

# **AGENDA (ANNOTATED)**

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY  
AUDIT COMMITTEE  
JUNE 15, 2022, 10:40 AM  
EXECUTIVE CONFERENCE ROOM, STATE CAPITOL, G LEVEL**

1. **(Treasurer)** Call Meeting to Order
2. **(Treasurer)** Approval of the AC Meeting Minutes June 15, 2021 **(Pg. 2) \***
3. **(Michael Campbell)** Review Audit Reports Issued by Comptroller's Office
  - a. Discuss TLDA Audit Report **(Pg. 5)**
  - b. Discuss Clean Water State Revolving Fund Audit Report **(Pg. 33)**
4. **(Alicia West)** Review Financial Statements including Significant Accounting & Reporting Standards **(Pg. 47)**
5. **(Adeniyi Bakare)** Status of the FY2021 EPA PERS Process
6. **(Sandi Thompson)** Risk Assessments Memo **(Pg. 48)**
  - a. 2021 SLF Risk Assessment **(Pg. 49)**
  - b. 2021 TDEC Water Resource Risk Assessment **(Pg. 57)**
7. **(Sandi Thompson)** Discuss Management's Responsibility to Prevent, Detect & Report Fraud, Waste & Abuse
8. **(Sandi Thompson)** Discuss Comptroller Hotline
9. **(Earle Pierce)** Audit Committee Responsibilities Calendar **(Pg. 66)**
10. **(Earle Pierce)** Current Internal Auditing Article **(Pg. 67)**
11. **(Treasurer)** Other Business
12. **(Treasurer)** Adjournment

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

## Agenda Item #2

### TENNESSEE LOCAL DEVELOPMENT AUTHORITY AUDIT COMMITTEE MEETING MINUTES June 15, 2021

The Tennessee Local Development Authority (TLDA) Audit Committee met on Tuesday, June 15, 2021. The meeting began at 2:30 p.m. in the State Capitol, Executive Conference room.

The following members were present:

- David H. Lillard, Jr., State Treasurer
- Butch Eley, Commissioner of Finance and Administration
- Tre Hargett, Tennessee Secretary of State
- Pat Wolfe, Senate Appointee

Others present were:

- Sandra Thompson, Director, Office of State and Local Finance
- Alicia West, Program Accountant, Office of State and Local Finance
- Michael Campbell, State Auditor, Office of the Comptroller of the Treasury
- Earle Pierce, Director of Internal Audit, TN Department of Treasury
- Adeniyi Bakare, State Revolving Fund Director, TN Department of Environment and Conservation (TDEC)
- Felicia Freeman, Environmental Manager, TN Department of Environment and Conservation (TDEC)

#### Call Meeting to Order

Treasurer Lillard called the meeting to order and asked for a roll call to determine a quorum. The results of the roll call confirmed a quorum was present for the meeting.

Roll Call: Treasurer Lillard-Present, Secretary Hargett-Present, Dr. Kenneth Moore-Absent, Mr. Pat Wolfe-Present, Commissioner Butch Eley-Present.

#### Approval of Meeting Minutes

Treasurer Lillard presented the minutes from the June 25, 2020 TLDA Audit Committee meeting for approval. There were no other recommended changes. Secretary Hargett motioned to accept the minutes as presented and Commissioner Eley seconded the motion. Mr. Pierce performed a roll-call vote and the motion passed unanimously.

Treasurer Lillard-Aye, Secretary Hargett-Aye, Mr. Wolfe-Aye, Commissioner Eley-Aye

#### Review Audit Reports Issued by Comptroller's Office

Treasurer Lillard recognized Michael Campbell 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, 2020 financial statements. No

material errors were found in the financial statements. There were no findings and no exceptions noted with internal controls or compliance.

### **Review Financial Statements Including Significant Accounting and Reporting Standards**

Treasurer Lillard recognized Alicia West to review the financial statements for the TLDA and the SRF programs. Ms. West presented an overview of the financial statements.

### **Review of Program Evaluation Reports from the EPA**

Treasurer Lillard recognized Adeniyi Bakare, State Revolving Fund Director from TDEC to discuss reports from the EPA. Mr. Bakare reviewed Program Evaluation Reports (PERs) from the Environmental Protection Agency for studies conducted in fiscal year 2020 with reports dated as of March 2021. The reports covered the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund. The 2020 PERs reports contained no findings or deficiencies. The PERS report for the drinking water SRF program included two recommendations. Mr. Bakare reviewed the recommendations with the Committee and the status of SRF's efforts to address them.

### **State and Local Finance 2020 Risk Assessments**

Treasurer Lillard recognized Sandra Thompson to discuss the Office of State and Local Finance (SLF) and Division of Water Resources 2020 Risk Assessments. Ms. Thompson stated the risk assessments cover risks and controls as required by the Financial Integrity Act. A memo regarding the act was included in the materials. Ms. Thompson discussed some of the testing performed to ensure controls documented in the risk assessments worked as intended.

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

Treasurer Lillard recognized Sandra 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 by SRF leadership.

### **Discuss Comptroller Hotline**

Treasurer Lillard recognized Sandra Thompson to discuss the Comptroller's Fraud, Waste, and Abuse (FWA) Hotline. Employees and members of the community are encouraged to call the Comptroller's toll-free hot line to report any instances of suspected waste and abuse of government funds. Citizens are referred to the hotline when they have complaints.

### **Discuss Current Internal Audit Article**

Treasurer Lillard recognized Earle Pierce to present a current article from the Institute of Internal Auditors entitled, "Control During the Pandemic". Mr. Pierce summarized the article with a brief discussion of the

challenges during the pandemic and the opportunities to review new risks and controls needed to address working remotely. He discussed how Internal Audit can work with management to key in on these risks during the annual risk assessment process.

### **Opportunity for Public Comment**

Treasurer Lillard opened the floor to any comments from the public regarding the meeting. No comments were made.

### **Other Business**

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

### **Adjournment**

Secretary Hargett motioned to adjourn. Commissioner Eley seconded the motion. A roll call vote was made to adjourn the meeting and the motion passed unanimously.

Treasurer Lillard-Aye, Secretary Hargett-Aye, Mr. Wolfe-Aye, Commissioner Eley-Aye

Treasurer Lillard adjourned the meeting at 2:42 p.m.

### **Approved:**

**David H. Lillard, Jr.**  
**TLDA Audit Committee Chairman**



**FINANCIAL AND COMPLIANCE AUDIT REPORT**

**Tennessee Local Development Authority**

*For the Year Ended June 30, 2021*

**Jason E. Mumpower**  
*Comptroller of the Treasury*



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JASON E. MUMPOWER  
*Comptroller*

December 7, 2021

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Local Development Authority for the year ended June 30, 2021. 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 "Katherine J. Stickel".

Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit

21/070

**Audit Report**  
**Tennessee Local Development Authority**  
**For the Year Ended June 30, 2021**

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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

## **Tennessee Local Development Authority**

For the Year Ended June 30, 2021

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### **Opinion on the Financial Statements**

The opinion on the financial statements is unmodified.

### **Audit Findings**

The audit report contains no findings.



JASON E. MUMPOWER  
*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, 2021, and June 30, 2020, 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, 2021, and June 30, 2020, 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 on pages 5 through 10 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 Tennessee Local Development Authority's basic financial statements. The accompanying financial information on pages 20 through 22 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 December 1, 2021, 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, 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 Tennessee Local Development Authority's internal control over financial reporting and compliance.



Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit  
December 1, 2021

## TENNESSEE LOCAL DEVELOPMENT AUTHORITY Management's Discussion and Analysis

As management of the Tennessee Local Development 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, 2021, and June 30, 2020, with comparative data for the year ended June 30, 2019. 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 Program and the State Infrastructure 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 include

- 1) the State Loan Program, which provides assistance to local government units in the construction of waterworks, sewage treatment, and energy and/or solid waste recovery facilities; and
- 2) the State Infrastructure Program, which 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.

	Local			State		
	Government Units			Infrastructure Program		
	2021	2020	2019	2021	2020	2019
Number of borrowers with outstanding loans	4	4	5	1	1	1
Total number of outstanding loans	4	4	7	1	1	1
Total amount of outstanding loans (in thousands)	\$1,023	\$1,230	\$1,494	\$1,371	\$1,434	\$1,490
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 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 an amount set aside 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% to a high of 4.375%. By pooling the financing of their capital projects, 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.

At June 30, 2021, the Authority's State Loan Program is rated AA by Standard & Poor's Rating Group (S&P) and AA by Fitch Ratings. On May 28, 2019, S&P placed the AA+ rating on credit watch with negative implications. The credit watch reflects the decline in the number of participants in the pool as the program has wound down. On October 1, 2019, S&P subsequently downgraded the rating to AA and removed the credit watch. The downgrade reflects S&P's assessment of the bonds based on the application of its "Issue Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness" criteria. In general, 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 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 the timing of related cash flows. Using the economic resources measurement focus, readers are 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 consist of two components: 1) the financial statements and 2) the 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.

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

**Statements of Net Position Summary**  
(in thousands of dollars)

	<u>2021</u>	<u>2020</u>	<u>2019</u>
Current assets	\$16,507	\$15,993	\$15,363
Restricted assets	272	348	515
Other assets	2,101	2,377	2,663
<b>Total assets</b>	<b>18,880</b>	<b>18,718</b>	<b>18,541</b>
Deferred outflows of resources	-	26	64
Current liabilities	358	455	605
Noncurrent liabilities	1,023	1,258	1,567
<b>Total liabilities</b>	<b>1,381</b>	<b>1,713</b>	<b>2,172</b>
<b>Net position (unrestricted)</b>	<b>\$17,499</b>	<b>\$17,031</b>	<b>\$16,433</b>

Note: The Authority owns no capital assets.

For the years ended June 30, 2021; June 30, 2020; and June 30, 2019, the largest component of the total asset balance is the cash balance. Loans receivable (both current and noncurrent) totaled \$2,394,055 at June 30, 2021; \$2,663,403 at June 30, 2020; and \$2,983,522 at June 30, 2019. Restricted assets represent the debt service reserve fund. Other assets decreased from 2020 to 2021 as no new loans were made and payments were received on existing loans receivable. The Authority's liabilities consist mostly of the outstanding portion of its bonds payable. No bonds have been issued since 2006. Bonds payable continues to decrease as bond payments are made. 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.



**Statements of Revenues, Expenses, and Changes in Net Position Summary**  
(in thousands of dollars)

	<u>2021</u>	<u>2020</u>	<u>2019</u>
<b>Operating Revenues</b>			
Revenue from loans	\$84	\$100	\$121
Administrative fees collected	583	503	443
Interest income	13	247	343
<b>Total operating revenues</b>	<b>680</b>	<b>850</b>	<b>907</b>
<b>Operating Expenses</b>			
Interest expense	69	90	108
Subsidy to borrowers	1	7	13
Administrative expenses	142	155	111
<b>Total operating expenses</b>	<b>212</b>	<b>252</b>	<b>232</b>
<b>Operating income</b>	<b>468</b>	<b>598</b>	<b>675</b>
<b>Increase in Net Position</b>	<b>\$468</b>	<b>\$598</b>	<b>\$675</b>

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 decreased from 2020 to 2021 and increased from 2019 to 2020. A decline in market interest rates created a significant decline in interest income. Administrative fees collected have steadily increased during the periods shown. However, this revenue may experience future decline as lower interest rates present opportunities for SRF borrowers to refund out of the program and also municipalities may choose to utilize American Rescue Plan grant funds for water and sewer projects in lieu of borrowing from the SRF program. Revenue from loans of the Authority is declining as the State Loan Program winds down. All 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 as the borrowers' principal portion of the payment increases, the interest portion of the payment decreases. 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 2020 to 2021 and increased from 2019 to 2020. Unless new loans are made, operating expenses are expected to trend downward.

## **COVID-19**

COVID-19 is not expected to have a significant impact on the Authority's State Loan Program. Borrowers that experience financial difficulties can be referred to the state's utilities boards, which support municipalities, counties, treatment authorities, water, and wastewater public utilities that operate water and sewer enterprises by ensuring that they are financially self-supporting. Additionally, loans are secured by a pledge of system revenues and are further secured by a pledge of borrower's state-shared taxes, a security deposit equal to maximum annual debt service, and a statutory reserve fund. Therefore, sufficient funds are available to meet debt service requirements on the bonds in the event of a loan default. Moreover, the Comptroller's Office has taken safety measures to control the spread of the virus among staff including teleworking opportunities, enhanced cleaning and disinfecting of office spaces, electronic meetings, and social distancing.

### **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 Division of State Government Finance, State of Tennessee, Cordell Hull Building, 425 Rep. John Lewis Way N., Tennessee 37243-3400 or visit our website at <https://comptroller.tn.gov/office-functions/sgf>.

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY**  
**Statements of Net Position**  
**June 30, 2021, and June 30, 2020**

(Expressed in Thousands)

	<u>June 30, 2021</u>	<u>June 30, 2020</u>
<b>Assets</b>		
Current assets:		
Cash (Note 2)	\$16,214	\$15,706
Receivables:		
Loans receivable	293	287
<b>Total current assets</b>	<b>16,507</b>	<b>15,993</b>
Noncurrent assets:		
Restricted cash (Notes 2 and 3)	272	348
Loans receivable	2,101	2,377
<b>Total noncurrent assets</b>	<b>2,373</b>	<b>2,725</b>
<b>Total assets</b>	<b>18,880</b>	<b>18,718</b>
<b>Deferred outflows of resources</b>		
Deferred amount on bond refunding	-	26
<b>Liabilities</b>		
Current liabilities:		
Accrued interest payable	17	21
Payable to borrowers (Note 4)	121	149
Revenue bonds payable (Note 5)	220	285
<b>Total current liabilities</b>	<b>358</b>	<b>455</b>
Noncurrent liabilities:		
Revenue bonds payable, net (Note 5)	1,023	1,258
<b>Total noncurrent liabilities</b>	<b>1,023</b>	<b>1,258</b>
<b>Total liabilities</b>	<b>1,381</b>	<b>1,713</b>
<b>Net position</b>		
Unrestricted (Note 6)	17,499	17,031
<b>Total net position</b>	<b>\$17,499</b>	<b>\$17,031</b>

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, 2021, and June 30, 2020**

(Expressed in Thousands)

	<u>Year Ended</u> <u>June 30, 2021</u>	<u>Year Ended</u> <u>June 30, 2020</u>
<b>Operating revenues</b>		
Revenue from loans	\$ 84	\$ 100
Administrative fees collected	583	503
Interest income	13	247
<b>Total operating revenues</b>	<b>680</b>	<b>850</b>
<b>Operating expenses</b>		
Interest expense	69	90
Subsidy to borrowers	1	7
Administrative expenses	142	155
<b>Total operating expenses</b>	<b>212</b>	<b>252</b>
<b>Operating income</b>	<b>468</b>	<b>598</b>
<b>Net position</b>		
Net position, July 1	17,031	16,433
<b>Net position, June 30</b>	<b>\$17,499</b>	<b>\$17,031</b>

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, 2021, and June 30, 2020**

(Expressed in Thousands)

	Year Ended June 30, 2021	Year Ended June 30, 2020
<b>Cash flows from operating activities</b>		
Payments to service providers	\$ (142)	\$ (155)
<b>Net cash used for operating activities</b>	<b>(142)</b>	<b>(155)</b>
<b>Cash flows from noncapital financing activities</b>		
Principal payments	(285)	(435)
Interest paid	(63)	(80)
<b>Net cash used for noncapital financing activities</b>	<b>(348)</b>	<b>(515)</b>
<b>Cash flows from investing activities</b>		
Collections of loan principal	269	319
Interest received on loans	84	100
Administrative revenue	583	503
Interest received on pooled investment fund	13	247
Amounts repaid to borrowers	(27)	(2)
<b>Net cash provided by investing activities</b>	<b>922</b>	<b>1,167</b>
Net increase in cash	432	497
Cash, July 1	16,054	15,557
Cash, June 30	#####	#####
<b>Reconciliation of operating income to net cash used for operating activities:</b>		
Operating income	\$ 468	\$ 598
Adjustments to reconcile operating income to net cash used for operating activities:		
Revenue from loans	(84)	(100)
Interest income	(13)	(247)
Interest expense	69	90
Subsidy to borrowers	1	7
Administrative revenue from borrowers	(583)	(503)
<b>Total adjustments</b>	<b>(610)</b>	<b>(753)</b>
<b>Net cash used for operating activities</b>	<b>\$ (142)</b>	<b>\$ (155)</b>

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

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY**  
**Notes to the Financial Statements**  
**June 30, 2021, and June 30, 2020**

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**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 and is a separate legal entity. In accordance with the Governmental Accounting Standards Board's (GASB) Statement 14, *The Financial Reporting Entity*, as amended, the Authority is discretely presented in Tennessee's *Annual Comprehensive 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 Government Finance serves as the assistant secretary; the Division of State Government 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.

The Authority does not have any employees. The members serve without salary but are entitled to reimbursement for their actual and necessary expenses incurred in the performance of their official duty.

**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

## **Notes to the Financial Statements (Continued)**

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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 State Pooled Investment Fund administered by the State Treasurer.

### **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 \$16,486,822 in the pooled investment fund at June 30, 2021, and \$16,055,309 at June 30, 2020. 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 <https://treasury.tn.gov/>.

### **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 was \$271,890 at June 30, 2021, and \$348,290 at June 30, 2020.

### **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.

## Notes to the Financial Statements (Continued)

### Note 5. Debt Payable

#### Revenue Bonds

Bonds payable at June 30, 2021, and June 30, 2020, were as follows (expressed in thousands):

	<u>June 30, 2021</u>	<u>June 30, 2020</u>
2006 Refunding Series A at interest rates of 4% maturing to 2021 (original par-\$20,070)	\$ -	\$ 75
2006 Series B at interest rates from 4% to 4.375% maturing to 2029 (original par-\$37,415)	1,250	1,460
Total par amount of bonds payable	1,250	1,535
Plus unamortized premium	-	16
Less unamortized discount	(7)	(8)
Net bonds payable	<u>\$ 1,243</u>	<u>\$ 1,543</u>

Debt service requirements to maturity of the revenue bonds payable at June 30, 2021, were as follows (expressed in thousands):

<u>For the Year(s) Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2022	\$ 220	\$ 52	\$ 272
2023	230	43	273
2024	240	34	274
2025	245	24	269
2026	260	13	273
2027–2029	55	5	60
Total	<u>\$1,250</u>	<u>\$171</u>	<u>\$1,421</u>

Changes in long-term debt payable for the year ended June 30, 2021, were as follows (expressed in thousands):



## Notes to the Financial Statements (Continued)

	Balance July 1, 2020	Additions	Deletions	Balance June 30, 2021	Amounts Due Within One Year
Revenue bonds payable	\$ 1,535	\$ -	\$ 285	\$ 1,250	\$ 220
Less: unamortized bond discount	(8)	-	(1)	(7)	-
Add: unamortized bond premium	16	-	16	-	-
<b>Total bonds payable</b>	<b>\$ 1,543</b>	<b>\$ -</b>	<b>\$ 300</b>	<b>\$ 1,243</b>	<b>\$ 220</b>

Changes in long-term debt payable for the year ended June 30, 2020, are as follows (expressed in thousands):

	Balance July 1, 2019	Additions	Deletions	Balance June 30, 2020	Amounts Due Within One Year
Revenue bonds payable	\$ 1,970	\$ -	\$ 435	\$ 1,535	\$ 285
Less: unamortized bond discount	(8)	-	-	(8)	-
Add: unamortized bond premium	40	-	24	16	-
<b>Total bonds payable</b>	<b>\$ 2,002</b>	<b>\$ -</b>	<b>\$ 459</b>	<b>\$ 1,543</b>	<b>\$ 285</b>

### Events of Default

Debt under the Tennessee Local Development Authority State Loan Program is secured by monthly payments of principal and interest made by local governments in accordance with the loan agreements. Under these loan agreements, local governments agree to levy fees, rates, or charges for services provided by the project and/or ad valorem taxes sufficient to pay debt service requirements. Additional security includes a pledge of state-shared taxes, a debt service reserve, and a statutory reserve.

Upon event of default, the General Bond Resolution empowers the trustee to institute any action or proceedings of law or equity for the collection of all payments due and unpaid under a loan agreement and to require the Authority to withhold state-shared taxes to the extent permitted by law and the terms of the loan agreement. In the event a local government should fail to make a timely and full payment with respect to the loan agreement, the Secretary or Assistant Secretary to the Authority will notify the Commissioner of Finance and Administration (the Commissioner) that the local government has failed to pay loan repayments due and payable with respect to a project and pursuant to the loan agreement and request the Commissioner to notify the local government of the default. The Commissioner shall deliver written notice by certified mail to the local government of such failure within five days of such failure. In the event the local government unit fails to remit the required payment or payments within 60 days of receipt of such notice, the Commissioner shall, without further authorization, withhold such sum or part of such sum from

## **Notes to the Financial Statements (Continued)**

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the state-shared taxes to make the local government current with respect to the unpaid loan. The balance of any deficit would be secured first by the debt service reserve and then the statutory reserve.

Upon the event of default of principal and interest due on bonds or notes, the Authority shall notify the trustee of such event and the corrective action, if any, the Authority intends to take. Upon the occurrence of an event of default of which the trustee has actual knowledge and at all times thereafter while such default shall continue, the trustee shall become vested with all the estate, property, rights, trusts, duties, and obligations of the trustee and shall take possession or supervision over the funds and account created under the General Bond Resolution and collect and receive all revenues and other monies in the same manner as the Authority and shall act in place of the Authority in the exercise of all rights and duties. The trustee shall give written notice by mail to all the registered holders of the bonds within 60 days after having obtained actual knowledge of default. Upon the occurrence and continuance of an event of default, the trustee (1) for and on behalf of the holders of the bonds, shall have the same rights which are possessed by the bondholders; (2) shall be authorized to proceed, in its own name and as trustee of an express trust; (3) may pursue any available remedy by action at law or suit in equity to enforce the payment of principal and interest and premium, if any, on the bonds; (4) may file such proofs of claim and other papers or documents as may be necessary; and (5) may, and upon written request of the holders of the bonds of not less than a majority in principal amount of the bonds then outstanding shall proceed to protect and enforce all rights of the bondholders and the trustee as permitted by the General Bond Resolution and the laws of the State of Tennessee.

### **Note 6. Statutory Reserve**

The statutory reserve is an amount set aside in the fund intended to ensure payment of the required annual debt service (principal and interest) for municipalities in the event of a default that have insufficient state-shared taxes available to the Authority to withhold. 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, 2021, the statutory reserve balance was \$3,307,219.

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 repay timely 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.

### **Note 7. State Infrastructure Fund**

The Tennessee Transportation State Infrastructure Fund was created pursuant to Section 4-31-1201, *Tennessee Code Annotated*. The State Infrastructure Program provides assistance to local

## **Notes to the Financial Statements (Continued)**

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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 2020 and 2019, no loans were approved.

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY**  
**Supplementary Schedules of Net Position - Program Level**  
**June 30, 2021, and June 30, 2020**

(Expressed in Thousands)

	June 30, 2021		June 30, 2020			
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs	State Infrastructure Loan Program	Total
<b>Assets</b>						
Current assets:						
Cash	\$15,198	\$ 1,016	\$16,214	\$14,782	\$ 924	\$15,706
Receivables:						
Loans receivable	229	64	293	224	63	287
Total current assets	15,427	1,080	16,507	15,006	987	15,993
Noncurrent assets:						
Restricted cash	272	-	272	348	-	348
Loans receivable	794	1,307	2,101	1,006	1,371	2,377
Total noncurrent assets	1,066	1,307	2,373	1,354	1,371	2,725
Total assets	16,493	2,387	18,880	16,360	2,358	18,718
<b>Deferred outflows of resources</b>						
Deferred amount on bond refunding	-	-	-	26	-	26
<b>Liabilities</b>						
Current liabilities:						
Accrued interest payable	17	-	17	21	-	21
Payable to borrowers	121	-	121	149	-	149
Revenue bonds payable	220	-	220	285	-	285
Total current liabilities	358	-	358	455	-	455
Noncurrent liabilities:						
Revenue bonds payable, net	1,023	-	1,023	1,258	-	1,258
Total noncurrent liabilities	1,023	-	1,023	1,258	-	1,258
Total liabilities	1,381	-	1,381	1,713	-	1,713
<b>Net position</b>						
Unrestricted	15,112	2,387	17,499	14,673	2,358	17,031
Total net position	\$15,112	\$ 2,387	\$17,499	\$14,673	\$ 2,358	\$17,031

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY**  
**Supplementary Schedules of Revenues, Expenses, and Changes in Net Position - Program Level**  
**For the Years Ended June 30, 2021, and June 30, 2020**

(Expressed in Thousands)

	Year Ended June 30, 2021		Year Ended June 30, 2020	
	State Loan Programs	State Infrastructure Loan Program	Total	State Loan Programs
<b>Operating revenues</b>				
Revenue from loans	\$ 58	\$ 26	\$ 84	\$ 72
Administrative fees collected	581	2	583	501
Interest income	12	1	13	234
Total operating revenues	651	29	680	807
				43
				\$ 28
				\$ 100
				2
				503
				13
				247
				850
<b>Operating expenses</b>				
Interest expense	69	-	69	90
Subsidy to borrowers	1	-	1	7
Administrative expenses	142	-	142	155
Total operating expenses	212	-	212	252
Operating income	439	29	468	555
				43
				\$ 2,315
				\$ 16,433
<b>Net position</b>				
Net position, July 1	14,673	2,358	17,031	14,118
Net position, June 30	\$ 15,112	\$ 2,387	\$ 17,499	\$ 14,673
				\$ 2,358
				\$ 17,031

**TENNESSEE LOCAL DEVELOPMENT AUTHORITY**  
 Supplementary Schedules of Cash Flows - Program Level  
 For the Years Ended June 30, 2021, and June 30, 2020

	Year Ended June 30, 2021		Year Ended June 30, 2020	
	State Loan Programs	State Infrastructure Loan Program	State Loan Programs	State Infrastructure Loan Program
<b>Cash flows from operating activities</b>				
Payments to service providers	\$ (142)	\$ -	\$ (142)	\$ -
Net cash used for operating activities	(142)	-	(142)	-
<b>Cash flows from noncapital financing activities</b>				
Principal payments	(285)	-	(285)	-
Interest paid	(63)	-	(63)	-
Net cash used for noncapital financing activities	(348)	-	(348)	-
<b>Cash flows from investing activities</b>				
Collections of loan principal	206	63	269	56
Interest received on loans	58	26	84	28
Administrative revenue	581	2	583	2
Interest received on pooled investment fund	12	1	13	13
Amounts repaid to borrowers	(27)	-	(27)	-
Net cash provided by investing activities	830	92	922	99
Net increase in cash	340	92	432	99
Cash, July 1	15,130	924	16,054	825
Cash, June 30	\$15,470	\$ 1,016	\$ 16,486	\$ 924
			\$ 15,130	\$ 924
			\$ 16,054	\$ 16,054
<b>Reconciliation of operating income to net cash used for operating activities:</b>				
Operating income	\$ 439	\$ 29	\$ 468	\$ 43
Adjustments to reconcile operating income to net cash used for operating activities:				
Revenue from loans	(58)	(26)	(84)	(72)
Interest income	(12)	(1)	(13)	(13)
Interest expense	69	-	69	-
Subsidy to borrowers	1	-	1	-
Administrative revenue from borrowers	(581)	(2)	(583)	(501)
Total adjustments	(581)	(29)	(610)	(43)
Net cash used for operating activities	\$ (142)	\$ -	\$ (142)	\$ -



JASON E. MUMPOWER  
*Comptroller*

**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 Lee, Governor  
Members of the General Assembly  
Members of the Tennessee Local Development Authority

We have audited the financial statements of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the Authority’s basic financial statements, and have issued our report thereon dated December 1, 2021. 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 Authority’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority’s internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be

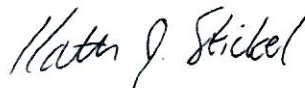
material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Tennessee Local Development Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions), 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.



Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit  
December 1, 2021





**FINANCIAL AND COMPLIANCE AUDIT REPORT**

**Clean Water State Revolving Fund**

*For the Year Ended June 30, 2021*

**Jason E. Mumpower**  
*Comptroller of the Treasury*



**DIVISION OF STATE AUDIT**

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JASON E. MUMPOWER  
*Comptroller*

December 7, 2021

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, 2021. 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 cursive script that reads "Katherine J. Stickel".

Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit

21/069

**Audit Report**  
**Clean Water State Revolving Fund**  
**For the Year Ended June 30, 2021**

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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, 2021

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### **Opinion on the Financial Statements**

The opinion on the financial statements is unmodified.

### **Audit Findings**

The audit report contains no findings.



JASON E. MUMPOWER  
*Comptroller*

## **Independent Auditor's Report**

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

### **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, 2021, and June 30, 2020, 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 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 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, 2021, and June 30, 2020, 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, 2021, and June 30, 2020, 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 December 1, 2021, 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.



Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit  
December 1, 2021

**CLEAN WATER STATE REVOLVING FUND**  
**Statements of Net Position**  
**June 30, 2021, and June 30, 2020**

(Expressed in Thousands)

	June 30, 2021	June 30, 2020
<b>Assets</b>		
Current assets:		
Cash (Note 2)	\$ 396,617	\$ 395,770
Loans receivable	58,508	59,626
<b>Total current assets</b>	<b>455,125</b>	<b>455,396</b>
Noncurrent assets:		
Loans receivable	727,401	698,810
<b>Total noncurrent assets</b>	<b>727,401</b>	<b>698,810</b>
<b>Total assets</b>	<b>1,182,526</b>	<b>1,154,206</b>
<b>Liabilities</b>		
Current liabilities:		
Payable to borrowers (Note 3)	6	128
Due to general fund	31	-
<b>Total current liabilities</b>	<b>37</b>	<b>128</b>
Noncurrent liabilities:		
Customer deposits payable (Note 2)	4,600	7,833
<b>Total noncurrent liabilities</b>	<b>4,600</b>	<b>7,833</b>
<b>Total liabilities</b>	<b>4,637</b>	<b>7,961</b>
<b>Net position</b>		
Unrestricted	1,177,889	1,146,245
<b>Total net position</b>	<b>\$ 1,177,889</b>	<b>\$ 1,146,245</b>

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, 2021, and June 30, 2020**

(Expressed in Thousands)

	Year Ended June 30, 2021	Year Ended June 30, 2020
<b>Operating revenues</b>		
Revenue from loans	\$ 9,927	\$ 9,774
Interest income	304	6,575
<b>Total operating revenues</b>	<b>10,231</b>	<b>16,349</b>
<b>Operating expenses</b>		
Administrative expenses	1,113	1,093
<b>Total operating expenses</b>	<b>1,113</b>	<b>1,093</b>
<b>Operating income</b>	<b>9,118</b>	<b>15,256</b>
<b>Nonoperating revenues</b>		
Capitalization grant	18,549	4,805
<b>Total nonoperating revenues</b>	<b>18,549</b>	<b>4,805</b>
<b>Nonoperating expenses</b>		
Principal forgiveness (Note 5)	639	2,106
<b>Total nonoperating expenses</b>	<b>639</b>	<b>2,106</b>
<b>Income before transfers</b>	<b>27,028</b>	<b>17,955</b>
<b>Transfers in (Note 4)</b>	<b>4,616</b>	<b>4,616</b>
<b>Change in net position</b>	<b>31,644</b>	<b>22,571</b>
<b>Net position, July 1</b>	<b>1,146,245</b>	<b>1,123,674</b>
<b>Net position, June 30</b>	<b>\$ 1,177,889</b>	<b>\$ 1,146,245</b>

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, 2021, and June 30, 2020**

(Expressed in Thousands)

	Year Ended June 30, 2021	Year Ended June 30, 2020
<b>Cash flows from operating activities</b>		
Payments for interfund services	\$ (1,082)	\$ (1,093)
<b>Net cash used for operating activities</b>	<b>(1,082)</b>	<b>(1,093)</b>
<b>Cash flows from noncapital financing activities</b>		
Operating grants received	18,549	4,805
Transfers in	4,616	4,616
<b>Net cash provided by noncapital financing activities</b>	<b>23,165</b>	<b>9,421</b>
<b>Cash flows from investing activities</b>		
Loans issued and other disbursements to borrowers	(169,559)	(125,402)
Collections of loan principal	141,446	47,828
Security deposits from borrowers	973	382
Interest received on loans	9,927	9,774
Interest received on investments	310	6,702
Amounts repaid to borrowers	(4,333)	(645)
<b>Net cash used for investing activities</b>	<b>(21,236)</b>	<b>(61,361)</b>
Net increase (decrease) in cash	847	(53,033)
Cash, July 1	395,770	448,803
<b>Cash, June 30</b>	<b>\$ 396,617</b>	<b>\$ 395,770</b>
<b>Reconciliation of operating income to net cash used for operating activities:</b>		
Operating income	\$ 9,118	\$ 15,256
Adjustments to reconcile operating income to net cash used for operating activities:		
Revenue from loans	(9,927)	(9,774)
Interest income	(304)	(6,575)
Due to general fund	31	-
<b>Total adjustments</b>	<b>(10,200)</b>	<b>(16,349)</b>
<b>Net cash used for operating activities</b>	<b>\$ (1,082)</b>	<b>\$ (1,093)</b>

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, 2021, and June 30, 2020**

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**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 *Annual Comprehensive Financial Report* as an enterprise fund (Sewer Treatment Loan Fund). That report is posted on the state's website at <https://www.tn.gov/finance/rd-doa/fa-accfin-ar.html>.

**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 State Pooled Investment Fund administered by the State Treasurer.

**Note 2. Deposits**

At June 30, 2021, the Clean Water State Revolving Fund had \$392,017,061 in the State Pooled Investment Fund for operating cash purposes and \$4,600,230 in customer security deposits in the Local Government Investment Pool. At June 30, 2020, the fund had \$387,936,715 in the State

## **Notes to the Financial Statements (Continued)**

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Pooled Investment Fund and \$7,833,365 in the Local Government Investment 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*. That report is posted on the state's website at <https://treasury.tn.gov/>.

### **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 Transfers**

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 U.S. Environmental Protection Agency to fund the program. To provide a state match for the federal grant to operate the program, the Clean Water State Revolving Fund received an interfund transfer of \$4,616,400 from the state's general fund during the year ended June 30, 2021, and \$4,616,400 during the year ended June 30, 2020.

### **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 ARRA 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 that the Clean Water State Revolving Fund received 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 part of "loans issued and other disbursements to borrowers."



JASON E. MUMPOWER  
*Comptroller*

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

We have audited the financial statements of the Clean Water State Revolving Fund, an enterprise fund of the State of Tennessee, as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements, and have issued our report thereon dated December 1, 2021. 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.



Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit  
December 1, 2021



JASON E. MUMPOWER  
Comptroller

## Fiscal Year Ending June 30, 2021

### TLDA Programs

1. State Loan Program Fund: (Water/Sewer)
  - 4 borrowers
  - 4 loans outstanding
  - \$1,250,000 bonds outstanding (Bonds mature 2029)
  
2. State Infrastructure Fund (Transportation)
  - 1 borrower
  - Collections:
    - \$62,994 loan principal
    - \$26,556 interest

Operating Income: \$468,109

Net Position at June 30, 2021: \$17,499,302

No new loans are being issued for these programs.


### State Revolving Fund Loan Programs

1. Clean Water Fund
  - Disbursements
    - \$169,558,809
  - Collections
    - \$141,445,858 loan principal
    - \$9,926,939 interest
  - Net position at June 30, 2021: \$1,117,889,634
  
2. Drinking Water Fund
  - Disbursements
    - \$6,813,966
  - Collections
    - \$26,668,433 loan principal
    - \$1,482,397 interest
  - Net position at June 30, 2021: \$209,896,183
  - No significant changes to accounting and reporting standards.

## Agenda Item #6



JASON E. MUMPOWER  
*Comptroller*

To: Members of the Tennessee Local Development Authority (TLDA) Audit Committee  
From: Sandi Thompson, Director, Division of State Government Finance (SGF)   
Date: May 16, 2022  
Subject: Risk Assessments

The management risk assessments for the SGF 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.



## Agenda Item #9

TLDA Audit Committee						
Responsibilities Calendar						
6/15/2022						
	Responsibilities	Documentation	Presented By	Agenda Reference	AC Meeting Date	Notes
1	Review significant accounting and reporting standards.	Minutes Discussion	Alicia West	Item #4	6/15/2021	
2	Review financial statements and comprehensive annual financial report.	Minutes Discussion	Michael Campbell, State Audit	Item #3	6/15/2021	
3	Review with management the adequacy of internal controls for compliance with policies, plans, procedures, laws, and regulations.	FY20 SLF & TDEC Risk Assessments	Sandi Thompson	Item #6	6/15/2021	
4	Understand the scope of external auditors' review of internal control.	June 30, 2020 Audit Report	Michael Campbell, State Audit	Item #3	6/15/2021	
5	Review processes in place to assess risk, including fraud risk, which shall include a review of management's risk assessment process, in the agency.	FY20 SLF & TDEC Risk Assessments	Sandi Thompson	Item #6	6/15/2021	
6	Inquire of management and auditors about significant risks and how those risks are managed.	FY20 SLF & TDEC Risk Assessments	Sandi Thompson	Item #6	6/15/2021	
7	Review reports issued by external auditors.	Minutes Discussion	Michael Campbell, State Audit Adeniyi Bakare, TDEC	Items #5 & 6	6/15/2021	SRF Drinking & Clean Water PERS Reports Comptroller's Audit Report
8	Ensure management has taken appropriate action on audit recommendations made by the auditors.	Minutes Discussion	N/A	Item #3	6/15/2021	No audit recommendations
9	Discuss the proposed scope and approach of the external audit.	June 30, 2020 Audit Report	Michael Campbell, State Audit Adeniyi Bakare, TDEC	Item #3	6/15/2021	SRF Drinking & Clean Water PERS Reports Comptroller's Audit Report
10	Discuss the results of the audit with representatives of the Comptroller of the Treasury, including any difficulties encountered during the course of the audit.	Minutes Discussion	Michael Campbell, State Audit	Item #3	6/15/2021	
11	Encourage external auditors to discuss any issues of concern with the audit committee.	Minutes Discussion	Michael Campbell, State Audit	Item #3	6/15/2021	
12	Immediately report any fraud to the Comptroller of the Treasury's office.	Minutes Discussion	Sandi Thompson	Item #7	6/15/2021	
13	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 the Comptroller of the Treasury.	Minutes Discussion	Sandi Thompson	Item #7	6/15/2021	
14	Ensure procedures exist for the receipt, retention, and treatment of complaints about accounting, internal controls, or auditing matters.	Minutes Discussion	Sandi Thompson	Item #8	6/15/2021	
15	Regularly update the board about committee activities and make appropriate recommendations.	Report given at each board meeting following AC	Treasurer Lillard	N/A	6/15/2021	Delivered by Treasurer at the TLDA Board meeting
16	Periodically review and amend, as necessary, the audit committee charter.	Exhibit- 4/15/2019 audit committee charter	Earle Pierce	Tab 2a	6/27/2019	
17	Review management's assertion that internal controls are effective and adequate.	FY20 SLF & TDEC Risk Assessments	Sandi Thompson	Item #6	6/15/2021	
18	Evaluate whether management is setting the appropriate 'control culture' and 'tone at the top' by communicating the importance of internal controls and risk management.	Internal Audit Article	Earle Pierce	Item #9	6/15/2021	
19	Provide a mechanism for staff to report any suspected fraud, abuse or other complaints related to operations to the audit committee.	Minutes Discussion	Sandi Thompson	Item #8	6/15/2021	

# — TONE — — at the — TOP®

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

Issue 109 | February 2022

## Maintaining Excellence in Corporate Governance

**The first year of the COVID-19 pandemic** created myriad challenges for organizations, but findings from a respected survey provided a glimmer of hope amid the gloom. Incremental improvements in key 2020 governance measures appeared to show organizations rallying to focus on improving how they operated. However, a year later, the same survey finds the quality of governance may be stagnating as organizations deal with unrelenting pandemic disruptions and uncertainty.

The Institute of Internal Auditors' and Neel Corporate Governance Center's [2021 American Corporate Governance Index \(ACGI\)](#), which surveyed chief audit executives (CAEs) on their organizations' performance on eight Guiding Principles of Corporate Governance, saw grades dip in seven of the eight categories compared to the previous year. Overall, the ACGI score slipped one point from 82 to 81, but maintained its B-rating.

### Key Takeaways in ACGI Results

**While the overall scores** appear to reflect some weariness from executive leadership, there were findings that boards ought to consider as they plan for the coming year:

**Internal audit can have a beneficial impact on governance quality.** The annual ACGI survey, now in its third year, has accumulated sufficient data to identify some correlations between company characteristics and governance quality. One of the most notable is the indication that governance quality is highest among companies where CAEs report administratively to the CEO or audit committee. Internal audit is designed to provide independent, objective information to leadership, and this reporting structure reinforces that role. What's more, because internal audit can provide assurance over a wide range of risk areas, it is preferable that the CAE report to the full board so that all members benefit from internal audit's insight and advice.



Strong governance quality was also associated with companies that had:

- Strong board independence accompanying a CEO-board chair duality.
- Simpler reporting structures and no international operations.

**Shareholder activism is not to be ignored.** The number of U.S. public shareholder activism campaigns jumped 28% during the 2021 proxy season from the 2020 season, returning to pre-pandemic levels after a decline, according to one assessment. ACGI survey results revealed there were significantly fewer companies that had not experienced a shareholder campaign during the year than was the case in 2020. Contrary to this spike in reported shareholder activism, the index saw a slight decline year over year in the likelihood of organizations considering a wide range of shareholder interests in their business decisions. This flies in the face of considerable changes in economic, political, and social environments given the disruptions of the past two years.

## About The IIA

The Institute of Internal Auditors, Inc. is a global professional association with more than 210,000 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.

## The IIA

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“Many shareholders are seeking a role in shaping the future, and boards may need to balance a broader, more diverse range of sometimes competing stakeholder interests in making decisions,” according to a Deloitte report published in *The Wall Street Journal*.

Board members should be aware of this trend and consider how best to address issues that might draw activist interest to their organizations. Their internal audit function can offer independent assessments and assurance on critical concerns that may be subject to potential shareholder activism before issues arise, minimizing the possible impact and giving organizations more time for decision-making on emerging problem areas.

**Keep an eye on ESG.** For corporate boards, the 2021 proxy season was an inflection point when it came to environmental, social, and governance (ESG) issues, according to the National Association of Corporate Directors' 2022 Governance Outlook. There were numerous shareholder activism campaigns focused on environmental concerns throughout 2021, and ESG considerations are expected to remain in the forefront in 2022. “All companies, regardless of their sector, are experiencing increased investor scrutiny on how they approach this issue,” according to a Morrow Sodali survey in 2021.

According to the ACGI, while some CAEs report that their companies' vigilance on environmental and social issues has led to improvements, the vast majority say it's too early to tell if their organizations' efforts are affecting governance or performance. Many companies have created board committees or executive-level positions that oversee ESG considerations. Boards should remember that their internal audit function is well-positioned to offer valuable independent assessments of many issues that fall under the ESG umbrella.

Unfortunately, good communication on ESG may be lacking in many companies. CAEs did not have strong faith in the quality of different types of ESG information at their organizations. A total of 41% thought the quality of ESG information used internally for decision-making was fair or poor. Another 31% called this data very good or excellent, and 28% thought it was good. When it came to information presented externally to shareholders, 34% thought it was fair or poor, 31% found it very good or excellent, and 34% deemed it good. These numbers point to room for improvement that internal audit can help organizations achieve.

**Employee-related governance may need strengthening.** The ACGI results found that employees were less likely to receive adequate job training and slightly less likely to receive incentives to achieve corporate objectives in an ethical manner. Companies were also slightly less likely to have sufficient time and money to address crises without cutting corners and/or sacrificing long-term performance. If these areas are not reinforced, companies could be making themselves vulnerable to future failures in risk management and control.

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## QUESTIONS FOR DIRECTORS

- » Has our organization experienced greater shareholder activism in the last year, and if so, how have we responded?
- » Has our company done a good job of anticipating and addressing shareholder concerns? Has our approach changed in recent years?
- » Are we leveraging internal audit's independent assurance and advice to identify and assess shareholder activism, as well as ESG risks/opportunities?
- » Does our full board routinely hear internal audit findings, recommendations, and reports?

## Fighting the Fatigue

While **pandemic fatigue** is an understandable response to a challenging time, boards should be alert not only to backsliding on corporate governance, but also to the need to take proactive steps to advance quality in this area. Additionally, they should consider how well their companies are anticipating and addressing shareholders' calls for greater accountability and change—especially regarding ESG concerns. Boards can turn to their internal audit function for valuable and objective assurance and advice on the best way to succeed in their efforts to enhance the quality of corporate governance.



Figure 1 - Source: PwC's 2021 Annual Corporate Directors Survey

## Guiding Principles of Corporate Governance

Principles	2021	2020	2019
Principle 1: Effective corporate governance requires regular and constructive interaction among key stakeholders, the board, management, internal audit, legal counsel, and external audit and other advisors.	B- (82)	B (83)	C+ (79)
Principle 2: The board should ensure that key stakeholders are identified and, where appropriate, stakeholder feedback is regularly solicited to evaluate whether corporate policies meet key stakeholders' needs and expectations.	B- (80)	B (86)	B- (81)
Principle 3: Board members should act in the best interest of the company and the shareholders while balancing the interests of other key external and internal stakeholders.	B- (83)	B (85)	B- (80)
Principle 4: The board should ensure that the company maintains a sustainable strategy focused on long-term performance and value.	C+ (77)	C+ (79)	C (75)
Principle 5: The board should ensure that the culture of the company is healthy, regularly monitor and evaluate the company's core culture and values, assess the integrity and ethics of senior management, and, as needed, intervene to correct misaligned corporate objectives and culture.	B (85)	B (86)	B- (82)
Principle 6: The board should ensure that structures and practices exist and are well-governed so that it receives timely, complete, relevant, accurate, and reliable information to perform its oversight effectively.	C+ (79)	C+ (79)	C+ (78)
Principle 7: The board should ensure that corporate disclosures are consistently transparent and accurate, and in compliance with legal requirements, regulatory expectations, and ethical norms.	B (84)	B (85)	B (83)
Principle 8: Companies should be purposeful and transparent in choosing and describing their key policies and procedures related to corporate governance to allow key stakeholders an opportunity to evaluate whether the chosen policies and procedures are optimal for the specific company.	B (84)	B (85)	B (83)

## About the ACGI

The ACGI, now in its third year, is a collaborative effort by The Institute of Internal Auditors and the Neel Corporate Governance Center. It surveyed 86 chief audit executives (CAEs) of publicly listed U.S. companies on how well their organizations performed on meeting eight Guiding Principles of Corporate Governance (see the box on previous page). The results can help boards, audit committees, and other stakeholders gain perspective on common governance problem areas.

The index is based on responses to a survey of CAEs or those best positioned for an independent, unbiased, and enterprisewide assessment of a company's governance practices. The Guiding Principles are based on a compendium of relevant guidance and principles advanced by experts in the field. The index gauges the extent to which companies are effectively achieving each of the Guiding Principles. It goes beyond the publicly observable aspects of corporate governance to provide an internal perspective on the effectiveness of corporate governance throughout the organization.

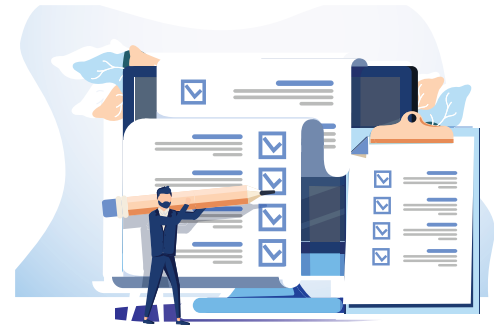
<sup>1</sup> [2021 U.S. Shareholder Activism Review](#), Sullivan & Cromwell LLP, December 20, 2021.

<sup>2</sup> ["Boards Can Prepare for Expected Wave of Activism,"](#) Chris Ruggeri, Maureen Bujno, Joel Schlachtenhaufen, and Annie Adams, *The Wall Street Journal CFO Journal*.

<sup>3</sup> [NACD 2022 Governance Outlook](#), 2021.

<sup>4</sup> ["Recent Shareholder Activism Trends,"](#) Shearman & Sterling LLP, posted on Harvard Law School Forum on Corporate Governance, November 29, 2021.

<sup>5</sup> [Institutional Investor Survey 2021](#), Morrow Sodali, May 11, 2021.



### Quick Poll Question

Given the effects of the pandemic, how has the quality of corporate governance fared in your organization in the past year?

- Improved
- Unchanged
- Worsened
- Don't know

Visit [www.theiia.org/Tone](http://www.theiia.org/Tone) to answer the question and learn how others are responding.

## QUICK POLL RESULTS

Is corporate governance in your organization healthy enough to manage new risk challenges, such as ESG?



15% We do not manage

9% I don't know

54% We may struggle a bit

23% Yes, absolutely

Source: *Tone at the Top December 2021 Survey*.

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