

**Alabama Drinking Water
Finance Authority**

Component Unit Financial Statements

For The Year Ended September 30, 2013

Alabama Drinking Water Finance Authority
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September 30, 2013

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INDEPENDENT AUDITORS' REPORT

Authority 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, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the major funds of the Authority, as of September 30, 2013, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, for the year ended September 30, 2013, the Authority adopted new accounting guidance to change its method of presentation and disclosure of bond issuance costs in accordance with Governmental Accounting Standards Authority Statement No. 65. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 7, 2014 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

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

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

Certified Public Accountants

February 7, 2014

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, 2013. For more detailed information, please refer to the financial statements including the Notes to the Financial Statements.

Overview of the Financial Statements

The Authority operates as a Proprietary Fund and presents the following basic financial statements: Statement of Net Position, Statement of Activity, Statement of Net Position - Proprietary Fund, Statement of Revenues, Expenses, and Changes in Net Position - 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 Position - Proprietary Fund – Includes all assets, liabilities, and deferred outflows of the Authority and provides a snapshot of the financial position of the Authority at the end of the fiscal year. Assets plus deferred outflows less liabilities results in net position that are restricted and used in assuring the perpetuation of the Authority. Net Position is comprised primarily of loans receivable that are not obligated to a bond issue, and cash or short term investments pledged to loans that are in the process of closing.

Statement of Changes in Net Position – Proprietary Fund – Reports all additions and deductions 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 position for the fiscal year. The change in restricted net position plus the beginning restricted net position results in the restricted net position available for the perpetuation of the Authority.

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

COMPARATIVE SUMMARY STATEMENTS

Statement of Net Position

<i>September 30,</i>	2013	2012 (Restated)	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	\$ 30,968,557	\$ 62,440,217	\$ (31,471,660)	(50%)
Receivables	244,841,316	240,578,519	4,262,797	2%
Investments	76,641,525	33,793,692	42,847,833	127%
Unamortized items	4,573,747	3,740,348	833,399	22%
Capital assets	405	1,377	(972)	(71%)
Total assets	357,025,550	340,554,153	16,471,397	5%

Deferred Outflows of Resources

Deferred charge on refunding	\$ 1,779,362	\$ 1,942,986	\$ (163,624)	(8%)
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Liabilities

Accrued liabilities	2,123,344	1,984,469	138,875	7%
Payable to municipalities	33,195,209	27,090,107	6,105,102	23%
Bonds payable, net	132,251,927	138,717,338	(6,465,411)	(5%)

Total liabilities	167,570,480	167,791,914	(221,434)	(.13%)
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Net position, restricted	\$191,234,432	\$174,705,225	\$ 16,529,207	9%
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<i>For the year ended September 30,</i>	2013	2012 (Restated)	Variance	% increase (decrease)
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Statement of Activities

Operating revenue	\$ 11,756,482	\$ 12,244,211	\$ (487,729)	(4%)
Operating expense	8,684,580	12,188,754	(3,504,174)	(29%)

Operating income	3,071,902	55,457	3,016,445	5439%
Non-operating revenue	13,457,305	10,117,281	3,340,024	33%

Change in net position	\$ 16,529,207	\$ 10,172,738	\$ 6,356,469	62%
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Statement of Cash Flows

Net cash provided by operating activities	\$ 5,248,346	\$ 1,366,887	\$ 3,881,459	284%
Net cash provided by (used in) non-capital and related financing activities	(36,720,006)	3,132,038	(39,852,044)	(1,272%)

Net increase (decrease) in cash and cash equivalents	\$(31,471,660)	\$ 4,498,292	\$(35,970,585)	(800%)
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Financial Highlights

- The Authority closed 17 new loans totaling \$20,855,000.
- Cash and cash equivalents and investments changed drastically due to money from money market accounts held at Regions Bank being used to purchase Treasury Bonds and Certificate of Deposits totaling \$33,236,602.
- Net position increased \$16,529,207 mainly due to the utilization of \$14,767,446 in federal funds transferred to loan recipients.

Alabama Drinking Water Finance Authority
Statement of Net Position
September 30, 2013

	Business-type Activities
Assets	
Current assets:	
Cash and cash equivalents - restricted	\$ 30,968,557
Accrued interest receivable on investments - restricted	179,692
Accrued interest receivable on loans receivable	908,861
Current portion of loans receivable	14,740,000
Grants and other receivables	397,144
Total current assets	47,194,254
Noncurrent assets:	
Investments - restricted	76,641,525
Loans receivable less unamortized premium of \$4,249,381	228,615,619
Principal forgiveness	4,121,377
Unamortized bond insurance	452,370
Capital assets, net	405
Total noncurrent assets	309,831,296
Total assets	357,025,550
Deferred Outflows of Resources	
Deferred charge on refunding	1,779,362
Liabilities	
Current liabilities:	
Accounts payable	16,392
Current portion of revolving loan bonds	6,840,000
Accrued interest payable	645,094
Due to Water Pollution Control Authority (WPCA)	73,859
Due to Alabama Department of Environmental Management (ADEM)	1,118,899
Total current liabilities	8,694,244
Long-term liabilities:	
Other post employment benefit obligation	269,100
Payables to municipalities	33,195,209
Revolving loan bonds payable	125,411,927
Total long-term liabilities	158,876,236
Total liabilities	167,570,480
Net Position	
Net investment in capital assets	405
Restricted for loans and debt service	191,234,027
Total net position	\$ 191,234,432

See accompanying notes to the financial statements.

Alabama Drinking Water Finance Authority
Statement of Activities
For the Year Ended September 30, 2013

Functions/Programs	Expenses	Program Revenues		Net (Expense)
		Charges for Services	Operating Grants and Contributions	Revenue and Changes in Net Position
				Business-type Activities
Business-type Activities:				
Drinking water loans	\$ 11,034,869	\$ 1,629,765	\$ 16,757,258	\$ 7,352,154
General Revenues				
Investment earnings				8,547,053
Transfers				630,000
Total general revenues and transfers				9,177,053
Change in net position				16,529,207
Net Position - Beginning, as originally stated				176,743,700
Prior Period Adjustment				(2,038,475)
Net Position - Beginning, as restated				174,705,225
Net Position - Ending				\$ 191,234,432

See accompanying notes to the financial statements.

Alabama Drinking Water Finance Authority
Statement of Net Position
Proprietary Fund
September 30, 2013

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Assets			
Current assets:			
Cash and cash equivalents - restricted	\$ 25,893,928	\$ 5,074,629	\$ 30,968,557
Accrued interest receivable on investments - restricted	179,692	-	179,692
Accrued interest receivable on loans receivable	908,861	-	908,861
Current portion of loans receivable	14,740,000	-	14,740,000
Grants and other receivables	397,144	-	397,144
Total current assets	42,119,625	5,074,629	47,194,254
Noncurrent assets:			
Investments - restricted	76,641,525	-	76,641,525
Loans receivable less unamortized premium of \$4,249,381	228,615,619	-	228,615,619
Principal forgiveness	4,121,377	-	4,121,377
Unamortized bond insurance	452,370	-	452,370
Capital assets, net	-	405	405
Total noncurrent assets	309,830,891	405	309,831,296
Total assets	351,950,516	5,075,034	357,025,550
Deferred Outflows of Resources			
Deferred charge on refunding	1,779,362	-	1,779,362
Liabilities			
Current liabilities:			
Accounts Payable	-	16,392	16,392
Current portion of revolving loan bonds	6,840,000	-	6,840,000
Accrued interest payable	645,094	-	645,094
Due to Water Pollution Control Authority	73,859	-	73,859
Due to ADEM	-	1,118,899	1,118,899
Total current liabilities	7,558,953	1,135,291	8,694,244
Long-term liabilities:			
Other post employment benefit obligation	-	269,100	269,100
Payables to municipalities	33,195,209	-	33,195,209
Revolving loan bonds payable	125,411,927	-	125,411,927
Total long-term liabilities	158,607,136	269,100	158,876,236
Total liabilities	166,166,089	1,404,391	167,570,480
Net Position			
Net investment in capital assets	-	405	405
Restricted for loans and debt service	187,563,789	3,670,238	191,234,027
Total net position	\$ 187,563,789	\$ 3,670,643	\$ 191,234,432

See accompanying notes to the financial statements.

Alabama Drinking Water Finance Authority
Statement of Revenues, Expenses, and Changes in Net Position
Proprietary Fund
For the Year Ended September 30, 2013

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Operating Revenues			
Investment earnings	\$ 1,848,025	\$ 50,995	\$ 1,899,020
Interest from loan receivable	8,227,697	-	8,227,697
Administrative fees	-	1,629,765	1,629,765
Total operating revenues	10,075,722	1,680,760	11,756,482
Operating Expenses			
Administration expense	1,956,849	-	1,956,849
Bond interest expense	5,356,121	-	5,356,121
Bond insurance amortization	79,525	-	79,525
Depreciation	-	972	972
Employee benefits	-	275,552	275,552
Office expense	-	111,238	111,238
Other expenses	-	225,436	225,436
Salaries	-	678,887	678,887
Total operating expenses	7,392,495	1,292,085	8,684,580
Operating income	2,683,227	388,675	3,071,902
Nonoperating Revenues (Expenses)			
Federal grant revenue	14,767,446	-	14,767,446
Principal forgiveness expense	(2,350,289)	-	(2,350,289)
State revenue	1,989,812	-	1,989,812
Net decrease in the fair value of investments	(1,579,664)	-	(1,579,664)
Total nonoperating revenues	12,827,305	-	12,827,305
Income Before Transfers	15,510,532	388,675	15,899,207
Transfers in	630,000	-	630,000
Change in net position	16,140,532	388,675	16,529,207
Net Position - Beginning, as originally stated	173,461,732	3,281,968	176,743,700
Prior period Adjustments	(2,038,475)	-	(2,038,475)
Net Position - Beginning, as restated	171,423,257	3,281,968	174,705,225
Net Position - Ending	\$ 187,563,789	\$ 3,670,643	\$ 191,234,432

See accompanying notes to the financial statements.

Alabama Drinking Water Finance Authority
Statement of Cash Flows
Proprietary Fund
For the Year Ended September 30, 2013

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Cash Flows from Operating Activities:			
Interest and dividends received on investments	\$ 1,784,915	\$ 50,995	\$ 1,835,910
Interest paid on revolving loan bonds	(5,384,031)	-	(5,384,031)
Receipts of payments from municipalities	15,253,786	-	15,253,786
Payments to employees and vendors	-	(120,588)	(120,588)
Interest received on loans receivable	7,592,850	-	7,592,850
Administration fees	(1,956,849)	1,629,765	(327,084)
Payments to municipalities	(12,524,898)	-	(12,524,898)
Payments (to) from ADEM	-	(1,077,599)	(1,077,599)
Net cash provided by operating activities	4,765,773	482,573	5,248,346
Cash Flows from Non-capital and Related Financing Activities:			
Grant revenue received	14,652,679	-	14,652,679
Principal forgiveness expense	(3,215,000)	-	(3,215,000)
State revenue	1,989,812	-	1,989,812
Net purchases of investment securities	(44,427,497)	-	(44,427,497)
Principal paid on revolving loan bonds	(6,350,000)	-	(6,350,000)
Transfers in	630,000	-	630,000
Net cash used in non-capital and related financing activities	(36,720,006)	-	(36,720,006)
Net increase (decrease) in cash and cash equivalents	(31,954,233)	482,573	(31,471,660)
Cash and Cash Equivalents - restricted, beginning of year	57,848,161	4,592,056	62,440,217
Cash and Cash Equivalents - restricted, end of year	\$ 25,893,928	\$ 5,074,629	\$ 30,968,557

-continued-

See accompanying notes to the financial statements.

**Alabama Drinking Water Finance Authority
Statement of Cash Flows (Continued)
Proprietary Fund
For the Year Ended September 30, 2013**

	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	\$ 2,683,227	\$ 388,675	\$ 3,071,902
Bond insurance amortization	79,525	-	79,525
Loan premium amortization	(693,059)	-	(693,059)
Depreciation	-	972	972
(Increase) decrease in operating assets:			
Due from WPCA	(60,073)	-	(60,073)
Accrued interest receivable on investments - restricted	(63,110)	-	(63,110)
Accrued interest receivable on loans receivable	(11,788)	-	(11,788)
Loans receivable and other receivables	(3,320,000)	-	(3,320,000)
Increase (decrease) in operating liabilities:			
Accounts payable	-	(9,350)	(9,350)
Accrued interest payable	(27,910)	-	(27,910)
Payables to municipalities	6,105,102	-	6,105,102
Due to ADEM	-	41,300	41,300
Due to WPCA	73,859	-	73,859
Other post employment benefit obligation	-	60,976	60,976
Net cash provided by operating activities	\$ 4,765,773	\$ 482,573	\$ 5,248,346

See accompanying notes to the financial statements.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Alabama Drinking Water Finance Authority (the "Authority") have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Authority ("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 Accounting

The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. In accordance with Governmental Accounting Standards Authority (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 Authority (FASB) pronouncements and Accounting Principles Authority Opinions, issued on or before and subsequent to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Deferred outflows/inflows of resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/ expenditure) until then. The Authority has one item that qualifies for reporting in this category, the deferred charge on refunding reported in the statement of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Budget Information

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

Cash and Cash Equivalents

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

Investments

Investments are reported at fair value. 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

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

Loans Receivable, Payables to Municipalities and Loan Premium

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

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Restricted Assets

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

Capital Assets

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

Unamortized Bond Insurance

Unamortized debt expense related to bond insurance is amortized by using the outstanding principal method over the life of the related debt and is reported as unamortized bond insurance on the Statement of Net Position. Other bond issuance costs are expensed as incurred.

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.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Grant Revenue

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

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

Interfund Transfers

The Authority has the ability to transfer and receive funds from the Clean Water State Revolving Fund and ADEM. There were funds transferred in during FY 2013 from ADEM in the amount of \$630,000.

Concentration of Credit Risk

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

Net Position

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

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

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)

Recently Issued Accounting Pronouncements

The GASB has issued the following statements:

- Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement improves financial reporting by codifying all sources of GAAP for state and local governments so that they derive from a single source. The Authority has elected to include all pre-November 30, 1989 FASB pronouncements which are now codified in GASB Statement No. 62, as mentioned in the *Basis of Accounting* section above. As such, disclosures of FASB or AICPA pronouncements applied to these and future financial statements are no longer required.
- Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides guidance for certain items formerly classified as assets and liabilities. GASB Concepts Statement 4 redefines these as “deferred outflows of resources” (formerly assets) and “deferred inflows of resources” (formerly liabilities). Each new category must have its own section on the Statement of Net Position. This statement also requires that the last line of the statements formerly titled “Net assets” now be titled “Net position” to reflect the new classifications. In addition, “Capital assets, net of related debt” should now be titled “Net investment in capital assets” in order to properly present the total of the items. Other than the new titles and presentation, this statement only addresses upfront payments of service concession arrangements and the deferral of annual changes in the fair value of derivatives as items to be reclassified as either a deferred outflow or deferred inflow.
- Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement provides more guidance for the items in GASB Statement No. 63. It requires the avoidance of the word “deferred” throughout financial statements, except as it relates to items that are designated as deferred outflows or deferred inflows. It addresses the calculation of a deferred outflow or inflow for refunding of debt. For nonexchange transactions such as grants, amounts received before the time period of eligibility are treated as deferred inflows. This statement also addresses taxes received prior to the period to which they relate. It requires issuance costs related to debt to be expensed in the period that the debt was issued versus amortizing over the life of the debt, as previously allowed. The effects of implementation of this statement are to be disclosed on the financial statements in the period of adoption. Losses on debt refundings are not expensed, but rather, are treated as deferred outflows. For operating leases, any initial direct costs are recognized in the period incurred instead of being amortized over the life of the lease which was effective for periods beginning after December 15, 2012. The Authority chose to early implement GASB Statement No. 65 for the year ended September 30, 2013. It required debt issuance costs to be recognized as an expense in the period incurred. Further, to retroactively apply the provisions, it required a restatement of beginning net position to expense bond issuance costs previously capitalized by the Authority.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 2 – CASH AND INVESTMENTS

Deposits

As of September 30, 2013, 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.

As of September 30, 2013, 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	\$ 7,358,768	\$ 1,808,198	\$ 1,707,871	\$ 3,842,699
Guaranteed investment contracts	16,258,519	-	-	16,258,519
U.S. Treasury SLGs	5,275,695	504,960	224,205	4,546,530
U.S. Treasury bonds/notes	43,542,083	31,005,415	8,023,998	4,512,670
Certificate of Deposits	4,206,460	3,716,697	489,763	-
Total investments	76,641,525	\$ 37,035,270	\$ 10,445,837	\$ 29,160,418
Cash Equivalents:				
Money Market Funds	30,968,557	N/A	N/A	N/A
Total cash equivalents	30,968,557	\$ -	\$ -	\$ -
Total holdings	\$ 107,610,082			

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 2 – CASH AND INVESTMENTS (Continued)

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 \$72,435,065 held in trust by either the Bank of New York, U.S. Bank, or Regions Bank in a fiduciary capacity.

These securities are bond reserve funds and are held under a trust agreement between the Authority and the trustee bank for the benefit of the bondholder and are not deemed to have 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, 2013, 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	Percentage of Total Holdings
Citigroup	Guaranteed Investment Contracts	\$ 5,375,871	5.00%

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, 2013 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, 2013:

Moody's Ratings	Fair Value	Fair Value as a Percent of Total Holdings Value
Exempt from disclosure	\$ 60,383,006	56.11%
AAA	30,968,557	28.78%
Not rated	16,258,519	15.11%
	<u>\$ 107,610,082</u>	<u>100.00%</u>

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 2 – CASH AND INVESTMENTS (Continued)

Investment holdings that are exempt from disclosure consist of U.S. Treasury strips, slugs, bonds, notes and certificate of deposits held by financial institutions. 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, 2013.

NOTE 3 – LOANS RECEIVABLE

Loans receivable at September 30, 2013, as discussed below, are as follows:

Completed projects	\$	188,135,000
Projects in progress		59,470,000
		<u>247,605,000</u>
Less:		
Current portion loans receivable		14,740,000
Unamortized premium		4,249,381
		<u>18,989,381</u>
Loans receivable, net	\$	<u>228,615,619</u>

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

2014	\$	14,740,000
2015		15,595,000
2016		16,335,000
2017		17,060,000
2018 and thereafter		183,875,000
	\$	<u>247,605,000</u>

As of September 30, 2013, the Authority's ten largest outstanding loans, in the aggregate, exceeded \$115 million. The outstanding balances of these loans represent approximately 47% of the total loans receivable, as follows:

<u>Loan Recipient</u>	<u>Balance</u>
Shelby County South Water Treatment Plant (Supplemental)	\$ 24,040,000
Shelby County South Water Treatment Plant	19,980,000
Warrior River Phase 1 Improvements	16,005,000
Shelby County South Water Treatment Plant	13,285,000
Albertville Water Treatment & Distribution Improvements	11,335,000
Madison Water System Improvements	7,140,000
West Morgan - East Lawrence Drinking Water Infrastructure Improvements	6,255,000
Harvest-Monrovia Water Improvements	5,945,000
Birmingham Water Line Improvements and Solar Bee Installation	5,780,000
Tuscaloosa Water System Improvements	5,525,000
	<u>\$ 115,290,000</u>

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 4 – CAPITAL ASSETS, NET

Capital assets, net consist of the following depreciable assets at September 30, 2013:

	Balance 10/1/2012	Additions	Deletions	Balance 9/30/2013
Data processing equipment	\$ 269,063	\$ -	\$ -	\$ 269,063
Scientific and technical equipment	188,389	-	-	188,389
	457,452	-	-	457,452
Less: Accumulated depreciation	456,075	972	-	457,047
Total capital assets, net	\$ 1,377	\$ (972)	\$ -	\$ 405

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, 2013, the EPA awarded ADEM capitalization funds under its annual grant agreements in the amount of \$10,438,000. During the year ended September 30, 2013, 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, 2013, the Authority had yet to receive any state matching funds.

The amount of unused federal capitalization grants was approximately \$13,748,949 at September 30, 2013. The Authority will apply for a federal capitalization grant in 2014. Any grants in 2014 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, 2013:

Year	Grant Amount	Draws prior to 2013	2013 Draws	Total Draws	Amount Available for Future Draws
2010	\$ 16,823,000	\$ 16,183,420	\$ 285,776	\$ 16,469,196	\$ 353,804
2011	11,674,000	5,037,799	6,455,118	11,492,917	181,083
2012	11,125,000	-	8,348,938	8,348,938	2,776,062
2013	10,438,000	-	-	-	10,438,000
	\$ 50,060,000	\$ 21,221,219	\$ 15,089,832	\$ 36,311,051	\$ 13,748,949
Less:					
	Administrative and set-aside expenses		(322,386)		
Total 2013 Draws			\$ 14,767,446		

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 6 – PAYABLES TO MUNICIPALITIES

As of September 30, 2013, the authority had \$33,195,209 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 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 2013:

	Balance 10/1/12	Additions	Reductions	Balance 9/30/13
Revolving fund loan bonds	\$ 138,210,000	\$ -	\$ (6,350,000)	\$ 131,860,000
Add: Unamortized premium/ (discounts)	507,338	-	(115,411)	391,927
Less: Unamortized deferred refunding costs	1,942,986	-	163,624	1,779,362
Total	\$ 136,774,352	\$ -	\$ (6,301,787)	\$ 130,472,565

Long-term debt at September 30, 2013 is payable as follows:

	Principal	Interest	Total
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	9,190,000	3,990,330	13,180,330
2019-2023	46,630,000	14,574,884	61,204,884
2024-2028	45,415,000	5,180,600	50,595,600
	131,860,000	\$ 42,852,959	\$174,712,959
Plus: Unamortized premium	391,927		
Less: Current portion	6,840,000		
Total long-term debt	\$ 125,411,927		

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, 2013, the unamortized deferred refunding costs totaled \$1,779,362 for the Series 1998A, 2000A & B, Series 2000C, and 2002A 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 obtained an arbitrage calculation during the year ended 2013. Per the calculation received there are no amounts due to or from the Internal Revenue Service at September 30, 2013.

Alabama Drinking Water Finance Authority

Notes To Financial Statements

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

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

This amount was set at a minimum of 50%, 30%, 30%, 5.55% and 20% of total grant funds provided by the 2009-ARRA grant, 2010 grant, 2011 grant, 2012 grant and the 2013 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, 2013 totaled \$2,350,289, leaving a remaining balance of \$4,121,377 capitalized as principal forgiveness on the statement of net position as of September 30, 2013.

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 Authority 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 Authority 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, 2013. A copy may be obtained by writing to:

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

State Employees' Insurance Authority
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 2013. The Medicare Part D retiree drug subsidy for fiscal year 2013 was \$8,794,713.

1. Annual OPEB Cost and Net OPEB Obligation - Government Accounting Standards Authority 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:

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

Annual required contribution (ARC)	\$	82,021
Interest on net OPEB obligation		11,019
Adjustment to ARC		(7,866)
<hr/>		
Annual OPEB cost		85,174
Contributions made		(36,459)
<hr/>		
Increase in net OPEB obligation		48,715
Net OPEB obligation, beginning of year		220,385
<hr/>		
Net OPEB obligation, end of year	\$	269,100

Percentage of annual OPEB cost contributed: 43%

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
9/30/2010*	\$ 97,485	\$ 4,162,276	\$4,064,792	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%
9/30/2012	126,670	3,215,956	3,089,286	3.9%	1,385,013	223.1%

* 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

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 11 – OTHER POST EMPLOYMENT BENEFIT OBLIGATIONS (Continued)

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 2013 are as follows:

Actuarial Methods for Retired State Employees' Health Care Trust:

Valuation Date:	September 30, 2012
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*
9/30/2010	5%	8.5%	10.5%	5%	2017
9/30/2011	5%	7.5%	9.5%	5%	2017
9/30/2012	5%	7.0%	8.5%	5%	2017

*Includes inflation at 3.00%.

The assumed investment rate of return reflects the fact that as of September 30, 2012 the Plan has \$126,670,288 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
2011	\$ 119,391	\$	217,936	55%	\$	526,310	
2012	110,271		285,221	39%		701,260	
2013	115,931		270,830	43%		855,662	

Alabama Drinking Water Finance Authority

Notes To Financial Statements

NOTE 12 – PRIOR PERIOD ADJUSTMENTS

As discussed in Note 1, the implementation of GASB Statement No. 65 required that debt issuance costs, with the exception of prepaid insurance costs, be recognized as an expense in the period incurred. The cumulative effect of applying this statement retroactively was a decrease in net position in the amount of \$2,038,475.

NOTE 13 – SUBSEQUENT EVENTS

The Authority has evaluated subsequent events through February 7, 2014, the date the financial statements were available to be issued, and there were none to disclose.

SUPPLEMENTARY INFORMATION

**Alabama Drinking Water Finance Authority
Schedule of Expenditures of Federal Awards
September 30, 2013**

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	FS984472-10	\$ 125,000
Capitalization grants for state revolving funds	66.468	FS984472-11	6,293,508
Capitalization grants for state revolving funds	66.468	FS984472-12	8,348,938
Total Environmental Protection Agency			14,767,446
Total federal financial assistance			\$ 14,767,446

Alabama Drinking Water Finance Authority

Notes To Schedule of Expenditures of Federal Awards

For the Year Ended September 30, 2013

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 February 7, 2014, 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**

Authority of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities and the major funds of the Alabama Drinking Water Finance Authority (the "Authority"), as of and for the year ended September 30, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated February 7, 2014.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct

material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

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

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

Certified Public Accountants

February 7, 2014

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY OMB CIRCULAR A-133**

Authority of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

Report on Compliance for Each Major Federal Program

We have audited Alabama Drinking Water Finance Authority's (the "Authority") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the Authority's major federal program for the year ended September 30, 2013. The Authority's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the Authority's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and 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 the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

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

Opinion on Each Major Federal Program

In our opinion, the Authority, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2013.

Report on Internal Control Over Compliance

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Authority's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with 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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

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

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

Certified Public Accountants

February 7, 2014

**Alabama Drinking Water Finance Authority
Schedule of Findings and Questioned Costs
For The Year Ended September 30, 2013**

SECTION I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unmodified

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: Unmodified

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? \$ 443,023

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.