

**Alabama Drinking Water
Finance Authority**

COMPONENT UNIT FINANCIAL STATEMENTS

For the Year Ended September 30, 2019



CRI CARR
RIGGS &
INGRAM

CPAs and Advisors

CRIcpa.com

Alabama Drinking Water Finance Authority
Table of Contents
September 30, 2019

REPORT	
Independent Auditors' Report	1
FINANCIAL STATEMENTS	
Management's Discussion and Analysis (MD& A)	4
AUTHORITY-WIDE FINANCIAL STATEMENTS	
Statement of Net Position	8
Statement of Activities	9
FUND-FINANCIAL STATEMENTS	
Statement of Net Position – Proprietary Funds	10
Statement of Revenues, Expenses and Changes in Net Position – Proprietary Funds	11
Statement of Cash Flows – Proprietary Funds	12
Notes to Financial Statements	14
SUPPLEMENTAL INFORMATION	
Schedule of Expenditures of Federal Awards	28
Notes to Schedule of Expenditures of Federal Awards	29
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 <i>Government Auditing Standards</i>	32
Independent Auditors' Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance	34
Schedule of Findings and Questioned Costs	36
Summary Schedule of Prior Audit Findings	37
MANAGEMENT LETTER	38



Carr, Riggs & Ingram, LLC
1117 Boll Weevil Circle
Enterprise, AL 36330

Mailing Address:
P.O. Box 311070
Enterprise, AL 36331

(334) 347-0088
(334) 347-7650 (fax)
www.cricpa.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

We have audited the accompanying financial statements of the business-type activities and the major funds of the Alabama Drinking Water Finance Authority (the "Authority"), a component unit of the State of Alabama, as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority'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 Authority's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the major funds of the Authority, as of September 30, 2019, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Information

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 30, 2019 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 solely 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 effectiveness of the Authority's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

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

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

Enterprise, Alabama

December 30, 2019

The Alabama Drinking Water Finance Authority (the Authority) was established in 1997 to provide a self-perpetuating source of low interest loans for the construction of public water treatment and distribution facilities needed to meet the public health goals of the Safe Drinking Water Act. The Authority is operated by the Alabama Department of Environmental Management who serves as agent for the Authority. The following discussion provides an overview of the financial position and results of operation for the Authority as of September 30, 2019. For more detailed information, please refer to the financial statements including the Notes to the Financial Statements.

Overview of the Financial Statements

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

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

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

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

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

Management's Discussion and Analysis

COMPARATIVE SUMMARY STATEMENTS

Statement of Net Position

<i>September 30,</i>	2019	2018	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	\$ 16,073,015	\$ 14,451,791	\$ 1,621,224	11%
Receivables	243,953,856	202,951,360	41,002,496	20%
Investments	135,937,783	123,912,810	12,024,973	10%
Unamortized items	5,427,912	5,609,037	(181,125)	-3%
Capital assets	6,292	6,274	18	0%
Total assets	401,398,858	346,931,272	54,467,586	16%
Deferred Outflows of Resources				
Deferred charge on refunding	996,676	1,185,450	(188,774)	-16%
Liabilities				
Accrued liabilities	186,903	167,661	19,242	11%
Payable to municipalities	76,601,531	41,872,499	34,729,032	83%
Bonds payable, net	35,139,874	42,302,455	(7,162,581)	-17%
Total liabilities	111,928,308	84,342,615	27,585,693	33%
Net position, restricted	\$ 290,467,226	\$ 263,774,107	\$ 26,693,119	10%

Statement of Activities

<i>For the year ended September 30,</i>	2019	2018	Variance	% increase (decrease)
Operating revenue	\$ 10,109,416	\$ 9,702,929	\$ 406,487	4%
Operating expense	3,127,183	3,048,216	78,967	3%
Operating income	6,982,233	6,654,713	327,520	5%
Non-operating revenue	19,710,886	6,337,556	13,373,330	211.0%
Change in net position	\$ 26,693,119	\$ 12,992,269	\$ 13,700,850	105%

Management's Discussion and Analysis

Statement of Cash Flows

<i>For the year ended September 30,</i>	2019	2018	Variance	% increase (decrease)
Net cash provided by (used in) operating activities	\$ (727,650)	\$ 4,638,576	\$ (5,366,226)	-116%
Net cash provided by (used in) non-capital and related financing activities	2,352,354	(8,525,907)	10,878,261	128%
Net cash used in capital and related financing activities	(3,480)	(8,066)	4,586	57%
Net increase (decrease) in cash and cash equivalents	\$ 1,621,224	\$ (3,895,397)	\$ 5,516,621	142%

Financial Highlights

- The Authority closed 18 new loans totaling \$67,071,000.
- Net position increased \$26,693,119 mainly due to the utilization of \$21,988,069 in federal funds transferred to loan recipients and an additional \$1,034,481 in federal funds used to pay set-aside loan fee fund expenses.

Statement of Net Position

<i>September 30,</i>	2018	2017	Variance	% increase (decrease)
Assets				
Cash and cash equivalents	\$ 14,451,791	\$ 18,347,188	\$ (3,895,397)	-21%
Receivables	202,951,360	182,388,475	20,562,885	11%
Investments	123,912,810	117,104,372	6,808,438	6%
Unamortized items	5,609,037	3,794,612	1,814,425	48%
Capital assets	6,274	-	6,274	100%
Total assets	346,931,272	321,634,647	25,296,625	8%
Deferred Outflows of Resources				
Deferred charge on refunding	1,185,450	1,374,225	(188,775)	-14%
Liabilities				
Accrued liabilities	167,661	278,981	(111,320)	-40%
Payable to municipalities	41,872,499	22,643,706	19,228,793	85%
Bonds payable, net	42,302,455	49,304,347	(7,001,892)	-14%
Total liabilities	84,342,615	72,227,034	12,115,581	17%
Net position, restricted	\$ 263,774,107	\$ 250,781,838	\$ 12,992,269	5%

Management's Discussion and Analysis

Statement of Activities

<i>For the year ended September 30,</i>	2018	2017	Variance	% increase (decrease)
Operating revenue	\$ 9,702,929	\$ 7,848,906	\$ 1,854,023	24%
Operating expense	3,048,216	3,156,869	(108,653)	-3%
Operating income	6,654,713	4,692,037	1,962,676	42%
Non-operating revenue	6,337,556	11,408,592	(5,071,036)	-44%
Intergovernmental transfers in	-	600,000	(600,000)	100%
Change in net position	\$ 12,992,269	\$ 16,700,629	\$ (3,708,360)	-22%

Statement of Cash Flows

<i>For the year ended September 30,</i>	2018	2017	Variance	% increase (decrease)
Net cash provided by (used in) operating activities	\$ 4,638,576	\$ (2,077,251)	\$ 6,715,827	-323%
Net cash provided by (used in) non-capital and related financing activities	(8,525,907)	11,939,768	(20,465,675)	171%
Net cash used in capital and related financing activities	(8,066)	-	(8,066)	-100%
Net increase (decrease) in cash and cash equivalents	\$ (3,895,397)	\$ 9,862,517	\$ (13,757,914)	139%

Financial Highlights

- The Authority closed 15 new loans totaling \$41,813,000.
- Net position increased \$12,992,269 mainly due to the utilization of \$11,466,997 in federal funds transferred to loan recipients.

Alabama Drinking Water Finance Authority
Statement of Net Position
September 30, 2019

	Business-type Activities
Assets	
Current assets:	
Cash and cash equivalents - restricted	\$ 16,073,015
Accrued interest receivable on investments - restricted	348,712
Accrued interest receivable on loans receivable	643,989
Current portion of loans receivable	18,155,000
Grants and other receivables	409,874
Total current assets	35,630,590
Noncurrent assets:	
Investments - restricted	135,937,783
Loans receivable, less unamortized premium of \$3,533,719	224,396,281
Principal forgiveness	5,427,912
Capital assets, net	6,292
Total noncurrent assets	365,768,268
Total assets	401,398,858
Deferred Outflows of Resources	
Deferred charge on refunding	996,676
Liabilities	
Current liabilities:	
Accounts payable	33,173
Current portion of revolving loan bonds	5,775,000
Accrued interest payable	125,592
Other payables	28,138
Total current liabilities	5,961,903
Long-term liabilities:	
Payables to municipalities	76,601,531
Revolving loan bonds payable	29,364,874
Total long-term liabilities	105,966,405
Total liabilities	111,928,308
Net Position	
Net investment in capital assets	6,292
Restricted for loans and debt service	290,460,934
Total net position	\$ 290,467,226

The accompanying "Notes to Financial Statements" form an integral part of this statement.

Alabama Drinking Water Finance Authority
Statement of Activities
For the Year Ended September 30, 2019

Functions/Programs	Expenses	Program Revenues		Net Revenue (Expense) and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	Business-type Activities
Business-type Activities:				
Drinking water loans	\$ 7,948,427	\$ 1,604,359	\$ 23,161,358	\$ 16,817,290
General Revenues				
Investment earnings				9,875,829
Change in net position				26,693,119
Net Position - Beginning				263,774,107
Net Position - Ending				\$ 290,467,226

The accompanying "Notes to Financial Statements" form an integral part of this statement.

Alabama Drinking Water Finance Authority
Statement of Net Position
Proprietary Funds
For the Year Ended September 30, 2019

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Assets			
Current assets:			
Cash and cash equivalents - restricted	\$ 11,299,661	\$ 4,773,354	\$ 16,073,015
Accrued interest receivable on investments - restricted	348,712	-	348,712
Accrued interest receivable on loans receivable	643,989	-	643,989
Current portion of loans receivable	18,155,000	-	18,155,000
Grants and other receivables	108,179	301,695	409,874
Total current assets	30,555,541	5,075,049	35,630,590
Noncurrent assets:			
Investments - restricted	135,937,783	-	135,937,783
Loans receivable, less unamortized premium of \$3,533,719	224,396,281	-	224,396,281
Principal forgiveness	5,427,912	-	5,427,912
Capital assets, net	-	6,292	6,292
Total noncurrent assets	365,761,976	6,292	365,768,268
Total assets	396,317,517	5,081,341	401,398,858
Deferred Outflows of Resources			
Deferred charge on refunding	996,676	-	996,676
Liabilities			
Current liabilities:			
Accounts Payable	-	33,173	33,173
Current portion of revolving loan bonds	5,775,000	-	5,775,000
Accrued interest payable	125,592	-	125,592
Other payables	27,705	433	28,138
Total current liabilities	5,928,297	33,606	5,961,903
Long-term liabilities:			
Payables to municipalities	76,601,531	-	76,601,531
Revolving loan bonds payable	29,364,874	-	29,364,874
Total long-term liabilities	105,966,405	-	105,966,405
Total liabilities	111,894,702	33,606	111,928,308
Net Position			
Net investment in capital assets	-	6,292	6,292
Restricted for loans and debt service	285,419,491	5,041,443	290,460,934
Total net position	\$ 285,419,491	\$ 5,047,735	\$ 290,467,226

The accompanying "Notes to Financial Statements" form an integral part of this statement.

Alabama Drinking Water Finance Authority
Statement of Revenues, Expenses, and Changes in Net Position
Proprietary Funds
For the Year Ended September 30, 2019

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Operating Revenues			
Investment earnings	\$ 2,829,633	\$ -	\$ 2,829,633
Interest from loan receivable	5,536,616	-	5,536,616
Bond premium accretion	138,808	-	138,808
Administrative fees	-	1,604,359	1,604,359
Total operating revenues	8,505,057	1,604,359	10,109,416
Operating Expenses			
Administration expense	1,963,525	701,981	2,665,506
Depreciation	-	3,462	3,462
Office expense	-	242,258	242,258
Other expenses	-	215,657	215,657
Travel	-	300	300
Total operating expenses	1,963,525	1,163,658	3,127,183
Operating income	6,541,532	440,701	6,982,233
Nonoperating Revenues (Expenses)			
Federal grant revenue	21,988,069	1,034,481	23,022,550
Principal forgiveness expense	(3,547,126)	-	(3,547,126)
Bond interest expense	(1,193,618)	-	(1,193,618)
Bond issuance cost	(80,500)	-	(80,500)
Net decrease in the fair value of investments	1,509,580	-	1,509,580
Total nonoperating revenues	18,676,405	1,034,481	19,710,886
Change in Net Position	25,217,937	1,475,182	26,693,119
Net Position - Beginning	260,201,554	3,572,553	263,774,107
Net Position - Ending	\$ 285,419,491	\$ 5,047,735	\$ 290,467,226

The accompanying "Notes to Financial Statements" form an integral part of this statement.

Alabama Drinking Water Finance Authority
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2019

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Cash Flows from Operating Activities:			
Investment earnings	\$ 2,822,390	\$ -	\$ 2,822,390
Receipts of payments from municipalities	21,955,000	-	21,955,000
Payments to vendors	1,419	(1,138,323)	(1,136,904)
Interest received on loans receivable	6,641,824	-	6,641,824
Administration fees	(1,963,525)	1,604,359	(359,166)
Payments to municipalities	(30,650,794)	-	(30,650,794)
Net cash provided by (used in) operating activities	(1,193,686)	466,036	(727,650)
Cash Flows from Non-capital and Related Financing Activities:			
Grant revenue received	21,959,303	732,786	22,692,089
Payments to municipalities-Principal forgiveness	(1,691,175)	-	(1,691,175)
Redemption of investment securities, net	(10,515,392)	-	(10,515,392)
Revolving loan bond proceeds	19,919,500	-	19,919,500
Principal paid on revolving loan bonds	(26,835,000)	-	(26,835,000)
Interest paid on revolving loan bonds	(1,217,668)	-	(1,217,668)
Net cash provided by non-capital and related financing activities	1,619,568	732,786	2,352,354
Cash Flows from Capital and Related Financing Activities:			
Purchases of capital assets	-	(3,480)	(3,480)
Net increase in cash and cash equivalents	425,882	1,195,342	1,621,224
Cash and Cash Equivalents - restricted, beginning of year	10,873,779	3,578,012	14,451,791
Cash and Cash Equivalents - restricted, end of year	\$ 11,299,661	\$ 4,773,354	\$ 16,073,015

-Continued-

The accompanying "Notes to Financial Statements" form an integral part of this statement.

Alabama Drinking Water Finance Authority
Statement of Cash Flows
Proprietary Funds (Continued)
For the Year Ended September 30, 2019

	Business-type Activities - Enterprise Funds		
	Loan Fund	Loan Fee Fund	Total
Reconciliation of Operating Income to Net Cash			
Provided by Operating Activities:			
Operating income	\$ 6,541,532	\$ 440,701	\$ 6,982,233
Bond premium accretion	(138,808)	-	(138,808)
Loan premium amortization	(542,682)	-	(542,682)
Depreciation	-	3,462	3,462
(Increase) decrease in operating assets:			
Due from WPCA	(20,000)	-	(20,000)
Accrued interest receivable on investments - restricted	(7,243)	-	(7,243)
Accrued interest receivable on loans receivable	(26,936)	-	(26,936)
Loans receivable and other receivables	(41,750,000)	-	(41,750,000)
Increase (decrease) in operating liabilities:			
Accounts payable	-	21,440	21,440
Payables to municipalities	34,729,032	-	34,729,032
Other payables	16,769	433	17,202
Due to WPCA	4,650	-	4,650
Net cash provided by (used in) operating activities	\$ (1,193,686)	\$ 466,036	\$ (727,650)

The accompanying "Notes to Financial Statements" form an integral part of this statement.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Description of Organization

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

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

Basis of Accounting

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

Deferred Outflows/Inflows of Resources

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

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Budget Information

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

Cash and Cash Equivalents

Highly liquid investments with a maturity of 90 days or less when acquired are classified as cash equivalents. Included in the cash equivalents are money market funds 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.

Investments

Investments are reported at fair value or amortized cost. All investment income, including changes in the fair value of investments, is recognized in the statement of revenues, expenses, and changes in net assets. 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

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

premium, which allows the Authority to recover certain costs associated with the loan, is amortized into income on the interest method over the life of the loan. The stated interest rate for these loans range from 2.20% to 3.95% and the effective interest rates range from 2.20% to 4.39%. The loans are typically repaid over a twenty-year period. The stated interest rates for loans bound prior to October 1, 2018 include a 0.75% fee charged to municipalities for administrative costs. The stated interest rates for loans bound on or subsequent to October 1, 2018 include a 2.10% fee charged to municipalities for administrative costs with the exception of three municipality loans that closed on October 1, 2018 and November 15, 2018, which were already being processed as of October 1, 2018.

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

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

Restricted Assets

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

Capital Assets

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

Revenues and Expenses

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

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Administrative Fees

The sole source of administrative fees is a 0.75% fee charged to municipalities on the principal amount of the loan made to the municipalities by the Authority, net of bank and trustee fees. The administrative fee is .75% for loans bound prior to October 1, 2018 and 2.10% for loans bound on or subsequent to October 1, 2018 with the exception of three municipality loans that closed on October 1, 2018 and November 15, 2018 which were already being processed as of October 1, 2018. These three loans have an administrative fee of .75%.

Grant Revenue

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

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

Interfund Transfers

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

Concentration of Credit Risk

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

Net Position

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

- *Net investment in capital assets* – This component of net position consists of the historical cost of capital assets, net of accumulated depreciation, and is reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt should also be included in this component of net position.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- *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.

New Accounting Standards Adopted

In Fiscal Year 2019, the Authority adopted two new statements of financial accounting standards issued by the Governmental Accounting Standards Board (GASB):

- Statement No. 83, *Certain Asset Retirement Obligations* (GASB 83)
- Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements* (GASB 88)

GASB 83 establishes standards of accounting and financial reporting requirements for legally enforceable liabilities associated with the retirement of certain tangible capital assets. State and local governments that have legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the regulation of GASB 83. The requirements of GASB 83 are effective for reporting periods beginning after June 15, 2018. GASB 83 had no impact on the Authority's financial statements.

GASB 88 defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. GASB 88 requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant subjective acceleration clauses. GASB 88 also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of GASB 88 are effective for reporting periods beginning after June 15, 2018. Details of the Authority's implementation with respect to GASB 88 is included in the long-term debt note (see Note 8).

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pronouncements Issued But Not Yet Effective

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

GASB Statement No.	GASB Accounting Standard	Effective Fiscal Year
84	<i>Fiduciary Activities</i>	2020
87	<i>Leases</i>	2021
89	<i>Accounting for Interest Cost Incurred before the End of a Construction Period</i>	2021
90	<i>Majority Equity Interests – An Amendment of GASB Statements No. 14 and No. 61</i>	2020
91	<i>Conduit Debt Obligations</i>	2022

NOTE 2 - CASH AND INVESTMENTS

Deposits

As of September 30, 2019, 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

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 2 - CASH AND INVESTMENTS (Continued)

have call provisions that could result in shorter maturity periods. However, the Authority's intent is to hold all securities to maturity, and as such, fixed maturity investments are classified as held to maturity. Investments are classified in the following table as if they were held to maturity.

As of September 30, 2019, the Authority had the following investment holdings and maturities:

	Market	Investment Maturities		
		Less than 3 years	3-6 years	Greater than 6 years
Investments:				
U.S. Treasury SLGs	\$ 6,553,935	\$ 655,265	\$ 4,850,830	\$ 1,047,840
U.S. Treasury Bonds/Notes	129,383,848	129,383,848	-	-
Total investments	135,937,783	\$ 130,039,113	\$ 4,850,830	\$ 1,047,840
Cash equivalents:				
Money Market Funds	16,073,015	N/A	N/A	N/A
Total holdings	\$ 152,010,798			

Custodial Credit Risk – Custodial credit risk is the risk that in the event of the failure of the counterparty to a transaction, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority has U.S. Government securities (bonds, notes, and slugs) totaling \$135,937,782 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 significant custodial credit risk. The securities are approved by bond insurers and are held in the name of the Trustee for the bond issue for the benefit of bondholder.

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, 2019, the Authority did not hold investments with any issuers that comprised 5% or more of total investment holdings, other than the U.S. Treasury.

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

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 2 - CASH AND INVESTMENTS (Continued)

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, 2019 are collateralized by U.S. Government securities rated AAA.

The ratings of total holdings are as follows at September 30, 2019:

Moody's Ratings	Recorded Amount	Recorded Amount as a Percent of Total Holdings Value
Exempt from disclosure	\$ 135,937,783	89.43%
Aaa	16,073,015	10.57%
	\$ 152,010,798	100.00%

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

NOTE 3 - FAIR VALUE MEASUREMENTS

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

- Level 1 inputs are quoted (unadjusted) prices in active markets for identical financial assets or liabilities that are accessible at the measurement date;
- Level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the financial asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the financial asset or liability.

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

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 3 - FAIR VALUE MEASUREMENTS (Continued)

The following table presents the Authority's financial assets carried at fair value by level within the valuation hierarchy as of September 30, 2019:

Investment Type	Level 1	Level 2	Level 3	Total
US Treasury obligations	\$ -	\$ 21,525,225	\$ -	\$ 21,525,225
Federal agency obligations	-	114,412,558	-	114,412,558
Total investments at fair value	\$ -	\$ 135,937,783	\$ -	\$ 135,937,783

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

NOTE 4 - LOANS RECEIVABLE

Loans receivable at September 30, 2019, as discussed below, are as follows:

Completed projects	\$ 121,815,000
Projects in progress	124,270,000
	<u>246,085,000</u>
Less:	
Current portion loans receivable	18,155,000
Unamortized Premium	3,533,719
	<u>22,688,719</u>
Loans receivable, net	\$ 224,396,281

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

2020	\$ 18,155,000
2021	18,070,000
2022	17,855,000
2023	15,770,000
2024 and thereafter	176,235,000
	<u>\$ 246,085,000</u>

As of September 30, 2019, the Authority's ten largest outstanding loans, in the aggregate, exceeded \$125 million. The outstanding balances of these loans represent approximately 51% of the total loans receivable, as follows:

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 4 - LOANS RECEIVABLE (Continued)

Loan Recipient	Outstanding Balance
Cullman Duck River Raw Water Pump Station, Transmission Main & WTP Improv.	\$ 22,220,000
Mobile Various Water Infrastructure Improvements (Supplemental)	20,010,000
Tuscaloosa 2018 DWSRF Projects	18,250,000
Madison 2015 Water Treatment Plant Improvements	14,795,000
Shelby County South Water Treatment Plant	12,560,000
Warrior River Phase 1 Improvements	12,195,000
Anniston Southeast Area Water Tank & Transmission Main	7,445,000
Mobile Various Water Infrastructure Improvements	7,205,000
Tuscaloosa Water System Improvements	5,265,000
Florence AMR & Wilson Lake Intake Improvements	5,120,000
	\$ 125,065,000

NOTE 5 - APPROPRIATIONS

The U. S. Environmental Protection Agency (EPA) awards ADEM capitalization funds under its annual grant agreement. During the year ended September 30, 2019, the EPA awarded ADEM capitalization funds under its annual grant agreement in the amount of \$23,721,000 with a budget and project period beginning October 1, 2019. During the year ended September 30, 2019, 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, 2019, the Authority had yet to receive any state matching funds.

The amount of unused federal capitalization grants was approximately \$5,286,175 at September 30, 2019. The Authority will apply for a federal capitalization grant in 2020. Any grants in 2020 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, 2019:

Alabama Drinking Water Finance Authority
Notes to Financial Statements

NOTE 5 - APPROPRIATIONS (Continued)

Year	Grant Amount	Draws prior to 2019	2019 Draws	Total Draws	Amount Available for Future Draws
2016	\$ 15,876,000	\$ 15,259,900	\$ 616,100	\$ 15,876,000	\$ -
2017	15,740,000	11,368,594	4,138,359	15,506,953	233,047
2018	23,944,000	-	18,890,872	18,890,872	5,053,128
	<u>\$ 55,560,000</u>	<u>\$ 26,628,494</u>	23,645,331	<u>\$ 50,273,825</u>	<u>\$ 5,286,175</u>
Less:					
	Administrative and set-aside expenses		(953,242)		
<u>Total 2019 Draws</u>			<u>\$ 22,692,089</u>		

NOTE 6 - PAYABLES TO MUNICIPALITIES

As of September 30, 2019, the authority had \$76,601,531 in payables to municipalities. These payables represent loans on projects in progress at year end. Loan funds are advanced as work is completed on each project.

NOTE 7 - LONG-TERM DEBT

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

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

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

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

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

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

On July 1, 2019, the Authority issued Series 2019 Revolving Fund Loan Bond totaling \$20,000,000. The Series 2019 Bond includes:

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 7 - LONG-TERM DEBT (Continued)

\$20,000,000 serial bonds commencing August 15, 2019, and due August 15, 2019, which bears a per annum interest rate of 4.62%. However, on August 8, 2019, the Authority paid off the entire balance along with accrued interest of \$20,533.

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

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

Summary of changes in long-term debt for 2019:

	Balance 09/30/18	Additions	Reductions	Balance 9/30/2019
Revolving fund loan bonds	\$ 40,760,000	\$ 20,000,000	\$ 26,835,000	\$ 33,925,000
Add: Unamortized premiums	1,542,455	-	327,581	1,214,874
Total	\$ 42,302,455	\$ 20,000,000	\$ 27,162,581	\$ 35,139,874

Long-term debt at September 30, 2019 is payable as follows:

	Principal	Interest	Total
2020	\$ 5,775,000	\$ 1,004,734	\$ 6,779,734
2021	5,655,000	831,484	6,486,484
2022	5,210,000	659,446	5,869,446
2023	3,140,000	488,646	3,628,646
2024	7,270,000	380,981	7,650,981
2025-2027	6,875,000	421,519	7,296,519
	33,925,000	\$ 3,786,810	\$ 37,711,810
Plus: Unamortized premium	1,214,874		
Less: Current portion	5,775,000		
Total long-term debt	\$ 29,364,874		

Summary of changes in deferred outflows related to debt for 2019:

	Balance 09/30/18	Additions	Reductions	Balance 9/30/2019
Unamortized deferred refunding costs	\$ 1,185,450	\$ -	\$ 188,774	\$ 996,676

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 7 - LONG-TERM DEBT (Continued)

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, 2019, the unamortized deferred refunding costs totaled \$797,620 for the Series 1998A, 2000A & B, Series 2000C, and 2002A Bonds.

The Authority issued the 2013A Refunding Series revolving loan bonds for the purpose of refunding the Series 2003A Bonds, which had an aggregate principal balance of \$29,305,000 on December 1, 2013. The refunding resulted in an accounting loss of approximately \$230,659 that has been capitalized and is being amortized on a straight-line basis, through 2027. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately \$19.2 million over the next 14 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately \$6.7 million. As of September 30, 2019, the unamortized deferred refunding costs totaled \$132,487 for the Series 2003A Bonds.

The Authority issued the 2015A Refunding Series revolving loan bonds for the purpose of refunding the Series 2004A Bonds, which had an aggregate principal balance of \$23,345,000 on January 1, 2015. The refunding resulted in an accounting loss of approximately \$106,094 that has been capitalized and is being amortized on a straight-line basis, through 2027. Although the refunding resulted in an accounting loss, the Authority reduced its aggregate debt service by approximately \$7.6 million over the next 13 years and obtained an economic gain (the difference between the present values of the old and new debt service requirements) of approximately \$3.9 million. As of September 30, 2019, the unamortized deferred refunding costs totaled \$66,569 for the Series 2004A Bonds.

NOTE 8 - ARBITRAGE REBATE CALCULATIONS

In accordance with Internal Revenue Code, Section 148, and related regulations as the issuer of tax-exempt debt, the Authority performed an arbitrage calculation during the year ended 2019 and determined there are no amounts due to or from the Internal Revenue Service at September 30, 2019.

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.

Alabama Drinking Water Finance Authority Notes to Financial Statements

NOTE 9 - RELATED PARTIES (Continued)

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

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 20% of total grant funds provided by the 2016 grant, 2017 grant, and 2018 grant, respectively. The principal forgiveness amount was allocated amongst qualifying projects for the municipalities. This amount is recognized as a receivable on the statement of net assets at the time a loan is issued and is included in the total amount payable to municipalities. Principal forgiveness is stated separately from the associated loans receivable as it is not required to be repaid by the municipalities. As the work is completed on these projects and the loan funds are advanced to the municipalities, a percentage of the total principal forgiveness amount is expensed in relation to the total amount paid to the respective municipalities. Principal forgiveness expense recognized during the year ended September 30, 2019 totaled \$3,547,126, leaving a remaining balance of \$5,427,912 capitalized as principal forgiveness on the statement of net position as of September 30, 2019.

NOTE 11 - SUBSEQUENT EVENTS

The Authority has evaluated subsequent events through December 30 2019, the date the financial statements were available to be issued, and there were none to disclose.

**Alabama Drinking Water Finance Authority
Schedule of Expenditures of Federal Awards
September 30, 2019**

Federal Grantor/Pass Through Grantor/Program Title	CFDA Number	Grantor's Number	Passed through to Subrecipients	Federal Expenditures
Environment Protection Agency				
Passed through the Alabama Department of Environmental Management				
Capitalization Grants for Drinking Water State Revolving Funds	66.468	FS984472-17	\$ 3,741,806	\$ 3,829,982
Capitalization Grants for Drinking Water State Revolving Funds	66.468	FS984472-18	18,158,086	19,192,568
Total Drinking Water State Revolving Fund Cluster			\$ 21,899,892	23,022,550
Total Federal Expenditures				\$ 23,022,550

See the independent auditors' report and accompanying notes to schedule of expenditures of federal awards.

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

NOTE 1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the schedule) summarizes the federal expenditures of the Authority under programs of the federal government for the year ended September 30, 2019. The amounts reported as federal expenditures were obtained from the Authority's trial balance. Because the schedule presents only a selected portion of the operations of the Authority, it is not intended to and does not present the financial position, changes in net position and cash flows of the Authority.

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

Drinking Water State Revolving Fund Cluster

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

NOTE 2 – RELATIONSHIP OF THE SCHEDULE TO PROGRAM FINANCIAL REPORTS

The amounts reflected in the financial reports submitted to the awarding Federal, State and/or pass-through agencies and the SEFA may differ. Some of the factors that may account for any difference include the following:

- The Authority's fiscal year end may differ from the program's year end.
- Accruals recognized in the SEFA, because of year-end procedures, may not be reported in the program financial reports until the next program reporting period.
- Fixed asset purchases and the resultant depreciation charges are recognized as fixed assets in the Authority's financial statements and as expenditures in the program financial reports.

NOTE 3 - FEDERAL PASS-THROUGH FUNDS

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



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

NOTE 4 - BASIS OF ACCOUNTING

This schedule was prepared on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the current period. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recorded when the related liability is incurred. In applying the susceptible-to-accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of such revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the Authority; therefore, revenues are recognized 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 5 - 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 September 30, 2019, there were no material questioned or disallowed costs as a result of grant audits in process or completed.

NOTE 6 - INDIRECT COST

The Authority operates under predetermined fixed indirect cost rates that are effective through September 30, 2019. The base rate for indirect cost recoveries is 42.77% for the year ended September 30, 2019.

NOTE 7 - NONCASH ASSISTANCE

The Authority did not receive any federal noncash assistance for the fiscal year ended September 30, 2019.

NOTE 8 - DE MINIMUS

The Authority has elected to not use the 10% de Minimis indirect cost rate for the fiscal year ended September 30, 2019.



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

NOTE 9 - SUBRECIPIENTS

The Authority provided federal funds to subrecipients totaling \$21,899,892 for the fiscal year ended September 30, 2019.

NOTE 10 - LOANS AND LOAN GUARANTEES

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

NOTE 11 – FEDERALLY FUNDED INSURANCE

The Authority did not have any federally funded insurance required to be reported on the schedule for the fiscal year ending September 30, 2019.

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

Board of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities and the major funds of the Alabama Drinking Water Finance Authority (the "Authority"), a component unit of the State of Alabama, as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated December 30, 2019.

Internal Control over Financial Reporting

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

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

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

We noted certain deficiencies in internal control that we reported to management of the Authority in a separate letter dated December 30, 2019.

Compliance and Other Matters

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

Purpose of this Report

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

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

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

Enterprise, Alabama

December 30, 2019

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

Board of Directors
Alabama Drinking Water Finance Authority
Montgomery, Alabama

Report on Compliance for Each Major Federal Program

We have audited Alabama Drinking Water Finance Authority's (the "Authority") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Authority's major federal program for the year ended September 30, 2019. The Authority's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditors' Responsibility

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

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

Opinion on Each Major Federal Program

In our opinion, the Authority, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2019.

Report on Internal Control over Compliance

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

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

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

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

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

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

Enterprise, Alabama

December 30, 2019

**Alabama Drinking Water Finance Authority
Schedule of Findings and Questioned Costs
For the Year Ended September 30, 2019**

Section I - Summary of Auditors' Results

Financial Statements

- | | |
|--|------------|
| 1. Type of auditors' report issued | Unmodified |
| 2. Internal control over financial reporting: | |
| a. Material weaknesses identified? | No |
| b. Significant deficiencies identified not considered to be material weaknesses? | None noted |
| c. Noncompliance material to the financial statements noted? | No |

Federal Awards

- | | |
|--|------------|
| 1. Type of auditors' report issued on compliance for major programs | Unmodified |
| 2. Internal control over major programs: | |
| a. Material weaknesses identified? | No |
| b. Significant deficiencies identified not considered to be material weaknesses? | None noted |
| 3. Any audit findings disclosed that are required to be reported in accordance with 2CFR section 200.516(a)? | None noted |

4. Identification of major programs

CFDA Number	Federal Program
66.468	Capitalization Grants for Drinking Water State Revolving Funds Cluster

- | | |
|--|-----------|
| 5. Dollar threshold used to distinguish between type A and type B programs | \$750,000 |
| 6. Auditee qualified as low-risk under 2CFR 200.520 | Yes |

Section II – Financial Statements Findings

No matters were reported.

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

**Alabama Drinking Water Finance Authority
Summary Schedule of Prior Audit Findings
For the Year Ended September 30, 2019**

LANCE R. LEFLEUR
DIRECTOR



KAY IVEY
GOVERNOR

Alabama Department of Environmental Management
adem.alabama.gov

1400 Coliseum Blvd. 36110-2400 ■ Post Office Box 301463
Montgomery, Alabama 36130-1463
(334) 271-7700 ■ FAX (334) 271-7950

2018-001 – Corrective action was taken

Members of the
Board of Directors of the
Alabama Drinking Water Finance Authority

In planning and performing our audit of the financial statements of Alabama Drinking Water Finance Authority (the "Authority") as of and for the year ended September 30, 2019, in accordance with auditing standards generally accepted in the United States of America, we considered the Authority's internal control over financial reporting (internal control) as a basis for designing our 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 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 was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. However, during our audit we became aware of the matters noted below that are opportunities for strengthening internal controls and operating efficiency. We previously reported on the Authority's internal control in our letter dated December 30, 2019. This letter does not affect our report dated December 30, 2019 on the financial statements of the Authority.

We will review the status of these comments during our next audit engagement. We have already discussed these comments with management, and we will be pleased to discuss the comments in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. Our comments are summarized as follows:

Password Security – The Authority's password security policy does not follow best practice such as having complexity and expiration. We recommend that management consider implementing a password policy to include greater security concerning passwords used by employees.

IT User Access – The Authority did not complete an IT new user access form to establish IT access rights for three new employees added to the Authority during the FY. We recommend that all IT user access changes should be formally documented and approved on a user access change form.

This communication is intended solely for the information and use of the Board of Directors and management, 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.

Enterprise, Alabama

December 30, 2019