

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Financial Statements

May 31, 2018



despain luther short & company

901 Windover Road | Jonesboro, AR 72401 | 870-932-5401 | 870-972-1141

INDEPENDENT AUDITORS' REPORT

Honorable Mayor and
Members of the City Council
Lake City, AR 72437

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Lake City Water and Sewer System Combined Group of Funds of the City of Lake City, Arkansas, which comprise the Statement of Net Position as of May 31, 2018 and 2017, and the related Statement of Revenues, Expenses and Changes in Net Position, and the Statement of Cash Flows for the years then ended, 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.

AUDITORS' RESPONSIBILITY

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

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

OPINION

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lake City Water and Sewer System Combined Group of Funds of the City of Lake City, Arkansas as of May 31, 2018 and 2017, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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ENTERPRISE FUND ONLY

As discussed in Note B, the financial statements present only the Lake City Water and Sewer System Combined Group of Funds of the City of Lake City, Arkansas and are not intended to present fairly the financial position of the City of Lake City, Arkansas, and the results of its operations and the cash flows of its proprietary and similar trust fund types in conformity with generally accepted accounting principles.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated October 5, 2018 on our consideration of the Lake City Water and Sewer System Combined Group of Funds of the City of Lake City, Arkansas's internal control over financial reporting and 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 testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Lake City Water and Sewer System Combined Group of Funds of the City of Lake City, Arkansas's internal control over financial reporting and compliance.

*Despain, Ruth, Short
& Company, CPA'S, PA*

Jonesboro, Arkansas
October 5, 2018

LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS

Statement of Net Position
 May 31,

	<u>2018</u>	<u>2017</u>
<u>ASSETS</u>		
Current Assets:		
Cash on Hand	\$ 50	\$ 50
Cash in Depositories	370,593	349,209
Less Restricted Cash	<u>(123,177)</u>	<u>(129,433)</u>
Unrestricted Cash	\$ 247,466	\$ 219,826
Accounts Receivable	973	1,259
Sales Tax Receivable	5,245	5,274
Accrued Interest Receivable	33	47
Unbilled Revenues	<u>36,983</u>	<u>35,214</u>
Total Current Assets	<u>\$ 290,700</u>	<u>\$ 261,620</u>
Capital Assets:		
Water and Sewer System	\$ 3,564,128	\$ 2,446,246
Machinery	96,245	67,845
Tools and Equipment	317,300	301,646
Office Equipment	32,920	32,920
Less Accumulated Depreciation	<u>(1,882,225)</u>	<u>(1,808,585)</u>
Net Depreciable Capital Assets	\$ 2,128,368	\$ 1,040,072
Construction in Progress	-	424,901
Land	<u>24,178</u>	<u>24,178</u>
Net Capital Assets	<u>\$ 2,152,546</u>	<u>\$ 1,489,151</u>
Other Assets:		
Restricted Cash	<u>\$ 123,177</u>	<u>\$ 129,433</u>
Total Assets	<u>\$ 2,566,423</u>	<u>\$ 1,880,204</u>

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

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Statement of Net Position

May 31,

	<u>2018</u>	<u>2017</u>
<u>LIABILITIES AND NET POSITION</u>		
Liabilities:		
Current Liabilities:		
Accounts Payable	\$ 7,994	\$ 7,514
Accounts Payable, Construction Project	7,630	332,975
Accrued Interest Payable	247	137
Customer Deposits	24,226	24,226
Bonds Payable - Current	<u>66,304</u>	<u>55,013</u>
Total Current Liabilities	<u>\$ 106,401</u>	<u>\$ 419,865</u>
Long-Term Liabilities:		
Bond Payable - Rural Development/Berkadia	\$ 56,639	\$ 90,765
Bonds Payable--Rural Development	1,049,861	77,030
Capital Lease--Case Excavator	22,333	-
Less Current Portion Above	<u>(66,304)</u>	<u>(55,013)</u>
Net Long-Term Liabilities	<u>\$ 1,062,529</u>	<u>\$ 112,782</u>
Total Liabilities	<u>\$ 1,168,930</u>	<u>\$ 532,647</u>
Net Position:		
Invested in Capital Assets, Net of Related Debt	\$ 1,015,836	\$ 988,244
Restricted	98,951	105,207
Unrestricted	<u>282,706</u>	<u>254,106</u>
Net Position	<u>\$ 1,397,493</u>	<u>\$ 1,347,557</u>
Total Liabilities and Net Position	<u>\$ 2,566,423</u>	<u>\$ 1,880,204</u>

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

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Combined Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended May 31,

	<u>2018</u>	<u>2017</u>
Revenue from Operations:		
City Sales Tax Revenue	\$ 72,107	\$ 70,543
Water and Sewer Revenue	292,498	294,001
Mosquito Spraying Revenue	18,193	17,973
Connection Fees	9,564	12,770
Miscellaneous Operating Revenue	3,174	5,193
Total Operating Revenues	\$ 395,536	\$ 400,480
Operating Expenses:		
Salaries and Wages	\$ 108,963	\$ 108,337
System Supplies, Repairs and Chemicals	73,753	67,816
Utilities and Telephone	32,185	31,756
Insurance and Bonds	16,905	16,618
Gas, Oil and Repairs	4,636	3,740
Payroll Taxes	8,292	7,973
Office Supplies and Postage	6,731	8,997
Professional Fees	7,435	4,600
Permits & Fees	6,507	8,977
Uniforms	932	1,014
Miscellaneous	21	81
Depreciation	73,640	70,162
Total Operating Expenses	\$ 340,000	\$ 330,071
Net Income (Loss) from Operations	\$ 55,536	\$ 70,409
Non-Operating Income (Expense)		
Interest Income	\$ 573	\$ 449
Interest Expense	(6,173)	(5,414)
Total Non-Operating Income (Expense)	\$ (5,600)	\$ (4,965)
Net Income Before Contributions	\$ 49,936	\$ 65,444
Capital Contributions:		
City of Lake City General Fund Contribution	-	-
Change in Net Position	\$ 49,936	\$ 65,444
Net Position, Beginning of Year	\$ 1,347,557	\$ 1,282,113
Net Position, End of Year	\$ 1,397,493	\$ 1,347,557

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

LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS
 Combined Statement of Cash Flows
 For The Year Ended May 31,

	<u>2018</u>	<u>2017</u>
Cash Flows from Operating Activities:		
Cash Receipts from Sales & Use Tax	\$ 72,136	\$ 71,120
Cash Receipts from Customers	321,946	329,318
Cash Paid to Suppliers	(156,917)	(152,501)
Cash Paid to Employees	<u>(108,963)</u>	<u>(108,337)</u>
Cash Flows from Operating Activities	<u>\$ 128,202</u>	<u>\$ 139,600</u>
Cash Flows from Non-Capital Financing Activities	<u>\$ -</u>	<u>\$ -</u>
Cash Flows from Investing Activities:		
Interest Received	<u>\$ 587</u>	<u>\$ 448</u>
Cash Flows from Capital & Related Financing Activities:		
Interest Paid on Debt (Expense Portion)	\$ (6,063)	\$ (5,482)
Interest Paid and Capitalized	(14,226)	(670)
Bond Proceeds from Rural Development	1,001,000	94,700
Loan Proceeds from Bank of the West	28,400	-
Principal Payments on new Bond Issue	(28,169)	(17,670)
Payments Water Tank Construction	(989,311)	(91,257)
Fixed Assets Purchased	(44,054)	(36,099)
Land Purchased	(14,789)	(7,394)
Principal Payments on Capital Lease	(6,067)	(8,163)
Meter Deposits Refunded	-	(115)
Debt Retirement-Rural Development/Berkadia	<u>(34,126)</u>	<u>(32,558)</u>
Cash Flows from Capital & Related Financing Activities	<u>\$ (107,405)</u>	<u>\$ (104,708)</u>
Increase (Decrease) in Cash and Cash Equivalents	\$ 21,384	\$ 35,340
Cash and Cash Equivalents, Beginning	<u>349,259</u>	<u>313,919</u>
Cash and Cash Equivalents, Ending	<u>\$ 370,643</u>	<u>\$ 349,259</u>
Reconciliation of Operating Income to		
Net Cash Provided by Operating Activities:		
Income (Loss) from Operations	\$ 55,536	\$ 70,409
Adjustments:		
Depreciation	73,640	70,162
Change in Assets and Liabilities:		
Decrease (increase) in:		
Accounts Receivable	286	428
Unbilled Revenues	(1,769)	(1,047)
Sales Tax Receivable	29	577
Increase (decrease) in:		
Accounts Payable	<u>480</u>	<u>(929)</u>
Net Cash Provided by Operating Activities	<u>\$ 128,202</u>	<u>\$ 139,600</u>

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

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Notes to Financial Statements
May 31, 2018 and 2017

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lake City Water and Sewer System Combined Group of Funds uses the Accrual Basis of Accounting. Their revenues are recognized when they are earned, and their expenses are recognized when they are incurred. Unbilled revenues are recorded at year end.

Measurement Focus and Financial Statement Presentation

The term “measurement focus” is used to denote what is being measured and reported in the Lake City Water and Sewer System Combined Group of Funds (LCWSS) operating statement. The LCWSS is accounted for on the flow of economic resources measurement focus. The fundamental objective of this focus is to measure whether the LCWSS is better or worse off economically as a result of events and transactions of the period.

The LCWSS adopted provisions of Governmental Accounting Standards Board Statement No. 34 “*Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments.*” Statement 34 established standards for external financial reporting for all state and local governmental entities which includes a Statement of Net Position, a Statement of Revenues, Expenses and Changes in Net Position and a Statement of Cash Flows. It requires classification of net position into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in capital assets, net of related debt*—This component of net position consists of capital assets, including restricted 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 improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net position component as unspent proceeds.
- *Restricted*—This component of net position consists of constraints placed on net position use through external 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 assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Management’s Discussion and Analysis is intended to be presented for the reporting entity as a whole, not for individual Departments or component units; therefore, it has not been included as supplemental information to these financial statements.

Lake City Water and Sewer System Combined Group of Accounts

The Lake City Water Department and Lake City Sewer Department are separate units. They were combined as a single proprietary unit until January 1, 1993, at which time they were separated to better monitor the activity of the Sewer Department in relation to requirements of a loan received through the Revolving Loan Fund (RLF) with the Construction Assistance Division (CAD) of the Arkansas Department of Pollution Control and Ecology (ADPC&E).

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Notes to Financial Statements
May 31, 2018 and 2017

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Allowance for Doubtful Accounts

Generally accepted accounting principles require that an allowance for doubtful accounts be accrued. The Lake City Water and Sewer System Combined Group of Funds uses the direct write-off method, which is to say that bad debts are recognized as they occur. This practice does not have a material effect on the financial statements because customers are required to make a deposit greater than an average month's bill.

Restricted Cash

Restricted cash represents 1) the amounts required to be accumulated per terms of the Rural Development (Berkadia) Bond Agreement; 2) the amount of customer service deposits held; 3) the amounts collected from a city sales tax for general improvements to the water and sewer system; 4) amounts on deposit in a construction project fund, and 5) a depreciation reserve account established by the 2017 Rural Development bond issue. These restrictions result in the cash not being available for general use and are more fully explained in Note C.

Inventory

Generally accepted accounting principles require that significant amounts of inventory should be reported on the statement of net position. Management has elected to omit inventory from these financial statements. Management's estimate of inventory is \$15,000, which is not material with respect to the statement of net position.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits (checking accounts), time deposits, and certificates of deposit with maturity date of twelve months or less. It also includes restricted cash.

Fixed Assets

Fixed Assets are recorded at historical cost. Depreciation is provided for in amounts sufficient to relate the cost of the depreciable assets to operations over their estimated service lives using the straight-line method. Service lives by type of asset are as follows:

Water & Sewer System	20 to 50 Years
Machinery	5 to 10 Years
Vehicles	3 to 7 Years
Tools & Equipment	5 to 10 Years
Office Equipment	5 to 10 Years

Expense Allocation

Water Department and Sewer Department direct expenses are charged to the appropriate department and common expenses are divided as deemed appropriate by Management. Administrative salaries are split equally, as are other general administrative expenses.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Notes to Financial Statements

May 31, 2018 and 2017

NOTE B - ENTERPRISE FUND

The Lake City Water and Sewer Systems are Enterprise Funds. The Lake City Water and Sewer System Combined Group of Funds have been presented for financial statement purposes as an enterprise fund entity. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered through user charges or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The financial statements present only the Lake City Water and Sewer System Combined Group of Funds' accounts and balances and are not intended to present the financial position, the results of operations and the cash flows of the City of Lake City, Arkansas.

The Water Department and Sewer Department were divided into separate operating entities on January 1, 1993. The financial statement presentation has been combined for comparative purposes.

NOTE C - RESTRICTED CASH FUND

The Water and Sewer System maintains cash in depositories that is restricted as to use. The two restricted funds are (1) Customer Meter Deposits which are collected when a customer connects to the System. These funds are maintained in separate accounts until the customer leaves the System. At that time the deposit will be refunded or used to offset the final billing; and (2) A Bond Reserve Fund is required by terms of the USDA Rural Development and Berkadia Notes. A full year's payment is required to be put into a reserve account over a ten year period; (3) amounts collected from a city sales tax which are restricted to water and sewer system improvements; (4) the amounts on deposit in a construction project fund, and (5) a short-lived asset reserve account established by the 2017 Rural Development bond issue that requires an annual reserve of \$5,360 for future asset replacement.

The City is in compliance with all of the above-described restricted cash requirements. The City ceased collecting refundable meter deposits from patrons in 2006 and began charging a \$100 nonrefundable connection fee. Following is a schedule of restricted cash requirements at financial statement dates.

	<u>May 31,</u> <u>2018</u>	<u>May 31,</u> <u>2017</u>
Customer Meter Deposits	\$ 24,226	\$ 24,226
Bond Reserve	44,514	39,742
Sales Tax/Improvement Fund	48,396	59,738
Construction Fund	681	3,494
Bond Short-Lived Asset Reserve	<u>5,360</u>	<u>2,233</u>
	<u>\$ 123,177</u>	<u>\$ 129,433</u>

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Notes to Financial Statements
May 31, 2018 and 2017

NOTE D - CASH IN DEPRECIATION FUND

Rural Development (Berkadia) requires that 5% of the preceding months gross revenues be contributed to the Depreciation Fund. The bond payable agreements do not require that a specific balance be on hand. The funds may be used to replace/repair assets as provided for within the agreement with Rural Development (Berkadia). The City is currently in compliance with this requirement. With the amount of repairs exceeding 5% of gross revenues, no amount is required to be funded in this account on the original note. The 2017 Rural Development bond agreement requires that an annual depreciation reserve of \$5,360 be established. The City is currently in compliance with this requirement.

NOTE E - ORDINANCES RELATED TO WATER & SEWER OPERATIONS

Ordinance #245-10 was passed by the Council on July 19, 2010. It authorized a 1% city sales tax. The ordinance, which was subsequently approved by voters, provides for half of the proceeds of the tax is to be used in the street department and the other half is to be used for improvements and repairs to the water and sewer systems. Collection began in May, 2011, and the tax is perpetual.

NOTE F - ACCRUED COMPENSATED ABSENCES

Compensated absences have not been accrued and are not material to the financial statements.

NOTE G - LONG-TERM LIABILITIES

Following is a schedule of long-term liabilities as they appear on the statement of net position.

	<u>RURAL DEV/ BERKADIA</u>	<u>CASE EXCAVATOR</u>	<u>RURAL DEV/ 2017</u>	<u>TOTALS</u>
Original Amount	\$ 645,000	\$ 28,400	\$ 1,234,700	\$ 1,908,100
Date of Bond	01/12/81	10/01/17	12/30/16	04/15/12
Interest Rate	5%	3%	1.875%	
Financing Fee	0%	0%	0%	
Method of Payment	Monthly	Monthly	Monthly	Monthly
Amount of Payment	\$ 3,159	\$ 1,114	\$ 3,668	\$ 7,941
Amount of Maturities for:				
FYE 05/31/19	\$ 35,926	\$ 9,332	\$ 21,046	\$ 66,304
05/31/20	20,713	9,650	21,444	51,807
05/31/21	-	3,351	21,849	25,200
05/31/22	-	-	22,262	22,262
05/31/23	-	-	22,683	22,683
05/31/24-28	-	-	120,016	120,016
05/31/29-33	-	-	131,803	131,803
05/31/34-38	-	-	144,746	144,746
05/31/39-43	-	-	158,961	158,961
05/31/44-48	-	-	174,572	174,572
05/31/49-53	-	-	191,716	191,716
05/31/54-58	-	-	18,763	18,763
	<u>\$ 56,639</u>	<u>\$ 22,333</u>	<u>\$ 1,049,861</u>	<u>\$ 1,128,833</u>
Balance May 31, 2018				
	<u>\$ 90,765</u>	<u>\$ -</u>	<u>\$ 77,030</u>	<u>\$ 167,795</u>
Balance May 31, 2017				

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Notes to Financial Statements
May 31, 2018 and 2017

NOTE G - LONG-TERM LIABILITIES (continued)

The 1981 bonds were used for making improvements to the Sewer System, and are secured by the assets of the System. The Case excavator capital lease is with Bank of The West. It is a 36 month lease with a \$1 buyout. The Water, Sewer & Street Departments each pay 1/3 of the payment and share the equipment. The above numbers represent only the Water and Sewer Department's 2/3 of the total note. The Rural Development 2017 Bonds will ultimately total \$1,234,700 and were used for a new water storage tank and other improvements to the water & sewer system.

NOTE H - OFF BALANCE SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Lake City Water and Sewer System Combined Group of Funds to concentrations of credit risk consist principally of cash deposits (i.e. demand deposit accounts and interest bearing accounts) and trade accounts receivable.

Credit risk information required by Governmental Accounting Standards Board ("GASB") Statement No. 3 pertains to the carrying amount of total cash deposits and investments with financial institutions classified into the following three categories:

1. Insured or collateralized with securities held by the Entity or by its agent in the Entity's name;
2. Collateralized with securities held by the pledging financial institution's trust department or agent in the Entity's name; and
3. Uncollateralized.

The disclosures required by GASB Statement No. 3 should generally be made for an entity as a whole (e.g. the City of Lake City and its component units, i.e. water and sewer departments). The Lake City Water and Sewer System Combined Group of Funds had the following amounts on deposit with local banks subject to the GASB Statement No. 3 requirements as of May 31: 2018 - \$370,593 and 2017 - \$349,209. The regulations of the FDIC are subject to various interpretations regarding insurance coverage for governmental unit accounts. Therefore, it is impractical to determine the Lake City Water and Sewer System Combined Group of Funds extent of insured and collateralized deposits separate from the City of Lake City

The Lake City Water and Sewer System Combined Group of Funds is engaged primarily in providing services to the residents of Lake City, Arkansas. Concentrations of Credit Risk with respect to trade receivables and unbilled service revenues are limited due to the customer deposits held by the Lake City Water and Sewer System Combined Group of Funds. As of May 31, 2018 and 2017, trade receivables and unbilled service revenues exceeded customer deposits by \$13,730 and \$12,247 respectively.

NOTE I - RISK MANAGEMENT

The Lake City Water and Sewer System Combined Group of Funds is exposed to various risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. To manage the risk of loss, the Lake City Water and Sewer System Combined Group of Funds purchases commercial insurance policies.

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Notes to Financial Statements
May 31, 2018 and 2017

NOTE J - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Lake City Water and Sewer System Combined Group of Funds has a number of financial instruments (i.e. cash in depositories, accounts receivable, accounts payable, bonds payable, etc.) none of which are held for trading purposes. The Lake City Water and Sewer System Combined Group of Funds, unless otherwise indicated, estimates that the fair values of all financial instruments at May 31, 2018, does not differ materially from the aggregate carrying values as stated in the accompanying statement of net position. Considerable judgment is required in interpreting market data to develop the estimates of fair value, and accordingly, the estimates are not necessarily indicative of the amounts that the Lake City Water and Sewer System Combined Group of Funds could realize in a current market change.

NOTE K – COMMITMENTS AND SUBSEQUENT EVENTS

The System recently completed a construction project that involved construction of a new water tower. The construction was substantially completed and the tower placed in service in May, 2018. The City still had an additional \$128,297 available to draw on the bond with which it financed the water tower project as of May 31, 2018, and anticipates using the additional funds to purchase radio-read water meters. Management has evaluated and reported on subsequent events up through October 5, 2018, the date that these financial statements were available.

NOTE L – TAX ASSESSMENTS

The City is subject to potential tax assessments from various taxing authorities, such as the Internal Revenue Service and the Arkansas Department of Finance and Administration, for payroll and sales taxes. The City files the necessary reports and remits tax as due. All returns are subject to examination and additional assessment for periods ranging from three to six years after the filing of the original returns. The Water and Sewer Departments calculate amounts due for payroll and related liabilities on a regular basis. These amounts are then transferred from the Departments to the City Payroll Fund, which pays employees, taxing authorities, other vendors and files all required reports.

SUPPLEMENTAL INFORMATION

dlS

despain luther short & company

901 Windover Road | Jonesboro, AR 72401 | 870-932-5401 | 870-972-1141

**INDEPENDENT AUDITORS' REPORT ON
SUPPLEMENTAL INFORMATION**

Honorable Mayor and
Members of the City Council
Lake City, Arkansas 72437

We have audited the financial statements of the Lake City Water and Sewer System Combined Group of Funds as of and for the periods ended May 31, 2018 and 2017, and our report thereon dated October 5, 2018, which expressed an unmodified opinion on those financial statements, appears on pages 1 & 2. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The combining and comparative financial statements and schedules listed in the table of contents, which are the responsibility of management, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information, except for that portion marked "UNAUDITED" was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. That information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or the financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, that information is fairly stated in all material respects in relation to the financial statements as a whole. The information marked "UNAUDITED" has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

*Despain, Luther, Short
& Company, CPAs, PA*
Jonesboro, Arkansas
October 5, 2018

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Schedule of Cash in Depositories
May 31, 2018

	<u>Water System</u>	<u>Sewer System</u>	<u>Combined</u>
Revenue Fund:			
Centennial Bank #2426110	\$ 114,287	\$ -	\$ 114,287
Unico Bank #114000131	<u>-</u>	<u>46,481</u>	<u>46,481</u>
Total Revenue Fund	<u>\$ 114,287</u>	<u>\$ 46,481</u>	<u>\$ 160,768</u>
Bond Reserve Fund:			
Unico Bank, CD 414000069	\$ -	\$ 1,943	\$ 1,943
Unico Bank # 114007667, USDA	6,239	-	6,239
Focus Bank, CD#3013350	<u>-</u>	<u>39,347</u>	<u>39,347</u>
Total Bond Reserve Fund	<u>\$ 6,239</u>	<u>\$ 41,290</u>	<u>\$ 47,529</u>
Meter Deposit Fund:			
Unico Bank #114000271	\$ 13,024	\$ -	\$ 13,024
First Community Bank CD#232899	<u>19,049</u>	<u>-</u>	<u>19,049</u>
Total Meter Deposit Fund	<u>\$ 32,073</u>	<u>\$ -</u>	<u>\$ 32,073</u>
Unrestricted/Depreciation Fund:			
Focus Bank CD#3013349	\$ -	\$ 25,952	\$ 25,952
Unico Bank # 114007659 USDA Short-Lived Assets	5,360	-	5,360
Focus Bank CD#3006808	<u>-</u>	<u>17,810</u>	<u>17,810</u>
	<u>\$ 5,360</u>	<u>\$ 43,762</u>	<u>\$ 49,122</u>
Construction Fund Unico #114006652	<u>\$ 681</u>	<u>\$ -</u>	<u>\$ 681</u>
Sales Tax Fund Centennial #9115315	<u>\$ 24,198</u>	<u>\$ 24,198</u>	<u>\$ 48,396</u>
Mosquito Control Fund Unico #114000158	<u>\$ 32,024</u>	<u>\$ -</u>	<u>\$ 32,024</u>
Total Cash in Depositories	<u>\$ 214,862</u>	<u>\$ 155,731</u>	<u>\$ 370,593</u>

See Independent Auditors' Report on Supplemental Information.

LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS
Schedule of Cash in Depositories
May 31, 2017

	<u>Water</u> <u>System</u>	<u>Sewer</u> <u>System</u>	<u>Combined</u>
Revenue Fund:			
Centennial Bank #2426110	\$ 94,418	\$ -	\$ 94,418
Unico Bank #114000131	-	<u>45,767</u>	<u>45,767</u>
Total Revenue Fund	<u>\$ 94,418</u>	<u>\$ 45,767</u>	<u>\$ 140,185</u>
Bond Reserve Fund:			
Unico Bank, CD 414000069	\$ -	\$ 1,909	\$ 1,909
Focus Bank, CD#3013350	-	<u>39,174</u>	<u>39,174</u>
Total Bond Reserve Fund	<u>\$ -</u>	<u>\$ 41,083</u>	<u>\$ 41,083</u>
Meter Deposit Fund:			
Unico Bank #114000271	\$ 13,074	\$ -	\$ 13,074
First Community Bank CD#232899	<u>18,973</u>	-	<u>18,973</u>
Total Meter Deposit Fund	<u>\$ 32,047</u>	<u>\$ -</u>	<u>\$ 32,047</u>
Unrestricted/Depreciation Fund:			
Focus Bank CD#3013349	\$ -	\$ 25,837	\$ 25,837
Focus Bank CD#3006808	-	<u>17,773</u>	<u>17,773</u>
	<u>\$ -</u>	<u>\$ 43,610</u>	<u>\$ 43,610</u>
Construction Fund Unico #114006652	<u>\$ 3,494</u>	<u>\$ -</u>	<u>\$ 3,494</u>
Sales Tax Fund Centennial #9115315	<u>\$ 29,868</u>	<u>\$ 29,868</u>	<u>\$ 59,736</u>
Mosquito Control Fund Unico #114000158	<u>\$ 29,054</u>	<u>\$ -</u>	<u>\$ 29,054</u>
Total Cash in Depositories	<u>\$ 188,881</u>	<u>\$ 160,328</u>	<u>\$ 349,209</u>

See Independent Auditors' Report on Supplemental Information.

**LAKE CITY WATER AND SEWER SYSTEM
 COMBINED GROUP OF FUNDS**
 Schedule of Insurance Policies
 May 31, 2018

<u>Description/Policy Number</u>	<u>Expiration Date</u>	<u>Carrier</u>
Commercial Property Coverage	12/31/18	Arkansas Municipal League Municipal Property Program
Workers Compensation	12/31/18	Municipal League Workers Compensation Trust
Auto Coverage A/C 7201	01/13/19	Arkansas Municipal League Municipal Vehicle Program

See Independent Auditors' Report on Supplemental Information.

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Combining Statement of Revenues, Expenses and Changes in Net Position for the
Lake City Water System and Lake City Sewer System: Sewer Department;
Sewer Construction Fund, and Sales and Use Tax Bond Fund
For the Year Ended May 31, 2018

	<u>Water</u> <u>System</u>	<u>Sewer</u> <u>System</u>	<u>Combined</u>
Revenue from Operations:			
City Sales Tax Revenue	\$ 36,053	\$ 36,054	\$ 72,107
Water Service Revenue	160,488	-	160,488
Sewer Service Revenue	-	132,010	132,010
Connection Fees	4,284	5,280	9,564
Mosquito Spraying Revenue	18,193	-	18,193
Miscellaneous Operating Revenue	<u>2,859</u>	<u>315</u>	<u>3,174</u>
Total Operating Revenues	<u>\$ 221,877</u>	<u>\$ 173,659</u>	<u>\$ 395,536</u>
Operating Expenses:			
Salaries and Wages	\$ 79,816	\$ 29,147	\$ 108,963
System Supplies, Repairs and Chemicals	42,359	31,394	73,753
Utilities and Telephone	10,443	21,742	32,185
Insurance and Bonds	13,280	3,625	16,905
Gas, Oil and Repairs	2,336	2,300	4,636
Payroll Taxes	5,932	2,360	8,292
Office Supplies and Postage	6,726	5	6,731
Professional Fees	4,957	2,478	7,435
Permits & Fees	979	5,528	6,507
Uniforms	537	395	932
Miscellaneous	13	8	21
Depreciation	<u>39,244</u>	<u>34,396</u>	<u>73,640</u>
Total Operating Expenses	<u>\$ 206,622</u>	<u>\$ 133,378</u>	<u>\$ 340,000</u>
Net Income (Loss) from Operations	<u>\$ 15,255</u>	<u>\$ 40,281</u>	<u>\$ 55,536</u>
Non-Operating Income (Expense)			
Interest Income	\$ 201	\$ 372	\$ 573
Interest Expense	<u>(2,005)</u>	<u>(4,168)</u>	<u>(6,173)</u>
Total Non-Operating Income (Expense)	<u>\$ (1,804)</u>	<u>\$ (3,796)</u>	<u>\$ (5,600)</u>
Net Income Before Contributions	\$ 13,451	\$ 36,485	\$ 49,936
Capital Contributions--From City General Fund	<u>-</u>	<u>-</u>	<u>-</u>
Change in Net Position	<u>\$ 13,451</u>	<u>\$ 36,485</u>	<u>\$ 49,936</u>
Net Position, Beginning of Year	<u>\$ 904,491</u>	<u>\$ 443,066</u>	<u>\$ 1,347,557</u>
Net Position, End of Year	<u>\$ 917,942</u>	<u>\$ 479,551</u>	<u>\$ 1,397,493</u>

See Independent Auditors' Report on Supplemental Information.

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**

Combining Statement of Revenues, Expenses and Changes in Net Position for the
Lake City Water System and Lake City Sewer System: Sewer Department;
Sewer Construction Fund, and Sales and Use Tax Bond Fund
For the Year Ended May 31, 2017

	Water System	Sewer System	Combined
Revenue from Operations:			
City Sales Tax Revenue	\$ 35,272	\$ 35,271	\$ 70,543
Water Service Revenue	161,421	-	161,421
Sewer Service Revenue	-	132,580	132,580
Connection Fees	6,720	6,050	12,770
Mosquito Spraying Revenue	17,973	-	17,973
Miscellaneous Operating Revenue	<u>4,743</u>	<u>450</u>	<u>5,193</u>
Total Operating Revenues	<u>\$ 226,129</u>	<u>\$ 174,351</u>	<u>\$ 400,480</u>
Operating Expenses:			
Salaries and Wages	\$ 77,242	\$ 31,095	\$ 108,337
System Supplies, Repairs and Chemicals	28,502	39,314	67,816
Utilities and Telephone	10,467	21,289	31,756
Insurance and Bonds	12,833	3,785	16,618
Gas, Oil and Repairs	1,505	2,235	3,740
Payroll Taxes	5,629	2,344	7,973
Office Supplies and Postage	8,997	-	8,997
Professional Fees	2,300	2,300	4,600
Permits & Fees	4,751	4,226	8,977
Uniforms	389	625	1,014
Miscellaneous	-	81	81
Depreciation	<u>36,833</u>	<u>33,329</u>	<u>70,162</u>
Total Operating Expenses	<u>\$ 189,448</u>	<u>\$ 140,623</u>	<u>\$ 330,071</u>
Net Income (Loss) from Operations	<u>\$ 36,681</u>	<u>\$ 33,728</u>	<u>\$ 70,409</u>
Non-Operating Income (Expense)			
Interest Income	\$ 152	\$ 297	\$ 449
Interest Expense	<u>-</u>	<u>(5,414)</u>	<u>(5,414)</u>
Total Non-Operating Income (Expense)	<u>\$ 152</u>	<u>\$ (5,117)</u>	<u>\$ (4,965)</u>
Net Income Before Contributions	\$ 36,833	\$ 28,611	\$ 65,444
Capital Contributions--From City General Fund	<u>-</u>	<u>-</u>	<u>-</u>
Change in Net Position	<u>\$ 36,833</u>	<u>\$ 28,611</u>	<u>\$ 65,444</u>
Net Position, Beginning of Year	<u>\$ 867,658</u>	<u>\$ 414,455</u>	<u>\$ 1,282,113</u>
Net Position, End of Year	<u>\$ 904,491</u>	<u>\$ 443,066</u>	<u>\$ 1,347,557</u>

See Independent Auditors' Report on Supplemental Information.

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Supplemental Schedule of Monthly Gallons Billed
For the Year Ended May 31, 2018

	<u># of Gallons</u>	<u># of Users</u>
June	5,631,110	911
July	4,830,210	915
August	5,381,390	920
September	4,356,760	918
October	4,732,760	913
November	4,760,310	915
December	3,665,670	913
January	6,935,140	907
February	5,424,140	903
March	4,157,290	907
April	3,814,200	905
May	<u>4,623,120</u>	<u>909</u>
Total	<u>58,312,100</u>	<u>10,936</u>
Average Per Month	<u>4,859,342</u>	<u>911</u>

NOTE- The System has only one class of users.
Sewer charges are billed according to water consumption.

UNAUDITED--See Independent Auditors' Report on Supplemental Information.

**LAKE CITY WATER AND SEWER SYSTEM
 COMBINED GROUP OF FUNDS**
 Supplemental Schedule of Monthly Gallons Billed
 For the Year Ended May 31, 2017

	<u># of Gallons</u>	<u># of Users</u>
June	3,961,870	898
July	6,543,900	899
August	7,021,890	894
September	5,510,230	908
October	4,849,070	898
November	5,077,770	899
December	4,483,400	900
January	4,592,780	897
February	4,494,270	903
March	4,305,940	902
April	3,543,570	904
May	<u>4,464,260</u>	<u>909</u>
Total	<u>58,848,950</u>	<u>10,811</u>
Average Per Month	<u>4,904,079</u>	<u>901</u>

NOTE- The System has only one class of users.
 Sewer charges are billed according to water consumption.

UNAUDITED--See Independent Auditors' Report on Supplemental Information.

**LAKE CITY WATER AND SEWER SYSTEM
 COMBINED GROUP OF FUNDS**
 Supplemental Schedule of Current Usage Rates
 May 31, 2018 and 2017

All Classes of Water Users

Water Usage Rates:

7.50		First	2,000 gallons
1.50 Per 1,000 gallons		Next	19,000 gallons
1.00 Per 1,000 gallons		Next	79,000 gallons
.75 Per 1,000 gallons		All Over	100,000 gallons

Sewer Usage Rates:

Residential		\$7.42 First	2,000 gallons
		1.75 Next	19,000 gallons
		1.25 All Over	21,000 gallons

Note - The base sewer rate includes \$4.92 for debt service and \$2.50 for operating, maintenance and repairs.

UNAUDITED--See Independent Auditors' Report on Supplemental Information.

REPORTS REQUIRED BY GOVERNMENT AUDITING STANDARDS

dls

despain luther short & company

901 Windover Road | Jonesboro, AR 72401 | 870-932-5401 | 870-972-1141

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

Honorable Mayor and
Members of the City Council
Lake City, Arkansas 72437

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 Lake City Water and Sewer System (LCWSS) Combined Group of Funds, which comprise the Statement of Net Position as of May 31, 2018 and 2017, and the related Statement of Revenues, Expenses and Changes in Net Position, and the Statement of Cash Flows for the years then ended, and the related Notes to the Financial Statements, and have issued our report thereon dated October 5, 2018, which was unmodified.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting.

In planning and performing our audit of the financial statements, we considered the LCWSS'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 LCWSS's internal control. Accordingly, we do not express an opinion on the effectiveness of the LCWSS's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and questioned costs (**ITEM 2018-1**), we identified a certain deficiency in internal control that we consider to be a material weakness and a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs to be a material weakness (**ITEM 2018-1**).

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the LCWSS'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 that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to Management of the LCWSS in a separate letter dated October 5, 2018.

THE DEPARTMENT'S RESPONSE TO FINDINGS AND QUESTIONED COSTS

The LCWSS's response to the findings and questioned costs identified in our audit is described in the accompanying schedule of findings and questioned costs. The LCWSS's response was 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 the testing, and not to provide an opinion on the effectiveness of the LCWSS'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 LCWSS's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Despain, Luther, Short
& Company, CPA'S, PA*

Jonesboro, Arkansas
October 5, 2018

**LAKE CITY WATER AND SEWER SYSTEM
COMBINED GROUP OF FUNDS**
Schedule of Findings and Questioned Costs
For the Year Ended May 31, 2018

SCHEDULE OF FINDINGS & QUESTIONED COSTS

1. The Independent Auditors' Report expresses an unmodified opinion on the financial statements of the Lake City Water & Sewer System (LCWSS) Combined Group of Funds.
2. The Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* (a) disclosed a deficiency in internal control described in this schedule of findings and questioned costs as **ITEM 2018-1** and (b) disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. The deficiency in internal control described in **ITEM 2018-1** is considered to be a material weakness.
3. There were no prior audit findings to be resolved. However, the deficiency in internal control described in **ITEM 2018-1** was present in the prior year.

MATERIAL WEAKNESS

ITEM 2018-1: The LCWSS has a limited number of accounting personnel that effectively precludes an adequate segregation of duties relating to the billing, collection, recording, coding, and classification of transactions that affect the general ledger. This same circumstance extends to other areas as well. There is a limited amount of control activities with respect to procurement, acquisition and use of materials.

DEPARTMENT'S RESPONSE: Management of the LCWSS realized that better internal control could be maintained by utilizing more individuals. However, it is Management's determination that the cost of hiring additional people would exceed the benefit realized.

COMPLIANCE AND OTHER MATTERS

No Findings for the Year Ended May 31, 2018. The City was in compliance with all bond covenants for the year.