

**Alabama Drinking Water
Finance Authority**

Component Unit Financial Statements

For The Year Ended September 30, 2012

Alabama Drinking Water Finance Authority
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September 30, 2012

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INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

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, 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 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 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 basic 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 Drinking Water Finance 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 an organizational description, a summary of significant accounting policies, information on cash and investments, loans receivable, payables to municipalities, long term debt, arbitrage, related parties and prior period corrections.

COMPARATIVE SUMMARY STATEMENTS

Statement of Net Assets

<i>September 30,</i>	2012	2011	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	\$ 62,440,217	\$ 57,941,292	\$ 4,498,925	8%
Receivables	240,578,519	245,875,970	(5,297,451)	(2%)
Investments	33,793,692	53,939,313	(20,145,621)	(37%)
Unamortized items	5,778,823	7,633,596	(1,854,773)	(24%)
Capital assets	1,377	2,349	(972)	(41%)
Total assets	342,592,628	365,392,520	(22,799,892)	(6%)

Liabilities				
Accrued liabilities	1,984,469	2,331,613	(347,144)	(15%)
Payable to municipalities	27,090,107	31,715,227	(4,625,120)	(15%)
Bonds payable, net	136,774,352	166,813,193	(30,038,841)	(18%)
Total liabilities	165,848,928	200,860,033	(35,011,105)	(17%)
Net assets, restricted	\$ 176,743,700	\$ 164,532,487	\$ 12,211,213	7%

Statement of Revenues Expenses and Changes in Fund Net Assets

<i>For the year ended September 30,</i>	2012	2011	Variance	% increase (decrease)
Operating revenue	\$ 12,244,211	\$ 12,892,337	\$ (648,126)	(5%)
Operating expense	10,150,279	12,094,425	(1,944,146)	(16%)
Operating income	2,093,932	797,912	1,296,020	162%
Non-operating revenue	10,117,281	15,082,402	4,965,121	33%
Change in net assets	\$ 12,211,213	\$ 15,880,314	\$ (3,669,101)	(23%)

Statement of Cash Flows

<i>For the year ended September 30,</i>	2012	2011	Variance	% increase (decrease)
Net cash provided by operating activities	\$ 1,366,887	\$ 1,878,974	\$ (512,087)	(27%)
Net cash provided by (used in) non-capital and related financing activities	3,132,038	10,420,651	(7,288,613)	(70%)
Cash flows from capital and related financing activities	-	(2,916)	(2,916)	(100%)
Net increase (decrease) cash and cash equivalents	\$ 4,498,925	\$ 12,296,709	\$ (7,797,784)	(63%)

Financial Highlights

- The Authority closed seven new loans totaling \$12,567,200.
- One refunding bond issue was completed. The net effect was the defeasance of 69,870,000 in old debt and replacing it with \$45,210,000 in new debt while realizing an economic gain of approximately \$15.9 million. Their savings was realized in the form of an interest rate reduction from a range of 3% to 8.35% to a range of 0.05% to 4.00%.
- Net assets increased \$12,211,213 mainly due to the utilization of \$15,132,259 in federal funds transferred to loan recipients.

Alabama Drinking Water Finance Authority
Statement of Net Assets
September 30, 2012

	Business-type Activities
Assets	
Current assets:	
Cash and cash equivalents - restricted	\$ 62,440,217
Accrued interest receivable on investments - restricted	116,582
Accrued interest receivable on loans receivable	897,073
Current portion of loans receivable	13,085,000
Grants and other receivables	292,304
Total current assets	76,831,176
Noncurrent assets:	
Investments - restricted	33,793,692
Loans receivable less unamortized premium of \$4,942,440	226,187,560
Principal forgiveness	3,256,666
Unamortized bond issue cost	2,522,157
Capital assets, net	1,377
Total noncurrent assets	265,761,452
Total assets	342,592,628
Liabilities	
Current liabilities:	
Accounts payable	25,742
Current portion of revolving loan bonds	6,350,000
Accrued interest payable	673,004
Due to Alabama Department of Environmental Management (ADEM)	1,077,599
Total current liabilities	8,126,345
Long-term liabilities:	
Other post employment benefit obligation	208,124
Payables to municipalities	27,090,107
Revolving loan bonds payable, less unamortized discount of \$1,946,986	130,424,352
Total long-term liabilities	157,722,583
Total liabilities	165,848,928
Net Assets	
Restricted for loans and debt service	176,743,700
Total net assets	\$ 176,743,700

See accompanying notes.

Alabama Drinking Water Finance Authority
Statement of Activities
For the Year Ended September 30, 2012

Functions/Programs	Expenses	Program Revenues		Net (Expense)
		Charges for Services	Operating Grants and Contributions	Revenue and Changes in Net Assets
				Business-type Activities
Business-type Activities:				
Drinking water loans	\$ 15,712,946	\$ 1,655,909	\$ 15,191,043	\$ 1,134,006
General Revenues				
Investment earnings				11,077,207
Change in net assets				12,211,213
Net Assets - beginning				164,532,487
Net Assets - ending				\$ 176,743,700

See accompanying notes.

Alabama Drinking Water Finance 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	\$ 57,848,161	\$ 4,592,056	\$ 62,440,217
Accrued interest receivable on investments - restricted	116,582	-	116,582
Accrued interest receivable on loans receivable	897,073	-	897,073
Current portion of loans receivable	13,085,000	-	13,085,000
Grants and other receivables	292,304	-	292,304
Total current assets	72,239,120	4,592,056	76,831,176
Noncurrent assets:			
Investments - restricted	33,793,692	-	33,793,692
Loans receivable less unamortized premium of \$4,942,440	226,187,560	-	226,187,560
Principal forgiveness	3,256,666	-	3,256,666
Unamortized bond issue cost	2,522,157	-	2,522,157
Capital assets, net	-	1,377	1,377
Total noncurrent assets	265,760,075	1,377	265,761,452
Total assets	337,999,195	4,593,433	342,592,628
Liabilities			
Current liabilities:			
Accounts Payable	-	25,742	25,742
Current portion of revolving loan bonds	6,350,000	-	6,350,000
Accrued interest payable	673,004	-	673,004
Due to ADEM	-	1,077,599	1,077,599
Total current liabilities	7,023,004	1,103,341	8,126,345
Long-term liabilities:			
Other post employment benefit obligation	-	208,124	208,124
Payables to municipalities	27,090,107	-	27,090,107
Revolving loan bonds payable, less unamortized deferred refunding cost of \$1,942,986	130,424,352	-	130,424,352
Total long-term liabilities	157,514,459	208,124	157,722,583
Total liabilities	164,537,463	1,311,465	165,848,928
Net Assets			
Restricted for loans and debt service	173,461,732	3,281,968	176,743,700
Total net assets	\$ 173,461,732	\$ 3,281,968	\$ 176,743,700

See accompanying notes.

Alabama Drinking Water Finance 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	\$ 2,119,835	\$ 16,795	\$ 2,136,630
Interest from loan receivable	8,451,672	-	8,451,672
Administrative fees	-	1,655,909	1,655,909
Total operating revenues	10,571,507	1,672,704	12,244,211
Operating Expenses			
Administration expense	1,858,220	-	1,858,220
Bond interest expense	6,754,202	-	6,754,202
Bond issuance amortization expense	232,194	-	232,194
Depreciation	-	972	972
Employee benefits	-	256,642	256,642
Office expense	-	173,349	173,349
Other expenses	-	229,720	229,720
Salaries	-	644,980	644,980
Total operating expenses	8,844,616	1,305,663	10,150,279
Operating income	1,726,891	367,041	2,093,932
Nonoperating Revenues (Expenses)			
Grant revenue	15,132,259	-	15,132,259
Principal forgiveness expense	(4,567,474)	-	(4,567,474)
Arbitrage Rebate expense	(995,193)	-	(995,193)
State Revenue	58,784	-	58,784
Net increase in the fair value of investments	488,905	-	488,905
Total nonoperating revenues	10,117,281	-	10,117,281
Change in net assets	11,844,172	367,041	12,211,213
Net Assets - beginning of year	161,617,560	2,914,927	164,532,487
Net Assets - end of year	\$ 173,461,732	\$ 3,281,968	\$ 176,743,700

See accompanying notes.

Alabama Drinking Water Finance 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	\$ 2,227,208	\$ 16,795	\$ 2,244,003
Interest paid on revolving loan bonds	(8,002,303)	-	(8,002,303)
Bond issuance costs	(1,102,814)	-	(1,102,814)
Premium on bonds issued	861,278	-	861,278
Receipts of payments from municipalities	14,423,777	-	14,423,777
Payments to employees and vendors	-	(174,060)	(174,060)
Interest received on loans receivable	8,156,902	-	8,156,902
Administration fees	(1,858,220)	1,655,909	(202,311)
Payments to municipalities	(13,690,120)	-	(13,690,120)
Payments (to) from the Loan Fee Fund	977,593	(977,593)	-
Payments (to) from ADEM	-	(1,147,465)	(1,147,465)
Net cash provided by (used in) operating activities	1,993,301	(626,414)	1,366,887
Cash Flows from Non-capital and Related Financing Activities:			
Grant revenue received	15,252,509	-	15,252,509
Principal forgiveness expense	(3,502,200)	-	(3,502,200)
Other Revenue	58,784	-	58,784
Net redemptions of investment securities	20,634,526	-	20,634,526
Revolving loan bond proceeds	45,210,000	-	45,210,000
Principal paid on revolving loan bonds	(74,521,581)	-	(74,521,581)
Net cash provided by non-capital and related financing activities	3,132,038	-	3,132,038
Net increase (decrease) in cash and cash equivalents	5,125,339	(626,414)	4,498,925
Cash and Cash Equivalents - restricted, beginning of year	52,722,822	5,218,470	57,941,292
Cash and Cash Equivalents - restricted, end of year	\$ 57,848,161	\$ 4,592,056	\$ 62,440,217

-continued-

See accompanying notes.

**Alabama Drinking Water Finance 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 to Net Cash Provided by (Used in) Operating Activities:			
Operating income	\$ 1,726,891	\$ 367,041	\$ 2,093,932
Bond issuance cost amortization	232,194	-	232,194
Bond Issuance cost incurred	(1,102,814)	-	(1,102,814)
Premium on bonds issued	861,278	-	861,278
Loan premium amortization	(781,079)	-	(781,079)
Depreciation	-	972	972
(Increase) decrease in operating assets:			
Due from Loan Fee Fund	977,593	-	977,593
Due from ADEM	-	-	-
Due from WPFA	(16,223)	-	(16,223)
Accrued interest receivable on investments - restricted	107,373	-	107,373
Accrued interest receivable on loans receivable	84,478	-	84,478
Loans receivable and other receivables	5,776,831	-	5,776,831
Accrued arbitrage rebate	(917,791)	-	(917,791)
Increase (decrease) in operating liabilities:			
Accounts payable	-	(710)	(710)
Accrued interest payable	(330,310)	-	(330,310)
Payables to municipalities	(4,625,120)	-	(4,625,120)
Due to Loan Fund	-	(977,593)	(977,593)
Due to ADEM	-	(69,866)	(69,866)
Other post employment benefit obligation	-	53,742	53,742
Net cash provided by (used in) operating activities	\$ 1,993,301	\$ (626,414)	\$ 1,366,887

See accompanying notes.

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 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 Alabama Drinking Water Finance Authority (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 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 (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and the 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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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. 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 Discount and Issue Costs

Bond discounts on long-term debt are amortized on 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 (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 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 2.50% to 3.95% and the effective interest rates range from 2.50% to 4.42%. 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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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).

Interfund Transfers

The Authority has the ability to transfer and receive funds from the Clean Water State Revolving Fund. No transfers were made to the Clean Water State Revolving Fund during 2012.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 contained 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.

Subsequent Events

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

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 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 maturity, and as such, fixed 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, 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	\$ 8,253,109	\$ 1,814,212	\$ 1,764,733	\$ 4,674,164
Guaranteed investment contracts	16,817,664	-	-	16,817,664
U.S. Treasury SLGs	5,480,785	550,295	344,735	4,585,755
U.S. Treasury bonds/notes	3,242,134	-	-	3,242,134
Total investments	33,793,692	\$ 2,364,507	\$ 2,109,468	\$ 29,319,717
Cash Equivalents:				
Money Market Funds	62,440,217	N/A	N/A	N/A
Total cash equivalents	62,440,217	\$ -	\$ -	\$ -
Total holdings	\$ 96,233,909			

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, strips, and repurchase agreements) totaling \$16,976,028 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.

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, 2012, the Authority entered into Guaranteed Investment Contracts with the following issuers that comprised 5% or more of total investment holdings:

Issuer	Investment Type	Fair Value	Total Holdings
AIG	Guaranteed Investment Contracts	\$ 4,827,371	5.02%
Citigroup	Guaranteed Investment Contracts	5,700,293	5.92%

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 2 – CASH AND INVESTMENTS (Continued)

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	\$ 16,976,028	17.64%
AAA	62,440,217	64.88%
Not rated	16,817,664	17.48%
	\$ 96,233,909	100.00%

Investment holdings that are exempt from disclosure consist of U.S. Treasury strips, bonds, and notes. Investment holdings that are not rated consist of repurchase agreements. 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	\$ 195,345,000
Projects in progress	48,870,000
	244,215,000
Less:	
Current portion loans receivable	13,085,000
Unamortized premium	4,942,440
Loans receivable, net	\$ 226,187,560

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 3 – LOANS RECEIVABLE (Continued)

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

2013	\$	13,085,000
2014		14,335,000
2015		15,045,000
2016		15,775,000
2017 and thereafter		185,975,000
	\$	244,215,000

As of September 30, 2012, the Authority's ten largest outstanding loans, in the aggregate, exceeded \$118 million. The outstanding balances of these loans represent approximately 49% of the total loans receivable, as follows:

Loan Recipient	Balance
Shelby County South Water Treatment Plant (Supplemental)	\$ 24,475,000
Shelby County South Water Treatment Plant	20,375,000
Warrior River Phase 1 Improvements	16,005,000
Shelby County South Water Treatment Plant	13,945,000
Albertville Water Treatment & Distribution Improvements	11,855,000
Madison Water System Improvements	7,680,000
West Morgan - East Lawrence Drinking Water Infrastructure Improvements	6,640,000
Harvest-Monrovia Water Improvements	6,485,000
Tuscaloosa Water System Improvements	5,865,000
Harvest-Monrovia Water Improvements (Supplemental)	5,545,000
	\$ 118,870,000

NOTE 4 – CAPITAL ASSETS, NET

Capital assets consist of the following depreciable assets at September 30, 2012:

	Balance 10/01/2011	Additions	Deletions	Balance 09/30/2012
Data processing equipment	\$ 283,175	\$ -	\$ 14,112	\$ 269,063
Scientific and technical equipment	188,389	-	-	188,389
	471,564	-	14,112	457,452
Less: Accumulated depreciation	469,215	972	14,112	456,075
Total capital assets, net	\$ 2,349	\$ (972)	\$ -	\$ 1,377

Alabama Drinking Water Finance Authority

Notes To Financial Statements

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 \$22,799,000. 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 federal capitalizing grants. As of September 30, 2012, the Authority had yet to receive any state matching funds.

The amount of unused federal capitalization grants was approximately \$18,400,781 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	\$ 8,146,000	\$ 7,941,630	\$ 204,370	\$ 8,146,000	\$ -
2009-A	19,500,000	18,014,568	1,485,432	19,500,000	-
2010	16,823,000	7,347,402	8,836,018	16,183,420	639,580
2011	11,674,000	-	5,037,799	5,037,799	6,636,201
2012	11,125,000	-	-	-	11,125,000
	<u>\$ 67,268,000</u>	<u>\$ 33,303,600</u>	<u>\$ 15,563,619</u>	<u>\$ 48,867,219</u>	<u>\$ 18,400,781</u>
Less:					
	Administrative and set-aside expenses		(311,111)		
	<u>Total 2012 Draws</u>		<u>\$ 15,252,508</u>		

NOTE 6 – PAYABLES TO MUNICIPALITIES

As of September 30, 2012, the authority had \$27,090,107 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 September 1, 1998, the Authority issued Series 1998A Revolving Fund Loan Bonds totaling \$36,785,000. The Series 1998A bonds include:

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 7 – LONG-TERM DEBT (Continued)

\$28,605,000 serial bonds commencing August 15, 1999 and due August 15, 2017, which bear interest at rates ranging from 4.00% to 4.80%.

\$8,180,000 term bonds due August 15, 2022, which bears interest at 4.85%.

As of September 30, 2012, the Series 1998A bonds were fully paid.

On February 1, 2000, the Authority issued Series 2000A&B Revolving Fund Loan Bonds totaling \$14,130,000. The Series 2000A&B bonds include:

\$5,130,000 Series 2000A serial bond commencing August 15, 2000 and due August 15, 2015, which bear interest at rates ranging from 4.10% to 5.85%.

\$3,475,000 Series 2000A term bonds due August 15, 2021, which bear interest at 6.00%.

\$5,525,000 Series 2000B term bonds due August 15, 2021, which bear interest at 8.35%.

As of September 30, 2012, the Series 2000A & B bonds were fully paid.

On December 1, 2000, the Authority issued Series 2000C Revolving Fund Loan Bonds totaling \$25,895,000. The Series 2000C bonds include:

\$12,075,000 serial bonds commencing February 15, 2001 and due February 15, 2014, which bear interest at rates ranging from 4.30% to 5.50%.

\$5,615,000 term bonds due August 15, 2018, which bear interest at 5.75%.

\$8,205,000 term bonds due August 15, 2023, which bear interest at 5.38%.

As of September 30, 2012, the Series 2000C bonds were fully paid.

On January 1, 2002, the Authority issued Series 2002A Revolving Fund Loan Bonds totaling \$37,575,000. The Series 2002A Bonds include:

\$12,955,000 serial bonds commencing February 15, 2002, and due August 15, 2012, which bear interest at rates ranging from 3.00% to 4.75%.

\$3,245,000 term bonds due August 15, 2014, which bear interest at 5.07%.

\$3,620,000 term bonds due August 15, 2016, which bear interest at 5.22%.

\$4,050,000 term bonds due August 15, 2018, which bear interest at 5.32%.

\$7,050,000 term bonds due August 15, 2021, which bear interest at 5.40%.

\$6,655,000 term bonds due August 15, 2024, which bear interest at 5.46%.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 7 – LONG-TERM DEBT (Continued)

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

On December 1, 2003, the Authority issued Series 2003A Revolving Fund Loan Bonds totaling \$38,915,000. The Series 2003A Bonds include:

\$24,805,000 serial bonds commencing February 15, 2004, and due August 15, 2021, which bear interest at rates ranging from 2.00% to 4.50%.

\$7,465,000 term bonds due August 15, 2024, which bears interest at 4.73%.

\$6,645,000 term bonds due August 15, 2027, which bear interest at 4.82%.

On December 1, 2004, the Authority issued Series 2004A Revolving Fund Loan Bonds totaling \$24,880,000. The Series 2004A Bonds include:

\$17,035,000 serial bonds commencing February 15, 2008, and due August 15, 2028, which bear interest at rates ranging from 4.00% to 4.63%.

\$7,845,000 term bonds due August 15, 2026, which bear interest at 4.50%.

On October 1, 2005, the Authority issued Series 2005A Revolving Fund Loan Bonds totaling \$42,580,000. The Series 2005A Bonds include:

\$27,095,000 serial bonds commencing August 15, 2008, and due August 15, 2024, which bear interest at rates ranging from 4.00% to 5.25%.

\$15,485,000 term bonds due August 15, 2028, which bear interest at 4.00%.

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%.

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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 7 – LONG-TERM DEBT (Continued)

Summary of changes in long-term debt for 2012:

	Balance 10/1/11	Additions	Reductions	Balance 9/30/12
Revolving fund loan bonds	\$ 167,450,000	\$ 45,210,000	\$ 74,450,000	\$ 138,210,000
Add: Unamortized premium/ (discounts)	(636,807)	861,278	(282,867)	507,338
Less: Unamortized deferred refunding costs	-	2,046,205	103,219	1,942,986
Total	\$ 166,813,193	\$ 44,025,073	\$ 74,063,914	\$ 136,774,352

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

	Principal	Interest	Total
2013	\$ 6,350,000	\$ 5,384,030	\$ 11,734,030
2014	6,840,000	5,160,755	12,000,755
2015	7,350,000	4,914,055	12,264,055
2016	7,920,000	4,683,255	12,603,255
2017	8,515,000	4,349,080	12,864,080
2018-2022	47,545,000	16,396,143	63,941,143
2023-2027	47,400,000	7,083,603	54,483,603
2028	6,290,000	266,069	6,556,069
	138,210,000	\$ 48,236,990	\$ 186,446,990
Plus:			
Unamortized premium	507,338		
Less:			
Unamortized deferred refunding	1,942,986		
Current portion of long-term deb	6,350,000		
	\$ 130,424,352		

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 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, 2012, the unamortized deferred refunding costs totaled \$1,942,986 for the Series 1998A, 2000A & B, Series 2000C, and 2002A Bonds.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

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 obtained an arbitrage calculation during the year ended 2012. Per the calculation received there are no amounts due to or from the Internal Revenue Service 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%, 30%, 30%, and 5.55% of total grant funds provided by the 2009-ARRA grant, 2010 grant, 2011 grant, and the 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 \$4,567,474, leaving a remaining balance of \$3,256,666 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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

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 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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

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 SEHIP:

Annual required contribution (ARC)	\$	82,415
Interest on net OPEB obligation		7,810
Adjustment to ARC		(5,575)
<hr/>		
Annual OPEB cost		84,650
Contributions made		(32,727)
<hr/>		
Increase in net OPEB obligation		51,923
Net OPEB obligation, beginning of year		156,201
<hr/>		
Net OPEB obligation, end of year	\$	208,124

Percentage of annual OPEB cost contributed: 39%

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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

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

Actuarial Assumptions for Retired State Employees' Health Care Trust:

Actuarial Valuation Date	Investment Rate of Return	Medical Cost Medicare Eligible	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

SUPPLEMENTARY INFORMATION

**Alabama Drinking Water Finance Authority
 Schedule of Expenditures of Federal Awards
 September 30, 2012**

Federal Grantor/Pass Through Grantor/Program Title	CFDA Number	Grantor's Number	Federal Expenditures
Environment Protection Agency			
Passed through the Alabama Department of Environmental Management			
Capitalization grants for state revolving funds	66.468	FS984472-09	\$ 17,033
Capitalization grants for state revolving funds	66.468	FS984472-10	8,937,578
Capitalization grants for state revolving funds	66.468	FS984472-11	5,037,799
ARRA - Capitalization grants for state revolving funds	66.468	2F954280-09	1,139,849
Total Environmental Protection Agency			15,132,259
Total federal financial assistance			\$ 15,132,259

**Alabama Drinking Water Finance Authority
Notes To Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2012**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies and presentation of the Single Audit Report of the Alabama Drinking Water Finance 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

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 the accompanying 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, 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

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 Drinking Water Finance Authority
Montgomery, Alabama

Compliance

We have audited Alabama Drinking Water Finance 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 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

**Alabama Drinking Water Finance Authority
Schedule of Findings and Questioned Costs
For The Year Ended September 30, 2012**

SECTION I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified yes no
- Reportable condition(s) 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
- Reportable condition(s) identified that are not considered to be material weakness(es)? yes 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 no

Identification of major programs:

CFDA Numbers

Name of Federal Program or Cluster

66.468 Capitalization Grants for Drinking Water State Revolving Funds

Dollar threshold used to distinguish between type A and type B programs? \$ 453,968

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.