

**CITY OF COTTONWOOD, ARIZONA
SINGLE AUDIT REPORTING PACKAGE
FOR THE YEAR ENDED JUNE 30, 2013**

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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 Mayor and Members of the City Council
City of Cottonwood, Arizona

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 governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Cottonwood, Arizona as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise City of Cottonwood, Arizona's basic financial statements, and have issued our report thereon dated December 12, 2013. Our report included an emphasis of matter paragraph as to comparability because of the implementation of Governmental Accounting Standards Board Statement No. 63.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding 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. However, as described in the accompanying schedule of findings and questioned costs we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 City'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 as item 2013-1 to be a material weakness.

Compliance and Other Matters

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

City of Cottonwood, Arizona's Response to Findings

City of Cottonwood, Arizona's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. City of Cottonwood, Arizona's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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 result of that testing, and not to provide an opinion on the effectiveness of the City'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 City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.
CPAs and Business Consultants

December 12, 2013

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM;
REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND
REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
REQUIRED BY OMB CIRCULAR A-133**

Independent Auditor's Report

Honorable Mayor and Members of the City Council
City of Cottonwood, Arizona

Report on Compliance for Each Major Federal Program

We have audited City of Cottonwood, Arizona's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of City of Cottonwood, Arizona's major federal programs for the year ended June 30, 2013. City of Cottonwood, Arizona's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of City of Cottonwood, Arizona's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Cottonwood, Arizona's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of City of Cottonwood, Arizona's compliance.

Unmodified Opinion on Each Major Federal Program

In our opinion, City of Cottonwood, Arizona complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2013-2. Our opinion on each major federal program is not modified with respect to these matters.

City of Cottonwood, Arizona's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. City of Cottonwood, Arizona's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of City of Cottonwood, Arizona is responsible for establishing and maintaining effective internal control over compliance with the types of compliance referred to above. In planning and performing our audit of compliance, we considered City of Cottonwood, Arizona's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of City of Cottonwood, Arizona's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2013-2 to be material weaknesses.

City of Cottonwood, Arizona's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. City of Cottonwood, Arizona's response was not subjected to the audit procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Cottonwood, Arizona as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise City of Cottonwood, Arizona's basic financial statements. We issued our report thereon dated December 12, 2013, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the 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 basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.
CPAs and Business Consultants

December 12, 2013

CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2013

| <u>Federal Grantor/Pass-Through Grantor/Program Title</u> | <u>CFDA Number</u> | <u>Pass-Through Grantor's Number</u> | <u>Expenditures</u> |
|--|-------------------------------|---|----------------------------|
| <u>U.S. Department of Commerce</u> | | | |
| Passed through Northern Arizona Council of Governments: Economic Development Support for Planning Organizations | 11.302 | 340YB | \$ <u>10,346</u> |
| <u>U.S. Department of Housing and Urban Development</u> | | | |
| Passed through Arizona Department of Housing: Community Development Block Grants / State's program | 14.228 | 115-12 | <u>4,630</u> |
| <u>U.S. Department of Transportation</u> | | | |
| Passed through Arizona Department of Transportation: Formula Grants for Rural Areas | 20.509 | AZ-18-0045-G4518 | 451,996 |
| Passed through Arizona Governor's Office of Highway Safety: State and Community Highway Safety | 20.600 | 2012-DOJ-006 | 2,095 |
| State and Community Highway Safety | 20.600 | 2012-PT-054 | 1,105 |
| State and Community Highway Safety | 20.600 | 2013-PT-015 | 4,837 |
| State and Community Highway Safety | 20.600 | 2013-AL-016 | <u>12,120</u> |
| Total U.S. Department of Transportation | | | <u>472,153</u> |
| <u>U.S. Department of Health and Human Services</u> | | | |
| Passed through the Northern Arizona Council of Governments: Social Services Block Grant | 93.667 | YAV2-12-2013 | <u>17,183</u> |
| <u>U. S. Department of Homeland Security</u> | | | |
| Direct Program: Staffing for Adequate Fire and Emergency Response | 97.083 | N/A | <u>136,206</u> |
| Total Expenditures of Federal Awards | | | <u>\$ <u>640,518</u></u> |

CITY OF COTTONWOOD, ARIZONA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2013

NOTE 1 - BASIS OF PRESENTATION

The Schedule of Expenditures of Federal Awards includes the federal grant activity of City of Cottonwood, Arizona and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

NOTE 2 - CATALOG OF FEDERAL DOMESTIC ASSISTANCE (CFDA) NUMBERS

The program titles and CFDA numbers were obtained from the federal or pass-through grantor or the 2013 *Catalog of Federal Domestic Assistance*.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2013**

SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? X yes no
- Significant deficiency(ies) identified? yes X none reported

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? X yes no
- Significant deficiency(ies) identified? yes X none reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? X yes no

Identification of major programs:

| <u>CFDA Numbers</u> | <u>Name of Federal Program or Cluster</u> |
|---------------------|---|
| 20.509 | Formula Grants for Rural Areas |

Dollar threshold used to distinguish between Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee? yes X no

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2013**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Reference Number: 2013-1

Type of Finding: Material Weakness

Description: Internals Controls over Financial Reporting

CRITERIA

City management is responsible for establishing internal controls over financial reporting that are adequate to ensure that a material misstatement would be prevented and/or detected. The system of internal controls must extend beyond the modified accrual basis general ledger and the supporting schedules prepared by the City; rather it must also include controls over the GAAP basis financial statements. Recipients of grant awards are responsible for establishing internal controls sufficient to accurately account for the financial activity related to grants received. The City should have controls in place to ensure that documentation is maintained supporting all disbursements, and disbursements are properly approved according to City policy. Additionally, the City should have controls in place to ensure that employee pay is accurately computed in agreement with underlying supporting documentation. City management is also responsible for establishing and maintaining internal controls that include the preparation of complete and accurate capital assets schedules for inclusion in the financial statements.

CONDITION/CONTEXT

The City's system of internal controls over financial reporting is not adequate to ensure that a material misstatement would be prevented and/or detected. We noted the following deficiencies:

- Multiple audit adjustments were necessary to correct errors and to correctly compile the financial statements.
- The general ledger included many asset and liability balances that could not be supported, did not agree to supporting documentation or subsidiary ledgers, were not reconciled, and/or had negative balances at year end. These balances were not material.
- The financial activity of grant awards was not always recorded separately in the accounting information system. Additionally, financial reports related to grant awards were not typically reviewed by an individual other than the preparer. As a result, expenditure amounts and other information did not always agree to supporting documentation during our review of the Schedule of Expenditures of Federal Awards.
- The City has not taken a physical inventory of capital assets and reconciled the results to the capital asset records.
- The City did not have adequate segregation of duties over preparation of the capital assets listings. The addition of assets to the listings, the reconciliation of the listings, and the computation of depreciation is performed by the same individual. The listings and reconciliations are not reviewed by another individual.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2013**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS* (Cont'd)**

Reference Number: 2013-1 (Cont'd)

CONDITION/CONTEXT

- The capital assets listings contained multiple material errors related to the calculation of depreciation. The City subsequently made corrections in order to properly record depreciation in the audited financial statements.
- The City did not always post revenues to the general ledger from the subsidiary ledgers on a timely basis. For example, in November 2013, revenues related to August 2013 were not yet posted.
- The June 30, 2012 accrual for sewer receivables had not been reversed, resulting in an overstatement of receivables and revenues by \$88,570. This was subsequently corrected.
- The City does not have policies and procedures in place to analyze and record uncollectible accounts for the Water and Sewer Funds. Accordingly, the City does not have historical evidence to determine the adequacy of the allowance for doubtful accounts.
- For four of 25 payroll records reviewed, the hours paid did not agree to the timesheets. As a result, one employee was overpaid \$27, and three employees were underpaid a total of \$88.
- For one of 45 disbursements reviewed for \$20, the City could not locate supporting documentation.
- For one of 45 disbursements reviewed, an approval for payment stamp was not included on the supporting documents.

EFFECT

Material misstatements were not always prevented and/or detected. The City was not always in compliance with GAAP and City policies.

CAUSE

The City has not dedicated sufficient resources to the development of an adequate system of internal controls over financial reporting. City policies were not always followed or were not in place. In addition, the City has not implemented best practices due to budgetary constraints.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2013**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS* (Cont'd)**

Reference Number: 2013-1 (Cont'd)

RECOMMENDATION

The City should design and implement effective internal control procedures to ensure the financial statements and related notes are free from material misstatements. Specifically, the City should implement the following recommendations:

- The City should complete reconciliations of balance sheet accounts at least annually. The reconciliations should be reviewed by another individual.
- The City should separately account for the financial activity of grant awards in the accounting information system. The City should ensure that an individual other than the preparer reviews financial reports related to grant awards.
- The City should analyze and record uncollectible accounts at least annually.
- The City should segregate duties in the capital asset cycle. Accordingly, the City should incorporate adequate review and supervision procedures.
- The City should ensure all disbursements and payroll records are properly supported and agree to supporting documentation.
- The City should develop procedures to ensure revenues are recorded in the general ledger in a timely manner.
- The City should perform a physical inventory of capital assets.

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS

The City of Cottonwood is trying to correct these issues. Our Accounting/Budget Manager has been working towards getting all reconciliations done at least annually. We will work on this matter with our auditors. The Administrative Services GM will review the reconciliations.

As for the separate financial tracking of grants, Springbrook software includes a grant tracking module which should improve grant tracking and reporting. This is already in the works.

The City has been looking into policies and procedures for analyzing and recording uncollectible accounts, primarily for our utilities. However, the policy building has been delayed until the utilities department consolidates their water and wastewater accounts, which has been a very tedious project and is expected to initiate in the March to April 2014 time frame. Springbrook software has agreed to assist in the merging of the 4,000+ accounts during conversion. The City anticipates continuing the work on the policies and procedures once the conversion is completed.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2013**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS* (Concl'd)**

Reference Number: 2013-1 (Concl'd)

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS (Concl'd)

The segregation of duties has always been an issue in such a small department. The finance department is looking into how best to handle this and has contracted with the auditors to review our overall internal controls in the various cash handling departments and make some recommendations. We recently got the draft report on improving our internal controls and will be reviewing it before issuing a final report and implementation strategy.

The City of Cottonwood tries to adhere to all of its rules as closely as possible and infrequently overlooks its policies. The Purchasing Agent and Accounts Payable has been dealing with several issues with department and has been asked to take a closer look at the purchase orders and matching invoices so as to avoid any discrepancies in the future. Inclusive, they will be asked to check closely on any change orders.

This year has been an unusual year with the conversion of software and the preparation involved. As we enter into the 2014 fiscal year, I anticipate that we will continue to see some of these issues as we work to complete the total ERP conversion involving utility billing, and other city services into the system.

Fiscal year 2013 also presented some other challenges with a firebombing of the Administrative Services Building in April creating disarray. The finance staff had to be relocated while the offices were gutted and rebuilt. Although we managed to continue operations there were some difficulties and delays as all files and documentation were cleaned and returned.

Lastly, the City originally was going to do a full asset inventory in-house, however, with the permanent loss of a staff position, we will be requesting consulting services to do a full inventory of our capital assets in the coming budget year.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2013**

FINDINGS AND QUESTIONED COSTS RELATED TO FEDERAL AWARDS

Reference Number: 2013-2

Program: Formula Grants for Rural Areas

CFDA Number: 20.509

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Arizona Department of Transportation

Applicable ARRA Programs: N/A

Grantor Number: AZ-18-0045-G4518

Questioned Costs: \$47

Type of Finding: Material Weakness, Noncompliance

Compliance Requirement: Allowable Costs/Cost Principles, Equipment and Real Property
Management, Other

CRITERIA

Bullets 3, 4, 10, and 11 of Finding 2013-1 relate to federal awards and are reported in the Findings Related to Financial Statements Reported in Accordance with Government Auditing Standards section of the Schedule of Findings and Questioned Costs.

**CITY OF COTTONWOOD, ARIZONA
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
YEAR ENDED JUNE 30, 2013**

Status of Federal Award Findings and Questioned Costs

Reference Number: 2012-2

Program: Assistance to Firefighters Grant, Staffing for Adequate Fire and Emergency Response

CFDA Numbers: 97.044, 97.083

Status: Corrected.

Reference Number: 2012-3

Program: Assistance to Firefighters Grant

CFDA Number: 97.044

Status: Not corrected.

Reference Number: 2012-4

Program: Assistance to Firefighters Grant, Staffing for Adequate Fire and Emergency Response

CFDA Numbers: 97.044, 97.083

Status: Not corrected.