

BERRY & ASSOCIATES, P.A.

Certified Public Accountants

American Institute of CPAs

Arkansas Society of CPAs

Texas Society of CPAs

October 25, 2017

City of Tontitown Water and Sewer Department
P.O. Box 305
201 E. Henri de Tonti Blvd.
Tontitown, AR 72770

MANAGEMENT REPORT

In planning and performing our audit of the financial statements of the Water and Sewer Department of the City of Tontitown ("Department") for the year ended December 31, 2016, we considered the Department's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. (We previously reported on the Department's internal control in our report dated October 25, 2017). This letter does not affect our report dated October 25, 2017, on the financial statements of the Water and Sewer Department of the City of Tontitown.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with the Department's personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations:

Sales Tax Reports

We noted the gross sales reported on the December 2016 sales tax report were reported and calculated from a report that was not the sales reported on the billing register for December 2016. State law requires sales tax to be based on billings. The gross sales reported on the sales tax report exceeded the gross sales reflected on the billing register by approximately \$32,000. This would result in an overstatement of the sales tax remitted for December 2016. It appears that sewer charges are being included in the calculation of gross sales. The billing register calculates gross sales and sales tax correctly, excluding sales tax on sewer charges. We recommend all sales tax reports be reviewed and amended for 2016 and to present to recover the potential over payment of sales tax remitted to the Arkansas Department of Finance.

Improve Financial Records

We noted three accounts that were not being properly maintained in the general ledger, which were the UMB Bank Account #141831.6; UMB Bank Account #141831.3; and the Regions Bond Fund #7080005698. Although these accounts are maintained by a third party trustee, they should be recorded and reconciled each month. Such a system does not permit the preparation of accurate and reliable financial statements. The importance of a good accounting system cannot be overemphasized. Without adequate financial records, management is basing its decision on incomplete and/or inaccurate information during the year, and excessive time is spent at year end in preparing and auditing the financial statements.

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Journal Entries

We noted numerous journal entries are being posted to the general ledger rather than actual cash receipts and disbursements. These journal entries do not provide a memorandum or description citing the purpose of the respective journal entry. This does not allow for detection or prevention of incorrect entries. We recommend all cash receipts and disbursements be entered as such, instead of being entered as a journal entry. Journal entries should be reduced to transactions that are in need of correction or necessary accruals.

Beginning Balances

We noted there had been changes to the 2015 amounts after the audit for 2015 was performed. Once the books have been turned over to the auditor, no changes should be made in prior years. This does not allow the Department to provide correct and reliable internal financial statements to the City Council. We suggest that after the books have been turned over for audit, no changes be made in the prior year.

Also, the 2015 audit adjustments were done incorrectly, thus also changing the 2015 beginning balances. The goal of posting the audit adjustments is to make the Department's internal records match the audited financial statements. We can assist the Department with posting these adjustments in the future.

General Comments

We wish to thank the accounting staff for their support and assistance during our audit.

Please mail a copy of the audit report to the following organizations:

UMB Bank
Attn: Dee Anna Schmidt, CPA
204 North Robinson
Oklahoma City, OK 73102

Arkansas Natural Resources Commission
101 East Capital Avenue, Suite 350
Little Rock, AR 72201

This report is intended solely for the information and use of the City Council, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Berry & Associates

Berry & Associates, P.A.
Little Rock, Arkansas
October 25, 2017

**CITY OF TONTITOWN
WATER AND SEWER DEPARTMENT
Tontitown, Arkansas
FINANCIAL STATEMENTS
and
SUPPLEMENTARY INFORMATION
For the Years Ended
December 31, 2016 and 2015
and
INDEPENDENT AUDITOR'S REPORT**

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
Tontitown, Arkansas
FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
For the Years Ended December 31, 2016 and 2015

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INDEPENDENT AUDITOR'S REPORT

**Honorable Paul Colvin, Jr., Mayor
and Members of the City Council
City of Tontitown Water and Sewer Department
Tontitown, Arkansas**

Report on the Financial Statements

We have audited the accompanying financial statements of the Water and Sewer Department of the City of Tontitown, Arkansas, as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit includes 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 opinions.

Basis for Qualified Opinion

Because of the inadequacy of accounting records for the year ended December 31, 2016, we were unable to obtain sufficient appropriate audit evidence regarding the amounts at which transfers are recorded in the accompanying Statement of Revenues, Expenses, and Changes in Net Position at December 31, 2016 (stated at \$216,785).

Qualified Opinion on the 2016 Financial Statements

In our opinion, except for the possible effects of the matter discussed in the Basis for Qualified Opinion paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the City of Tontitown Water and Sewer Department as of December 31, 2016, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Honorable Paul Colvin, Jr., Mayor
and Members of the City Council
City of Tontitown
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Opinion on the 2015 Financial Statements

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the City of Tontitown Water and Sewer Department as of December 31, 2015, and the respective 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2017 on our consideration of the Water and Sewer Department of the City of Tontitown, Arkansas'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 Water and Sewer Department of the City of Tontitown, Arkansas's internal control over financial reporting and compliance.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Water Department and do not purport to, and do not, present fairly the financial position of the City of Tontitown, Arkansas, as of December 31, 2016 and 2015, the changes in its financial position, or, where applicable, its cash flows 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.

Prior Period Financial Statements

The financial statements of the Water & Sewer Department of the City of Tontitown, Arkansas, as of December 31, 2015, were audited by other auditors whose report dated July 25, 2017, expressed an unmodified opinion on those statements.

Berry & Associates

BERRY & ASSOCIATES, P.A.
Little Rock, Arkansas
October 25, 2017

**CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
STATEMENTS OF NET POSITION
December 31, 2016 and 2015**

ASSETS

	<u>2016</u>	<u>2015</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,164,018	\$ 2,406,777
Accounts receivable	104,481	103,192
Sales tax receivable	83,934	77,402
Inventory	69,104	12,959
Prepaid expenses	5,593	4,850
Total current assets	<u>2,427,130</u>	<u>2,605,180</u>
NON-CURRENT ASSETS		
Restricted assets		
Cash and cash equivalents	253,409	255,002
Investments	275,686	275,376
Total Restricted assets	<u>529,095</u>	<u>530,378</u>
Capital assets		
Capital assets, net of accumulated depreciation	<u>11,890,866</u>	<u>11,632,826</u>
Other assets		
Bond fees, net of accumulated amortization	<u>58,860</u>	<u>62,539</u>
TOTAL ASSETS	<u>\$ 14,905,951</u>	<u>\$ 14,830,923</u>

LIABILITIES AND NET POSITION

CURRENT LIABILITIES		
Accounts payable	\$ 68,876	\$ 65,217
Retainage payable	22,585	
Accrued liabilities	2,282	10,062
Due to general fund	-	4,171
Current portion of long-term debt	222,400	216,802
Accrued interest payable	16,791	34,571
Total current liabilities	<u>332,934</u>	<u>330,823</u>
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS		
Meter deposits	57,903	50,941
NON-CURRENT LIABILITIES		
Long-term debt, net of current portion	<u>4,072,576</u>	<u>4,384,950</u>
TOTAL LIABILITIES	<u>4,463,413</u>	<u>4,766,714</u>
NET POSITION		
Net investment in capital assets	7,654,752	7,093,613
Temporarily restricted	171,466	442,096
Unrestricted	<u>2,616,320</u>	<u>2,528,500</u>
Total net position	<u>10,442,538</u>	<u>10,064,209</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 14,905,951</u>	<u>\$ 14,830,923</u>

The accompanying notes to the financial statements are an integral part of these statements.

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGE IN NET POSITION
For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
OPERATING REVENUES		
Water revenue	\$ 726,857	\$ 905,785
Sewer revenue	211,383	72,579
Water & sewer tapping/connection fees	144,232	135,253
Solid waste revenue	149,626	52,209
Other income	68,285	-
Total operating revenues	<u>1,300,383</u>	<u>1,165,826</u>
OPERATING EXPENSES		
Water purchases	308,081	270,844
Sewer service purchases	648,154	724,159
Solid waste reimbursement	127,301	117,918
Salaries & payroll taxes	143,964	142,308
Employee benefits	19,585	21,023
Sales tax expenses	21,377	-
Auto expenses	10,811	10,081
Insurance	5,629	2,473
Computer support	13,594	19,375
Professional fees	27,394	46,021
Repairs and maintenance	70,417	43,272
Utilities and telephone	23,448	41,490
Dues and subscriptions	12,360	13,563
Materials and supplies	53,159	40,454
Office expense	17,362	13,479
Bank fees	5,447	3,397
Uniforms	1,403	646
Training	3,978	2,779
Miscellaneous expenses	139,613	14,098
Depreciation and amortization	459,801	443,805
Total operating expenses	<u>2,112,878</u>	<u>1,971,185</u>
OPERATING LOSS	<u>\$ (812,495)</u>	<u>\$ (805,359)</u>

The accompanying notes to the financial statements are an integral part of these statements.

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGE IN NET POSITION, Continued
For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
NONOPERATING REVENUE (EXPENSES)		
City sales tax	\$ 716,032	\$ 713,071
Other income	1,520	-
Interest income	6,401	7,760
Gain (loss) on fixed asset disposal	(1,610)	9,999
Interest expense	<u>(124,691)</u>	<u>(149,290)</u>
Net nonoperating income	<u>597,652</u>	<u>581,540</u>
NET LOSS BEFORE TRANSFERS	(214,843)	(223,819)
TRANSFERS OUT	-	(58,782)
TRANSFERS IN FROM CITY FOR SALES TAX	286,413	280,365
OTHER TRANSFERS IN	<u>216,785</u>	<u>-</u>
CHANGE IN NET POSITION	288,355	(2,236)
NET POSITION - BEGINNING OF YEAR		
ORIGINALLY STATED	10,064,209	10,066,445
PRIOR PERIOD ADJUSTMENT	<u>89,974</u>	<u>-</u>
NET POSITION - BEGINNING OF YEAR		
RESTATED	<u>10,154,183</u>	<u>10,066,445</u>
NET POSITION - END OF YEAR	<u>\$ 10,442,538</u>	<u>\$ 10,064,209</u>

The accompanying notes to the financial statements are an integral part of these statements.

**CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	\$ 1,299,094	\$ 1,239,175
Cash payments to suppliers	(1,549,755)	(1,396,707)
Cash payments to employees	(143,964)	(142,308)
Net cash used operating activities	<u>(394,625)</u>	<u>(299,840)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchases of capital assets	(96,310)	(259,929)
Costs paid on construction in progress	(619,465)	-
Principal payments on long-term debt	(216,802)	(211,278)
Interest payments on long-term debt	(142,471)	(151,953)
Net cash used by capital and related financing activities	<u>(1,075,048)</u>	<u>(623,160)</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Sales tax proceeds	716,032	691,597
Transfers from City for sales tax	286,413	280,365
Other transfers from (to) City	216,785	(58,782)
Net cash provided by non-capital financing activities	<u>1,219,230</u>	<u>913,180</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net activity of restricted cash	1,283	(45,794)
Interest received	6,401	7,760
Net cash used by investing activities	<u>7,684</u>	<u>(38,034)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	<u>(242,759)</u>	<u>(47,854)</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>2,406,777</u>	<u>2,454,631</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 2,164,018</u>	<u>\$ 2,406,777</u>

The accompanying notes to the financial statements are an integral part of these statements.

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
STATEMENTS OF CASH FLOWS, Continued
For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (812,495)	\$ (805,359)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation and amortization	459,801	443,805
Provision for loss on abandonment of fixed assets	1,610	-
(Increase) Decrease in:		
Accounts receivable	(1,289)	65,751
Sales tax receivable	(6,532)	
Inventory	(56,144)	9,970
Prepaid expenses	(743)	(2,819)
Increase (Decrease) in:		
Accounts payable	3,659	(24,984)
Retainage payable	22,585	-
Accrued liabilities	(7,868)	10,062
Due to general fund	(4,171)	(3,864)
Customer deposits	6,962	7,598
	<u>417,870</u>	<u>505,519</u>
Net cash used by operating activities	<u>\$ (394,625)</u>	<u>\$ (299,840)</u>

The accompanying notes to the financial statements are an integral part of these statements.

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization

The City of Tontitown, Arkansas, Water and Sewer Department is an enterprise fund. Enterprise funds are proprietary funds used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector. The fund is used to record the revenues and expenses from the operation of the water and sewer system.

Basis of Presentation and Accounting

The accounts of the Department are organized on the basis of a proprietary fund type, specifically an enterprise fund. The activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the Department's assets, liabilities, net position, revenues and expenses. Enterprise Funds account for activities (i) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or (ii) that are required by laws or regulations that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or (iii) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The accounting and financial reporting treatment applied to the Department is determined by its measurement focus. The transactions of the Department are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net position. Net position (i.e., total assets net of total liabilities) are segregated into net investment in capital assets, restricted for debt service; and unrestricted components.

Estimates

Management of the Department has made certain estimates and assumptions relating to the reporting of assets and liabilities and revenues and expenses to prepare these financial statements in conformity with generally accepted accounting principles. Actual results may differ from those estimates.

Cash and Cash Equivalents

The Department considers all highly liquid investments (including restricted cash and investments) with maturities of three months or less when purchased to be cash equivalents. Certificate of deposits are presented at fair value. Short-term investments generally mature or are otherwise available for withdrawal in less than one year.

Inventories

Inventories consist of expendable supplies held for consumption. Inventory is valued at the lower of cost or market, on a first-in, first-out basis. Cost is deemed to approximate market value.

Allowance for Bad Debts

The Department has elected to record bad debts using the direct write-off method. Generally accepted accounting principles require that the allowance method be used to recognize bad debts; however as of December 31, 2016 management had determined that no additional accounts needed to be written off. Bad debt expense for the year ended December 31, 2016 was \$0.

Budgets and Budgetary Accounting

Prior to the beginning of the new fiscal year, the Council Members adopt an annual budget for the Department. The budget of the Department is adopted under a basis consistent with GAAP, except that depreciation, certain capital expenses, and nonoperation income and expense items are not considered. All annual appropriations lapse at the fiscal year-end.

Reclassification

Certain amounts reported in 2015 have been reclassified to conform to the presentation at December 31, 2016.

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Capital Assets

The cost of additions and major replacements of retired units of property are capitalized. The Department defines capital assets as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of two years. Cost includes direct labor, outside services, materials and transportation, employee fringe benefits, overhead, and interest on funds borrowed to finance construction. The cost and accumulated depreciation of property sold or retired is deducted from capital assets and any profit or loss resulting from the disposal is credited or charged in the nonoperating section of the statements of revenues, expenses and changes in net position. The cost of current repairs, maintenance, and minor replacements is charged to expense. Construction in progress primarily relates to upgrades of existing facilities.

Depreciation has been provided over estimated useful lives of the assets using the straight-line method. The estimated useful lives are as follows:

Asset	Years
Land improvements	15-39
Water & Sewer System	40
Buildings	40
Equipment	5-15
Vehicles	5

Long-Term Debt and Costs

Long-term debt is reported at face value, net of applicable discounts and deferred loss on refunding. Costs related to the issuance of debt are deferred and amortized over the lives of the various debt issues. Losses occurring from advance refundings of debt are deferred and amortized as interest expense over the remaining life of the old bonds, or the life of the new bonds, whichever is shorter.

Operating Revenues and Expenses

Operating revenues and expenses consist of those revenues that result from the ongoing principal operations of the Department. Operating revenues consist primarily of charges for services. Nonoperating revenues and expenses consist of those revenues and expenses that are related to financing and investing type of activities and result from nonexchange transactions or ancillary activities. When an expense is incurred for purposes for which there are both restricted and unrestricted net position available, it is the Department's policy to apply those expenses to restricted net position to the extent such are available and then to unrestricted net position.

Equity Classification

Net position comprises the various net earnings from operating income, nonoperating revenues and expenses, and capital contributions. Net position is classified in the following three components:

Net Investment in Capital Assets-This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvements of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net investment in capital assets. Rather, that portion of debt is included in the same net position component as the unspent proceeds.

Temporarily Restricted- This component of net position consists of constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted - This component of net position consists of net position that does not meet the definition of "restricted."

Investments

Marketable securities are classified as "available for sale". Securities classified as "available for sale" are carried in the financial statements at fair value. Realized gains and losses, determined using the first-in, first-out (FIFO) method, are included in the earnings; unrealized holding gains and losses are reported in other comprehensive income.

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):**Capitalized Interest**

Interest costs are capitalized when incurred on debt where proceeds were used to finance the construction of assets. Interest earned on proceeds of tax-exempt borrowing arrangements restricted to the acquisition of qualifying assets is offset against interest costs in determining the amount to be capitalized.

NOTE 2 – DEPOSITS WITH FINANCIAL INSTITUTIONS:

All funds are deposited in approved banks. The deposited funds are insured by the Federal Deposit Insurance Corporation (“FDIC”) or collateralized by securities held by the banks in the Department’s name. The deposited funds were adequately insured at December 31, 2016.

NOTE 3 – CAPITAL ASSETS:

Capital asset activity for the years ended December 31, 2016 and 2015 was as follows:

	Balance 12/31/15	Additions	Retirements and transfers	Balance 12/31/16
Land & Improvements	\$ 336,293	\$ 51,005	\$ -	\$ 387,298
Sewer System	8,956,702	-	-	8,956,702
Water System	5,217,808	-	-	5,217,808
Buildings	249,216	-	-	249,216
Equipment	660,938	18,624	(11,507)	668,055
Vehicles	31,730	26,681	-	58,411
Construction in Progress	-	619,465	-	619,465
	<u>15,452,687</u>	<u>\$ 715,775</u>	<u>\$ (11,507)</u>	<u>16,156,955</u>
Less Accumulated Depreciation	<u>(3,819,861)</u>			<u>(4,266,089)</u>
Total Net Capital Assets	<u>\$ 11,632,826</u>			<u>\$ 11,890,866</u>

	Balance 12/31/14	Additions	Retirements and transfers	Balance 12/31/15
Land & Improvements	\$ 336,293	\$ -	\$ -	\$ 336,293
Sewer System	8,917,512	39,190	-	8,956,702
Water System	5,096,727	121,081	-	5,217,808
Buildings	231,066	18,150	-	249,216
Equipment	588,932	91,506	(19,500)	660,938
Vehicles	31,730	-	-	31,730
	<u>15,202,260</u>	<u>\$ 269,927</u>	<u>\$ (19,500)</u>	<u>15,452,687</u>
Less Accumulated Depreciation	<u>(3,395,557)</u>			<u>(3,819,861)</u>
Total Net Capital Assets	<u>\$ 11,806,703</u>			<u>\$ 11,632,826</u>

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 4 – LONG-TERM DEBT:

Long-term debt consists of the following:

	<u>2016</u>	<u>2015</u>
Water System Revenue Bond, serviced by Regions Bank and payable to Arkansas Natural Resources Commission, due in semi-annual installments of \$9,670, including interest at 4.6%, beginning April 2002 through June 2027. The bond is secured by revenues of the Department. (1)	\$ 154,976	\$ 166,778
City of Tontitown, Arkansas Sales & Use Tax Refunding Bonds - Series 2013. Due annually beginning October 2013 through October 2032. Interest rates range from 2.0% to 4.25%. Interest is payable semi annually. The bond is secured by 75% of the net collections of the 1% sales and use tax levied within the City of Tontitown. (2)	4,140,000	4,345,000
	<u>4,294,976</u>	<u>4,511,778</u>
Less Current Portion	<u>(222,400)</u>	<u>(216,802)</u>
Long Term Portion	4,072,576	4,294,976
Plus Unamortized Bond Premium	<u>-</u>	<u>89,974</u>
Long-Term Debt, Net	<u>\$ 4,072,576</u>	<u>\$ 4,384,950</u>

- (1) The bond agreement with Arkansas Natural Resources Commission contains a provision which requires the Department to maintain their water rates at an amount sufficient to (1) pay all operation, repair and maintenance expenses, and (2) leave a balance equal to the debt service requirements to which the system revenues are pledged. For the year ended December 31, 2016, the Department did satisfy this requirement of the rate covenant.
- (2) The revenue bonds have no restrictive covenants.

The annual maturities of long-term debt at December 31, 2016, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 222,400	\$ 137,773	\$ 360,173
2018	228,000	132,972	360,972
2019	233,500	128,173	361,673
2020	239,200	123,072	362,272
2021	244,800	117,410	362,210
2022-2026	1,320,100	483,070	1,803,170
2027-2031	1,476,976	227,713	1,704,689
2032	330,000	11,385	341,385
	<u>\$ 4,294,976</u>	<u>\$ 1,361,568</u>	<u>\$ 5,656,544</u>

CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 4 – LONG-TERM DEBT (continued):

Long-term liability activity for the years ended December 31, 2016 and 2015 is as follows:

	Balance 12/31/15	Additions	Retirements	Balance 12/31/16	Due Within One Year
Long Term Debt					
Sales & Use Tax Bonds	\$ 4,345,000	\$ -	\$ (205,000)	\$ 4,140,000	\$ 210,000
Water Revenue Bonds	166,778	-	(11,802)	154,976	12,400
	<u>\$ 4,511,778</u>	<u>\$ -</u>	<u>\$ (216,802)</u>	<u>\$ 4,294,976</u>	<u>\$ 222,400</u>
	Balance 12/31/14	Additions	Retirements	Balance 12/31/15	Due Within One Year
Long Term Debt					
Sales & Use Tax Bonds	\$ 4,545,000	\$ -	\$ (200,000)	\$ 4,345,000	\$ 205,000
Water Revenue Bonds	178,056	-	(11,278)	166,778	11,802
	<u>\$ 4,723,056</u>	<u>\$ -</u>	<u>\$ (211,278)</u>	<u>\$ 4,511,778</u>	<u>\$ 216,802</u>

The Department has pledged future water customer revenues, net of specified operating expenses, to repay \$4,294,976 in revenue bonds. Proceeds from the bonds were used for building of the Department's water and sewer system. Principal and interest on the bonds are payable through 2032, solely from the water customer net revenues. Principal and interest paid in the year ended December 31, 2016 were \$216,802 and \$142,471, respectively. Principal and interest paid in the year ended December 31, 2015 were \$211,278 and \$151,953, respectively.

NOTE 5 – SUBSEQUENT EVENTS:

Management has evaluated all the activities of the Department through October 25, 2017 (the date the financial statements were available to be issued) and concluded that no subsequent events have occurred that would require recognition in the financial statements or disclosure in the notes to the financial statements as of December 31, 2016.

NOTE 6 – RESTRICTED ASSETS:

Restricted assets consist of cash reserves restricted for specific use and cash deposits for meters by customers.

The following is a list of the restricted cash at December 31:

	2016	2015
Customer Meter Deposits	\$ 57,614	\$ 53,711
Construction Funds	195,795	201,291
	<u>\$ 253,409</u>	<u>\$ 255,002</u>

**CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE 6 – RESTRICTED ASSETS (continued):

The long-term debt covenants require minimum reserves for debt service reserves (see Note 2). These funds are held investment accounts as seen in Note 8.

	2016	2015
2002 Series Revenue Bond Fund	\$ 1,613	\$ 1,613
2013 Series Sales Tax Principal Account	52,548	51,260
2013 Series Sales Tax Bond Debt Service Reserve	204,275	205,253
2013 Series Sales Tax General Account	17,250	17,250
	<u>\$ 275,686</u>	<u>\$ 275,376</u>

NOTE 7 – RISK MANAGEMENT:

The Department is exposed to various levels of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The Department carries property, vehicle insurance and workers compensation insurance.

There has been no significant reduction in the Department's insurance coverage from the previous year. In addition, there have been no settlements in excess of the Department's coverage in any of the prior three fiscal years.

NOTE 8 – INVESTMENTS:

FASB Accounting Standards Codification (ASC) 820-10 established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted observable quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The three levels of the FASB fair value hierarchy are described below:

Basis of Fair Value Measurement

Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 – Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. All of the entity's investments are determined to be Level 1.

**CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE 8 – INVESTMENTS (continued):

The following table sets forth by level, within the fair value hierarchy, the Company's assets at fair value at December 31, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Bond Funds	\$ 1,613	\$ -	\$ -	\$ 1,613
Money Market	274,073	-	-	274,073
Total Assets at Fair Value	<u>\$ 275,686</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 275,686</u>

The Department's investments in securities are stated at fair market value and consist of the following:

	<u>Costs</u>	<u>Fair Value</u>
Bond Funds	\$ 1,613	\$ 1,613
Money Market	<u>274,073</u>	<u>274,073</u>
	<u>\$ 275,686</u>	<u>\$ 275,686</u>

NOTE 9 – COMMITMENTS:

On April 24, 2007, the Department entered into a service contract with Northwest Arkansas Conservation Authority (NACA). The agreement as amended provides for the treatment of waste water for the Department by NACA. The agreement also provides that the commission will share in the cost of operating the NACA facilities primarily based upon the Department's pro rata share of treated waste water, that the Department will charge its customers at rates adequate to cover the cost of NACA's services (to the extent allowed by law), and that the Department will not be required to compensate NACA in amounts in excess of waste water revenues. Treatment costs from NACA for the years ended December 31, 2016 and 2015 were \$648,154 and \$715,559, respectively. The agreement has a term expiring the later of April 2047 or such time as all NACA debt has been retired.

BERRY & ASSOCIATES, P.A.

Certified Public Accountants

American Institute of CPAs

Arkansas Society of CPAs

Texas Society of CPAs

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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*

Independent Auditor's Report

Honorable Paul Colvin, Jr., Mayor
and Members of the City Council
City of Tontitown Water and Sewer Department
Tontitown, Arkansas

We have audited, 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, the financial statements of the Water and Sewer Department of the City of Tontitown, Arkansas, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Water and Sewer Department of the City of Tontitown, Arkansas's financial statements and have issued our report thereon dated October 25, 2017.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected in 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings as items 2016-001, 2016-002, and 2016-003 that we consider to be significant deficiencies.

Compliance and Other Matters

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

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Honorable Paul Colvin, Jr., Mayor
and Members of the City Council
City of Tontitown
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Response to Findings

The Water and Sewer Department of the City of Tontitown, Arkansas' responses to the findings identified in our audit are described in the accompanying schedule of findings. The Department's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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.

Berry & Associates

Berry & Associates, P.A.
Little Rock, Arkansas
October 25, 2017

**CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2016**

2016-001 Internal Control – Complete set of accounting records

Criteria: Maintaining a complete set of accounting records.

Condition: At December 31, 2016, two of the Department's UMB Bank Accounts and the Regions Bond Fund Account, were absent from the general ledger.

Cause: The Department did not properly record transactions and maintain accounting records.

Effect or Potential Effect: General ledger accounts were not properly accounted for in the Department's internal financial statements. With these accounts missing, it does not permit the preparation of accurate and reliable financial statements.

Recommendation: We recommend that management of the Department properly record all transactions and appropriately maintain all accounting records in a timely manner.

Responsible Official's Response: The Department concurs with the recommendation.

2016-002 Internal Control – Insufficient documentation of journal entry transactions

Criteria: The Department is responsible for the proper recording and documentation of transactions to enable management and City Council oversight of the recording process according to generally accepted accounting principles in the United States of America.

Condition: Journal entries in the accounting records do not have a sufficient memorandum to enable a reasonable person to know what the entry was made for. This includes reimbursements to the City for payroll, electronic fund transfers, and payments and debit memos at the bank. This finding was also noted in 2015.

Cause: Review and oversight by management was impaired by improper documentation of entries in the accounting records. All journal entries in the accounting records should have documentation as to what the entry was for.

Effect or Potential Effect: Management was unable to detect or prevent entries that were coded incorrectly, thus not permitting the preparation of accurate and reliable financial statements.

Recommendation: All steps in the review and approval process should be followed. Journal entries need to be well documented to allow oversight. Management should try to reduce journal entries to transactions that are in need of correction. Entries should have invoices or receipts that can be vouched as evidence that the journal entry was according to generally accepted accounting principles in the United States.

Responsible Official's Response: The Department concurs with the recommendation.

**CITY OF TONTITOWN WATER AND SEWER DEPARTMENT
SCHEDULE OF FINDINGS AND RESPONSES, Continued
For the Year Ended December 31, 2016**

2016-003 Internal Control – Changes to Beginning Balances

Criteria: Prior year accounting records should not be changed.

Condition: The 2016 beginning balances did not match the 2015 audited balances, in numerous instances.

Cause: The Department made changes to the prior year accounting records.

Effect or Potential Effect: Balance sheet accounts were reported incorrectly, thus not permitting the preparation of accurate and reliable financial statements.

Recommendation: We recommend that the Department post all audit adjustments to their books and to not make any changes in prior years.

Responsible Official's Response: The Department concurs with the recommendation and will correct the books accordingly.