

**CITY OF COTTONWOOD, ARIZONA
SINGLE AUDIT REPORTING PACKAGE
FOR THE YEAR ENDED JUNE 30, 2014**

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<u>CONTENTS</u>	<u>Page</u>
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	1
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	3
Schedule of Expenditures of Federal Awards	6
Notes to Schedule of Expenditures of Federal Awards	7
Schedule of Findings and Questioned Costs	8
Summary Schedule of Prior Audit Findings	13

**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, 2014, 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 23, 2014. Our report included an emphasis of matter paragraph as to comparability because of the implementation of Governmental Accounting Standards Board Statement No. 65.

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 a deficiency in internal control that we consider to be a material weakness.

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 as item FS-2014-001 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 results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Heinfeld, Meech & Co., P.C.

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

December 23, 2014

**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, 2014. 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 the 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 other major federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2014.

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 2014-001. 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 requirements 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 a certain deficiency in internal control over compliance that we consider to be a material weakness.

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 deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2014-001 to be a material weakness.

City of Cottonwood, Arizona's response to the internal control over compliance 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 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, 2014, 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 23, 2014, 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 23, 2014

CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2014

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Pass-Through Grantor's Number	Expenditures
<u>Institute of Museum and Library Services</u>			
Passed through Arizona State Library, Archives, and Public Records:			
Grants to States	45.310	2013-33026-06	\$ 18,000
Grants to States	45.310	2013-33026-07	20,000
Grants to States	45.310	2013-33020-E	10,000
Grants to States	45.310	2013-34017-09	<u>13,480</u>
Total Institute of Museum and Library Services			<u>61,480</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>282,128</u>
<u>U.S. Department of Transportation</u>			
Passed through Arizona Department of Transportation:			
Formula Grants for Rural Areas	20.509	AZ-18-0054-G4518	154,739
Formula Grants for Rural Areas	20.509	AZ-18-0060-G6018	865,400
Airport Improvement Program	20.106	03-04-0012-014-2012	19,688
Passed through Arizona Governor's Office of Highway Safety:			
State and Community Highway Safety	20.600	2013-V13-124	10,980
State and Community Highway Safety	20.600	2013-PT-015	1,163
State and Community Highway Safety	20.600	2013-AL-016	2,880
State and Community Highway Safety	20.600	2014-AL041	3,275
State and Community Highway Safety	20.600	2014-PT-024	2,730
State and Community Highway Safety	20.600	2014-PT-061	7,871
State and Community Highway Safety	20.600	2014-AL-018	<u>8,998</u>
Total U.S. Department of Transportation			<u>1,077,724</u>
Total Expenditures of Federal Awards			\$ <u>1,421,332</u>

CITY OF COTTONWOOD, ARIZONA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2014

NOTE 1 – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal grant activity of City of Cottonwood, Arizona under programs of the federal government for the year ended June 30, 2014. The information in the Schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the City, it is not intended to and does not present the financial position, changes in net position or cash flows of the City.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the applicable OMB cost principles circular, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Any negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

NOTE 3 – CATALOG OF FEDERAL DOMESTIC ASSISTANCE (CFDA) NUMBERS

The program titles and CFDA numbers were obtained from the federal or pass-through grantor or the 2014 *Catalog of Federal Domestic Assistance*. When no CFDA number had been assigned to a program, the two-digit federal agency identifier, a period, and the federal contract number were used. When there was no federal contract number, the two-digit federal agency identifier, a period, and the word “unknown” were used.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2014**

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, 2014**

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

Reference Number: FS 2014-001

Type of Finding: Material Weakness

Description: Internal 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:

- For three of 40 disbursements reviewed, the account coding was not in accordance with City's adopted chart of accounts.
- For one of 40 disbursements reviewed, a purchase order was not prepared and three quotes were not obtained as required by City policy.
- 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.
- The City misclassified \$27,696 of grant revenue.
- 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 City has not taken a physical inventory of capital assets and reconciled the results to the capital asset records.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2014**

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

Reference Number: FS 2014-001 (Cont'd)

CONDITION/CONTEXT

- 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.
- The City did not appropriately amortize goodwill in the water fund.
- There were multiple errors noted in the general ledger related to business-type bond activity.

EFFECT

Internal controls were not in place to ensure that material misstatements would be prevented and/or detected. The City was not always in compliance with GAAP and City policies. Additionally, although no specific instances of misappropriation of assets were noted, the City is susceptible to risk of noncompliance in the future.

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.

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 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 are properly supported and agree to supporting documentation.
- The City should develop procedures to ensure revenues are accurately recorded in the general ledger.
- The City should perform a physical inventory of capital assets.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2014**

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

Reference Number: FS 2014-001 (Concl'd)

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS

The numerous account misclassifications occurred due to the new chart of accounts structure established as part of the new ERP software: Springbrook. The staff has become familiar with the new structure since which will reduce or eliminate these type of errors. Additionally, there are items that were not entirely cleaned up prior to the conversion. Staff has been working on addressing this but it has been a slow and tedious process ensuring they are handled correctly. We anticipate these coding errors and account reorganizations to be completed within the upcoming fiscal year, including errors related to business-type bond activities as this has not been reported in prior years.

Regarding purchasing and inventory management, our biggest issue was two-fold, emergency purchases and sole source purchases. Jeff Cook, our Purchasing Agent has developed a form requiring written justification for emergency and/or sole source purchases. The objective of the form is to justify the purchase as such. Furthermore, we are implementing a procedure, upon asset acquisition, for our Purchasing Agent to tag any capital purchase order and invoices. They will be forwarded to the Accounting Manager for review of account coding and approval, then to the Administrative Services General Manager for final review and approval before entry into the system. Inclusive, a similar procedure will be established for the annual review of the asset listing, whereby the Accounting Manager produces the asset listing for the Purchasing Agent to review and approve, then forward to the Administrative Services General Manger for final review and approval. Due to limited staffing the city has not done a physical inventory. We have budgeted for an inventory in the past; however, due to budget reductions, it never has come to fruition. We will once again make the request to hire a firm to assist with a city-wide asset inventory. This finding will help us support the need for the physical inventory budget allocation.

The city wrote off approximately \$300k in bad debt from the Sewer department that had been on the books for many years. Though there are no official polices, the merging of the sewer and water billing will keep the uncollectable accounts from being so large in the future. Currently, the policy is to apply utility payments to sewer first and then water to mitigate the account growth.

**CITY OF COTTONWOOD, ARIZONA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2014**

FINDINGS AND QUESTIONED COSTS RELATED TO FEDERAL AWARDS

Reference Number: 2014-001

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 Numbers: AZ-18-0054-G4518/AZ-18-0060-G6018

Questioned Costs: N/A

Type of Finding: Noncompliance, Material Weakness

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

CRITERIA

Bullets 6 and 7 of Finding FS-2014-001 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, 2014**

Status of Federal Award Findings and Questioned Costs

Reference Number: 2013-2

Program: Formula Grants for Rural Areas

CFDA Number: 20.509

Status: Partially corrected – see FS 2014-001.