Alabama Water Pollution Control Authority

Component Unit Financial Statements

For The Year Ended September 30, 2012

Alabama Water Pollution Control Authority
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INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

Board of Directors
Alabama Water Pollution Control Authority
Montgomery, Alabama

We have audited the accompanying financial statements of the business-type activities and the major funds of the Alabama Water Pollution Control Authority (the "Authority"), a component unit of the State of Alabama, as of and for the year ended September 30, 2012, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion 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 **Governmental Auditing Standards**, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

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, 2012, and the respective changes in financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with **Governmental Auditing Standards**, we have also issued our report dated January 24, 2013 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 **Governmental Auditing Standards** and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 4 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" and is not a required part of the 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

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

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

Certified Public Accountants

January 24, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Alabama Water Pollution Control Authority (the Authority) was established in 1987 to provide a self-perpetuating source of low interest loans for the construction of public wastewater treatment and transport facilities needed to meet water quality standards and provide capacity for future growth. The Authority is operated by The Alabama Department of Environmental Management serving 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, 2012. 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 financial statements: Statement of Net Assets, Statement of Activity, Statement of Net Assets - Proprietary Fund, Statement of Revenues, Expenses, and Changes in Net Assets - Proprietary Fund, and Statement of Cash Flows – Proprietary Fund. 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.

The Proprietary Fund statements provide financial information about the Alabama Water Pollution Control Authority which the Alabama Department of Environmental Management operates like a business.

Statement of Net Assets - Proprietary fund – Includes all assets and liabilities of the Authority and provides a snapshot of the financial position of the Authority at the end of the fiscal year. Assets less liabilities results in net assets that are restricted and used in assuring the perpetuation of the Authority. Net assets are 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 Assets – Proprietary Fund – Reports all additions and deductions of the Authority for the fiscal year. Additions are primarily comprised of loan and investment income and federal awards. Deductions are mainly bond interest expense. Additions minus deductions provide the change in restricted net assets for the fiscal year. The change in restricted net assets plus the beginning restricted net assets results in the restricted net assets available for the perpetuation of the Authority.

The Notes to the Financial Statements include 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.

COMPARATIVE SUMMARY STATEMENTS

Statement of Net Assets

September 30,	**2012**	2011	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	**$ 154,736,555**	$ 100,256,391	$ 54,480,164	54%
Receivables	**419,011,881**	488,705,650	(69,693,769)	(14%)
Investments	**53,729,159**	74,260,541	(20,531,382)	(28%)
Unamortized items	**12,284,869**	14,257,407	(1,972,538)	(14%)
Capital assets	**65,323**	17,032	48,291	284%
Total assets	**639,827,787**	677,497,021	(37,669,234)	(6%)

Liabilities				
Accrued liabilities	**6,000,214**	4,321,392	1,678,822	39%
Payable to municipalities	**52,867,039**	36,378,321	16,488,718	45%
Bonds payable, net	**212,797,230**	287,855,041	(75,057,811)	(26%)
Total liabilities	**271,664,483**	328,554,754	(56,890,271)	(17%)
Net assets - restricted	**$ 368,163,304**	$ 348,942,267	$ 19,221,037	6%

Statement of Revenues Expenses and Changes in Fund Net Assets

For the year ended September 30,	**2012**	2011	Variance	% increase (decrease)
Operating revenue	**$ 23,188,754**	$ 23,670,038	$ (481,284)	(2%)
Operating expense	**20,371,379**	22,302,817	(1,931,438)	(9%)
Operating income	**2,817,375**	1,367,221	1,450,154	106%
Non-operating revenue	**16,403,662**	26,406,744	(10,003,082)	(38%)
Change in net assets	**$ 19,221,037**	$ 27,773,965	$ (8,552,928)	(31%)

Summary Statement of Cash Flows

For the year ended September 30,	**2012**	2011	Variance	% increase (decrease)
Net cash provided by operating activities	**$ 93,633,209**	$ 1,233,987	$ 92,399,222	7,488%
Net cash provided by (used in) non- capital and related financing activities	**(39,091,133)**	15,009,177	(54,100,310)	(360%)
Cash flows from capital and related financing activities	**(61,912)**	(13,584)	(48,328)	(356%)
Net increase in cash and cash equivalents	**$ 54,480,164**	$ 16,229,580	$ 38,250,584	236%

Financial Highlights

- The Authority closed five new loans totaling $37,530,000
- Three bond issues were paid off early totaling $55,390,000.
- Net assets increased $19,221,037 mainly due to the utilization of $18,382,493 in federal funds transferred to loan recipients.

Alabama Water Pollution Control Authority
Statement of Net Assets
September 30, 2012

	Business-type Activities
Assets	
Current assets:	
Cash and cash equivalents - restricted	$ 154,736,555
Accrued interest receivable on investments - restricted	222,642
Accrued interest on loans receivable	1,555,991
Current portion of loans receivable	37,626,500
Grants and other receivables	170,429
Prepaid rent	166,282
Total current assets	194,478,399
Noncurrent assets:	
Investments - restricted	53,729,159
Loans receivable, less unamortized premium of $6,723,281	379,436,319
Principal forgiveness	2,511,152
Unamortized bond issue cost	4,073,938
Prepaid rent	5,533,497
Capital assets, net	65,323
Total noncurrent assets	445,349,388
Total assets	639,827,787
Liabilities	
Current liabilities:	
Current portion of revolving loan bonds	27,155,000
Accrued interest payable	953,849
Accounts payable	135,496
Escheated bonds	95,000
Due to Alabama Department of Environmental Management (ADEM)	3,242,070
Total current liabilities	31,581,415
Long-term liabilities:	
Other post employment benefit obligation	647,667
Accrued arbitrage rebate	926,132
Payables to municipalities	52,867,039
Revolving loan bonds payable, less unamortized premiums, discounts, and deferred refunding costs of $1,132,770	185,642,230
Total long-term liabilities	240,083,068
Total liabilities	271,664,483
Net Assets	
Invested in capital assets, net of related debt	65,323
Restricted for loans and debt service	368,097,981
Total net assets	$ 368,163,304

See accompanying notes to financial statements.

Alabama Water Pollution Control Authority
Statement of Activities
For the Year Ended September 30, 2012

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets: Business-type Activities
Business-type Activities:				
Water Pollution loans	$ 22,623,808	$ 3,101,911	$ 18,472,484	$ (1,049,413)
General Revenues				
Investment earnings				20,270,450
Change in net assets				19,221,037
Net Assets - beginning				348,942,267
Net Assets - ending				$ 368,163,304

See accompanying notes to financial statements.

Alabama Water Pollution Control Authority
Statement of Net Assets
Proprietary Fund
September 30, 2012

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Assets			
Current assets:			
Cash and cash equivalents - restricted	$ 149,645,511	$ 5,091,044	$ 154,736,555
Accrued interest receivable on investments - restricted	222,642	-	222,642
Accrued interest on loans receivable	1,555,991	-	1,555,991
Current portion of loans receivable	37,626,500	-	37,626,500
Grants and other receivables	170,429	-	170,429
Prepaid rent	-	166,282	166,282
Total current assets	189,221,073	5,257,326	194,478,399
Noncurrent assets:			
Investments - restricted	53,729,159	-	53,729,159
Loans receivable, less unamortized premium of $6,723,281	379,436,319	-	379,436,319
Principal forgiveness	2,511,152	-	2,511,152
Unamortized bond issue cost	4,073,938	-	4,073,938
Prepaid rent	-	5,533,497	5,533,497
Capital assets, net	-	65,323	65,323
Total noncurrent assets	439,750,568	5,598,820	445,349,388
Total assets	628,971,641	10,856,146	639,827,787
Liabilities			
Current liabilities:			
Current portion of revolving loan bonds	27,155,000	-	27,155,000
Accrued interest payable	953,849	-	953,849
Accounts payable	87,804	47,692	135,496
Escheated bonds	95,000	-	95,000
Due to ADEM	-	3,242,070	3,242,070
Total current liabilities	28,291,653	3,289,762	31,581,415
Long-term liabilities:			
Other post employment benefit obligation	-	647,667	647,667
Accrued arbitrage rebate	926,132	-	926,132
Payables to municipalities	52,867,039	-	52,867,039
Revolving loan bonds payable, less unamortized premiums, discounts and deferred refunding costs of $1,132,770	185,642,230	-	185,642,230
Total long-term liabilities	239,435,401	647,667	240,083,068
Total liabilities	267,727,054	3,937,429	271,664,483
Net Assets			
Invested in capital assets, net of related debt	-	65,323	65,323
Restricted for loans and debt service	361,244,587	6,853,394	368,097,981
Total net assets	$ 361,244,587	$ 6,918,717	$ 368,163,304

See accompanying notes to financial statements.

Alabama Water Pollution Control Authority
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Fund
For the Year Ended September 30, 2012

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Operating Revenues			
Investment earnings	$ 3,206,186	$ 18,098	$ 3,224,284
Interest from loans receivable	16,862,559	-	16,862,559
Administrative fees	-	3,101,911	3,101,911
Total operating revenues	20,068,745	3,120,009	23,188,754
Operating Expenses			
Administration expenses	3,514,426	-	3,514,426
Bond interest expense	10,263,781	-	10,263,781
Bond issuance cost amortization	2,791,017	-	2,791,017
Rental expense	-	166,282	166,282
Depreciation	-	13,621	13,621
Employee benefits	-	746,718	746,718
Miscellaneous	-	1,098,352	1,098,352
Office expense	-	169,025	169,025
Repairs and maintenance	-	3,238	3,238
Salaries	-	1,584,412	1,584,412
Travel	-	20,507	20,507
Total operating expenses	16,569,224	3,802,155	20,371,379
Operating income (expense)	3,499,521	(682,146)	2,817,375
Nonoperating Revenues (Expenses)			
Federal grant revenue	18,382,493	-	18,382,493
Principal forgiveness expense	(2,252,429)	-	(2,252,429)
State grant revenue	89,991	-	89,991
Net increase in the fair value of investments	183,607	-	183,607
Total nonoperating revenues	16,403,662	-	16,403,662
Change in net assets	19,903,183	(682,146)	19,221,037
Net Assets - beginning	341,341,404	7,600,863	348,942,267
Net Assets - ending	$ 361,244,587	$ 6,918,717	$ 368,163,304

See accompanying notes to financial statements.

Alabama Water Pollution Control Authority
Statement of Cash Flows
Proprietary Fund
For the Year Ended September 30, 2012

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Cash Flows from Operating Activities:			
Interest and dividends received on investments	$ 3,314,794	$ 18,098	$ 3,332,892
Interest paid on revolving loan bonds	(11,598,859)	-	(11,598,859)
Receipts of payments from municipalities	107,504,723	-	107,504,723
Payments to employees and vendors	-	(159,445)	(159,445)
Interest received on loans receivable	14,419,415	-	14,419,415
Administration fees	(3,514,426)	3,101,911	(412,515)
Payments to municipalities	(19,006,282)	-	(19,006,282)
Payments (to) from ADEM	-	(446,720)	(446,720)
Net cash provided by operating activities	91,119,365	2,513,844	93,633,209
Cash Flows from Non-capital and Related Financing Activities:			
Grant revenue received	18,417,298	-	18,417,298
Principal forgiveness	(2,035,000)	-	(2,035,000)
Sale of investment securities	20,714,988	-	20,714,988
Principal paid on revolving loan bonds	(76,188,419)	-	(76,188,419)
Net cash provided by non-capital and related financing activities	(39,091,133)	-	(39,091,133)
Cash Flows from Capital and Related Financing Activities:			
Purchase of capital assets	-	(61,912)	(61,912)
Net increase in cash and cash equivalents	52,028,232	2,451,932	54,480,164
Cash and Cash Equivalents - restricted, beginning of year	97,617,279	2,639,112	100,256,391
Cash and Cash Equivalents - restricted, end of year	$ 149,645,511	$ 5,091,044	$ 154,736,555

-continued-

See accompanying notes to financial statements.

Alabama Water Pollution Control Authority
Statement of Cash Flows (Continued)
Proprietary Fund
For the Year Ended September 30, 2012

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Reconciliation of Operating Income (Expense) to Net Cash Provided by (Used in) Operating Activities:			
Operating income (expense)	$ 3,499,521	$ (682,146)	$ 2,817,375
Bond issuance cost amortization	2,791,017	-	2,791,017
Depreciation	-	13,621	13,621
(Increase) decrease in operating assets:			
Accrued interest receivable on investments - restricted	108,292	-	108,292
Accrued interest receivable on loans receivable	256,181	-	256,181
Loan premium	(2,699,325)	-	(2,699,325)
Loans receivable	71,943,500	-	71,943,500
Other receivables	50,316	-	50,316
Prepaid rent	-	166,282	166,282
Increase (decrease) in operating liabilities:			
Accrued interest payable	(402,045)	-	(402,045)
Accrued arbitrage rebate	(933,033)	-	(933,033)
Payables to municipalities	16,488,718	-	16,488,718
Accounts payable	-	33,469	33,469
Due to DWFA	16,223	-	16,223
Due to ADEM	-	2,795,350	2,795,350
Other post employment benefit obligation	-	187,268	187,268
Net cash provided by operating activities	$ 91,119,365	$ 2,513,844	$ 93,633,209

See accompanying notes to financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Alabama Water Pollution Control Authority (the "Authority") have been prepared in conformity with accounting principles generally accepted in the United States of America 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 1989 to issue revolving loan bonds and lend the bond proceeds to eligible municipalities at below market interest rates to pay for the construction of wastewater treatment and collection facilities. The Water Quality Act of 1987 (Clean Water Act) requires the implementation of a state revolving fund (SRF) 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 agency 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 Presentation

The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. In accordance with Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,* the Authority has elected to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board Opinions, issued on or before and subsequent to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

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.

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 trust funds are maintained on the cash receipts and disbursements basis and are adjusted for financial statement purposes to reflect accrued receivables and payables.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Additional restricted assets are held by the State of Alabama on behalf of the Authority until the disbursement of the assets to municipalities occurs.

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 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. 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 and AAA rated investments.

Bond Discounts and Issue Costs

Bond discounts on long-term debt are amortized using the interest method over the life of the debt to which it relates. Bond issue costs are capitalized and amortized using the straight-line method over the life of the respective issues.

Loans Receivable, Payables to Municipalities, and Loan Premium

The Authority issues loans to eligible municipalities or their agencies 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 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 using the interest method over the life of the loan. The stated interest rates for these loans range from 2.50% to 5.50% and the effective interest rates range from 3.02% to 6.63%. 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prepaid Rent

In 2008, the Authority paid $6,485,000 in prepaid rent to the State of Alabama for the use of newly renovated laboratory facilities. This amount is amortized to rental expense over a period of 39 years, the estimated life of the associated building, or $166,282, annually. Amortization expense recognized during the year ended September 30, 2012 was $166,282.

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.

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).

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interfund Transfers

The Authority has the ability to transfer and receive funds from the Drinking Water State Revolving Fund. There were no interfund transfers during 2012.

Subsequent Events

The Authority has evaluated subsequent events through January 24, 2013, the date the financial statements were available to be issued.

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.

Concentration of Credit Risk

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

NOTE 2 – CASH AND INVESTMENTS

Deposits

As of September 30, 2012, 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 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 the fair value of those instruments. The fair value of interest sensitive instruments may

NOTE 2 – CASH AND INVESTMENTS (Continued)

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.

As of September 30, 2012, the Authority had the following investment holdings and maturities:

		Investment Maturities		
	Market	Less than 3 years	3-6 years	Greater than 6 years
Investments:				
U.S. Treasury Strips	$ 8,024,020	$ 6,447,368	$ 161,591	$ 1,415,061
Guaranteed Investment Contracts	21,362,405	1,135,000	5,299,399	14,928,006
U.S. Treasury SLGs	21,511,650	9,130,895	1,439,350	10,941,405
U.S. Treasury Bonds/Notes	2,831,084	-	-	2,831,084
Total investments	53,729,159	$ 16,713,263	$ 6,900,340	$ 30,115,556
Cash equivalents:				
Money Market Funds	$ 154,736,555	N/A	N/A	N/A
Total cash equivalents	154,736,555	$ -	$ -	$ -
Total holdings	$ 208,465,714			

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, slugs, and strips) totaling $32,366,754 held in trust by either the Bank of New York or U.S. 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 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.

NOTE 2 – CASH AND INVESTMENTS (Continued)

Concentration of Credit Risk – Concentration of credit risk is defined as investing 5% or more of total investments in any single issuer. As of September 30, 2012, the Authority entered into Guaranteed Investment Contracts with the following issuers that comprised 5% or more of the total holdings:

Issuer	Investment Type	Fair Value	Percentage of Total Holdings
AIG	Guaranteed Investment Contracts	$ 21,362,405	10.25%

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 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, 2012 are collateralized by U.S. Government securities rated AAA by Moody's Investor Services.

The ratings of total holdings are as follows at September 30, 2012:

Moody's Ratings	Fair Value	Fair Value as a Percent of Total Holdings Value
Exempt from disclosure	$ 32,366,754	15.53%
AAA	154,736,555	74.22%
Not rated	21,362,405	10.25%
	$ 208,465,714	100.00%

Investment holdings that are exempt from disclosure consist of U.S. Treasury strips, bonds, and SLGs. Investment holdings that are not rated consist of repurchase agreements and guaranteed investment contracts. Repurchase agreements are not rated by Moody's Investors Service. The underlying collateral for the repurchase agreements was rated AAA by Moody's Investors Service at September 30, 2012.

NOTE 3 – LOANS RECEIVABLE

Loans receivable at September 30, 2012, as discussed below, are as follows:

Completed projects	$ 328,916,100
Projects in progress	94,870,000
Loans receivable	423,786,100
Less:	
Current portion loans receivable	37,626,500
Unamortized premium	6,723,281
Loans receivable, net	$ 379,436,319

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

2013	$ 37,626,500
2014	39,024,600
2015	37,275,000
2016	33,580,000
2017 and thereafter	276,280,000
	$ 423,786,100

As of September 30, 2012, the Authority had loans outstanding to ten agencies that, in the aggregate, exceed $130 million. The outstanding balances of these loans represent approximately 31% of the total loans receivable, as follows:

Loan Recipient	Outstanding Balance
Mobile Smith WWTF & Regional Force Main, Pump Station	$ 20,000,000
Mobile Sewer Rehabilitation	19,400,000
Athens Wastewater Treatment Plant Improvements	13,705,000
Jefferson Co. WWTP's, Interceptors & Sewer Rehab (See Note 12)	11,690,000
Pell City Sanitary Sewer System Upgrade and Rehabilitation	11,540,000
Madison Wastewater Treatment Plant & Interceptors	11,500,000
Sheffield WWTP and Sewer Rehabilitation	11,460,000
Florence WWTP Upgrade & Interceptor	10,710,000
Florence WWTP Upgrade & Inter. (Supplemental A)	10,300,000
Decatur Wastewater System Improvements	10,160,000
Total	$ 130,465,000

NOTE 4 – CAPITAL ASSETS, NET

Capital assets consist of the following depreciable assets:

	Balance 10/1/11	Additions	Deletions	Balance 9/30/12
Data processing equipment	$ 231,026	$ 902	$ 49,396	$ 182,532
Scientific and technical equipment	908,741	61,010	-	969,751
Communication equipment	168,709	-	17,634	151,075
Other equipment	97,833	-	-	97,833
	1,406,309	61,912	67,030	1,401,191
Less: Accumulated depreciation	1,389,277	13,621	67,030	1,335,868
Total capital assets, net	$ 17,032	$ 48,291	$ -	$ 65,323

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, 2012, the EPA awarded ADEM capitalization funds under its annual grant agreements in the amount of $32,314,000. During the year ended September 30, 2012, 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 capitalizing grants. The Authority has also recognized as income only the percentage of State match actually received in relation to the federal grant drawn.

The amount of cumulative unreceived federal capitalization grants was $20,316,568 at September 30, 2012. The Authority will apply for a federal capitalization grant in 2012. Any grants in 2012 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, 2012:

Year	Grant Amount	Draws Prior to 2012	2012 Draws	Total Draws	Amount Available for Future Draws
2009-ARRA	$ 43,821,600	$ 41,449,387	$ 2,372,213	$ 43,821,600	$ -
2010	22,783,000	17,885,643	4,897,357	22,783,000	-
2011	16,511,000	-	11,997,432	11,997,432	4,513,568
2012	15,803,000	-	-	-	15,803,000
	$ 98,918,600	$ 59,335,030	19,267,002	$ 78,602,032	$ 20,316,568
Less:					
Administrative and set-aside expenses			(849,704)		
Total 2012 draws			$ 18,417,298		

NOTE 6 – PAYABLES TO MUNICIPALITIES

As of September 30, 2012, the Authority had $52,867,039 in payables to municipalities. These payables represent approved 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 October 1, 1997, the Authority issued Refunding Series 1997 Revolving Loan Bonds totaling $59,040,000. The Refunding Series 1997 Bonds include:

$59,040,000 serial bonds commencing August 15, 1999, and due February 15, 2013, which bear interest at rates ranging from 4.25% to 4.75%.

On January 15, 2002, the Authority issued Series 2002A Revolving Loan Bonds totaling $32,555,000. The Series 2002A Bonds include:

$20,450,000 serial bonds commencing February 15, 2002, and due August 15, 2018, which bear interest at rates ranging from 3.00% to 5.00%.

$5,980,000 term bonds due August 15, 2021, which bear interest at 5.05%.

$6,125,000 term bonds due August 15, 2024, which bear interest at 5.10%.

As of September 30, 2012, the Series 2002A bonds were fully paid.

On February 14, 2002, the Authority issued Series 2002B Revolving Loan Bonds totaling $58,425,000. The Series 2002B Bonds include:

$58,425,000 serial bonds commencing August 15, 2002, and due August 15, 2014, which bear interest rates ranging from 3.00% to 5.40%.

As of September 30, 2012, the Series 2002B bonds were fully paid.

On January 1, 2003, the Authority issued Series 2003A Revolving Loan Bonds totaling $30,985,000. The Series 2003A Bonds include:

$18,250,000 serial bonds commencing August 15, 2006, and due August 15, 2023, which bear interest at rates ranging from 3.00% to 5.00%.

$12,735,000 term bonds due August 15, 2026, which bear interest at 5.00%.

NOTE 7 – LONG-TERM DEBT (Continued)

On January 1, 2003, the Authority issued Refunding Series 2003B Revolving Loan Bonds totaling $52,650,000. The Series 2003B Bonds include:

$52,650,000 serial bonds commencing February 15, 2004, and due February 15, 2016, which bear interest rates ranging from 3.00% to 4.38%.

On August 1, 2003, the Authority issued Refunding Series 2003C Revolving Loan Bonds totaling $11,385,000. The Series 2003C Bonds include:

$11,385,000 serial bonds commencing February 15, 2004, and due August 15, 2015, which bear interest rates ranging from 2.50% to 4.25%.

On April 1, 2004, the Authority issued Refunding Series 2004A Revolving Loan Bonds totaling $34,580,000. The Series 2004A Bonds include:

$34,580,000 serial bonds commencing August 15, 2005, and due August 15, 2016, which bear interest rates ranging from 2.00% to 4.00%.

As of September 30, 2012, the Series 2004A bonds were fully paid.

On February 1, 2008, the Authority issued Refunding Series 2008A Revolving Loan Bonds totaling $44,680,000. The Series 2008A Bonds include:

$44,680,000 serial bonds commencing August 15, 2008, and due August 15, 2019, which bear interest rates ranging from 3.00% to 4.00%.

On August 15, 2010, the Authority issued Refunding Series 2010A Revolving Loan Bonds totaling $36,440,000. The Series 2010A Bonds include:

$36,440,000 serial bonds commencing August 15, 2011, and due August 15, 2023, which bear interest rates ranging from 3.00% to 4.00%.

On August 15, 2010, the Authority issued Refunding Series 2010B Revolving Loan Bonds totaling $64,750,000. The Series 2010B Bonds include:

$64,750,000 serial bonds commencing August 15, 2012, and due August 15, 2021, which bear interest rates ranging from 2.00% to 3.00%.

On December 1, 2010, the Authority issued Refunding Series 2010C Revolving Loan Bonds totaling $36,850,000. The Series 2010C Bonds include:

$36,850,000 serial bonds commencing August 15, 2011, and due August 15, 2023, which bear interest rates ranging from 2.00% to 4.00%.

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.

NOTE 7 – LONG-TERM DEBT (Continued)

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 2012:

	Balance 10/1/11	Additions	Reductions	Balance 9/30/12
Revolving fund loan bonds	$ 290,190,000	$ -	$ 76,260,000	$ 213,930,000
Add: Unamortized premiums	2,945,113	-	789,085	2,156,028
Less: Unamortized deferred refunding costs	5,280,072	-	1,991,274	3,288,798
Total	$ 287,855,041	$ -	$ 75,057,811	$ 212,797,230

Long-term debt at September 30, 2012 is payable as follows:

	Principal	Interest	Total
2013	$ 27,155,000	$ 7,389,868	$ 34,544,868
2014	23,000,000	6,598,115	29,598,115
2015	24,130,000	5,866,924	29,996,924
2016	23,960,000	5,094,671	29,054,671
2017	18,210,000	4,419,943	22,629,943
2018-2022	73,000,000	13,618,021	86,618,021
2023-2027	24,475,000	2,344,700	26,819,700
	213,930,000	$ 45,332,242	$ 259,262,242
Plus:			
Unamortized premium	2,156,028		
Less:			
Unamortized deferred refunding cost	3,288,798		
Current portion	27,155,000		
Total long-term debt	$ 185,642,230		

The Authority issued the 1997 Refunding Series revolving loan bonds for the purpose of refunding the Series 1989 Bonds, the Series 1990A bonds, and the Series 1990B, which had an aggregate principal balance of $57,470,000 on October 1, 1997, the date of the refunding. The refunding resulted in an accounting loss of approximately $6,600,000, which has been capitalized and is being amortized, on a straight-line basis, through 2012. As of September 30, 2012, the unamortized deferred refunding costs totaled $0 for the Series 1989, Series 1990A, and 1990B bonds.

NOTE 7 – LONG-TERM DEBT (Continued)

The Authority issued the 2002B Refunding Series revolving loan bonds for the purpose of refunding the Series 1991 Bonds that had an aggregate principal balance of $59,770,000 on February 1, 2002. The refunding resulted in an accounting loss of approximately $2,200,000 that has been capitalized and is being amortized, on a straight-line basis, through 2012. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $8.3 million over the next 12 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately $1.9 million. As of September 30, 2012, the unamortized deferred refunding cost totaled $0 for the Series 1991 Bonds.

The Authority issued the 2003B Refunding Series revolving loan bonds for the purpose of refunding the Series 1992A Bonds that had an aggregate principal balance of $54,210,000 on January 1, 2003. The refunding resulted in an accounting loss of approximately $2,000,000 that has been capitalized and is being amortized, on a straight-line basis, through 2016. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $1 million. As of September 30, 2012, the unamortized deferred refunding costs totaled $500,002 for the Series 1992A Bonds.

The Authority issued the 2003C Refunding Series revolving loan bonds for the purpose of refunding the Series 1992B Bonds that had an aggregate principal balance of $11,695,000 on August 1, 2003. The refunding resulted in an accounting loss of approximately $253,000 that has been capitalized and is being amortized, on a straight-line basis, through 2015. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $2.5 million over the next 12 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately $50,000. As of September 30, 2012, the unamortized deferred refunding costs totaled $61,496 for the Series 1992B Bonds.

The Authority issued the 2004A Refunding Series revolving loan bonds for the purpose of refunding the Series 1993 and 1994 Bonds. The 1993 Bonds were refunded on August 15, 2004 with an aggregate principal balance of $46,385,000 and the 1994 Bonds were refunded on August 15, 2005 with an aggregate principal balance of $36,720,000. The refunding of the 1993 and 1994 Bonds resulted in an accounting loss of approximately $2,116,433, respectively, that has been capitalized and is being amortized, on a straight-line basis, through 2012. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service of the 1993 and 1994 Series Bonds by approximately $5.3 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 $2 million. As of September 30, 2012, the unamortized deferred refunding cost totaled $0 for the Series 1993 and 1994 Bonds.

The Authority issued the 2008A Refunding Series revolving loan bonds for the purpose of refunding the Series 1996A and 1996B Bonds that had aggregate principal balances of $27,690,000 and $30,180,000 on February 15, 2008, respectively. The refunding resulted in accounting loss of approximately $489,102 and $685,136, respectively that has been capitalized and is being amortized on a straight-line basis, through 2020. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $21 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 $10.4 million. As of September 30, 2012, the unamortized deferred refunding costs totaled $708,736 for the Series 1996A and 1996B Bonds.

NOTE 7 – LONG-TERM DEBT (Continued)

The Authority issued the 2010A Refunding Series revolving loan bonds for the purpose of refunding the Series 1999 Bonds that had an aggregate principal balance of $42,615,000 on August 15, 2010. The refunding resulted in accounting loss of approximately $795,521 that has been capitalized and is being amortized, on a straight-line basis, through 2023. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $16.6 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 $7.4 million. As of September 30, 2012, the unamortized deferred refunding costs totaled $673,133 for the Series 1999 Bonds.

The Authority issued the 2010B Refunding Series revolving loan bonds for the purpose of refunding the Series 1998A and 1998B Bonds that had aggregate principal balances of $39,535,000 and $40,410,000 on August 15, 2010, respectively. The refunding resulted in accounting losses of approximately $492,910 and $537,824, respectively, that has been capitalized and is being amortized on a straight-line basis, through 2020. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $23 million over the next 11 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately $11.7 million. As of September 30, 2012, the unamortized deferred refunding costs totaled $824,587 for the Series 1998A and 1998B Bonds.

The Authority issued the 2010C Refunding Series revolving loan bonds for the purpose of refunding the Series 2000 Bonds that had an aggregate principal balance of $43,370,000 on December 1, 2010, respectively. The refunding resulted in an accounting loss of approximately $608,991 that has been capitalized and is being amortized on a straight-line basis, through 2023. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately $17.3 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 $7.3 million. As of September 30, 2012, the unamortized deferred refunding costs totaled $520,844 for the Series 2000 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 has calculated the amount of rebate due to the Internal Revenue Service. The liability is $926,132 at September 30, 2012.

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 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

During fiscal years 2009, 2010, 2011, and 2012, 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 50%, 14.98%, 9.27%, and 5.55% of total grant funds provided by the 2009-ARRA grant, 2010 grant, 2011 grant, and 2012 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 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, 2012 totaled $2,252,429, leaving a remaining balance of $2,511,152 capitalized as principal forgiveness on the statement of net assets as of September 30, 2012.

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS

The State provides postretirement health care benefits, in accordance with *Code of Alabama 1975*, Section 36-29-10, to all retired state employees through the State Employees' Health Insurance Plan (SEHIP). The retiree portion of the SEHIP is accounted for through the Alabama Retired State Employees' Health Care Trust. Employees covered under this plan who retire from active service and begin receiving monthly benefits from the Employees' Retirement System of Alabama may elect to continue coverage under the group insurance plan by consenting to have deducted from their monthly benefit payment the difference in the total cost of their insurance coverage and the portion authorized to be expended by the SEHIP for coverage of such retired employees. The State Employees' Insurance Board administers SEHIP. In order to fund the ongoing costs of these other postemployment benefits (OPEB), the State has established a trust fund as described below to comply with GASB Statements 43 and 45.

A. Plan Descriptions

The Alabama Retired State Employees' Health Care Trust (the Trust) is a single employer defined benefit health care plan established as an irrevocable trust in 2007 by Constitutional Amendment 798. The State Employees' Insurance Board issued a stand-alone financial report that includes the Alabama Retired State Employees' Health Care Trust financial statements and detailed disclosures for the year ended September 30, 2012. A copy may be obtained by writing to:

State Employees' Insurance Board
P. O. Box 304900
201 South Union Street, Suite 200
Montgomery, AL 36130-4900

B. Summary of Significant Accounting Policies

1. Basis of Accounting - The Trust is an "other employee benefits trust fund" that operates under the accrual basis of accounting. Plan member contributions are recognized in the period

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

in which contributions are due. Employer contributions are recognized when earned, pursuant to plan requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

2. Investments - All plan assets are carried at fair value except short-term investments which are reported at cost, which approximates fair value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates. Mortgage-backed securities are reported based on estimated future principal and interest payments discounted at the prevailing interest rate for similar instruments. Investments not traded on exchanges are valued based on the selling price of similar investments sold in the open market. In those instances where there are no similar investments sold in the open market, an appraisal is performed to determine the fair value of the investments.

C. Funding Policy

The State provides health care benefits for retired state employees through SEHIP. For retirees who retired prior to October 1, 2005, the State pays 100 percent of the premium for a retiree who is over 65 and eligible for Medicare. The State pays a portion of the premium for a retiree who is under 65. Under the SEHIP statute, the State contribution per month per retiree is funded on a pay-as-you-go basis through the active employee premiums each agency pays for its active employees. COBRA insurance is also available to state employees who terminate state service, but the employee is liable for the premiums. For retirees, who retire on or after October 1, 2005 except for disability, Act 2004-648 provides that the State contribution for retiree health insurance premiums shall be based on years of service. The State contribution to the health insurance premium shall be reduced by two percent for each year of service less than twenty-five and increased by two percent for each year of service over twenty-five. The retiree is responsible for the amount of contribution not covered by the State. Also, the State may make additional contributions. Additional funds of approximately $1 million were contributed during fiscal year 2012. The Medicare Part D retiree drug subsidy for fiscal year 2012 was $10,581,609.

1. Annual OPEB Cost and Net OPEB Obligation - Government Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, requires additional reporting and disclosures for OPEB plans. The SEHIP is a single employer plan. The following OPEB amounts are for the Authority's portion of the benefits under the SEHIP:

Annual required contribution (ARC)	$	256,468
Interest on net OPEB obligation		24,304
Adjustment to ARC		(17,349)
Annual OPEB cost		263,423
Contributions made		(101,844)
Increase in net OPEB obligation		161,579
Net OPEB obligation, beginning of year		486,088
Net OPEB obligation, end of year	$	647,667

Percentage of annual OPEB cost contributed: 39%

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

2. Funded Status and Funding Progress - The schedule of funding progress as shown below presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Retired State Employees Health Care Trust
(Amounts in Thousands)

Actuarial Valuation Date	(A) Actuarial Value of Assets	(B) Actuarial Accrued Liability (AAL)	(B-A) Unfunded AAL	(A/B) Funded Ratio	(C) Covered Payroll	((B-A)/C) UAAL as a % of Covered Payroll
9/30/2009**	$ 88,588	4,142,076	$ 4,053,488	2.1%	$ 1,607,097	252.2%
9/30/2010***	97,485	4,162,276	4,064,791	2.3%	1,594,767	254.9%
9/30/2011^	108,723	3,369,897	3,261,173	3.2%	1,506,539	216.5%

** Medicare eligible retirees reverted back to self-funded traditional Medicare and plan changes regarding copays and deductibles for all retirees.
*** Reflects Act 2011-27, which closes the DROP program to new participants effective March 24, 2011 and Act 2011-698, which increases retiree premiums for members retiring on or after January 1, 2012.
^ Reflects the impact of the EGWP + Wrap plan and the five year experience study.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

3. Actuarial Methods and Assumptions - Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five year period.

The actuarial methods and significant assumptions used to determine the ARC for fiscal year 2012 are as follows:

Actuarial Methods for Retired State Employees' Health Care Trust:

Valuation Date:	September 30, 2011
Actuarial Cost Method:	Projected Unit Credit
Asset Valuation Method:	Market Value of Assets
Amortization Method:	Level Percent of Pay
Remaining Amortization Period:	30 Years
Period Closed/Open:	Open

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

Actuarial Assumptions for Retired State Employees' Health Care Trust:

Actuarial Valuation Date	Investment Rate of Return	Medical Cost Trend Rate* Medicare Eligible	Medical Cost Trend Rate* Pre-Medicare	Ultimate Trend Rate*	Year of Ultimate Trend Rate*
9/30/2009	5%	9.0%	11.0%	5%	2016
9/30/2010	5%	8.5%	10.5%	5%	2017
9/30/2011	5%	7.5%	9.5%	5%	2017

*Includes inflation at 3.00%.

The assumed investment rate of return reflects the fact that as of September 30, 2011 the Plan has $108,423,499 in trust solely to provide benefits to retirees and their beneficiaries. A policy has been established to make regular contributions representing a partial payment toward the ARC each year. If the Plan starts fully pre-funding benefits, the discount rate may be increased to reflect equity investment the fund may have after full pre-funding begins. This investment rate of return assumption is independent of the inflation assumption.

4. Trend Information - The employer contributions and annual OPEB cost of the SEHIP is presented in the table below.

(Amounts in thousands)

	Employer Contribution	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2010	$ 106,078	$ 215,777	49%	$ 424,283
2011	119,391	217,936	55%	526,310
2012	110,271	285,221	39%	701,260

NOTE 12 - LOAN RECEIVABLE - JEFFERSON COUNTY

In November 2011, Jefferson County filed for bankruptcy. As of September 30, 2012, the Authority held a loan receivable from Jefferson County in the amount of $11,690,000. As of the date of these financial statements, the Authority is unable to estimate the impact this will have on their ability to collect this receivable. Therefore, no allowance against this receivable has been recorded as of September 30, 2012.

SUPPLEMENTARY INFORMATION

Alabama Water Pollution Control Authority
Schedule of Expenditures of Federal Awards
September 30, 2012

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grantor's Number	Federal Expenditures
Environmental Protection Agency			
Passed through the Alabama Department of Environmental Management			
ARRA - Capitalization grants for state revolving funds	66.458	2W954279-09	$ 1,598,581
Capitalization grants for state revolving funds	66.458	CS010001-10	4,616,051
Capitalization grants for state revolving funds	66.458	CS010001-11	12,167,861
Total Environmental Protection Agency			18,382,493
Total federal financial assistance			$ 18,382,493

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies and presentation of the Single Audit Report of the Alabama Water Pollution Control Authority (the "Authority") have been designed to conform to generally accepted accounting principles as applicable to governmental units, including the reporting and compliance requirements of the Audits of States, Local Governments, and Non-Profit Organizations and Office of Management and Budget Circular A-133, Compliance Supplement (A-133).

Reporting Entity – The Authority consists of the Loan Fund and the Loan Fee Fund, both of which are Enterprise Funds. The Authority included a schedule of federal financial assistance in the Single Audit section.

Basis of Accounting – Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The modified accrual basis of accounting is followed in the Schedule of Expenditures of Federal Awards. 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 based upon the expenditures recorded. In the other, monies are virtually recognized 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 2 – 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 January 24, 2013, there were no material questioned or disallowed costs as a result of grant audits in process or completed.

COMPLIANCE SECTION

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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 Water Pollution Control Authority
Montgomery, Alabama

We have audited the accompanying financial statements of the business-type activities and the major funds of the Alabama Water Pollution Control Authority (the "Authority"), as of and for the year ended September 30, 2012, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated January 24, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in **Government Auditing Standards**, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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**.

We noted certain matters that we reported to management of the Authority in a separate letter dated January 24, 2013.

This report is intended solely for the information and use of management, the board members and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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

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

Certified Public Accountants

January 24, 2013

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Directors
Alabama Water Pollution Control Authority
Montgomery, Alabama

Compliance

We have audited Alabama Water Pollution Control Authority's (the "Authority") compliance with the types of compliance requirements described in the (OMB) Circular A-133 Compliance Supplement that could have a direct and material effect on each of the Authority's major federal programs for the year ended September 30, 2012. The Authority's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

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 OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations". Those standards and OMB Circular A-133 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. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2012.

Internal Control Over Compliance

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the board members, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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

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

Certified Public Accountants

January 24, 2013

SECTION I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified ____ yes X no
- Reportable condition(s) identified that are not considered to be material weaknesses? ____ yes X none reported

Noncompliance material to financial statements noted? ____ yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ____ yes X no
- Reportable condition(s) identified that are not considered to be material weakness(es)? ____ yes X none reported

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

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? ____ yes X no

Identification of major programs:

CFDA Numbers	Name of Federal Program or Cluster
66.458	Capitalization Grants for Clean Water State Revolving Funds

Dollar threshold used to distinguish between type A and type B programs? $ 551,475

Auditee qualified as low-risk auditee? X yes ____ no

SECTION II – Financial Statements Findings

No matters were reported.

SECTION III – Federal Award Findings and Questioned Costs

No matters were reported.