

RECTOR WATER DEPARTMENT

AUDIT REPORT

DECEMBER 31, 2017

RECTOR WATER DEPARTMENT

YEAR ENDED DECEMBER 31, 2017

Table of Contents

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	1
FINANCIAL STATEMENTS:	
Statement of Net Position	3-4
Statement of Revenues, Expenses, and Changes in Net Position	5
Statement of Cash Flows	6-7
Notes to Financial Statements	8-16

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INDEPENDENT AUDITOR'S REPORT

To the City Council
City of Rector, Arkansas

We have audited the accompanying financial statements of Rector Water Department of the City of Rector, Arkansas as of and for the year ended December 31, 2017, and the related notes to the 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rector Water Department of the City of Rector, Arkansas as of December 31, 2017 and the 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.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Rector Water Department and do not purport to, and do not present fairly the financial position of the City of Rector, Arkansas as of December 31, 2017, the

changes in its financial position, or, where applicable, its cash flows for the year 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.

Smith + Davis

September 25, 2018

**RECTOR WATER DEPARTMENT
STATEMENT OF NET POSITION
DECEMBER 31, 2017**

ASSETS

Current assets:

Cash	\$ 200,838
Accounts receivable, net	87,732
Prepaid expenses	1,091
Total current assets	<u>289,661</u>

Noncurrent assets:

Restricted assets:

Cash, including time deposits	357,617
Capital assets (net)	1,634,990
Total noncurrent assets	<u>1,992,607</u>

Total assets	<u>2,282,268</u>
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DEFERRED OUTFLOWS OF RESOURCES

Unamortized charge on refunding of revenue bonds	<u>11,651</u>
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LIABILITIES

Current liabilities:

Accrued expenses	516
Current portion of long-term debt	70,000
Total current liabilities	<u>70,516</u>

Noncurrent liabilities:

Customer deposits payable	31,835
Long-term debt	1,471,329
Total noncurrent liabilities	<u>1,503,164</u>

Total liabilities	<u>\$ 1,573,680</u>
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**RECTOR WATER DEPARTMENT
STATEMENT OF NET POSITION
DECEMBER 31, 2017**

NET POSITION

Net investment in capital assets	\$ 105,312
Restricted for debt service	154,304
Restricted for meter deposits	13,824
Unrestricted	<u>446,799</u>
Total net position	<u><u>\$ 720,239</u></u>

See accompanying notes to the financial statements.

**RECTOR WATER DEPARTMENT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2017**

OPERATING REVENUES

Charges for services	\$ 505,369
EPA fees	3,201
Special services	10,894
Miscellaneous	<u>1,318</u>
Total operating revenues	<u>520,782</u>

OPERATING EXPENSES

Personal services	142,743
Materials and supplies	34,568
Other services and charges	157,451
Power	26,344
Depreciation	<u>75,714</u>
Total operating expenses	<u>436,820</u>

Operating income	<u>83,962</u>
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NONOPERATING REVENUES (EXPENSES)

Interest income	2,658
Interest expense	<u>(55,935)</u>
Total nonoperating revenue (expense)	<u>(53,277)</u>

Income (loss) before transfers	30,685
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TRANSFERS OUT

<u>0</u>

Change in Net Position	30,685
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Net position-beginning of year	674,111
Prior period adjustment	<u>15,443</u>
Net position-end of year	<u>\$ 720,239</u>

See accompanying notes to the financial statements.

**RECTOR WATER DEPARTMENT
STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2017**

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$ 495,668
Other operating cash receipts	15,413
Payments for operating goods and services	(218,363)
Payments to employees	(142,743)
Net cash provided (used) by operating activities	<u>149,975</u>

**CASH FLOWS FROM NON-CAPITAL
FINANCING ACTIVITIES**

Operating transfers in (out)	<u>0</u>
Net cash provided (used) by non-capital financing activities	<u>0</u>

**CASH FLOWS FROM CAPITAL AND
RELATED FINANCING ACTIVITIES**

Acquisition of capital assets	(13,503)
Principal paid on bonds payable	(70,000)
Interest paid on bonds payable	(51,435)
Net cash provided (used) by capital and related financing activities	<u>(134,938)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Interest and dividends	<u>2,658</u>
Net cash provided (used) by investing activities	<u>2,658</u>

Net increase (decrease) in cash and cash equivalents	17,695
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Cash - beginning of year	525,317
Prior period adjustment	15,443
Cash - end of year	<u>\$ 558,455</u>

See accompanying notes to the financial statements.

**RECTOR WATER DEPARTMENT
STATEMENT OF CASH FLOWS-CONTINUED
YEAR ENDED DECEMBER 31, 2017**

**RECONCILIATION OF OPERATING INCOME
(LOSS) TO NET CASH PROVIDED (USED)
BY OPERATING ACTIVITIES**

Operating income (loss)	\$ 83,962
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Cash flows reported in other categories:	
Depreciation and amortization	75,714
Change in assets and liabilities:	
(Increase) Decrease in receivables, net	(10,006)
Increase (Decrease) in accrued expenses	(1,745)
Increase (Decrease) in deposits payable	2,050
Net cash provided by operating activities	<u>\$ 149,975</u>

See accompanying notes to the financial statements.

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Rector Water Department, an enterprise fund of the City of Rector, Arkansas, operates under a City Council form of government. The major operations of the enterprise fund include the City's water and sewer system.

The Rector Water Department's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The more significant accounting policies established in GAAP and used by the water department are discussed below.

1.A. REPORTING ENTITY

The financial statements include only the accounts of the Rector Water Department's operations. The criteria for including organizations as component units within the Department's reporting entity is set forth in Section 2100 of GASB's Codification of Governmental Accounting and Financial Reporting Standards. Based on the criteria included in Section 2100, the Rector Water Department has no component units.

1.B. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements. Basis of accounting refers to "when" transactions are recorded regardless of the measurement focus applied.

Measurement Focus

The proprietary fund utilizes an "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net position.

Basis of Accounting

All proprietary funds, i.e. utility funds, utilize the accrual basis of accounting. Under the accrual basis of accounting revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

1.C. ASSETS, LIABILITIES, AND EQUITY

Cash

For the purpose of the Statement of Net Position, "cash, including time deposits" includes all demand, savings accounts, and certificates of deposit of the Department. For the purpose of the proprietary fund Statement of Cash Flows, "cash and cash equivalents" include all demand and saving accounts, and certificates of deposit or short-term investments with an original maturity of three months or less.

Receivables

Proprietary fund material receivables consist of all revenues earned at year-end and not yet received. Utility accounts receivable compose the majority of proprietary fund receivables. Uncollectible receivables are not considered material. An allowance for doubtful accounts is recorded on the financial statements equal to .5% of the utilities water and sewer revenues.

Fixed Assets

Fixed assets are accounted for as capital assets. All capital assets are valued at historical cost, or estimated historical cost if actual is unavailable, except for donated capital assets which are recorded at the estimated fair value at the date of donation.

Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation ranging from 5 to 40 years.

Restricted Assets

Restricted assets include cash of the Department that is legally restricted to its use. The primary restricted assets are related to the bond accounts.

Long-term Debt

All long-term debt to be repaid from business-type resources are reported as liabilities in the financial statements. The long-term debt consists of revenue bonds payable.

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

Compensated Absences

The Department allows full-time employees one week paid vacation per year after one year of employment and two weeks vacation after three years employment. Employees are also granted ten sick days per year which can carry over up to thirty (30) days. The Department does not record any accrual for compensated absences. Any such accrual would be immaterial to the financial statements.

Equity Classifications

Equity is classified as net position and displayed in three components:

- a. Net investment in capital assets-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.
- b. Restricted net position-Consists of net assets with constraints placed on the use by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net position-All other net position that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

1.D. REVENUES, EXPENDITURES, AND EXPENSES

Operating Revenues and Expenses

Operating revenues and expenses for proprietary funds are those that result from providing services and producing and delivering goods and/or services. It also includes all revenue and expenses not related to capital and related financing, noncapital financing, or investing activities.

Expenditures/Expenses

Proprietary funds report expenses relating to the use of economic resources.

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

1.E. USE OF 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

1.F. DEFERRED OUTFLOWS / INFLOWS OF RESOURCES

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The government has only one item that qualifies for reporting in this category. It is the deferred charge on refunding. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter life of the refunded or refunding debt.

NOTE 2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

By its nature as a local government unit, the Department is subject to various federal, state, and local laws and contractual regulations. An analysis of the Department's compliance with significant laws and regulations and demonstration of its stewardship over the Department's resources follows.

2.A. DEPOSITS LAWS AND REGULATIONS

In accordance with state law, all uninsured deposits of municipal funds in financial institutions must be secured with acceptable collateral valued at the lower of market or par. As reflected in Note 3A., all deposits were fully insured or collateralized at December 31, 2017.

2.B. REVENUE RESTRICTIONS

The Department has various restrictions placed over certain revenue sources from state or local requirements. The primary restricted revenue sources include:

Revenue Source
Water Revenue

Legal Restrictions of Use
Utility Operations and Debt Service

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

For the year ended December 31, 2017, the Department complied, in all material respects, with these revenue restrictions.

2.C. DEBT COVENANTS

The loan agreements relating to the Water & Sewer Refunding and Revenue Bonds, Series 2016 contain restrictions for covenants that are financial related. These include covenants such as required reserve account balances. The following schedule presents a brief summary of the most significant requirements and the Department's level of compliance thereon as of December 31, 2017.

Requirement	Level of Compliance
\$1,725,000 City of Rector, Arkansas Water & Sewer Refunding Revenue Bonds, Series 2016	
a. Bond Fund:	
Deposit in bond fund 1/6 of the next interest payment due plus 1/12 of the next principal payment due.	Fund complied with at December 31, 2017.
b. Debt Service Reserve Fund:	
Continuously maintain an amount equal to 1/2 the maximum annual principal and interest requirements on the Bonds (the "Required Level")	Fund complied with at December 31, 2017.
c. Depreciation Fund:	
Deposit each month an amount equal to not less than 3% of gross revenues for such month.	Fund complied with at December 31, 2017.

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

On January 26, 2016, the Rector Water Department refunded the City Water & Sewer Refunding Revenue Bonds, Series 2011 which financed improvements to the City's Water & Sewer System. This was accomplished through the issuance of the \$1,725,000 City of Rector, Arkansas Water & Sewer Refunding Revenue Bonds, Series 2016.

NOTE 3. DETAIL NOTES ON TRANSACTION CLASS/ACCOUNTS

The following notes present detail information to support the amounts reported in the basic financial statements for its various assets, liabilities, equity, revenues, and expenditures/expenses.

3.A. CASH

The Department's cash consists of cash on hand, deposits with local financial institutions and certificates of deposit. It is the Department's policy to require collateral for all deposits at 100% of all amounts not covered by federal deposit insurance.

At December 31, 2017, the Department's carrying amount of deposits was \$558,455 and the bank balance was \$501,639. Of the bank balance, \$250,000 was covered by federal depository insurance and \$251,639 was pledged and collateralized with securities.

3.B. RESTRICTED ASSETS

The amounts reported as restricted assets are deposited in a financial institution and are related to the required bond accounts as described in Note 2.C.

The restricted assets as of December 31, 2017, are as follows:

Checking-bond reserve & depreciation funds	\$ 156,985
CD's-bond reserve funds	<u>200,632</u>
	<u>\$ 357,617</u>

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

3.C. ACCOUNTS RECEIVABLE

Accounts receivable of the business-type activities consist of utilities receivable. Receivables detail at December 31, 2017, is as follows:

		Business- type Activities	
Billed receivables	\$	61,466	
Unbilled receivables		<u>28,547</u>	
Total receivables		90,013	
Less-allowance for doubtful accounts		<u>(2,281)</u>	
Net accounts receivable	\$	<u><u>87,732</u></u>	

3.D. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2017, was as follows:

	Balance at Jan. 1, 2017	Additions	Disposals		Balance at Dec. 31, 2017
Business-type activities:					
Buildings	\$ 60,932	\$ 0	\$ 0	\$	60,932
Land	45,000	0	0		45,000
Water & sewer plant	2,995,655	13,505	0		3,009,160
Machinery & equipment	459,759	0	0		459,759
Totals at historical cost	<u>3,561,346</u>	<u>13,505</u>	<u>0</u>		<u>3,574,851</u>
Accumulated depreciation	<u>(1,864,146)</u>	<u>(75,715)</u>	<u>0</u>		<u>(1,939,861)</u>
Business-type capital assets, net	<u>\$ 1,697,200</u>	<u>\$ (62,210)</u>	<u>\$ 0</u>	\$	<u><u>1,634,990</u></u>

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

3.E. LONG-TERM DEBT

As of December 31, 2017, the long-term debt payable from proprietary fund resources consisted of the following:

\$1,725,000 City of Rector, Arkansas Water & Sewer Refunding Revenue Bonds,		
Series 2016, int rate 2.0% - 5.0%, maturing 5-1-2036	\$	1,630,000
Less-bond discount		(16,606)
Less-bond issue costs		<u>(72,065)</u>
Net long-term debt		<u>1,541,329</u>
Current Portion	\$	70,000
Noncurrent Portion		<u>1,471,329</u>
	\$	<u>1,541,329</u>

Changes in Long-term Debt

The following is a summary of changes in long-term debt for the year ended December 31, 2017:

Type of Debt	Balance Jan. 1, 2017	Additions	Deductions	Balance Dec. 31, 2017	Amounts Due within One Year
\$1,725,000 City of Rector, Arkansas Water & Sewer Refunding Revenue Bonds, Series 2016	<u>1,700,000</u>	<u>0</u>	<u>70,000</u>	<u>1,630,000</u>	<u>70,000</u>
Total Enterprise Fund Debt	<u>\$ 1,700,000</u>	<u>\$ 0</u>	<u>\$ 70,000</u>	<u>\$ 1,630,000</u>	<u>\$ 70,000</u>

**RECTOR WATER DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017**

Annual Debt Service Requirements

The annual debt service requirements to maturity, including principal and interest, for long-term debt as of December 31, 2017, are as follows:

Year Ending December 31	Principal	Interest	Total
2018	70,000	50,487	120,487
2019	70,000	49,297	119,297
2020	70,000	47,915	117,915
2021	70,000	46,340	116,340
2022	70,000	44,607	114,607
2023-2027	405,000	189,593	594,593
2028-2032	460,000	120,587	580,587
2033-2036	415,000	33,250	448,250
Total	<u>\$ 1,630,000</u>	<u>\$ 582,076</u>	<u>\$ 2,212,076</u>

4. PRIOR PERIOD ADJUSTMENT

A prior period adjustment was made at December 31, 2017 to correct a transfer of funds from the Construction Fund to the Operation & Maintenance Fund.

5. DATE OF MANAGEMENT REVIEW

Subsequent events have been evaluated through September 26, 2017, which is the date the financial statements were available to be issued.