass-through funds.

NOTE 3 - BASIS OF ACCOUNTING

This schedule was prepared on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the current period. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recorded when the related liability is incurred. In applying the susceptible-to-accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of such revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the Authority; therefore, revenues are recognized

Alabama Drinking Water Finance Authority Notes to Schedule of Expenditures of Federal Awards

NOTE 3 - BASIS OF ACCOUNTING (Continued)

based upon the expenditures recorded. In the other, monies are virtually unrestricted as to purpose of expenditure and substantially irrevocable; i.e., revocable only for failure to comply with prescribed compliance requirements, such as with equal employment opportunity. These resources are reflected as revenues at the time of receipt or earlier if they meet the availability criteria.

NOTE 4 - CONTINGENCIES

Grant monies received and disbursed by the Authority are for specific purposes and are subject to review by the grantor agencies. Such audits may result in requests for reimbursement due to disallowed expenditures. Based upon prior experience, the Authority does not believe that such disallowance, if any, would have a material effect on the financial position of the Authority. As of March 21, 2018, there were no material questioned or disallowed costs as a result of grant audits in process or completed.

NOTE 5 - INDIRECT COST

The Authority operates under predetermined fixed indirect cost rates that are effective through September 30, 2017. The base rate for indirect cost recoveries is 39.59% for the year ended September 30, 2017.

NOTE 6 - NONCASH ASSISTANCE

The Authority did not receive any federal noncash assistance for the fiscal year ended September 30, 2017.

NOTE 7 - DE MINIMIS

The Authority has elected to not use the 10% de Minimis indirect cost rate.

NOTE 8 - SUBRECIPIENTS

The Authority provided federal funds to subrecipients totaling \$15,241,372 for the fiscal year ended September 30, 2017.

NOTE 9 - LOANS AND LOAN GUARANTEES

The Authority did not have any loans or loan guarantee programs required to be reported on the schedule.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities and the major funds of the Alabama Drinking Water Finance Authority (the "Authority"), as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated March 21, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, L.L.C.

Enterprise, Alabama

March 21, 2018

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY THE UNIFORM GUIDANCE**

Board of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

Report on Compliance for Each Major Federal Program

We have audited Alabama Drinking Water Finance Authority's (the "Authority") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Authority's major federal program for the year ended September 30, 2017. The Authority's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the Authority's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the Authority's compliance.

Opinion on Each Major Federal Program

In our opinion, the Authority, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2017.

Report on Internal Control over Compliance

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Authority's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, L.L.C.

Enterprise, Alabama

March 21, 2018

**Alabama Drinking Water Finance Authority
Schedule of Findings and Questioned Costs
For the Year Ended September 30, 2017**

SECTION I - Summary of Auditors' Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiencies identified that are not considered to be material weaknesses? yes none reported

Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes no
- Significant deficiencies identified that are not considered to be material weaknesses? yes none reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with Uniform Guidance 2 CFR Part 200.516(a)? yes no

Identification of major programs:

CFDA Numbers	Name of Federal Program or Cluster
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66.468	Capitalization Grants for Drinking Water State Revolving Funds Cluster
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Dollar threshold used to distinguish between type A and type B programs? \$ 750,000

Auditee qualified as low-risk auditee? yes no

SECTION II - Financial Statements Findings

No matters were reported.

SECTION III - Federal Award Findings and Questioned Costs

No matters were reported.