

AGENDA

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY
AUDIT COMMITTEE
JUNE 27, 2019
HOUSE HEARING ROOM 2
CORDELL HULL BUILDING**

1. Call Meeting to Order
2. Approval of the Audit Committee Meeting Minutes May 16, 2018 **(Tab 1) ***
3. Revised TLDA Audit Committee Charter **(Tab 2)***
4. Review Audit Reports Issued By Comptroller's Office
 - a. Discuss TLDA Audit Report **(Tab 3a)**
 - b. Discuss Clean Water State Revolving Fund Audit Report **(Tab 3b)**
5. Review Financial Statements including Significant Accounting & Reporting Standards **(Tab 4)**
6. Discuss PERS Reports From EPA **(Tab 5)**
7. Risk Assessments Memo **(Tab 6)**
 - a. 2018 SLF Risk Assessment **(Tab 6a)**
 - b. 2018 TDEC Water Resource Risk Assessment **(Tab 6b)**
8. Discuss Management's Responsibility to Prevent, Detect & Report Fraud, Waste & Abuse
9. Discuss Comptroller Hotline
10. Current Internal Auditing Article **(Tab 7)**
11. Other Business
12. Adjournment

* Items with an asterisk denote action required by the Audit Committee

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
AUDIT COMMITTEE MEETING MINUTES
May 16, 2018

The Tennessee Local Development Authority (TLDA) Audit Committee met on Wednesday, May 16, 2018. The meeting began at 12:45 p.m. in the Executive Conference Room of the State Capital.

The following members were present:

- David H. Lillard, Jr., State Treasurer
- Dr. Kenneth Moore, House Appointee
- Larry Martin, Commissioner of Finance and Administration
- Tre Hargett, Tennessee Secretary of State
- Pat Wolfe, Senate Appointee

Others present were:

- Sandi Thompson, Director, Office of State and Local Finance
- Alicia West, Program Accountant, Office of State and Local Finance
- Derek Martin, State Audit Manager, Comptroller of the Treasury
- Earle Pierce, Director of Internal Audit, TN Department of Treasury
- Paula Mitchell, Environmental Program Director, TN Department of Environment and Conservation
- Andrea Fenwick, ASA Manager, TN Department of Environment and Conservation

Call Meeting to Order

Treasurer Lillard called the meeting to order and presented the minutes from the May 11, 2017 TLDA Audit Committee meeting for approval. There were no other recommended changes. Secretary Hargett motioned to accept the minutes as presented and Dr. Kenneth Moore seconded the motion. The roll was called with the meeting minutes unanimously approved by the Committee members.

Review Audit Reports Issued by Comptroller's Office

Treasurer Lillard recognized Derek Martin from State Audit to review the audit reports for the Tennessee Local Development Authority (TLDA) and the Clean Water State Revolving Fund (CWSRF). Both the TLDA and CWSRF received unmodified opinions on their June 30, 2017 financial statements. No material errors were found in the financial statement. There were no findings and no problems were noted with internal controls or compliance.

The report for the 2016 Single Audit of the Clean Water State Revolving Fund included a finding for sub-recipient monitoring not completed as required. Derek Martin from State Audit updated the Committee on this prior year finding stating they conducted a follow up on the 2016 finding

and found it had been resolved. He further stated the 2017 Single Audit of the Clean Water State Revolving Fund did not have any findings.

Review Financial Statements Including Significant Accounting and Reporting Standards

Treasurer Lillard recognized Alicia West to review the financial statements for the TLDA and the CWSRF. Ms. Scott presented an overview of the financial statements. Secretary Hargett asked when the last loan from the prior State Loan program would mature and Ms. West responded the last two loans under the old program are scheduled to mature in 2032.

Discuss Reports from Other Entities

Treasurer Lillard recognized Paula Mitchell from TDEC to discuss reports from other entities. Ms. Mitchell started by reviewing a report of responses and actions taken by TDEC to address the previous report findings from the 2014 & 2015 Environmental Protection Agency (EPA) Performance Evaluations Reports (PERs). Ms. Mitchell then reviewed the performance evaluation reports from the Environmental Protection Agency for studies conducted in fiscal year 2016 with a report date of April 2017 and reviews conducted in fiscal year 2017 with a report date of December 2017. The fiscal 2016 and 2017 PERs reports from the EPA had noted no findings or deficiencies.

State and Local Finance 2017 Risk Assessments

Treasurer Lillard recognized Alicia West to discuss the Office of State and Local Finance (SLF) and Division of Water Resources 2017 Risk Assessments. Ms. Scott stated the risk assessments included in the meeting material contained highlighted sections which covered the TLDA. Secretary for the TLDA Audit Committee, Earle Pierce, noted the SLF risk assessment printout was somewhat hard to read because of the original document size and he could provide Committee members with an electronic copy upon request.

Discuss Management's Responsibility to Prevent, Detect and Report Fraud, Waste and Abuse

Treasurer Lillard recognized Sandi Thompson to speak about management's responsibility to prevent, detect, and report fraud, waste, and abuse. Ms. Thompson stated the tone at the top is the first line of defense for preventing fraud, waste, and abuse. Ms. Thompson noted she was not aware of any instances of reported fraud, waste, or abuse within the Office of State and Local Finance. Department personnel are aware risk exists with performing their duties. Those risks are monitored and mitigated daily. The annual risk assessment and system of controls is updated when necessary to alleviate risk.

Discuss Comptroller Hotline

Treasurer Lillard recognized Sandi Thompson to discuss the Comptroller's Fraud, Waste, and Abuse (FWA) Hotline. A couple of calls were received in the past fiscal year in the department and forwarded to the Hotline for investigation.

Discuss Current Internal Audit Article

Treasurer Lillard introduced Earle Pierce to the Audit Committee and those in attendance. Mr. Pierce was recognized to present "What Happens When Internal Audit is Ignored? Ask Atlanta" article from the Institute of Internal Auditors. The article focused on consequences the City of Atlanta experienced after ignoring internal audit recommendations to address deficiencies in their I.T. infrastructure.

Review Audit Committee Charter

Mr. Pierce was recognized to present the Audit Committee Charter. Mr. Pierce stated the charter is included in the meeting material on an annual basis for review and update as necessary. The last update occurred in May of 2009. Mr. Pierce informed the Committee of plans to review the charter for possible updates needed since the last revision. Any changes will be brought to the Committee for their review and approval possibly at next year's meeting.

Other Business

Treasurer Lillard opened the floor for any other business to be brought before the committee. No new business was presented.

Adjournment

Treasurer Lillard deemed the meeting to be adjourned since there was no further business before the Audit Committee.

Approved:

David H. Lillard, Jr.
TLDA Audit Committee Chairman



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

March 15, 2019

Mr. Earle Pierce, Internal Audit Director
Tennessee Department of the Treasury
13.305, Andrew Jackson Building
502 Deaderick Street
Nashville, Tennessee 37243

Dear Mr. Pierce:

Thank you for your submission of a revised audit committee charter for the Tennessee Local Development Authority. We have reviewed the charter for compliance with the Comptroller's Guidelines for Audit Committee Charters. I am pleased to approve the revised charter.

Sincerely,

A handwritten signature in black ink, appearing to read "Justin P. Wilson", is written over the typed name and title.

Justin P. Wilson
Comptroller of the Treasury

JPW/geb

Tennessee Local Development Authority Audit Committee Charter

Purpose

The primary purpose of the Committee is to assist the Tennessee Local Development Authority (i.e.- Authority) in fulfilling its oversight with respect to:

- The financial reporting process
- The system of internal controls and risk management
- The internal audit and external audit process
- The standards of professional conduct

The Audit Committee's responsibility is one of oversight, recognizing the Authority's management, which is housed within the Office of the Comptroller of the Treasury Office of State and Local Finance, is:

- Responsible for preparing the financial statements
- Subject to the financial and accounting policies of the State of Tennessee
- Implementing and monitoring internal controls and compliance with laws and regulations
- The Comptroller of the Treasury is statutorily responsible for financial compliance and auditing

Composition and Qualifications

The Audit Committee shall be a standing committee of the Authority and shall consist of five members: The members of the Audit Committee shall be independent and have the appearance of independence of any conflicts of interest in regards to their duties as members of the Audit Committee. The Board has the responsibility to ensure the audit committee chair has the requisite accounting/business management background to discharge the duties of the audit committee. The audit committee membership should have an adequate background and education to discharge their duties.

The Audit Committee shall consist of:

- The State Treasurer
- The Secretary of State
- The Commissioner of Finance and Administration
- The House Appointee and the Senate Appointee, and their successors in office by virtue of their incumbency in such offices and without further appointment or qualification.

The State Treasurer shall serve as Chairman for the Audit Committee. The Audit Committee may appoint a member of staff to serve as its Secretary.

Meetings

The Audit Committee shall meet to discuss internal and external audit reports as well as other business no less often than once per year. The Committee shall also meet at the request of the Comptroller of the Treasury. Participation in committee meetings may be in person or via teleconferencing with designated representatives as permitted by state law or regulation. A majority of the audit committee shall constitute a quorum.

The Audit Committee shall abide by the notice requirements of the Authority. All meetings of the Audit Committee shall be subject to the open meetings provisions of Title 8, Chapter 44, *Tennessee Code*

Annotated, except that, as provided by Section 4-35-108(b), *Tennessee Code Annotated*, the Committee may hold confidential, nonpublic executive sessions to discuss:

1. Items deemed not subject to public inspection under Sections 10-7-503 and 10-7-504, *Tennessee Code Annotated*, and all other matters designated as confidential or privileged under this code;
2. Litigation;
3. Audits or investigations; and
4. Matters involving information under Section 4-35-107(a), *Tennessee Code Annotated*, where the informant has requested anonymity.

Written minutes covering all meetings and actions of the Audit Committee shall be prepared and maintained on file in the Office of the Comptroller of the Treasury Division of Office and State and Local Finance. Minutes of meetings exempt from the open meetings provisions of Title 8, Chapter 44, *Tennessee Code Annotated*, by Section 4-35-108(b), *Tennessee Code Annotated*, will not be open to public inspection.

Authority

The Audit Committee has authority to conduct or authorize investigations into any matters within its scope of responsibility including:

- Oversee resolution of any disagreements between management and the auditor regarding financial reporting
- Seek any information required from employees whom are directed to cooperate with such requests
- Meet as needed with officers, state auditors or legal counsel
- Requiring internal auditors to report directly to the Audit Committee

Responsibilities

Audit Committee responsibilities include:

Financial Reporting Process

- Review significant accounting and reporting standards, as applicable
- Review financial statements and the comprehensive annual financial report

Internal Controls & Risk Management

- Review management's processes for monitoring compliance with policies, plans, procedures, laws, and regulations
- Understand the scope of internal and external auditors' review of internal controls
- Inquire of management and auditors about significant risks and how those risks are managed
- Review management's processes for assessment of risk, including fraud risk, for adequacy
- Review risk assessment results ensuring internal controls sufficiently mitigate assessed risks in the agency

Internal & External Audit

- Review reports issued by internal and external auditors
- Ensure management has taken appropriate action on audit recommendations made by the internal or external auditors

- Discuss the proposed scope and approach of the external audit and subsequently the results of the audit with representatives of the Comptroller of the Treasury, including any difficulties encountered during the course of the audit
- Encourage internal or external auditors to discuss any issues of concern with the Audit Committee

Standards of Conduct

- Immediately report any fraud to the Comptroller of the Treasury's Office
- Communicate to management their responsibility for preventing, detecting, and reporting fraud, waste, and abuse, and reporting any instances of fraud, waste, and abuse to the Audit Committee and to the Comptroller of the Treasury
- Review communications from management to authority personnel concerning their obligation to prevent, detect, and report fraud, waste and abuse as well as reporting any instances of fraud, waste and abuse to the Audit Committee and the Comptroller of the Treasury;
- Ensure procedures exist for the receipt, retention, and treatment of complaints about accounting, internal controls, or auditing matters
- Regularly update the board about audit committee activities and make appropriate recommendations
- Periodically review and amend the Audit Committee Charter

Audit Committee Relationship with Management

- Review management's assertion internal controls are effective and adequate
- Evaluate whether management is setting the appropriate 'control culture' and 'tone at the top' by communicating the importance of internal controls and risk management
- Ensure a confidential mechanism is in place for staff to report any suspected fraud, abuse, or other complaints related to operations to the Audit Committee

Approved this _____ day of _____, 2019

Chairman, TLDA Audit Committee

Adopted by TLDA Board

Date _____

Chairman _____

Secretary _____

Tennessee Local Development Authority Audit Committee Charter

Introduction Purpose

The primary purpose of the Committee is to assist the Tennessee Local Development Authority (i.e.- Authority) in fulfilling its oversight with respect to:

- The financial reporting process;
- The system of internal controls and risk management;
- The internal audit and external audit process; and
- The standards of professional conduct

The Audit Committee's responsibility is one of oversight, recognizing ~~that~~ the Authority's management, which is housed within the Office of the Comptroller of the Treasury ~~Division of Bond Finance~~ Office of State and Local Finance, is responsible for:

- ~~Preparing the financial statements,~~ is
- ~~Subject to the financial and accounting policies of the State of Tennessee,~~ is accountable for
- ~~Implementing and monitoring internal controls and compliance with laws and regulations,~~ and that
- ~~The Comptroller of the Treasury is statutorily responsible for financial compliance and auditing~~

Purpose and Mission

The Audit Committee is appointed by the Authority to assist ~~the~~ Authority members in fulfilling their responsibility to the General Assembly, the citizens of the State of Tennessee and the Authority's bondholders in the oversight of the quality and integrity of the Authority's financial accounting and reporting practices. The Audit Committee's role also includes a particular focus on the Authority's processes to manage business and financial risk, and compliance with significant applicable legal, ethical, and regulatory requirements. The Committee shall provide a forum for communication among the auditors, management and the members of the Authority.

Organization Composition and Qualifications

The Audit Committee shall be a standing committee of the Authority and shall consist of five ~~ex-officio~~ members; The members of the Audit Committee shall be independent and have the appearance of independence of any conflicts of interest in regards to their duties as members of the Audit Committee. The Board has the responsibility to ensure the audit committee chair has the requisite accounting/business management background to discharge the duties of the audit committee. The audit committee membership should have an adequate background and education to discharge their duties.

The Audit Committee shall consist of:

- ~~The~~ State Treasurer,
- ~~The~~ Secretary of State,
- ~~The~~ Commissioner of Finance and Administration,
- ~~The~~ House Appointee and the Senate Appointee, and their successors in office by virtue of their incumbency in such offices and without further appointment or qualification.

The State Treasurer shall serve as Chairman for the Audit Committee. The Audit Committee may appoint a member of staff to serve as its Secretary.

~~The audit committee membership should have an adequate background and education to discharge their duties.~~

~~The members of the Audit Committee should be independent of any conflicts of interest or from any appearance of other interests that are in conflict with their duties as members of the audit committee. A majority of the Audit Committee shall constitute a quorum.~~

DRAFT

Meetings

~~The Audit Committee shall meet to discuss internal and external audit reports as well as other business no less often than once per year. The Audit Committee shall meet to discuss the external audit report and other business as necessary, but not less than once annually.~~ The Committee shall also meet at the request of the Comptroller of the Treasury. Participation in committee meetings may be in person or via teleconferencing with designated representatives as permitted by state law or regulation.

The Audit Committee shall abide by the notice requirements of the Authority. All meetings of the Audit Committee shall be subject to the open meetings provisions of Title 8, Chapter 44, *Tennessee Code Annotated*, except that, as provided by Section 4-35-108(b), *Tennessee Code Annotated*, the Committee may hold confidential, nonpublic executive ~~sessions~~ [AB1] to discuss:

1. Items deemed not subject to public inspection under Sections 10-7-503 and 10-7-504, *Tennessee Code Annotated*, and all other matters designated as confidential or privileged under this code;
2. Litigation;
3. Audits or investigations; and
4. Matters involving information under Section 4-35-107(a), *Tennessee Code Annotated*, where the informant has requested anonymity.

Written minutes covering all meetings and actions of the Audit Committee shall be prepared and ~~shall be kept maintained~~ on file in the Office of the Comptroller of the Treasury Division of ~~Bond Finance Office and State and Local Finance~~.

~~Minutes of meetings that are~~ exempt from the open meetings provisions of Title 8, Chapter 44, *Tennessee Code Annotated*, by Section 4-35-108(b), *Tennessee Code Annotated*, will not be open to public inspection.

AUTHORITY

~~The Audit Committee has authority to conduct or authorize investigations into any matters within its scope of responsibility including:~~

- ~~• Oversee resolution of any disagreements between management and the auditor regarding financial reporting~~
- ~~• Seek any information required from employees whom are directed to cooperate with such requests~~
- ~~• Meet as needed with officers, state auditors or legal counsel~~
- ~~• Requiring internal auditors to report directly to the Audit Committee~~

~~Powers and Duties~~

~~The Audit Committee shall have the power and duty to take whatever actions the Committee deems necessary in carrying out its responsibilities, including, but not limited to:~~

- ~~1. Seeking any information that the Committee requires from employees or external parties; and~~
- ~~2. Meeting with the Authority, the Authority's management, internal or external auditors, legal counsel, or others.~~

Responsibilities

Audit Committee responsibilities include:

~~For each of the topics addressed below, the responsibilities of the Audit Committee are:~~

Financial Reporting Process

~~—~~ Review significant accounting and reporting standards, as applicable; ~~and~~

~~•~~

• Review financial statements and the comprehensive annual financial report

~~•~~

Internal Controls & Risk Management

- ~~Review management's processes for monitoring internal controls for~~ Review management's processes for monitoring internal controls for compliance with policies, plans, procedures, laws, and regulations;
- Understand the scope of internal and external auditors' review of internal controls;
- Inquire of management and auditors about significant risks and how those risks are managed;
- Review management's processes for assessment of risk, including fraud risk, for adequacy; ~~and~~
- ~~Review risk assessment results ensuring internal controls sufficiently mitigate assessed risks in the agency. Review documentation of assessment results to determine that internal controls are sufficient to mitigate the assessed risks in the agency.~~

Internal & External Audit

- Review reports issued by internal and external auditors;
- Ensure management has taken appropriate action on audit recommendations made by the internal or external auditor;
- Discuss the proposed scope and approach of the external audit and subsequently the results of the audit with representatives of the Comptroller of the Treasury, including any difficulties encountered during the course of the audit; ~~and~~
- Encourage internal or external auditors to discuss any issues of concern with the ~~a~~ Audit Committee.

Standards of Conduct

- Immediately report any fraud to the Comptroller of the Treasury's Office;
- ~~Communicate to management their responsibility for preventing, detecting, and reporting fraud, waste, and abuse, and reporting any instances of fraud, waste, and abuse to the Audit Committee and to the Comptroller of the Treasury;~~
- ~~Review communications from management to authority personnel concerning their obligation to prevent, detect, and report fraud, waste and abuse as well as reporting any instances of fraud, waste and abuse to the Audit Committee and the Comptroller of the Treasury;~~
- ~~Ensure that~~ procedures exist for the receipt, retention, and treatment of complaints about accounting, internal controls, or auditing matters;
- Regularly update the board about Audit Committee activities and make appropriate recommendations; ~~and~~
- Periodically review and amend, ~~as necessary,~~ the Audit Committee Charter.

Audit Committee Relationship with Management

- Review management's assertion ~~that~~ internal controls are effective and adequate;
- Evaluate whether management is setting the appropriate 'control culture' and 'tone at the top' by communicating the importance of internal controls and risk management; ~~and~~
- Ensure a confidential mechanism is in place for staff to report any suspected fraud, abuse, or other complaints related to operations to the Audit Committee.

Approved this _____ day of _____, ~~2009~~2019

Chairman, TLDA Audit Committee

Adopted by TLDA Board

Date

Chairman

Secretary

FINANCIAL STATEMENTS OF THE AUTHORITY



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

Independent Auditor's Report

The Honorable Bill Lee, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority

Report on the Financial Statements

We have audited the accompanying financial statements of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of and for the years ended June 30, 2018, and June 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of the Tennessee Local Development Authority. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Authority.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Local Development Authority as of June 30, 2018, and June 30, 2017, and the changes in financial position and cash flows thereof for the years 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, as listed in the table of contents, 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, which 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.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The accompanying financial information listed as supplementary information in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information 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. The information has been subjected to the auditing procedures applied in the audits 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

information 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 January 25, 2019, on our consideration of the Tennessee Local Development Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions) 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 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.



Deborah V. Loveless, CPA, Director
Division of State Audit
January 25, 2019

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

As management of the Tennessee Local Development Authority (the "Authority"), we offer readers of the Authority's basic financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal years ended June 30, 2018, and June 30, 2017, with comparative data for the year ended June 30, 2016. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the Independent Auditor's Report, the audited financial statements, and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

Program Activity Highlights

The Authority's purpose is to provide loans to Local Government Units under the State Loan Programs and State Infrastructure Program, and to qualified borrowers under the Community Provider Loan program. The table below summarizes this business activity.

Pursuant to Title 4, Chapter 31, *Tennessee Code Annotated*, the General Assembly of the state created the Tennessee Local Development Authority to issue bonds and notes to fund capital projects for a variety of purposes. Currently, the programs of the Authority which have made loans to borrowers in the past include:

- 1) the State Loan Programs providing assistance to Local Government Units in the construction of waterworks, sewage treatment, and energy and/or solid waste recovery facilities;
- 2) the Community Provider Program providing facility construction assistance to licensed, nonprofit, 501(c)(3) corporations under grant contracts with the state to deliver mental health, mental retardation, or alcohol and drug services; and
- 3) the State Infrastructure Program providing assistance to Local Government Units in the construction of transportation infrastructure projects that provide public benefits by enhancing mobility or safety, promoting economic development, or increasing the quality of life and general welfare of the public.

	Local			State		
	Government Units			Infrastructure Program		
	2018	2017	2016	2018	2017	2016
Number of borrowers with outstanding loans	8	10	16	1	1	1
Total number of outstanding loans	10	12	18	1	1	1
Total amount of outstanding loans (in thousands)	\$1,891	\$2,311	\$2,873	\$1,126	\$211	\$117
Number of outstanding loans approved in fiscal year	0	0	0	0	0	0
Amount of loans approved in fiscal year (in thousands)	\$0	\$0	\$0	\$0	\$0	\$0

The Community Provider Program had no outstanding debt for the last three fiscal years, and no loans were outstanding. As no future transactions are anticipated, the unexpended fund balance was transferred to the State's general fund in the fiscal year ended June 30, 2016.

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

The State is not liable on any debt of the Authority, and the bonds are not a debt of the State of Tennessee. For more specific financial information on long-term debt activity, see Note 5, Debt Payable, in the Notes to the Financial Statements.

The financial statements and the analysis provided in the remainder of this report reflect the financial results of this activity.

Debt Administration

The Authority's most long-standing program is its State Loan Program. To date, the State Loan Program has only been utilized to make loans for the construction of water and sewer projects. A financial analysis is conducted for each loan applicant to be funded through the State Loan Program before the application is approved by the Authority. Each Local Government Unit must demonstrate that it has enacted rates and charges sufficient to repay the debt, as well as to fund operations, maintenance, and depreciation. The Authority also compares state-shared taxes, which are pledged by the Local Government Unit, in relation to projected debt service. The Authority is authorized to intercept these state-shared taxes, should the government unit fail to timely repay its loan. The balance of any deficit would be secured by the debt service reserve fund and the statutory reserve fund. The statutory reserve fund is a set aside amount in the fund from appropriations of the State's General Assembly from 1985 to 1987, intended to ensure payment of debt service on debt issued for any purpose under the State Loan Program.

During its construction phase, a project in the State Loan Program is typically funded through the issuance of Bond Anticipation Notes. When a sufficient dollar amount of projects are completed to assure an appropriate economy of scale to sell bonds, the Authority may fix the interest rate for the term of the projects by issuing long-term debt. Interest rates on the State Loan Program facilities long-term fixed-rate debt range from a low of 4.00%% to a high of 4.375%. By pooling the financing of their capital needs, management believes that economic efficiencies of a single large borrowing administered by one agency are achieved. The creditworthiness of both large and small Local Government Units is blended into one credit resulting in a lower cost of borrowing to most participants.

The Authority's State Loan Program is currently rated AA+ by Standard & Poor's Rating Group and AA by Fitch Ratings. The rating reports include comments about the Authority's ongoing commitment to conservative practices, as well as sound legal provisions, strong state oversight, and an ample debt service reserve as strengths of the credit. Rating agencies also note that added strengths of the credit of the program are the underlying credit quality of the local governments receiving loans, the responsibility of the localities to repay loans, and the Authority's history of never needing to intercept state-shared taxes or tap the statutory reserve fund.

The Community Provider program was originally authorized in 1990 by the General Assembly to provide construction financing for eligible borrowers at interest rates lower than would otherwise be obtainable in the capital market. The program was initially funded through the issuance of the 1992 and the 1994 Community Provider bonds. No new loan applications have been received since the issuance of the 1994 bonds. All of the debt has been repaid and there are no longer any loans outstanding.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The State Infrastructure Fund was created in 2009 with the transfer of the existing state infrastructure bank which had been under the administration of the Tennessee Department of Transportation (TDOT). The following sources can be used to provide additional capitalization to the fund: appropriations from the State's General Assembly; federal funds apportioned and available to the State and approved by TDOT; contributions, donations, and grants from the federal government or other governmental units or private entities; and principal and interest repayments from the borrowers. The Authority reviews each loan application to determine the borrower's capability to assure sufficient revenues to operate and maintain the project for its useful life and to repay the loan. The borrower may pledge its state-shared taxes, its full faith and credit and unlimited taxing power, or other security as the Authority deems appropriate. No debt may be issued in order to provide loans to borrowers from the State Infrastructure Fund. The Authority is charged with the responsibilities of approving loan applications and administering the loans. The Authority has received and approved one loan application from the fund.

Overview of the Financial Statements

The Authority is a discretely presented component unit of the State of Tennessee and uses proprietary fund accounting. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting and the flow of economic resources measurement focus. This basis recognizes revenues when earned and expenses at the time liabilities are incurred, regardless of when cash is received or paid. Using the economic resources measurement focus, a reader is presented information that allows them to determine the transactions and events that have increased or decreased the total economic resources for the period.

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements are comprised of two components: 1) the financial statements and 2) notes to the financial statements. The financial statements consist of the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. The Statement of Net Position reports the Authority's overall financial position at June 30, the end of each fiscal year presented. The Statement of Revenues, Expenses and Changes in Net Position reports the results of operations for the year. The Statement of Cash Flows summarizes the inflows and outflows of cash throughout the fiscal year. These statements are supplemented by notes to the financial statements, which provide information essential to the reader's understanding of the financial statements. In addition to the financial statements and notes, this report also contains supplementary information containing financial statement information at the program level.

Financial Analysis of the Authority

Standard indicators of financial success are not applicable to the Authority. The financial goal of the Authority is to provide timely access to the capital markets at the lowest possible cost and to make creditworthy loans. There have been no incidents which required the Authority to refuse a loan application due to the inability to obtain capital funding. Also, the Authority has never had to use the intercept of state-shared taxes, nor has it had to draw from the debt service reserve fund or the statutory reserve fund in order to pay debt service.

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

The following is a discussion highlighting certain elements of the Authority's financial statements.

Statements of Net Position Summary (in thousands of dollars)			
	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current assets	\$15,115	\$15,655	\$15,598
Restricted assets	595	709	936
Other assets	2,628	2,058	2,445
Total assets	18,338	18,422	18,979
Deferred outflows of resources	102	141	179
Current liabilities	656	697	887
Noncurrent liabilities	2,026	2,545	3,154
Total liabilities	2,682	3,242	4,041
Net position (unrestricted)	\$15,758	\$15,321	\$15,117
<i>Note: The Authority owns no capital assets.</i>			

For the years ended June 30, 2018, June 30, 2017, and June 30, 2016, the largest component of the total asset balance is the cash balance. Loans receivable (both current and noncurrent) totaled and \$3,017,883 at June 30, 2018, \$2,522,871 at June 30, 2017, and \$2,991,280 at June 30, 2016. Restricted assets represent the debt service reserve fund. Other assets slightly increased from 2017 to 2018 due to disbursements made to the one borrower in the state infrastructure fund; however, over time it is expected to trend downward unless new loans are made. The Authority's liabilities consist mostly of the outstanding portion of its bonds payable. No bonds have been issued since 2006. No Revenue Bond Anticipation Notes were issued during any of the three years presented. The Authority has not received any loan applications in the current fiscal year and therefore has no plans to issue debt in the immediate future. In the current market, communities who have previously utilized the program have identified other funding opportunities that better suit their needs at this time.

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

Statements of Revenues, Expenses, and Changes in Net Position Summary (in thousands of dollars)			
	<u>2018</u>	<u>2017</u>	<u>2016</u>
Operating Revenues			
Revenue from loans	\$111	\$130	\$135
Administrative fees	378	264	162
Interest income	203	83	39
Total operating revenues	692	477	336
Operating Expenses			
Interest expense	131	163	200
Subsidy to borrowers	13	-	8
Administrative expense	111	110	176
Total operating expenses	255	273	384
Operating income (loss)	437	204	(48)
Transfer from Community Providers state loan program to General fund	-	-	(638)
Increase (Decrease) in Net Position	\$437	\$204	(\$686)

The Authority's operating expenses are supported by revenue received from the borrowers as a one-time cost of issuance expense not to exceed 2% at the time of permanent financing, interest on loans, and income on investments. In addition, the Authority has oversight and approval duties related to loans made from the Clean Water and Drinking Water State Revolving fund (SRF) programs. In 2010, the Authority was given statutory authority to charge the SRF borrowers a fee for the administration of the loans. Therefore, subsequent loans approved are charged an eight-basis point (0.08%) fee on the outstanding balance of the loan over its life. These administrative fees are recognized by the Authority as operating revenue. Operating expenses include interest expense on outstanding debt and administrative expenses of the program. A portion of investment earnings will be returned to borrowers as a subsidy to borrowers upon bond maturity.

Revenue to the Authority increased from 2017 to 2018 and also from 2016 to 2017. The increase in total operating revenues is mainly attributed to administrative fees collected on SRF program loans. Improved market interest rates were responsible for an increase in interest earned on the

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

Authority's investments. Meanwhile, revenue from loans of the Authority is declining. All of the Authority's loans are structured such that the borrowers pay level debt service payments for the life of the loan, meaning that over time the borrowers' principal payment will increase, and the interest payment will decrease. Because no new loans have been made, as the existing loans approach maturity, the interest revenue will trend downward. The Authority's total operating expenses decreased from 2016 to 2017 and from 2017 to 2018. An operating loss occurred in 2016. The operating income reported in 2017 and 2018 is attributable to the administrative fees collected on SRF program loans and a decrease in operating expenses. As revenue from loans continues to decline, subsequent operating losses may occur even if operating expenses decrease.

Contacting the Authority's Management Team

This discussion and analysis is designed to provide our citizens, local government units, community providers, investors, and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Office of State and Local Finance, State of Tennessee, Cordell Hull Building, 425 Fifth Avenue North, Tennessee 37243-3400 or visit our website at <http://www.comptroller.tn.gov/sl/>.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENTS OF NET POSITION
JUNE 30, 2018, AND JUNE 30, 2017

(Expressed in Thousands)

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
ASSETS		
Current assets:		
Cash (Note 2)	\$ 14,726	\$ 15,191
Receivables:		
Loans receivable	<u>389</u>	<u>464</u>
Total current assets	<u>15,115</u>	<u>15,655</u>
Noncurrent assets:		
Restricted cash (Notes 2 and 3)	595	709
Loans receivable	<u>2,628</u>	<u>2,058</u>
Total noncurrent assets	<u>3,223</u>	<u>2,767</u>
Total assets	<u>18,338</u>	<u>18,422</u>
DEFERRED OUTFLOWS OF RESOURCES		
Deferred amount on bond refunding	<u>102</u>	<u>141</u>
LIABILITIES		
Current liabilities:		
Accrued interest payable	33	41
Payable to borrowers (Note 4)	128	71
Revenue bonds payable (Note 5)	<u>495</u>	<u>585</u>
Total current liabilities	<u>656</u>	<u>697</u>
Noncurrent liabilities:		
Revenue bonds payable, net (Note 5)	<u>2,026</u>	<u>2,545</u>
Total noncurrent liabilities	<u>2,026</u>	<u>2,545</u>
Total liabilities	<u>2,682</u>	<u>3,242</u>
NET POSITION		
Unrestricted (Note 6)	<u>15,758</u>	<u>15,321</u>
Total net position	<u>\$ 15,758</u>	<u>\$ 15,321</u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
 FOR THE YEARS ENDED JUNE 30, 2018, AND JUNE 30, 2017

(Expressed in Thousands)

	<u>Year Ended June 30, 2018</u>	<u>Year Ended June 30, 2017</u>
OPERATING REVENUES		
Revenue from loans	\$ 111	\$ 130
Administrative fees collected	378	264
Interest income	<u>203</u>	<u>83</u>
Total operating revenues	<u>692</u>	<u>477</u>
OPERATING EXPENSES		
Interest expense	131	163
Subsidy to borrowers	13	-
Administrative expense	<u>111</u>	<u>110</u>
Total operating expenses	<u>255</u>	<u>273</u>
Operating income	<u>437</u>	<u>204</u>
Change in net position	437	204
Net position, July 1	<u>15,321</u>	<u>15,117</u>
Net position, June 30	<u>\$ 15,758</u>	<u>\$ 15,321</u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2018, AND JUNE 30, 2017

(Expressed in Thousands)

	<u>Year Ended June 30, 2018</u>	<u>Year Ended June 30, 2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to service providers	<u>\$ (111)</u>	<u>\$ (110)</u>
Net cash used by operating activities	<u>(111)</u>	<u>(110)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Principal payments	(585)	(775)
Interest paid	<u>(124)</u>	<u>(161)</u>
Net cash used by noncapital financing activities	<u>(709)</u>	<u>(936)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans issued	(915)	(94)
Collections of loan principal	464	574
Interest received on loans	111	130
Administrative revenue	378	264
Interest received on pooled investment fund	<u>203</u>	<u>83</u>
Net cash provided by investing activities	<u>241</u>	<u>957</u>
Net decrease in cash	(579)	(89)
Cash, July 1	<u>15,900</u>	<u>15,989</u>
Cash, June 30	<u>\$ 15,321</u>	<u>\$ 15,900</u>
Reconciliation of operating Income to net cash used by operating activities:		
Operating income	<u>\$ 437</u>	<u>\$ 204</u>
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(111)	(130)
Interest income	(203)	(83)
Interest expense	131	163
Subsidy to Borrowers	13	-
Administrative revenue from borrowers	<u>(378)</u>	<u>(264)</u>
Total adjustments	<u>(548)</u>	<u>(314)</u>
Net cash used by operating activities	<u>\$ (111)</u>	<u>\$ (110)</u>

The Notes to the Financial Statements are an integral part of this statement.

Tennessee Local Development Authority
Notes to the Financial Statements
June 30, 2018, and June 30, 2017

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee Local Development Authority was created to provide financial assistance to local governments through the issuance of revenue bonds or notes. The Authority has also issued bonds to assist nonprofit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities.

The Authority is a component unit of the State of Tennessee (the state) and a separate legal entity. In accordance with the Governmental Accounting Standards Board's (GASB) Statement No. 14, *The Financial Reporting Entity*, as amended, the Authority is discretely presented in the *Tennessee Comprehensive Annual Financial Report* because the Authority's board consists of state officials which include the Governor, the Secretary of State, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Finance and Administration, a State Senate appointee and a State House appointee. The Governor serves as chairman and the Secretary of State serves as vice chairman. The Comptroller of the Treasury serves as secretary. The Director of the Office of State and Local Finance serves as the assistant secretary; the Office of State and Local Finance provides administrative and financial services to the Authority. Therefore, the state has the ability to affect the day-to-day operations of the Authority.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

The Tennessee Local Development Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The Authority's principal operation is to provide loans to local governments through the issuance of revenue bonds or notes. Therefore, the principal operating revenues of the Authority are from interest on loans made to borrowers. The Authority also recognizes income on investments as operating revenue. The Authority's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, arbitrage, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash

This classification includes cash on hand and deposits in the pooled investment fund administered by the State Treasurer.

Tennessee Local Development Authority
Notes to the Financial Statements (Continued)
June 30, 2018, and June 30, 2017

Bond Discounts, Bond Premiums, and Issuance Costs

Bond discounts and premiums are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable unamortized bond discounts and premiums. Bond issuance costs are expensed when incurred.

NOTE 2. DEPOSITS

Under the general bond resolution of the Tennessee Local Development Authority, the funds of the Authority are to be held and invested by the State Treasurer.

The Authority does not utilize its own bank accounts but has cash on deposit for its operating cash purposes in the State Pooled Investment Fund administered by the State Treasurer. The Authority had \$15,321,385 in the pooled investment fund at June 30, 2018 and \$15,899,242 at June 30, 2017. The pooled investment fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The funds are very liquid; there are no minimum amounts or lengths of time for investment with the exception of a 24-hour notice for withdrawals exceeding \$5,000,000. The fund is not rated by a nationally recognized statistical rating organization. The fund's investments are measured at amortized cost. Its investment policy and required risk disclosures are presented in the *State of Tennessee's Treasurer's Report*. The report is posted on the State's website at <http://www.tn.gov/treasury>.

NOTE 3. RESTRICTED ASSETS

The general bond resolution of the Authority requires that the principal of each bond issue include an amount equal to one year's debt service requirement and that such amount be placed in special trust accounts with the trustee. The required debt service reserve is \$595,490 at June 30, 2018, and \$708,890 at June 30, 2017.

NOTE 4. PAYABLE TO BORROWERS

This account represents interest earnings on restricted assets and loan principal that is being held until the bonds mature and then will be refunded to borrowers.

Tennessee Local Development Authority
Notes to the Financial Statements (Continued)
June 30, 2018, and June 30, 2017

NOTE 5. DEBT PAYABLE

Revenue bonds. Bonds payable at June 30, 2018, and June 30, 2017, are as follows (expressed in thousands):

	<u>June 30,</u> <u>2018</u>	<u>June 30,</u> <u>2017</u>
2006 Refunding Series A at interest rates of 4.0% maturing to 2021 (original par-\$20,070)	\$ 610	\$ 1,005
2006 Series B at interest rates from 4.0% to 4.375% maturing to 2029 (original par-\$37,415)	1,855	2,045
Total par amount of bonds payable	2,465	3,050
Plus unamortized premium	65	90
Less unamortized discount	(9)	(10)
Net bonds payable	\$ 2,521	\$ 3,130

Debt service requirements to maturity of the revenue bonds payable at June 30, 2018, are as follows (expressed in thousands):

<u>For the Year(s)</u> <u>Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	495	100	595
2020	435	81	516
2021	285	63	348
2022	220	52	272
2023	230	43	273
2024-2028	780	75	855
2029	20	1	21
Total	\$ 2,465	\$ 415	\$ 2,880

Tennessee Local Development Authority
Notes to the Financial Statements (Continued)
June 30, 2018, and June 30, 2017

Changes in long-term debt payable for the year ended June 30, 2018, are as follows (expressed in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Revenue bonds payable	\$ 3,050	\$ -	\$ 585	\$ 2,465	\$ 495
Unamortized amounts:					
Premium	90	-	25	65	-
Discount	(10)	-	(1)	(9)	-
Total bonds payable	\$ 3,130	\$ -	\$ 609	\$ 2,521	\$ 495

Changes in long-term debt payable for the year ended June 30, 2017, are as follows (expressed in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Revenue bonds payable	\$ 3,825	\$ -	\$ 775	\$ 3,050	\$ 585
Unamortized amounts:					
Premium	115	-	25	90	-
Discount	(11)	-	(1)	(10)	-
Total bonds payable	\$ 3,929	\$ -	\$ 799	\$ 3,130	\$ 585

Tennessee Local Development Authority
Notes to the Financial Statements (Continued)
June 30, 2018, and June 30, 2017

NOTE 6. STATUTORY RESERVE

The Statutory Reserve is a set aside amount in the fund intended to ensure payment of the required annual debt service (principal and interest) for municipalities that have insufficient state-shared taxes available to the Authority to withhold in the event of a default. Per review of the General Bond Resolution, it was determined that this amount should be classified as unrestricted net position. The Statutory Reserve was funded at \$3 million from appropriations of the State's General Assembly from 1985 to 1987. As of June 30, 2018, the Statutory Reserve balance was \$3,182,097.

As a part of the application process, each loan applicant pledges its available state-shared taxes, giving the Authority the authorization to intercept these state-shared taxes, should the local government unit fail to timely repay its loan. An analysis is conducted to compare this state-shared tax amount to projected maximum annual debt service. The balance of any deficit would be secured first by the debt service reserve and then the Statutory Reserve. Of the Authority's current borrowers, Mount Carmel was the only borrower with a deficit. Maximum annual debt service for Mount Carmel is \$130,372. This loan, which is a part of the 2006 Refunding Series A bonds, is scheduled to mature in February 2020. The bonds have a final maturity of March 2021.

NOTE 7. STATE INFRASTRUCTURE FUND

The Tennessee Transportation State Infrastructure Fund was created pursuant to *Tennessee Code Annotated*, 4-31-1201. The State Infrastructure Program provides assistance to Local Government Units in the construction of transportation infrastructure projects that provide public benefits by enhancing mobility or safety, promoting economic development, or increasing the quality of life and general welfare of the public. In fiscal years 2018 and 2017, no loans were approved.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
 SUPPLEMENTARY SCHEDULES OF NET POSITION - PROGRAM LEVEL
 JUNE 30, 2018, AND JUNE 30, 2017

(Expressed in Thousands)

	June 30, 2018			June 30, 2017		
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
ASSETS						
Current assets:						
Cash	\$ 13,584	\$ 1,142	\$ 14,726	\$ 13,165	\$ 2,026	\$ 15,191
Receivables:						
Loans receivable	389	-	389	464	-	464
Total current assets	13,973	1,142	15,115	13,629	2,026	15,655
Noncurrent assets:						
Restricted cash	595	-	595	709	-	709
Loans receivable	1,502	1,126	2,628	1,847	211	2,058
Total noncurrent assets	2,097	1,126	3,223	2,556	211	2,767
Total assets	16,070	2,268	18,338	16,185	2,237	18,422
DEFERRED OUTFLOWS OF RESOURCES						
Deferred amount on bond refunding	102	-	102	141	-	141
LIABILITIES						
Current liabilities:						
Accrued interest payable	33	-	33	41	-	41
Payable to borrowers	128	-	128	71	-	71
Revenue bonds payable	495	-	495	585	-	585
Total current liabilities	656	-	656	697	-	697
Noncurrent liabilities:						
Revenue bonds payable, net	2,026	-	2,026	2,545	-	2,545
Total noncurrent liabilities	2,026	-	2,026	2,545	-	2,545
Total liabilities	2,682	-	2,682	3,242	-	3,242
NET POSITION						
Unrestricted	13,490	2,268	15,758	13,084	2,237	15,321
Total net position	\$ 13,490	\$ 2,268	\$ 15,758	\$ 13,084	\$ 2,237	\$ 15,321

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
 SUPPLEMENTARY SCHEDULES OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION - PROGRAM LEVEL
 FOR THE YEARS ENDED JUNE 30, 2018, AND JUNE 30, 2017

(Expressed in Thousands)

	Year Ended June 30, 2018			Year Ended June 30, 2017		
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
OPERATING REVENUES						
Revenue from loans	\$ 101	\$ 10	\$ 111	\$ 127	\$ 3	\$ 130
Administrative fees collected	377	1	378	264	-	264
Interest income	183	20	203	72	11	83
Total operating revenues	661	31	692	463	14	477
OPERATING EXPENSES						
Interest expense	131	-	131	163	-	163
Subsidy to Borrowers	13	-	13	-	-	-
Administrative expense	111	-	111	110	-	110
Total operating expenses	255	-	255	273	-	273
Operating income (loss)	406	31	437	190	14	204
Change in net position	406	31	437	190	14	204
Net position, July 1	13,084	2,237	15,321	12,894	2,223	15,117
Net position, June 30	\$ 13,490	\$ 2,268	\$ 15,758	\$ 13,084	\$ 2,237	\$ 15,321

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
 SUPPLEMENTARY SCHEDULES OF CASH FLOWS-PROGRAM LEVEL
 FOR THE YEARS ENDED JUNE 30, 2018, AND JUNE 30, 2017

(Expressed in Thousands)

	Year Ended June 30, 2018			Year Ended June 30, 2017		
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
CASH FLOWS FROM OPERATING ACTIVITIES						
Payments to service providers	\$ (111)	\$ -	\$ (111)	\$ (110)	\$ -	\$ (110)
Net cash used by operating activities	(111)	-	(111)	(110)	-	(110)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Principal payments	(585)	-	(585)	(775)	-	(775)
Interest paid	(124)	-	(124)	(161)	-	(161)
Net cash used by noncapital financing activities	(709)	-	(709)	(936)	-	(936)
CASH FLOWS FROM INVESTING ACTIVITIES						
Loans issued	-	(915)	(915)	-	(94)	(94)
Collections of loan principal	464	-	464	574	-	574
Interest received on loans	101	10	111	127	3	130
Administrative revenue	377	1	378	264	-	264
Interest received on pooled investment fund	183	20	203	72	11	83
Net cash provided by (used by) investing activities	1,125	(884)	241	1,037	(80)	957
Net increase (decrease) in cash	305	(884)	(579)	(9)	(80)	(89)
Cash, July 1	13,874	2,026	15,900	13,883	2,106	15,989
Cash, June 30	\$ 14,179	\$ 1,142	\$ 15,321	\$ 13,874	\$ 2,026	\$ 15,900
Reconciliation of operating income to net cash used by operating activities:						
Operating income	\$ 406	\$ 31	\$ 437	\$ 190	\$ 14	\$ 204
Adjustments to reconcile operating income to net cash used by operating activities:						
Revenue from loans	(101)	(10)	(111)	(127)	(3)	(130)
Interest income	(183)	(20)	(203)	(72)	(11)	(83)
Interest expense	131	-	131	163	-	163
Subsidy to borrowers	13	-	13	-	-	-
Administrative revenue from borrowers	(377)	(1)	(378)	(264)	-	(264)
Total adjustments	(517)	(31)	(548)	(300)	(14)	(314)
Net cash used by operating activities	\$ (111)	\$ -	\$ (111)	\$ (110)	\$ -	\$ (110)



FINANCIAL AND COMPLIANCE AUDIT REPORT

Clean Water State Revolving Fund

For the Year Ended June 30, 2018

Justin P. Wilson
Comptroller of the Treasury



DIVISION OF STATE AUDIT

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JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

April 16, 2019

The Honorable Bill Lee, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority
The Honorable David Salyers, Commissioner
Department of Environment and Conservation

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Clean Water State Revolving Fund for the year ended June 30, 2018. You will note from the independent auditor's report that an unmodified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

A handwritten signature in black ink that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA, Director
Division of State Audit

18/064

Audit Report
Clean Water State Revolving Fund
For the Year Ended June 30, 2018

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State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

Clean Water State Revolving Fund

For the Year Ended June 30, 2018

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority
The Honorable Shari L. Meghreblian, Commissioner
Department of Environment and Conservation

Report on the Financial Statements

We have audited the accompanying financial statements of the Clean Water State Revolving Fund, an enterprise fund of the State of Tennessee, as of and for the years ended June 30, 2018, and June 30, 2017, and the related notes to the financial statements, which collectively comprise the fund'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 an opinion on these financial statements based on our audits. We conducted our audits 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 principles used and 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. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of the Tennessee Local Development Authority. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Clean Water State Revolving Fund.

Opinion

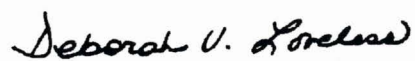
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Clean Water State Revolving Fund of the State of Tennessee as of June 30, 2018, and June 30, 2017, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Clean Water State Revolving Fund, an enterprise fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2018, and June 30, 2017, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 27, 2018, on our consideration of the Clean Water State Revolving Fund'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 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 fund's internal control over financial reporting and compliance.



Deborah V. Loveless, CPA, Director
Division of State Audit
November 27, 2018

CLEAN WATER STATE REVOLVING FUND
Statements of Net Position
June 30, 2018, and June 30, 2017

(Expressed in Thousands)

	June 30, 2018	June 30, 2017
Assets		
Current assets:		
Cash (Note 2)	\$ 423,883	\$433,866
Loans receivable	36,059	26,301
Total current assets	459,942	460,167
Noncurrent assets:		
Loans receivable	589,306	532,262
Total noncurrent assets	589,306	532,262
Total assets	1,049,248	992,429
Liabilities		
Current liabilities:		
Payable to borrowers (Note 3)	95	34
Total current liabilities	95	34
Noncurrent liabilities:		
Customer deposits payable (Note 2)	7,834	6,871
Total noncurrent liabilities	7,834	6,871
Total liabilities	7,929	6,905
Net position		
Unrestricted	1,041,319	985,524
Total net position	\$1,041,319	\$985,524

The notes to the financial statements are an integral part of this statement.

CLEAN WATER STATE REVOLVING FUND
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2018, and June 30, 2017

(Expressed in Thousands)

	Year Ended June 30, 2018	Year Ended June 30, 2017
Operating revenues		
Revenue from loans	\$ 9,088	\$ 8,123
Interest income	5,451	2,372
Total operating revenues	14,539	10,495
Operating expenses		
Administrative expenses	1,377	1,065
Total operating expenses	1,377	1,065
Operating income	13,162	9,430
Nonoperating revenues		
Capitalization grant	43,030	7,437
Total nonoperating revenues	43,030	7,437
Nonoperating expenses		
Principal forgiveness (Note 5)	2,199	3,038
Total nonoperating expenses	2,199	3,038
Income before transfers	53,993	13,829
Transfers in (Note 4)	1,802	6,421
Change in net position	55,795	20,250
Net position, July 1	985,524	965,274
Net position, June 30	\$1,041,319	\$985,524

The notes to the financial statements are an integral part of this statement.

CLEAN WATER STATE REVOLVING FUND
Statements of Cash Flows
For the Years Ended June 30, 2018, and June 30, 2017

(Expressed in Thousands)

	<u>Year Ended</u> <u>June 30, 2018</u>	<u>Year Ended</u> <u>June 30, 2017</u>
Cash flows from operating activities		
Payments for interfund services	\$ (1,377)	\$ (1,065)
Net cash used by operating activities	(1,377)	(1,065)
Cash flows from noncapital financing activities		
Operating grants received	43,030	7,438
Transfers in	1,802	6,421
Net cash provided by noncapital financing activities	44,832	13,859
Cash flows from investing activities		
Loans issued and other disbursements to borrowers	(101,071)	(119,016)
Collections of loan principal	32,070	27,140
Security deposits from borrowers	986	727
Interest received on loans	9,088	8,123
Interest received on investments	5,546	2,406
Amounts repaid to borrowers	(57)	(163)
Net cash used by investing activities	(53,438)	(80,783)
Net decrease in cash	(9,983)	(67,989)
Cash, July 1	433,866	501,855
Cash, June 30	\$423,883	\$433,866
Reconciliation of operating income to net cash used by operating activities:		
Operating income	\$ 13,162	\$ 9,430
Adjustments to reconcile operating income to net cash used by operating activities:		
Revenue from loans	(9,088)	(8,123)
Interest income	(5,451)	(2,372)
Total adjustments	(14,539)	(10,495)
Net cash used by operating activities	\$ (1,377)	\$ (1,065)

The notes to the financial statements are an integral part of this statement.

CLEAN WATER STATE REVOLVING FUND
Notes to the Financial Statements
June 30, 2018, and June 30, 2017

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The Clean Water State Revolving Fund was created to provide local governments and utility districts with low-cost financial assistance to improve and protect water quality and public health. The Clean Water State Revolving Fund has been included in Tennessee's *Comprehensive Annual Financial Report* as an enterprise fund (Sewer Treatment Loan Fund).

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

Operating revenues and expenses are distinguished from nonoperating items in the Clean Water State Revolving Fund. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The principal operation of the fund is to provide loans to local governments through a revolving loan fund established under Title VI of the Clean Water Act. Therefore, the principal operating revenues of the fund are from interest on loans made to borrowers. The fund also recognizes interest income as operating revenue. The fund's operating expenses are its administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash

This classification includes cash on hand and deposits in the pooled investment fund administered by the State Treasurer.

Note 2. Deposits

At June 30, 2018, the Clean Water State Revolving Fund had \$416,047,938 in the State Treasurer's pooled investment fund for operating cash purposes, and \$7,834,578 in customer security deposits in the Local Government Investment Pool. At June 30, 2017, the fund had \$426,993,796 in the State Treasurer's pooled investment fund and \$6,872,059 in the Local Government Investment

Notes to the Financial Statements (Continued)

Pool. The Local Government Investment Pool is part of the pooled investment fund administered by the State Treasurer. The pooled investment fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The funds are very liquid; there are no minimum amounts or lengths of time for investment. The fund is not rated by a nationally recognized statistical rating organization. The fund's investments are measured at amortized cost. Its investment policy and required risk disclosures are presented in the *State of Tennessee's Treasurer's Report*. The report is posted on the state's website at www.treasury.state.tn.us.

Note 3. Payable to Borrowers

This account represents loan principal overpayments that will be refunded to borrowers and interest earned on security deposits, which is due to the borrowers per the loan agreements.

Note 4. Interfund Transfer

Each year since the Clean Water State Revolving Fund Loan Program's inception in 1987, the state has been awarded a capitalization grant from the United States' Environmental Protection Agency to fund the program. The Clean Water State Revolving Fund received an interfund transfer from the state's general fund to provide a state match for the federal grant to operate the program of \$1,802,361 during the year ended June 30, 2018, and \$6,421,254 during the year ended June 30, 2017.

Note 5. Principal Forgiveness

In fiscal year 2010, the Clean Water State Revolving Fund received money from the American Recovery and Reinvestment Act (ARRA) of 2009. As part of the conditions stipulated by the Act for acceptance of this money, the State Revolving Fund program granted principal forgiveness to the borrowers. Each community that received an ARRA loan was granted 40% principal forgiveness; thus, only 60% of the total award was recorded as a repayable loan. Additionally, each community was limited to one ARRA loan in an amount that could not exceed \$12.5 million.

Beginning in fiscal year 2011, and continuing through the present, the capitalization grant received by the Clean Water State Revolving Fund also stipulated that the state must subsidize a portion of the borrower loans. Therefore, for the first time as a part of its normal operations, the fund began granting principal forgiveness as a part of the loans made from the capitalization grant. The communities to receive this subsidization are determined according to normal procedures of priority ranking used in the past to make loans. Principal forgiveness is recognized on the statements of cash flows as "loans issued and other disbursements to borrowers."



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

**Independent Auditor's 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***

The Honorable Bill Haslam, Governor
Members of the General Assembly
Members of the Tennessee Local Development Authority
The Honorable Shari L. Meghreblian, Commissioner
Department of Environment and Conservation

We have audited the financial statements of the Clean Water State Revolving Fund, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements, and have issued our report thereon dated November 27, 2018. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Clean Water State Revolving Fund'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 fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the fund'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 Clean Water State Revolving Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

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



Deborah V. Loveless, CPA, Director
Division of State Audit
November 27, 2018

Fiscal Year Ending June 30, 2018

TLDA Programs

1. State Loan Program Fund: (Water/Sewer)
 - 8 borrowers
 - 10 loans outstanding
 - \$2,465,000 bonds outstanding (Final maturity 2029)
 2. State Infrastructure Fund (Transportation)
 - 1 borrower
 - \$914,772 disbursed during fiscal year
- No new loans are being issued for these programs
- Operating Income: \$437,999
- Net Position at June 30, 2018: \$15,759,072

State Revolving Fund Loan Programs

1. Clean Water Fund
 - Disbursements
 - \$101,071,195
 - Collections
 - \$32,070,133 loan principal
 - \$9,087,900 interest
 - Net position at June 30, 2018: \$1,041,318,580
2. Drinking Water Fund
 - Disbursements
 - \$16,759,015
 - Collections
 - \$13,146,413 loan principal
 - \$1,942,268 interest
 - Net position at June 30, 2018: \$222,916,047

No significant changes to accounting and reporting standards



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 4
ATLANTA FEDERAL CENTER
61 FORSYTH STREET
ATLANTA, GEORGIA 30303-8960

MAY 07 2019

Ms. Jennifer Dodd
Director
Division of Water Resources
Tennessee Department of Environment and Conservation
Tennessee Tower, 11th Floor
312 Rosa Parks Avenue
Nashville, Tennessee 37243

Dear Ms. Dodd:

Enclosed are the annual program evaluation reports for Tennessee's Clean Water and Drinking Water State Revolving Fund Programs.

If you have any questions, please feel free to contact me, or have your staff contact Ms. Sheryl Parsons at (404) 562-9337.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jeaneanne M. Gettle".

Jeaneanne M. Gettle, Director
Water Division

Enclosures

PROGRAM EVALUATION REPORT

**Tennessee
Clean Water State Revolving Fund
FY 2018 Program Review**

**Region 4
U.S. Environmental Protection Agency
December 2018**

INTRODUCTION

The Tennessee Department of Environment and Conservation (TDEC) initiated operations of the Clean Water State Revolving Fund (CWSRF) in 1987 with its first capitalization grant from the U.S. Environmental Protection Agency (EPA) Region 4.

During Fiscal Year (FY) 2018, the State entered into 32 new loans totaling \$186 million for the construction of wastewater facilities. As of June 30, 2018, the pace of the program was 98 percent. The State is commended for their recent partnership efforts with EPA Region 4. During the past year TDEC staff have actively sought out technical assistance from EPA Region 4 staff members, participated in EPA workgroup meetings and received additional SRF program training. TDEC has requested additional training for SRF staff.

The CWSRF has been administered in accordance with Title VI of the Clean Water Act as amended and is in compliance with the terms, schedules; provisions and assurances of the current fiscal year Intended Use Plan (IUP), the current operating agreement between the state and the EPA and the conditions of the CWSRF Capitalization Grant Agreements.

SECTION I: PURPOSE AND SCOPE

Region 4 conducted the FY 2018 annual review of TDEC on December 3-5, 2018. The process was conducted as prescribed in Section 606 (e) of the Clean Water Act (CWA), 40 CFR §35.3165, Chapter 7 of the State Revolving Fund Management Manual and the Annual Review Guidance issued in December 2015. Activities incorporated into the Annual Review included an analysis of Tennessee's 2018 Annual Report and an onsite visit to the State offices in Nashville, Tennessee to review files.

The annual review included an examination of the State's Capitalization Grant (plus any amendment thereto), the Intended Use Plan (IUP), operating agreement and any additional documentation used to establish the CWSRF, relative to the annual report and other necessary and appropriate materials describing how the CWSRF performed during FY 2018, as outlined in 40 CFR §35.3165. The scope of the annual review includes consideration of the legal, technical, managerial, financial and operational capabilities of TDEC. Areas of general interest are compliance with grant conditions, certifications and assurances, adherence to specific proposals and, progress toward stated goals and objectives.

Attending the entrance conference for TDEC were Paula Mitchell, Jenny Dodd, Leslie Gillespie-Marthaler, Benny Romero, Felicia Freeman, Andrea Fenwick, LaWanda Johnson, Benh Awala, Vidya Bhupathratu and Vince Haymon. Attending from the EPA Headquarters (HQ) DWSRF was Nick Chamberlain. Attending from EPA Region 4 were Sheryl Parsons and Tom Cooney.

The overview team interviewed the appropriate staff persons as identified at the entrance conference and reviewed the following: project loan files, loan agreements, standard operating procedures, loan payment records, Disadvantaged Business Enterprises (DBE) records, financial records and any other documents the State uses to manage the program.

After the on-site review was completed, an exit briefing was held to review the observations with the TDEC staff and to obtain clarification of any outstanding issues. Attending the exit conference for TDEC were Leslie Gillespie-Marthaler, Benny Romero, Felicia Freeman, Andrea Fenwick, Rick Tamble, Benh Awala, Vidya Bhupathratu and Vince Haymon. Attending from the EPA HQ DWSRF was Nick Chamberlain. Attending from EPA Region 4 were Sheryl Parsons and Tom Cooney.

SECTION II: COMPLIANCE REQUIREMENTS

The State is in compliance with the nineteen items stated in the grant agreement.

The operating agreement should be amended to reflect changes to the CWSRF from the Water Resources Reform and Development Act (WRRDA) and to reflect changes to the Tennessee program. The EPA will work with TDEC staff to update the agreement by December 31, 2019. Additionally, the most recent annual independently-conducted financial and compliance audit of the CWSRF for the year ending June 30, 2017 had no findings. At the time of this review, the audit for the year ending June 30, 2018 had not been completed.

The State's overall Disadvantaged Business Enterprises (DBE) program percentage goal for fiscal year 2018 was 7.8 percent. The actual DBE procurement awarded was 9.91 percent. The State ensures borrowers follow the six (6) affirmative steps. The State is commended on the increase in DBE participation.

Based on the review, the following items describe the activities and observations of interest:

- A. Acceptance of Grant: Payments, 40 CFR §35.3135(a). The state must agree to accept grant payments in accordance with the negotiated payment schedule.

During the reporting period, the State accepted grant payments in accordance with the negotiated payment schedule.

- B. State Match, 40 CFR §35.3135(c). The state must agree to deposit into its CWSRF an amount equaling at least 20 percent of the amount of each grant payment. The State match must be deposited on or before the date on which the state receives each payment from the grant award.

The FY 2017 capitalization grant in the amount of \$19,259,000 was received September 18, 2017. The 20 percent State match amount of \$3,851,800 was provided through state funds.

- C. Binding Commitments, 40 §CFR 35.3135(c). The state must make binding commitments in an amount equal to 120 percent of each quarterly grant payment within one year after receipt of each quarterly grant payment.

The State is in compliance with this requirement.

- D. Timely Expenditure of Funds, 40 CFR §35.3135(d). The state must expend all funds in the CWSRF in an expeditious and timely manner.

The overall pace percentage for the State is 98 percent (the national average is 99 percent). The State disbursed a total of \$101,071,195 from the CWSRF in FY 2018.

- E. Eligible Activities, 40 CFR §35.3115, 3120 and 3125. The CWSRF must be used solely to provide loans and other authorized forms of assistance: (a) to municipalities, inter-municipal, interstate, or state agencies for the construction of publicly owned treatment works as defined in Section 212 of the Act and that appear on the state's priority list developed pursuant to Section 216 of the Act; and (b) for implementation of a nonpoint source pollution control management program under Section 319 of the Act; and (c) for development and implementation of an estuary conservation and management plan under Section 320 of the Act.

The State has funded only eligible projects.

- F. Abide by State Law, 40 CFR §35.3135(g). The state must agree to commit or expend each quarterly capitalization grant payment in accordance with the state's own laws and procedures regarding the commitment or expenditure of revenues.

The State certified that they followed their own laws and procedures regarding the commitment or expenditure of revenues.

- G. Other Federal Authorities, 40 CFR §35.3145(a). The state must agree to comply and to require all recipients of funds directly made available by capitalization grants to comply with applicable federal authorities.

In the Annual Report, under the provisions of the operating agreement/conditions of their grant, the State certified compliance with other federal authorities.

- H. Rules of Cash Draw, 40 CFR §35.3155(d) and 35.3160. Cash draws for the reporting period ending June 30, 2018, were made in accordance with 40 CFR 35.3160. Tests were conducted regarding cash draws for administrative assistance. All cash draws for administrative assistance were made after costs had been incurred in compliance with 40 CFR 35.3160(e)(2).

- I. Generally Accepted Accounting Principles, 40 CFR §35.3135(h). The state must agree to establish fiscal control and accounting procedures that are sufficient to assure proper accounting for payments received by the CWSRF, disbursements made by the CWSRF, and CWSRF balances at the beginning and end of the accounting period. The state must also agree to use accounting, audit, and fiscal procedures conforming to generally accepted government accounting standards as these are promulgated by the Governmental Accounting Standard Board.

In the annual report, the State certified adherence to state auditing and accounting procedures which comply with the Single Audit Act of 1984 and OMB circular A-128 by reference to the Operating Agreement.

- J. Recipient Accounting, 40 CFR §35.3135(i). The state must agree to require recipients of CWSRF assistance to maintain project accounts in accordance with generally accepted government accounting standards as these are promulgated by the Government Accounting Standards Board.

The State has complied with this requirement via the loan agreement.

- K. Annual Report, 40 CFR §35.3135(j) and 35.3165. The state must agree to make available an Annual Report to the Regional Administrator (RA) on the actual use of the funds, in accordance with Section 606(d) of the CWA. The state must also provide an Annual Report to the EPA RA beginning the first fiscal year after it receives payments under Title VI. The state submits this report to the RA according to the schedule established in the grant agreement.

The Annual Report for Tennessee's CWSRF program was received by September 29, 2018, for the State fiscal year ending June 30, 2018. The report contained adequate and accurate information regarding program data.

- L. Environmental Reviews, 40 CFR §35.3140. Generally, the state must agree to conduct reviews of the potential environmental impacts of all Section 212 construction projects receiving assistance from the CWSRF, including nonpoint source pollution control Section 319 and estuary protection Section 320 projects that are also Section 212 projects. Equivalency projects must undergo a State Environmental Review Process (SERP) that conforms generally to the National Environmental Policy Act (NEPA). The state may elect to apply the procedures at 40 CFR Part 6, subpart E and related subparts, or apply its NEPA like SERP for conducting environmental reviews.

The State has a NEPA-like SERP which was approved by the RA. Two (2) projects were reviewed for compliance with the SERP. All projects followed the SERP and were well documented.

- M. Consistency with Planning, 40 CFR §35.3125(e). The CWSRF may provide assistance only to projects that are consistent with any plans developed under Sections 2050, 208, 303(e), 319 and 320 of the CWA.

The State is in compliance with this regulation.

- N. Outlay Management, 40 CFR §35.3155(b). With the first application for a capitalization grant, the state shall submit a schedule that reflects, by quarters, the estimated disbursements from that grant for the year following the grant award date. At the end of the third quarter of each federal fiscal year thereafter, the state must provide the Agency with a schedule of estimated disbursements for the following federal fiscal year. The state must advise the Agency when significant changes from the schedule of estimated disbursements are anticipated. This schedule must be developed in conformity with the procedures applicable to cash draws in 40 CFR 35.3160 and must be at a level of detail sufficient to allow the Agency and the state to jointly develop and maintain a forecast of cash draws.

The State is in compliance with this regulation.

- O. Intended Use Plan, 40 CFR §35.3150. The state must prepare a plan identifying the intended uses of the funds in the CWSRF and describing how those uses support the goals of the CWSRF. The IUP must be prepared annually and must be subjected to public comment and review before being submitted to the EPA. The EPA must receive the IUP prior to the award of the capitalization grant.

According to Section 606(c) of the CWA, after providing the IUP for public comment and review, each state shall annually prepare a plan identifying the intended uses of the amounts (including repayments) available to its water pollution control revolving fund.

The State's FY 2018 IUP was complete and included repayments and interest earnings in the amounts available for assistance.

P. Perpetuity, 40 CFR §35.3 100(a). The Agency implements the state water pollution control revolving fund program in a manner that reserves the state a high degree of flexibility for operating their revolving funds in accordance with each state's unique needs and circumstances. These regulations advance the general intent of Title VI of the CWA, which is to ensure that each state's program is designed and operated to continue providing assistance for water pollution control activities in perpetuity.

Section 606(c) requires that the states shall annually prepare a plan identifying the intended uses of the amounts available to its water pollution control revolving fund. Generally, based on an Office of General Council (OGC) opinion in a January 19, 1995, memo, a one-year time frame seems reasonable for committing repayments and other funds to projects. If all available funds are not committed to projects, then the IUP must contain a plan which details how and when the funds will be used.

The State is complying with this requirement. The State has a plan to commit funds to projects in a timely fashion.

SECTION III: PROGRAM GOALS

The State has two long term goals for the CWSRF. These goals and accomplishments are reported by the State and verified by the Region include:

Goal #1: Maintain a self-sustaining revolving loan program through the CWSRF Loan Program to provide local governments in Tennessee with low-cost financial assistance for wastewater facilities projects.

Status: The Tennessee Comptroller of the Treasury audits the CWSRF annually. The CWSRF is presented in a separate column of in the State of Tennessee's Comprehensive Annual Financial Report. The fiscal responsibilities are coordinated among TDEC, the Comptroller's Office and the Department of Finance and Administration to ensure appropriate internal controls and proper accounting procedures.

Goal #2. Protect and enhance the water quality in Tennessee by ensuring the technical integrity of funded projects.

Status: The SRFLP maintains a priority ranking system, and all potential CWSRF projects are assigned priority points. All projects are reviewed for compliance with federal crosscutting authorities and has an environmental review according to the approved SERP prior to loan award.

The State has two short term goals for the CWSRF. These goals and accomplishments are reported by the State and verified by the Region include:

Goal #1: Maximize funds available through cooperation with the Environmental Protection Agency.

Status: Staff from SRFLP have attended the Tennessee Municipal League and Tennessee Association of Utility Districts to actively pursue potential borrowers.

Goal #2: Manage an effective and efficient CWSRF Loan Program.

Status: The program and the Comptroller's Office continues to exchange ideas and information concerning the CWSRF. The standard operating procedures are being reviewed and updated.

SECTION IV: PROJECT FILES REVIEWED

There were two project files reviewed during the annual oversight review. These projects were:

Jasper, a \$750,000 (\$29,974 principal forgiveness) 20-year loan for infiltration and inflow correction. The loan was awarded on October 26, 2017. The interest charged was 1.5 percent and a Categorical Exclusion (CE) was issued on July 3, 2017.

Troy, a \$625,725 20-year loan for infiltration and inflow corrections. The loan was awarded on July 26, 2017. The interest rate was 0.39 percent and a CE was issued on July 21, 2017.

Both projects were eligible for SRF funding and followed all environmental review and procurement requirements.

SECTION V: ENVIRONMENTAL BENEFITS REPORTING

During FY 2018, the State entered into 32 new loans totaling \$186 million for the construction of wastewater facilities.

TDEC updated the Clean Water Benefits Reporting (CBR) database as required in a timely fashion. All the necessary information about projects funded in FY 2018 had been entered into the CBR system.

SECTION VI: CASH DRAWS

Four draws were reviewed during the annual oversight visit. The draws were: \$14,894.17 on December 29, 2017; \$63,268.33 on February 7, 2018; \$294,870.83 on February 12, 2018; and \$542,758.33 on January 23, 2018. No improper payments were identified.

SECTION VII: FINANCIAL INDICATORS

As of June 30, 2018, the pace of the CWSRF was 98 percent (a cumulative amount of loans issued as a percentage of all funds available from the data). The national average for the CWSRF is 99

percent. The State has made progress over the past few years and should continue efforts to increase loan executions.

Disbursements as a percentage of assistance provided shows how quickly loans are being disbursed to borrowers, which, of course, follows costs incurred. TDECs disbursement percentage is 79 percent compared to the national average of 86 percent.

Return on federal investment is a performance measure used to evaluate the efficiency of an investment, that is, it measures the gain (or loss) generated relative to the federal dollars invested. The State's return on federal investment is 223 percent. The national average for non-leveraged states is 205 percent.

On the basis of our financial review, we conclude that TDEC is in sound financial condition.

SECTION VIII: FOLLOW UP ON PRIOR YEAR PROGRAM EVALUATION REPORT RECOMMENDATIONS

1. The State should update their operating agreement to reflect the WRRDA amendment changes as well as changes in their program.

Status: The EPA will work with TDEC staff to provide samples update the agreement.

2. The State should continue efforts to increase the pace of the program.

Status: Completed. The loan executions have increased.

The State should continue to ensure borrowers follow the six (6) affirmative steps to maximize DBE participation.

Status: The State ensures borrowers follow the six (6) affirmative steps. The actual DBE procurement awarded was 9.91 percent which is above the goal of 7.8 percent.

SECTION IX: RECOMMENDATIONS

1. It is recommended the State finalize their updated draft operating agreement to reflect the WRRDA amendment changes as well as changes in their program.
2. It is recommended the State add American Iron and Steel and Davis-Bacon to their inspection checklist.
3. It is recommended the State update loan agreements to include the most recent American Iron and Steel and Davis-Bacon provisions.
4. It is recommended the State consider increasing the amount of the loan closing fee charged.

PROGRAM EVALUATION REPORT

**Tennessee
Drinking Water State Revolving Fund
FY 2018 Program Review**

**Region 4
U.S. Environmental Protection Agency
December 2018**

INTRODUCTION

The Tennessee Department of Environment and Conservation (TDEC) initiated operations of the Drinking Water State Revolving Fund (DWSRF) program in 1997, with their first capitalization grant from the U.S. Environmental Protection Agency Region 4.

During Fiscal Year (FY) 2018, the State awarded 14 new loans totaling \$7,513,725. All the loans were to small communities.

The State is commended for their recent partnership efforts with the EPA Region 4. TDEC staff have actively sought out technical assistance from the EPA Region 4 staff, participated in EPA workgroup meetings and received additional SRF program training. TDEC has requested additional training for SRF staff and training for Tennessee Public Utility Commission on funding for their regulated drinking water systems.

The DWSRF has been administered in accordance with Section 1452 of the SDWA as amended, and is in compliance with the terms, schedules, provisions and assurances of the current fiscal year work plans, the current operating agreement between the State, the EPA and the conditions of the DWSRF Capitalization Grant Agreements.

SECTION I: PURPOSE AND SCOPE

The EPA Region 4 conducted the FY 2018 annual review of TDEC on December 3-5, 2018. The process was conducted as prescribed in the Annual Review Guidance issued December 2015. Activities incorporated into the Annual Review included an analysis of Tennessee's 2018 Annual Report and an onsite visit to the State offices in Nashville, Tennessee to review files.

The annual review included an examination of the State's Capitalization Grant (plus any amendment thereto), Intended Use Plan (IUP), operating agreement and any additional documentation used to establish the DWSRF, relative to the annual report, and other necessary and appropriate materials describing how the DWSRF performed during FY 2018. The scope of the annual review includes consideration of the legal, technical, managerial, financial and operational capabilities of TDEC. Areas of general interest are compliance with grant conditions, certifications and assurances, adherence to specific proposals, and progress toward stated goals and objectives.

Attending the entrance conference for TDEC were Paula Mitchell, Jenny Dodd, Leslie Gillespie-Marthaler, Benny Romero, Felicia Freeman, Andrea Fenwick, LaWanda Johnson, Benh Awala, Vidya Bhupathratu and Vince Haymon. Attending from the EPA Headquarters (HQ) DWSRF was Nick Chamberlain. Attending from the EPA Region 4 were Sheryl Parsons and Tom Cooney. The overview team interviewed the appropriate staff persons as identified at the entrance conference and reviewed the following: project loan files, loan agreements, standard operating procedures, loan payment records, Disadvantaged Business Enterprises (DBE) records, financial records and any other documents the State uses to manage the program.

After the on-site review was completed, an exit briefing was held to review the observations with the TDEC staff and to obtain clarification of any outstanding issues. Attending the exit conference

for TDEC were Leslie Gillespie-Marthaler, Benny Romero, Felicia Freeman, Andrea Fenwick, Rick Tamble, Benh Awala, Vidya Bhupathratu and Vince Haymon. Attending from the EPA HQ DWSRF was Nick Chamberlain. Attending from the EPA Region 4 were Sheryl Parsons and Tom Cooney.

SECTION II: COMPLIANCE REQUIREMENTS

The State is in compliance with the thirteen assurances stated in the grant agreement, including capacity development and operator certification requirements.

The operating agreement should be amended to reflect changes to the DWSRF from the Water Infrastructure Improvements for the Nation Act (WIIN) and to reflect changes to the Tennessee program. The EPA will work with TDEC staff to update the agreement by December 31, 2019. The Tennessee DWSRF is part of the state single audit. At the time of the review, the latest independently conducted financial and compliance audit covering the year ending June 30, 2017, had no findings for the Tennessee DWSRF. The audit for the year ending June 30, 2018 had not been completed.

The State's overall DBE program percentage goal for FY 2018 was 7.8 percent. The actual DBE procurement awarded was 0 percent. The State should ensure borrowers follow the six affirmative steps to maximize DBE participation.

Based on the review, the following items describe the activities and observations of interest:

1. Assurance that the state has the authority to establish a fund and to operate the DWSRF program in accordance with the SDWA.

The State provided the required Attorney General certification with the grant application.

2. Assurance that the state will comply with state statutes and regulations and abide by state law.

The State certified this in the IUP.

3. Assurance that the state has the technical capability to operate the program.

The State is in compliance with this assurance.

4. Assurance that the state will accept capitalization grant funds in accordance with a payment schedule.

The State certified this in the IUP.

5. Assurance that the state will deposit all capitalization grant funds in the fund or set-aside account.

The State is in compliance with this assurance.

6. Assurance that the state will provide an amount at least equal to 20 percent of the capitalization grant (state match) in the fund.

The FY 2017, capitalization grant in the amount of \$8,241,000 was received September 18, 2017. The 20 percent State match amount of \$1,648,200 was provided through state funds.

7. Assurance that the state will deposit net bond proceeds, interest earnings and repayments into the fund.

The State does not leverage. All repayments and interest earnings are credited to the fund.

8. Assurance that the state will use Generally Accepted Accounting Principles.

The State has complied with this assurance.

9. Assurance that the state will have the fund and set-aside account audited annually in accordance with Generally Accepted Government Auditing Standards.

The DWSRF is audited with the state accounts.

10. Assurance that the state will adopt policies and procedures to assure that borrowers have a dedicated source of revenue for repayments (or in the case of a privately-owned system, demonstrate that there is adequate security).

The State has complied with this assurance

11. Assurance that the state will commit and expend funds as efficiently as possible and in an expeditious and timely manner.

The overall pace percentage for the State is 72 percent (the national average is 96 percent). The State disbursed a total of \$16,759,015 from the DWSRF in FY 2018.

12. Assurance that funds will be used in accordance with the IUP.

The State is in compliance with this assurance.

13. Assurance that the state will provide the EPA with a Biennial Report.

The Annual Report for Tennessee's DWSRF program was received by September 29, 2018, for the State fiscal year ending June 30, 2018. The report contained adequate and accurate information regarding program data.

SECTION III: PROGRAM GOALS

The State has two long term goals for the DWSRF. These goals and accomplishments reported by the State and verified by the Region include:

Goal #1: Ensure the financial stability of loan recipients by reviewing the financial history, loan security and user rates of loan applicants.

Status: A State Revolving Fund Loan Program (SRFLP) accountant attends the pre-application conferences to explain the applicant's financial responsibilities. The accountant reviews comparative historical financial statements and projected financial information prior to loan award.

Goal #2: Protect and enhance the drinking water quality in Tennessee by ensuring the technical integrity of funded projects.

Status: The SRFLP works with the Drinking Water Section to provide a priority ranking system in accordance with DWSRF program requirements. The SRFLP has worked with those projects ranking highest in priority points that are ready to proceed.

The State has four short term goals for the DWSRF. Two of these goals and accomplishments, reported by the State and verified by the Region include:

Goal #1: Maximize funds available through cooperation with the EPA.

Status: The SRFLP sent letters to potential borrowers with the highest-ranking projects on the state's Priority List requesting them to submit a letter of request and schedule a pre-application conference.

Goal #2: Direct the necessary resources for Section 1452(g)(2) and 1452(k) to the State's most pressing compliance and public health needs.

Status: Managerial, financial and technical assistance has been provided to municipal water systems and utility districts through the SRFLP staff. Capacity development reviews have been completed on all loan applicants.

SECTION IV: PROJECT FILES REVIEWED

There were two project files reviewed during the annual oversight review. These projects were:

Troy, a \$699,950 loan for the replacement of water lines. The loan was awarded on July 13, 2017. The interest charged was 0.39 percent. A Categorical Exclusion (CE) was issued on July 21, 2017.

Bell Buckle, a \$166,000 loan for the replacement of water lines. The loan was awarded on September 5, 2017. The interest charged was 0.17 percent. A CE was issued on August 18, 2017.

Both projects were eligible for DWSRF funding and followed the environmental review and procurement requirements.

SECTION V: ENVIRONMENTAL BENEFITS REPORTING

During FY 2018, the State awarded 14 new loans totaling \$7,513,725.

Additionally, TDEC updated the Public Water Supply Benefits Reporting (PBR) database as required in a timely fashion. All necessary information about projects funded in FY 2018 had been entered in the PBR system.

SECTION VI: CASH DRAWS

Four draws were reviewed during the annual oversight visit. The draws were: \$82,290.16 on August 17, 2017; \$12,877.29 on August 1, 2017; \$40,831.67 on July 3, 2017; and \$169,109.37 on February 2, 2018. No improper payments were identified.

SECTION VII: FINANCIAL INDICATORS

As of June 30, 2018, the pace of the program was 72 percent (cumulative amount of loans issued as a percentage of all funds available from data). The national average for the DWSRF is 96 percent. The pace has dropped from 78 percent as of June 30, 2017. The State is engaged in trying to market the program and has asked to have direct marketing assistance from the Region.

Disbursements as a percentage of assistance provided shows how quickly loans are being disbursed to borrowers, which, of course, follows costs incurred. TDECs disbursement percentage is 102 percent compared to the national average of 87 percent.

Return on federal investment is a performance measure used to evaluate the efficiency of an investment, that is, it measures the gain (or loss) generated relative to the federal dollars invested. The State's return on federal investment is 126 percent. The national average for non-leveraged states is 194 percent.

On the basis of our financial review, we conclude that TDEC is in sound financial condition.

SECTION VIII: SET ASIDE PERFORMANCE

The DWSRF program gives states the option of using up to 31 percent of their capitalization grant for activities that protect sources of drinking water and enhance water systems management. Tennessee has elected to use the set-asides in the following manner.

State Program Management

Section 1452(g) (2) of the SDWA allows up to 10 percent of the DWSRF capitalization grant to be set-aside to support other program initiatives of the SDWA. For State Program Management, the State used \$824,100. These funds provided program support for the PWSS program, including data management and compliance.

Small System Technical Assistance

In FY 2018, the program used \$166,820 for this set aside. The Fleming Training Center (FTC) in Murfreesboro, Tennessee administers the small system technical assistance set-aside. The FTC conducts operator training for water operators. For FY 2018, 68 operators were trained, and 107 days of instruction were provided.

SECTION IX: FOLLOW UP ON PRIOR YEAR PROGRAM EVALUATION REPORT

1. The State should finalize their updated draft Operating Agreement with the EPA Region 4 to incorporate the WIIN Act.

Status: The EPA has received a draft of the document and will work with TDEC staff to update the agreement.

2. The State should continue efforts to increase the pace of the program.

Status: While TDEC is committed to exploring efforts to increase loan executions, the pace fell to 72 percent in FY 2018. The State has requested additional assistance via training and marketing from the Region.

3. The State should continue to ensure borrowers follow the six affirmative steps to maximize DBE participation.

Status: The State continues to take the necessary steps to ensure DBE participation.

SECTION X: RECOMMENDATIONS

1. It is recommended the State continue efforts to increase the pace of the program.
2. It is recommended the State finalize their updated draft Operating Agreement with the EPA Region 4 to incorporate the WIIN Act by December 31, 2019.
3. It is recommended the State consider increasing the amount of loan fee charged.
4. It is recommended the State continue to ensure borrowers follow the six affirmative steps to maximize DBE participation.

SRF Program Summary for TLDA June 27, 2019 Audit Committee Meeting

1. Clean Water State Revolving Fund – Financial and Compliance Audit Report (June 30, 2018)

- The audit resulted in no observations or findings

2. EPA Region 4 SRF Program Evaluation Report - Clean Water SRF (CWSRF) Program

- EPA conducted a review of the CWSRF Program December 3-5, 2018
- Items identified by EPA that require action are summarized below with a current status:

#	Item	Action Needed	Status
1	Update CWSRF Operating Agreement	Update to reflect: Water Resources Reform and Development Act (WRRDA), and any changes to the Tennessee program	Currently working with EPA R4 to update and will finalize by December 31, 2019
2	Add American Iron and Steel and Davis-Bacon to CWSRF inspection checklist	Add appropriate language	Completed
3	Update CWSRF loan agreements to include the most recent American Iron and Steel and Davis-Bacon provisions	Add appropriate language	Completed
4	Institute a loan fee to meet State match requirements for EPA CWSRF Capitalization Grant	Amend language in TN Code 68-221-1004 to allow for fee collection and creation of an account for deposit	Currently coordinating with SLF and EPA R4 to determine fee details

3. EPA Region 4 SRF Program Evaluation Report - Drinking Water SRF (DWSRF) Program

- EPA conducted a review of the DWSRF Program December 3-5, 2018
- Items identified by EPA that require action are summarized below with a current status:

#	Item	Action Needed	Status
1	Update DWSRF Operating Agreement	Update to reflect: Water Infrastructure Improvements for the Nation Act (WIIN), American Water Infrastructure Act (AWIA), and any changes to the Tennessee program	Currently working with EPA R4 to update and will finalize by December 31, 2019

2	Did not meet 7.8% Disadvantaged Business Enterprises (DBE) goal	Ensure borrowers follow the six affirmative steps to maximize DBE participation	Currently updating IUP, loan documents, and other internal processes to ensure that emphasis on affirmative steps to meet goal
3	Increase DWSRF pace (cumulative amount of loans issued as a percentage of all loan funds available); TN is currently at 72% and the national average is 96%	Increase pace to at least 80% by June 30, 2019 (increase number of loans by increasing demand through education, outreach, technical assistance , and other actions)	SRF will receive marketing assistance from EPA this summer; currently increasing community engagement; improved solicitation method for 2019 with greater response in PRLs; improving internal communication and monitoring of PRLs; developing strategy for small and disadvantaged communities; transferred \$42.8M from DWSRF to CWSRF
4	Institute a loan fee to meet State match requirements for EPA DWSRF Capitalization Grant	Amend language in TN Code 68-221-1204 to allow for fee collection and creation of an account for deposit	Currently coordinating with SLF and EPA R4 to determine fee details



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

To: Members of the Tennessee Local Development Authority (TLDA) Audit Committee
From: Sandi Thompson, Director, Office of State and Local Finance (OSLF) *Sandi*
Date: May 3, 2019
Subject: Risk Assessments

The management risk assessments for the OSLF and the Division of Water Resources are attached. These annual reports address agency-wide risk management and internal control requirements of Tenn. Code Ann. § 9-18-102, known as the Tennessee Financial Integrity Act, as amended.

This code requires that each agency of state government and institution of higher education to establish and maintain internal controls, to provide reasonable assurance that:

- (1) Obligations and costs are in compliance with applicable law;
- (2) Funds, property and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and
- (3) Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.

To document compliance with the requirements set forth above, the code requires that each agency of state government and institution of higher education annually perform a management assessment of risk and that the internal controls discussed above be incorporated into such assessment.

The objectives of the annual risk assessment are:

- (1) to provide accountability for meeting program objectives;
- (2) to promote operational efficiency and effectiveness;
- (3) to improve reliability of financial statements;
- (4) to strengthen compliance with laws, regulations, rules, and contracts and grant agreements; and
- (5) to reduce the risk of financial or other asset losses due to fraud, waste and abuse.



The ERM components listed above correlate with Green Book principles 7 - 12, which address the identification, analysis, and response to risks throughout the organization, including fraud risk as well as significant changes that could impact the internal control system, and the effective design and implementation of control activities to mitigate risks in accordance with management's risk appetite. Additional information on these principles can be found at the Green Book link to the left beginning on page 37.

SECTION A HEADER INFORMATION
Contact Information for Individual Completing Form
 Name - _____ Reporting Year - 2018
 Email - _____ State Agency - COT
 Division/Section - State and Local Finance

SECTION C

Risk / Control #	Event (Risk) Identification & Control Activities	Frequency	Control Effective Y/N	Links to Objective #'s from Form 2	Risk Assessment (Inherent & Residual) & Risk Response				
					Inherent Risk		Risk Response	Residual Risk	
					Impact	Likelihood	Response	Impact	Likelihood
SECTION B Insert risk # here, according to your agency's numbering convention	Describe the risk here, be as specific as necessary in order to focus on the actual risk faced by your organization.	DO NOT USE	DO NOT USE	Insert the objective number(s) from Form 2 that the related risk would impact if it materialized, do so for each risk. The same objective may be linked to more than one risk and vice versa.	Select the appropriate Inherent Impact rating from the dropdown list	Select the appropriate Inherent Likelihood rating from the dropdown list	Select the appropriate Risk Response from the dropdown list	Select the appropriate Residual Impact rating from the dropdown list	Select the appropriate Residual Likelihood rating from the dropdown list
SECTION D You may wish to use a unique control numbering convention	Describe here the control activities in place to mitigate the risk above, one control activity per cell, insert or delete rows as needed.	Indicate how often each control activity occurs, e.g. daily, monthly, as needed, etc.	Insert results of effectiveness testing (Y/N) here, if N then document action plan in 'CAP' tab	DO NOT USE	DO NOT USE	DO NOT USE	DO NOT USE	DO NOT USE	DO NOT USE

ROWS ABOVE ARE FOR INSTRUCTIONAL PURPOSES - CAPTURE RISKS, CONTROLS, ETC. BELOW, INSERT ADDITIONAL ROWS AS NECESSARY

Risk / Control #	Event (Risk) Identification & Control Activities	Frequency	Control Effective Y/N	Risk Links to Objective #'s from Form 2	Risk Assessment (Inherent & Residual) & Risk Response					Describe Test of Controls
					Inherent Risk		Risk Response	Residual Risk		
					Impact	Likelihood	Response	Impact	Likelihood	
Risk SLF - 1	A rating downgrade of one of the state issuers could negatively impact the cost of borrowing.			SLF-2.2	Low	Medium	Reduce	Low	Low	
Control SLF - 1.1	SLF provides information as requested by the rating agencies and periodically schedules calls to update the rating agencies of relevant developments within the state.	Monthly, or more often as necessary	Y							On 9/19/2018, we posted the State's Revenue Reports to the Investor Update website and distributed the report to the ListServ which includes the rating agency analysts.
Control 1.2										
Risk SLF - 2	Opportunities to issue (or refund) debt at the right time are missed.			SLF-2.1	Medium	Medium	Reduce	Low	Low	
Control SLF - 2.1	SLF has secured professional services to assist with identifying these opportunities (i.e., bond counsel, financial advisor, etc.) and monitor the level of service provided.	Ongoing	Y							Public Financial Management serves as the state's financial advisor to identify these opportunities.
Control SLF - 2.2	There is ongoing monitoring of CP program balances and project expenditures through monthly meetings with F&A, attendance at State Building Commission meetings, periodic conference calls with financial advisor and discussions within SLF to ensure timeliness of debt issuances.	Monthly	Y							Observed on 10/25/2018, that the state's commercial paper capacity, based on the CP outstanding, was insufficient to cover expenditures for the next several months and an additional \$10 million in taxable CP should be issued.
Control 2.3										
Risk SLF - 3	Allocation of proceeds to a project is calculated incorrectly which results in the bond issue being over or undersized.			SLF-2.1	Medium	Low	Reduce	Low	Low	
Control SLF - 3.1	SLF works in conjunction with the financial advisor who performs all calculations using special software designed for this purpose. (PFM, the state's current financial advisor, uses DBC Finance, the most generally accepted software in the market for this purpose.) When numbers are prepared to be sent to the financial advisor for use in the sizing calculations these numbers are reviewed by the appropriate supervisor within SLF before being sent.	Annually	Y							During TSSBA bond sale in September 2017, observed and reviewed the schedules of projects to be financed to be submitted to Public Financial Management who serves as the state's financial advisor. No bond issue occurred in 2018.
Control SLF - 3.2	In the case of GO debt, all projects and amounts to be bonded are reviewed and verified by Capital Projects and Accounts, as well as bond counsel and the state's financial advisor.	Annually	Y							In July - September 2017, worked directly with Capital Projects, PFM and bond counsel and provided the necessary information to calculate the amounts of debt to be issued for each project. No bond issue occurred in 2018
Control 3.3										
Risk SLF - 4	Failure to become aware of pertinent information regarding approval of a project which may affect the decision for the need to issue more short-term or long-term debt.			SLF-2.1	Medium	Medium	Reduce	Low	Low	
Control SLF - 4.1	SLF maintains an awareness for the activity of all governing bodies who approve projects (to be funded with debt) or who may approve the issuance of debt, by attending the meetings of such governing bodies. (i.e. State Building Commission, State Funding Board, TLDA, TSSBA).	As needed	Y							Appropriate staff attended the TSSBA meeting on June 19, 2018, to approve specific projects to be financed with short-term and long-term debt.
Control SLF - 4.2	SLF also maintains records of such meetings in order to keep documentation of the decisions made.	As needed	Y							The program accountant documented the discussion of the TSSBA meeting dated June 19, 2018.
Control 4.3										
Risk SLF - 5	Failure to disclose material information related to an investor's decision to purchase a bond issued through one of the state's bond programs.			SLF-7.1	High	Medium	Reduce	Low	Low	
Control SLF - 5.1	SLF monitors important events that may require action.	As needed	Y							SLF is assisted in this process by the AG's office, bond counsel and PFM, the financial advisor. In addition, monthly investor updates are issued around the 15th of each month which includes at least the state's revenue report.

Risk	SLF - 35	Processed transactions and procedures fail to provide timely data to compile financial statements that are accurate and reliable.			SLF-1.1	Medium	Low	Reduce	Low	Low	
Control	SLF - 35.1	Reviews are required both by SLF and by reviewers in F&A before any transactions may post.	As needed	Y							Reviewed and submitted financial statements for all bond programs for fiscal year end 2018 by the 9/28/2018 deadline. Program accountants were not aware of any transactions that did not post or procedures that failed.
Control	35.4										
Risk	SLF - 36	SLF fails to properly adopt new accounting pronouncements due to uninformed and untrained personnel.			SLF-6.1	Medium	Low	Reduce	Low	Low	
Control	SLF - 36.1	SLF coordinates with a Fund Coordinator in F&A during the financial statement preparation process.	As needed	Y							OSLF in the Comptroller's Office is committed to providing proper training to its employees. Observed the training schedule maintained by Jacque Felland for FY2018 which included internal accounting training provided by the department of State Audit and the Division of Finance and Administration.
Control	SLF - 36.2	Efforts are also made to send SLF staff to appropriate annual training on new accounting standards.	As needed	Y							
Control	36.4										
Risk	SLF - 37	Approval is granted for debt requests materially non-compliant with state law (including laws regarding balloon indebtedness.)			SLF-3.1	Medium	Medium	Reduce	Low	Low	
Control	SLF - 37.1	Only SLF staff who have sufficient training and experience regarding applicable debt statutes are authorized to review/approve debt requests.	Daily (ongoing)	Y							On11/2/2018 I reviewed one debt request and approval from our tracking system for a capital outlay note for the City of Bells. Our approval letter is dated May 31, 2018. Lori Barnard, Senior Financial Analyst reviewed the transaction and drafted the approval letter. As Assistant Director, I performed a supervisory review and Sandi Thompson, Director, reviewed the documents supporting the request and draft approval letter and signed the approval letter. No exception noted. - SAR
Control	SLF - 37.2	Annual independent audits of local governments are conducted in accordance with <i>Government Auditing Standards</i> per state law.	Annually	Y							On 11/2/2018 I observed that the FY2017 audit for the City of Bells had been filed and posted to the Division of Local Government Audit's website. No exception noted. SAR
Control	37.3										
Control	37.4										
Risk	SLF - 38	Approval is granted for budgets that are materially non-compliant with state law			SLF-3.2	Medium	Medium	Reduce	Low	Low	
Control	SLF - 38.1	Only SLF staff who have sufficient training and experience regarding applicable budget statutes are authorized to review/approve budgets.	Daily (ongoing)	Y							On 11/2/2018 I reviewed supporting documents for a budget review entered and tracked in our SharePoint tracking system for Fentress County. The budget year is FY2019 and our acknowledgement letter is dated October 19, 2018. Lori Barnard, Senior Financial Analyst reviewed the budget and related documents and drafted an approval letter. As Assistant Director, I performed a supervisory review of the draft letter and budget and Sandi Thompson, Director, reviewed and signed the approval letter. No exception noted. - SAR
Control	SLF - 38.2	Annual independent audits of local governments are conducted in accordance with <i>Government Auditing Standards</i> per state law.	Annually	Y							On 11/1/2018 I observed that the FY2017 audit for Fentress County had been filed and posted to the Division of Local Government Audit's website. No exception noted. - SAR
Control	38.3										
Control	38.4										
Risk	SLF - 39	Acceptance of debt information reports that are materially non-compliant with state law; approval of investment requests that are materially non-compliant with state law; approval of feasibility of cable plans that are unfeasible			SLF-4.1	Medium	Medium	Reduce	Low	Low	
Control	SLF - 39.1	Only SLF staff who have sufficient training and experience regarding applicable statutes related to debt information reports, investments, and cable plans are authorized to perform the duties involved with these functions.	Daily (ongoing)	Y							On 11/2/2018 I reviewed supporting documents for a cable feasibility plan tracked in our SharePoint tracking system for the Johnson City Energy Authority dba BrightRidge. Our letter for the plan is dated June 21, 2018, and filed on the H Drive with other permanent files. Ron Queen, Senior Financial Analyst, and Steve Osborne, Senior Financial Analyst both participated in the feasibility review. As Assistant Director, I performed a supervisory review and Sandi Thompson, Director, reviewed and signed the letter addressing our conclusions. - SAR
Control	SLF - 39.2	Annual independent audits of local governments are conducted in accordance with <i>Government Auditing Standards</i> per state law.	Annually	Y							On 11/2/2018 I observed that the FY2017 audit for the Johnson City Energy Authority had been filed and posted to the Division of Local Government Audit's website. No exception noted. - SAR
Control	39.3										
Control	39.4										
Risk	SLF - 40	Provide untimely, inadequate and incorrect information to management			SLF-8.1	Medium	Medium	Reduce	Low	Low	

Control	SFL - 40.1	SLF staff providing information to management have sufficient education and experience in the applicable areas. Information is reviewed by SLF management prior to submission.	Ongoing	Y								On 11/2/2018 I observed a request from Montgomery County to enter into a PBA Loan. The request was received on 6/29/2018 and the senior financial analyst, Steve Osborne, reviewed the request and drafted a letter. After assistant director review the letter and supporting request documents were submitted to our director for review and approval, the final approval letter was sent on 7/3/2018, six days prior to the due date. No exception noted. - SAR
Control	40.2											
Control	40.3											
Control	40.4											
Risk	SLF - 41	Local government defaults on a payment to a loan program.			SLF-2.2, SLF-3.1, SLF-3.2	Low	Medium	Reduce	Low	Low		
Control	SLF - 41.1	Monitor through the budgeting process to verify all debt payments are budgeted and that budgets are balanced.	As needed	Y								On 11/7/2018 I reviewed the supporting documents for Steve Osborne's review of the budget for the City of Lebanon. Lebanon participates in the Drinking Water State Revolving Fund program, per the confirmation information on the Division of Local Government's website. Lebanon's Biennial FY2018/FY2019 budget included budgeted amounts for debt service for this loan program. No exception noted. -SAR
Control	SLF - 41.2	Certain loan programs (State Revolving Funds) are administered by SLF. A program accountant records and monitors the payments made by borrowers.	As needed	Y								On 11/7/2018 I observed the excel spreadsheet maintained by Donna Kaukas that contained documentation that the City of Lebanon is current on its principal and interest payments for the revolving loan program. No exception noted. -SAR
Control	41.3											
Risk	SLF - 42	Failure to comply with record retention requirements			SLF-8.1	Medium	Low	Share	Low	Low		
Control	SLF - 42.1	SLF is made aware of record retention requirements as required by the IRS.	As needed; Ongoing	Y								On 11/2/2018 I observed an interoffice email communication from Martha L. Brown dated 5/7/2018 regarding RDAs. The email shared all updated RDAs and noted where the RDAs had been saved on OSLF's H Drive (H Drive>State and Local Finance>Approved RDAs.4.2018) No exceptions noted. SAR
Control	SLF - 42.2	RDAs have been put in place for critical document types.	As needed	Y								On 11/2/2018 I observed RDAs that have been put into place filed in a folder on the H Drive named: Approved RDAs.4.2018. No exceptions noted. SAR
Control	42.3											
Control	42.4											
Risk	SLF - 43	Employee turnover - Changes in or loss of key personnel or the loss of valuable employees. The number of staff within SLF is small and tends to be specialized in certain areas. New employees may not have a clear understanding of what their duties or responsibilities are and may overlook critical job tasks.			SLF-6.1	High	Medium	Share	Medium	Low		
Control	SLF - 43.1	The overall experience and knowledge of some SLF staff allows for the ability to perform day-to-day operations. Because many of the programs have similar characteristics, SLF staff may assist each other with certain functions and/or provide a backup.	Daily (ongoing)	Y								On 11/8/2018 I spoke with Alicia West and Tammy Fields. Alicia and Tammy both work with the EESI and SRF programs. Alicia explained that staff are cross-trained to perform different tasks related to EESI and the SRF programs to ensure that our office can continue to function when employee turnover occurs or employees are out on medical or annual leave or assigned on special projects. No exception noted. SAR
Control	SLF - 43.2	Critical job tasks are not immediately assigned to new employees.	As necessary	Y								On 11/8/2018 I spoke with Tammy Fields. When she was first hired to OSLF, training was purposefully progressive. Tasks performed were closely supervised. More critical responsibilities will continue to be added as specific foundational concepts continue to be established. - SAR
Control	SLF - 43.3	The work of new employees is closely supervised until they are familiar with the task.	As necessary	Y								Refer to immediately preceding test. - SAR
Control	43.4											
Risk	SLF - 44	Provide insufficient or inadequate training to SLF staff			SLF-6.1	Medium	Medium	Reduce	Low	Low		
Control	SLF - 44.1	Adhere to Comptroller's Office Training Standards.	Ongoing	Y								On 11/8/2018 I observed a document that outlines our planned training for FY2019. This is a plan that is submitted to OMS to ensure we comply with COT training standards. It is used throughout the year by management and is located at: H:\State and Local Finance\Secretarial (MB)\Reference-General SLF Info\PERTINENT SLF RECORDS. Additionally, there is a folder on the H Drive named: Training. This folder includes documents that track training for each employee in SLF. No exceptions noted. - SAR

Risk	SLF - 50	Not performing a requirement/duty or missing a deadline under a contract may put the State at risk.			SLF-2.2	High	Medium	Share	Low	Low	
Control	SLF - 50.1	Senior management is familiar with the contracts that SLF maintains.	As needed	Y							Contract provisions are reviewed by SLF periodically.
Control	50.2										
Control	50.3										
Control	50.4										
Risk	SLF - 51	Unknown legislative changes in law.			SLF-5.1	High	Medium	Share	Low	Low	
Control	SLF - 51.1	SLF works with the Comptroller's Office of General Counsel (OGC) and legislative liaisons to ensure that we are aware of all legislative changes and that they are properly addressed. We rely upon OGC's process to notify our office to keep us informed.	As needed	Y							On 11/2/2018 I observed an email dated 3/27/2018, 10:01 AM from Greg Cothron with OGC notifying our office of passed legislation (i.e., public chapters) that that has potential impact to SLF. OGC notifies SLF of both proposed and passed legislation. No exception noted. SAR
Control	51.2	SLF receives notification of new bills and we track the ones that may have impact to our office.	As needed	Y							On 11/2/2018 I observed an email dated 1/24/2018 from Steve Osborne with our office that included legislation that was introduced that may have potential impact to SLF. Our office also keeps a log of bills of interest that we track. The log is maintained by Steve Osborne and located at <G:\Fiscal Notes\OSLF\2018>. I observed the log on 11/22/2018. SAR
Control	51.3										
Control	51.4										
Risk	SLF - 52	Lack of good relationships with General Assembly.			SLF-10.1	Medium	Low	Reduce	Low	Low	
Control	SLF - 52.1	SLF works through the Comptroller's legislative liaisons and responds timely to all requests for information to ensure that relationships are maintained.	As needed	Y							On 11/2/2018 I observed an email documenting an entry made by Lori Barnard to the "Five-Minute Rule Legislative Contact Tracking" online system. Documentation as to the resolution noted that the request from the legislator was handled immediately. No exception noted. - SAR
Control	52.2										
Control	52.3										
Control	52.4										
Risk	SLF - 53	Employee could benefit illegally from insider information related to a negotiated bond sale.			SLF-6.1	Low	Low	Reduce	Low	Low	
Control	SLF - 53.2	The RFP process (used for negotiated sales) requires multiple reviews of proposals for selection of the underwriter.	As needed	Y							Although the OSLF did not conduct a bond sale in 2018, the process remains the same. Request for Proposal/Pricing would be submitted by the Authority's financial advisor, PFM, and responses would be reviewed and a selection would be made by the Authority at the recommendation of staff and the financial advisor.
Control	SLF - 53.3	Employees are annually required to certify that they do not directly own, or have not directly purchased State of Tennessee bonds.	As needed	Y							On November 16, 2018, observed file containing signed copies of conflict of interest statements from SLF employees.
Control	53.4										
Risk	SLF - 54	Lack of interagency cooperation - SLF relies on other divisions and outside entities for timely and accurate information for board meetings, rating presentations, etc.			SLF-5.1	Medium	Medium	Share	Low	Low	
Control	SLF - 54.1	SLF takes the initiative to contact those entities on which we rely, instead of simply waiting for that information to be communicated.	Ongoing	Y							For GO, observed and initiated the process for gathering information to be included in the state's credit rating presentation. Information was obtained from Budget, F&A, TCRS, Treasury and the Governor's office. For TSSBA, observed the process of gathering information from THEC and the institutions of higher education in order to prepare for the TSSBA surveillance review by S&P Global. I am aware that we set deadlines to receive the information and that the information was reviewed for accuracy.
Control	SLF - 54.2	SLF staff communicates the need for information and the time at which it is needed.	Ongoing	Y							
Control	SLF - 54.3	Once the information is received, it is reviewed for accuracy.	Ongoing	Y							
Control	54.4										
Risk	SLF - 55	Accounting systems do not fully meet the needs of the department.			SLF-1.2	Medium	Medium	Share	Low	Low	
Control	SLF - 55.1	Dedicated individual on staff is coordinating the department's efforts to communicate the department's needs to Edison staff.	Ongoing	Y							A review process is followed to ensure proper and accurate accounting entries. Observed various emails from Sharon Schmucker to Edison staff and to Emphasys staff (DMS), inquiring about system issues, entry issues, access issues.
Control	SLF - 55.2	The Office of State and Local Finance is currently seeking a new provider for a sub-accounting or Debt Management System (DMS)	Ongoing	Y							
Control	55.3										
Control	55.4										
Risk	SLF - 56	Risk of losing critical/sensitive data that is used to administer the State's debt financing program (catastrophe, data corruption, sabotage).			SLF-1.1; SLF-1.2	High	Medium	Share	Low	Low	

Division: Division of Water Resources	Date Completed: December 20, 2018
Function/Process Reviewed:	Staff: Jennifer Dodd, April Grippo and Paula Mitchell

Risk	Impact	Likelihood	Controls	Monitoring
Fiscal year budgetary shortfall- inability to operate program within budget	<input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low	<input type="checkbox"/> Probably <input checked="" type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote	<ul style="list-style-type: none"> • Close management and tracking of revenue collections and expenditures throughout the year. • Detailed monthly budget reports and close interactions with TDEC fiscal services, along with established budgetary baselines from previous fiscal years to more closely track and identify spending and revenue trends earlier in the fiscal year. • Increased controls on discretionary spending to stay within line item budget. • Budgets now detailed down to the division unit to provide more direct oversight on expenditures and grant management at the unit level. • Close tracking of workload and staffing needs throughout the year. 	<p>Division management pulls and reviews budget status reports on at least a monthly basis to gauge expenses and revenue collections, identifying any potential problems. Division of Fiscal Services prepares monthly reports and communicates with key DWR budget contacts on a regular basis. TDEC leadership holds annual budget planning meetings at the beginning of each fiscal year and then semiannually to track budget status.</p> <p>Quarterly workload analysis performed along with monthly activity monitoring by DWR unit and field office managers.</p>

<p>Misuse, incomplete, or improper use of federal grant funding.</p>	<input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low	<input type="checkbox"/> Probably <input checked="" type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote	<ul style="list-style-type: none"> • Use of the Performance Partnership Grant in FY19 with US EPA allows DWR to combine multiple environmental program grants into a single grant. DWR has established an internal budgeting structure to directly involve DWR managers ensuring sound management of grant funds and assurance workplan commitments are met. • Close management and better accuracy of speedcharts tied to specific grant funding. • Edison reporting improvements have allowed for more accurate staff time entry. • The addition of a Grants Manager to the Budget and Information Unit to ensure grants are tracked in real time and Unit Managers are made aware of issues as they occur. • Updating the process by which the Division finalizes its annual workplan with EPA. 	<p>Division Grant manager prepares and reviews monthly federal fund activities, identifying any issues as they occur, and reporting same to Unit Managers and Division Management. TDEC Fiscal Services account for federal expenditures and collections. Unit Managers and DWR Management meet quarterly with US EPA to review and examine each federal grant, activities associated with each grant, remaining balances, and workplan commitments.</p> <p>Using the workload analysis, the Division is tying work to grant funding in an effort to ensure funds are used appropriately and that annual workplan commitments are achievable.</p>
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<p>Ineffective or lack of staff training and succession planning</p>	<p><input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low</p>	<p><input checked="" type="checkbox"/> Probably <input type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote</p>	<ul style="list-style-type: none"> • Ongoing and detailed division-wide assessment of staffing skills through the development of a staff service inventory to identify staff expertise and knowledge gaps tied to regulatory authority and administrative support. • Proper staff training and mentoring resulting from analysis of staff expertise and knowledge gaps. • Strategic examination of DWR training needs and opportunities. 	<p>Division Management continues to develop a skill inventory tracking tool that identifies the skills of each staff member, assesses areas of weakness, and helps inform hiring needs and succession planning. The skill inventory continues to evolve to include an assessment of skill complexity and competency both for those skills required by regulations and the administrative skills necessary to support regulatory tasks. Division Management is tasked with overall staff development during this performance cycle starting with management style and leadership skills self-evaluations to identify strengths and weaknesses.</p> <p>TDEC Office of Talent Management assists in examining DWR talent, staff engagement and career growth opportunities. Fleming Training Center is utilized for specific training of internal staff. Division staff is engaged in an ongoing workgroup geared toward technical onboarding with a goal of developing a</p>
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				<p>training framework for technical staff and managers to use during the onboarding process.</p> <p>Division staff is engaged in an ongoing workgroup geared toward realigning the dual track program with a goal of providing a framework for advancement within the dual track system aimed at succession planning and retention.</p>
<p>Substantial increase in number of TN Streams / waterbodies failing to meet all statutory designated uses</p>	<input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low	<input type="checkbox"/> Probably <input checked="" type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote	<ul style="list-style-type: none"> • Effective wastewater permitting, effluent reporting and facility inspections; • Meaningful watershed protection and outreach; • Stream water quality assessments, • Effective stormwater management, • SRF loan assistance to municipalities for infrastructure improvements, • Collaboration with TDA, TWRA, USACE, EPA and other agencies and NGOs, citizen awareness, • Effective operator training 	<p>Mission-driven DWR staff implement a watershed approach to assess water quality and to inform stakeholders-a 5 yr watershed monitoring cycle is used to monitor watersheds statewide to determine that all designated uses for the water resource is available;</p> <p>Most DWR water permits are issued on 5 yr cycles which allows for an iterative process, recognition of emerging and improved technologies towards water quality and other continued improvements towards permit compliance.</p> <p>Broad collaboration occurs with federal, state and local agencies, stakeholder groups and regulatory boards to insure the</p>

				safety and sustainability of Tennessee's waters
Public Drinking Water System failing to meet drinking water / public health standards	<input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low	<input checked="" type="checkbox"/> Probably <input type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote	<ul style="list-style-type: none"> • Effective and frequent sanitary surveys and technical assistance; water treatment operator and distribution system operator training; • Effective compliance and enforcement efforts, educated customers, wellhead and sourcewater protection efforts; • A number of recent vacant positions filled and devoted to DW program efforts and DW Compliance and Enforcement. 	<p>Mission-driven DWR staff perform thorough sanitary surveys of all of public drinking water systems in order to determine compliance with Safe Drinking Water Act requirements aimed at public health; the frequency of the sanitary surveys average one inspection every 18 months which exceeds EPA expectation of once every 3 years.</p> <p>Partnering closely with US EPA to monitor PWSS performance coupled with data management and data exchange with EPA;</p> <p>Collaborating with Tennessee Association of Utility Districts (TAUD) to communicate regulatory requirements and expectations of public drinking water facilities;</p> <p>Fleming Training Center (FTC) provides Tennessee with an important, unique training venue for drinking water and wastewater operator training. Numerous classes held at FTC aimed at highly technical training needs.</p>

<p>On the job and off the job injuries resulting in missed work days and lessened productivity</p>	<input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low	<input checked="" type="checkbox"/> Probably <input type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote	<ul style="list-style-type: none"> • Proper OSHA training where appropriate, • SOPs, program activity risk assessments, • onboard training for new employees, safety awareness and reminders 	<p>Division management rack such injuries on a monthly basis and communicate number of injuries on the Division's scorecard that is prominently displayed to serve as a reminder of the importance of workplace safety;</p> <p>TDEC safety initiatives spearheaded by the Office of Emergency Services assist in monitoring this risks;</p> <p>Programs provided by US EPA/TOSHA and TEMA</p> <p>FTC collaborations with safety organizations such as TEMA/FEMA</p>
<p>Employee Conflicts of Interest</p>	<input checked="" type="checkbox"/> High <input type="checkbox"/> Medium <input type="checkbox"/> Low	<input type="checkbox"/> Probably <input checked="" type="checkbox"/> Reasonably Possible <input type="checkbox"/> Remote	<ul style="list-style-type: none"> • Ethics training, informed management and staff, signed policies regarding COI 	<p>Division management, OGC, Internal Audit, Staff Reporting, Policy adherence are all aimed at this risks.</p>

Reviewed by: Paula Mitchell for Jenny Dodd Date: 12/20/18 Page 6 of 6

— at the — TONE TOP[®]

Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

Issue 92 | April 2019

Generating and Bringing Accurate Information to the Board

Every executive strives to make the best decisions possible. Still, even the most thoughtful decisions in the world are only as good as the information people rely upon to make them.

Board directors know this; that's why they spend so much time seeking assurance about corporate operations before a decision is made. The very word "assurance" raises the question board directors implicitly ask when working toward a decision: Are we confident that what we've been told is in fact accurate and reliable?

The answer is uncertain right now. In the latest corporate governance survey from the National Association of Corporate Directors, 53 percent of respondents said they want improvement in the quality of information supplied by management. That figure is on par with The IIA's own 2019 Pulse of Internal Audit survey of audit executives, in which 36 percent of respondents only somewhat agreed with the statement that "management provides the Board with all pertinent risk information," and another 15 percent somewhat or strongly disagree.

This is an issue neither boards nor chief audit executives (CAEs) can ignore.

"It's a struggle," says Carolyn Dittmeier, a former audit executive who now serves on the boards of several



European companies: Generali in Italy, Alpha Bank in Greece, and Ferrero in Luxembourg.

Like corporate directors everywhere, Dittmeier relies on whatever board packet lands on her desk from management. "It's all handed to you," she says. Yes, committees and directors can then push management for more specific information, "but it's still whatever is handed to you."

The problem isn't deliberate deception. That happens, but it's relatively rare. More accurate is to say that the governance duties of boards and the risk landscapes of organizations are shifting so rapidly that traditional channels of gathering and conveying information to the board might no longer be fit for purpose.

About The IIA

The Institute of Internal Auditors Inc. (IIA) is a global professional association with more than 190,000 members in more than 170 countries and territories. The IIA serves as the internal audit profession's chief advocate, international standard-setter, and principal researcher and educator.

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Understanding the Board's Challenges

The shift that challenges boards so much is an inexorable increase in the importance of risk monitoring – especially emerging or atypical risks the organization has never before encountered.

Such risks are now more likely to pose a greater threat to the organization's ability to generate value for its stakeholders. For example, a new competitor with a digital-only platform that undercuts your business model, or a supplier that uses slave labor and whose misconduct is suddenly telegraphed across Twitter, tarnishing your brand and reputation along with it.

What's more, regulators around the world have also stepped up their attention to corporate governance – or more accurately, the lack thereof – which can lead to misconduct. For an organization to avoid criminal charges, monetary penalties, and other punishment, it must be able to show it understood the compliance risks in its operations and took appropriate steps to mitigate those risks.

Those pressures now drive the audit committee to focus more on “anticipatory” risk and internal control systems that quantify how well the organization is preventing adverse events from happening. Which, in turn, increases the importance of getting high-quality information into the audit committee's hands so it can understand where its priorities should be.

“It is highly important, and we do feel the pressure” to be responsive, says Jeff Austin, chair of the audit subcommittee for the Texas Transportation Commission. Austin always wants his committee to have the opportunity to intervene on burgeoning risks within the Texas Department of Transportation rather than have outsiders surprise everyone with unexpected information.

That sounds sensible enough, but are organizations succeeding at monitoring anticipatory risks in a competent, disciplined manner?

Again, the answer is not clear. In the 2019 Pulse of Internal Audit survey, more than 90 percent of CAEs were very or moderately confident in their ability to identify and assess emerging risks. Further, 80 percent of CAEs were very or moderately confident in their ability to identify and assess atypical risks. At the same time, 47 percent also strongly or somewhat agreed that it was fairly common for an emerging or atypical risk to surprise management.

That suggests a disconnect between the ability to detect and monitor a risk and the ability to relay that information to the highest echelons of the organization in a timely manner.



Systems and Channels

To be clear, it is management’s job to bring information to the board. That won’t change. The questions here are whether the board is getting the right information in a timely manner and whether the systems for relaying information work well. Both are questions that audits could address.

In her time as an auditor, Dittmeier says she routinely warned boards that completeness, accuracy, and reliability of information was “an uncovered area” of risk. She divides the potential trouble into two categories.

First are problems of people: either the corporate culture overall, or specific senior executives, don’t have any disciplined process to gather and convey risk information. You might have a good, risk-aware culture, but the escalation processes are unstructured. Dittmeier describes this as “risk management without method.”

Second are problems of process: the systems that organizations use to relay information might not work efficiently enough to deliver news in a timely manner, or may not be versatile enough to capture all the data the board needs.

That brings up the question of key performance indicators (KPIs), and whether they should be built into dashboards that board members can use to monitor risks. “Absolutely yes,” Dittmeier says. “Big time.”

Audit executives can work with their audit committees to design KPIs that give board members more objective, reliable information. First comes a conversation about what the organization’s objectives are, and what the risks to achieving those objectives might be. Then the audit team can design more data-driven KPIs to monitor those risks and feed that data directly to the board.

Clarence Davis, former chief operating officer at the American Institute of Certified Public Accountants (AICPA) and board member at GAMCO Investors Inc. and Telephone and Data Systems (TDS), gives the example of management estimates. If management, internal audit,



and the audit committee could better define the business process in question – if the process could be “machined” with data, he says – then the audit committee might be able to rely more on data-driven KPIs and less on the subjective judgment of management about an important line item.

It’s worth noting that when the Securities and Exchange Commission fined Hertz Corp. \$16 million in late 2018 for poor accounting practices that led to a restatement in 2015, abuse of management estimates was the culprit. The Public Company Accounting Oversight Board has also made better auditing of estimates a priority. So the more a company can move away from reliance on estimates in favor of data-driven KPIs, the better.

“That’s in its infancy now and needs to be fleshed out more, because it’s critically getting down to the nuts and bolts of the process,” Davis says. He adds that, when creating a KPI, you need to understand why it is important and what the data are that make it up.

The transition from ad hoc discussions of risk that are reliant upon management’s subjective judgment toward more disciplined, data-driven, up-to-the-moment snapshots of risk has the potential to be difficult, but it’s a move boards need to make. That’s one piece of information board members can rely upon.

Action Items

- Assess the organization's systems to escalate information about risk. Are the systems themselves effective at relaying complete, accurate information in a timely manner? Does senior management accept that information and bring it to the board properly?
- Consider corporate culture and its influence on generating accurate information. For example, conduct an employee survey asking whether employees feel confident that concerns they bring to management are heard and addressed properly.
- Review accounts that are material to the financial statements to determine which ones rely on management estimates. Work with management and the audit committee to see whether those business processes could be redesigned to rely more on KPIs and less on estimates.
- Hone your own audit function's abilities with data analytics. This can apply to all sorts of risk and audit issues, but remember that KPIs and risk monitoring can't happen in any disciplined way without strong capabilities in this area.



Quick Poll Question

How involved is internal audit in assuring accurate and complete information flows to the Board?

- Not at all involved
- Slightly involved
- Moderately involved
- Very involved
- Extremely involved

Visit www.theiia.org/toner to answer the question and learn how others are responding.



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