

City of Spencer, Oklahoma

**Financial Statements and Independent
Auditor's Report Thereon**

June 30, 2011

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INDEPENDENT AUDITOR'S REPORT

The Honorable Mayor,
Members of the City Council
City of Spencer, Oklahoma

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Spencer, Oklahoma (the City) as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

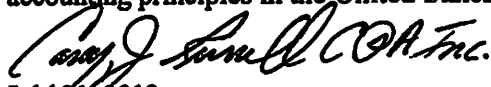
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis of our opinion.

The City prepares its annual financial statements and schedules on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position - modified cash basis of the governmental activities, the business-type activities, and major funds of the City as of June 30, 2011, and the respective changes in financial position - modified cash basis and cash flows, where applicable, thereof for the year then ended in conformity with the basis of accounting described in Note I.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 31, 2012 on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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* and should be read in conjunction with this report in considering the results of our audit.

Management has elected to not present a management, discussion, and analysis, a budget to actual comparison and employee pension and retirement plan information as is required by generally accepted accounting principles in the United States of America.


July 31, 2012

City of Spencer
Statement of Net Assets - Modified Cash Basis
June 30, 2011

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Totals</u>
ASSETS			
Current Assets:			
Cash in Bank - Unrestricted	588,937.40	708,050.48	1,296,987.88
Cash in Bank - Restricted	<u>45,159.01</u>	<u>2,251,605.99</u>	<u>2,296,765.00</u>
Total Current Assets	634,096.41	2,959,656.47	3,593,752.88
Noncurrent Assets:			
Capital Assets, net	<u>400,214.57</u>	<u>2,672,863.95</u>	<u>3,073,078.52</u>
Total Noncurrent Assets	400,214.57	2,672,863.95	3,073,078.52
TOTAL ASSETS	<u>\$ 1,034,310.98</u>	<u>\$ 5,632,520.42</u>	<u>\$ 6,666,831.40</u>
LIABILITIES			
Current Liabilities:			
Payroll Taxes Payable	41,971.08	16,322.09	58,293.17
Customer Deposits	0.00	137,389.49	137,389.49
Notes Payable - Current Portion	<u>0.00</u>	<u>35,000.00</u>	<u>35,000.00</u>
Total Current Liabilities	41,971.08	188,711.58	230,682.66
Noncurrent Liabilities:			
Mortgages and Notes Payable	<u>0.00</u>	<u>3,748,450.00</u>	<u>3,748,450.00</u>
Total Noncurrent Liabilities	0.00	3,748,450.00	3,748,450.00
TOTAL LIABILITIES AND NET ASSETS	41,971.08	3,937,161.58	3,979,132.66
NET ASSETS			
Invested in Capital Assets, Net of Related Debt	400,214.57	701,706.73	1,101,921.30
Net Assets - Restricted	45,159.01	2,251,605.99	2,296,765.00
Net Assets - Unrestricted	<u>546,966.32</u>	<u>(1,257,953.88)</u>	<u>(710,987.56)</u>
TOTAL NET ASSETS	992,339.90	1,695,358.84	2,687,698.74
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,034,310.98</u>	<u>\$ 5,632,520.42</u>	<u>\$ 6,666,831.40</u>

City of Spencer
Statement of Activities - Modified Cash Basis
For the Year Ending June 30, 2011

Functions/Programs	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net (expense) revenue</u> <u>Changes in net ass</u>	
		<u>Charges for</u> <u>Services</u>	<u>Capital</u> <u>Grants</u>	<u>Governmental</u> <u>Activities</u>	<u>Primary Governm</u> <u>Busin</u> <u>Act</u>
Primary Government					
Governmental Activities					
General Government	206,631.08	129,500.75	0.00	(77,130.33)	
Police Department	513,929.51	77,713.29	0.00	(436,216.22)	
Fire Department	300,537.77	0.00	0.00	(300,537.77)	
Street and Alleys	27,887.70	0.00	0.00	(27,887.70)	
Parks	2,416.66	1,400.00	0.00	(1,016.66)	
Total Governmental Activities	1,051,402.72	208,614.04	0.00	(842,788.68)	
Business-Type Activities					
Water Department	519,389.03	407,034.85	104,616.73	0.00	(
Sanitation Department	167,134.57	383,873.60	0.00	0.00	21
Sewer Department	56,400.26	169,978.15	0.00	0.00	11
Total Business-Type Activities	742,923.86	960,886.60	104,616.73	0.00	32
Total Primary Governmen	<u>\$1,794,326.58</u>	<u>\$1,169,500.64</u>	<u>\$ 104,616.73</u>	<u>\$ (842,788.68)</u>	<u>\$ 32</u>
General Revenues					
Sales Taxes				724,398.92	
Other Taxes				195,963.74	
Total General Government Revenue				920,362.66	
Transfer In/Out				(151,041.32)	15
Change in Net Assets				(73,467.34)	47
Net Assets Beginning				1,065,807.24	1,22
Net Assets Ending				<u>\$ 992,339.90</u>	<u>\$1,69</u>

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

**City of Spencer
Governmental Funds
Balance Sheet - Modified Cash Basis
June 30, 2011**

	General Fund	Court Fund	Special Revenue Fund	Total Governmental Fund
ASSETS				
Cash in Bank - Unrestricted	350,887.53	67,108.42	170,941.45	588,937.40
Cash in Bank - Restricted	0.00	0.00	45,159.01	45,159.01
Total Assets	<u>\$ 350,887.53</u>	<u>\$ 67,108.42</u>	<u>\$ 216,100.46</u>	<u>\$ 634,096.41</u>
LIABILITIES				
Payroll Taxes Payable	41,971.08	0.00	0.00	41,971.08
Total Liabilities	<u>41,971.08</u>	<u>0.00</u>	<u>0.00</u>	<u>41,971.08</u>
NET ASSETS				
Assigned Fund Balance	0.00	67,108.42	216,100.46	283,208.88
Unassigned Fund Balance	308,916.45	0.00	0.00	308,916.45
TOTAL NET ASSETS	<u>308,916.45</u>	<u>67,108.42</u>	<u>216,100.46</u>	<u>592,125.33</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 350,887.53</u>	<u>\$ 67,108.42</u>	<u>\$ 216,100.46</u>	<u>\$ 634,096.41</u>

***Reconciliation of Total Governmental Fund to
Net Assets of Governmental Activities***

Total Governmental Fund Balances	\$ 592,125.33
Amounts reported for governmental activities in the statement net assets are different because:	
Capital assets used in governmental activities are not financial resources resources and therefore are not reported in the funds.	<u>400,214.57</u>
Net Assets of Governmental Activities	<u>\$ 992,339.90</u>

City of Spencer
Governmental Funds
Statement of Revenues, Expenditures and Changes in Net Assets - Modified Cash Basis
For the Year Ending June 30, 2011

	General Fund	Court Fund	Special Revenue Funds	Total Governmental Funds
Revenues				
Taxes	898,910.45	0.00	21,452.21	\$920,362.66
Charges for Services	121,557.56	0.00	9,343.19	130,900.75
Court Fines	<u>1,606.00</u>	<u>74,162.29</u>	<u>1,945.00</u>	<u>77,713.29</u>
Total Revenues	<u>1,022,074.01</u>	<u>74,162.29</u>	<u>32,740.40</u>	<u>1,128,976.70</u>
Expenditures				
Personal Services	837,867.68	0.00	0.00	837,867.68
Maintenance and Operations	<u>110,269.16</u>	<u>8,411.49</u>	<u>42,958.29</u>	<u>161,638.94</u>
Total Expenditures	<u>948,136.84</u>	<u>8,411.49</u>	<u>42,958.29</u>	<u>999,506.62</u>
Excess revenues over (under) expenditures	73,937.17	65,750.80	(10,217.89)	129,470.08
Transfers In/Out	<u>(49,647.19)</u>	<u>(70,498.08)</u>	<u>(30,896.05)</u>	<u>(151,041.32)</u>
Excess revenue over (under) expenditures after transfers	24,289.98	(4,747.28)	(41,113.94)	(21,571.24)
Net Assets at beginning of year	<u>284,626.47</u>	<u>71,855.70</u>	<u>257,214.40</u>	<u>613,696.57</u>
Net Assets at end of year	<u>\$ 308,916.45</u>	<u>\$ 67,108.42</u>	<u>\$216,100.46</u>	<u>\$592,125.33</u>

***Reconciliation of Change in Net Assets Governmental Funds to
Change in Net Assets Governmental Wide***

Change in Net Assets, Fund Financial Statements	(21,571.24)
Depreciation recorded in the government wide financial statements not recorded in the fund financial statements	<u>(51,896.10)</u>
Change in Net Assets per the Governmental Wide Financial Statements	<u>\$ (73,467.34)</u>

**City of Spencer
Proprietary Fund
Statement of Net Assets - Modified Cash Basis
June 30, 2011**

ASSETS

Current Assets:

Cash in Bank - Unrestricted	\$ 708,050.48
Cash in Bank - Restricted	<u>2,251,605.99</u>
Total Current Assets	2,959,656.47

Noncurrent Assets:

Capital Assets, net	<u>2,672,863.95</u>
Total Noncurrent Assets	<u>2,672,863.95</u>
TOTAL ASSETS	<u>\$ 5,632,520.42</u>

LIABILITIES AND NET ASSETS

Current Liabilities:

Payroll Taxes Payable	16,322.09
Meter Deposits	137,389.49
Current Portion of Long Term Debt	<u>35,000.00</u>
Total Current Liabilities	188,711.58

Noncurrent Liabilities

Mortgages and Notes Payable	<u>3,748,450.00</u>
Total Noncurrent Liabilities	<u>3,748,450.00</u>
TOTAL LIABILITIES	3,937,161.58

NET ASSETS

Invested in Capital Assets, Net of Related Debt	701,706.73
Net Assets - Restricted	2,251,605.99
Net Assets - Unrestricted	<u>(1,257,953.88)</u>
TOTAL NET ASSETS	<u>1,695,358.84</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 5,632,520.42</u>

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

**City of Spencer
Proprietary Fund
Statement of Revenues, Expenditures and Changes in Net Assets - Modified Cash Basis
For the Year Ending June 30, 2011**

Operating Revenues:	
Water Sales	407,034.85
Sewer Fees	169,978.15
Sanitation Fees	<u>383,873.60</u>
Total Operating Revenues	960,886.60
 Operating Expenditures:	
Personnel Services	357,788.06
Maintenance and Operations	271,967.68
Other Services and Charges	73,999.22
Depreciation and Amortization Expense	38,018.89
Interest Expense	<u>1,150.00</u>
Total Operating Expenditures	742,923.85
 Excess Revenues over Expenditures	 217,962.75
 Non-operating Revenues (Expenditures)	
Transfer in (out)	151,041.32
Grant Revenues	<u>104,616.73</u>
Net Non-operating Revenues (Expenditures)	255,658.05
 Excess Revenues over (under) Expenditures after transfers	 473,620.80
 Net Assets at beginning of year	 <u>1,221,738.05</u>
Net Assets at end of year	<u><u>\$ 1,695,358.85</u></u>

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

**City of Spencer
Proprietary Fund
Statement of Cash Flows - Modified Cash Basis
For the Year Ending June 30, 2011**

Cash flows from operating activities	
Receipts from customers	960,886.60
Grants Received	104,616.73
Transfers to other funds	151,041.32
Net Change in Due to/Due from other funds	2,536.65
Net Change in Customer Deposits	(9,039.41)
Prior Period Correction	91,494.73
Payments to employees	(341,465.97)
Payments to supplies	<u>(345,966.90)</u>
Net cash provided by operating activities	614,103.75
 Cash flows from capital and related financing activities	
Purchases of Capital Assets	(456,433.18)
Principal Paid on Long Term Debt	<u>(35,000.00)</u>
Net cash flows from capital and related financing activities	(491,433.18)
 Net increase (decrease) in cash	122,670.57
 Cash, Beginning of the Year	<u>2,836,985.91</u>
Cash, End of the Year	<u>\$ 2,959,656.48</u>

Reconciliation of operating income (loss) to net cash provided (used) by operating activities:

Change in Net Assets	473,620.80
Adjustments to reconcile change in net assets to net cash provided	
Depreciation	39,168.89
Increase (decrease) in payroll taxes payable	16,322.09
Increase (decrease) in customer deposits	(9,039.41)
Prior Period Correction	91,494.73
Net Change in Due to/Due from other funds	<u>2,536.65</u>
Net cash provided by operating activities	<u>\$ 614,103.75</u>

NOTE ONE - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Spencer (the "City"), was incorporated in 1903. The City operates under the Council-Manager form of government under title 11 of the *Oklahoma Statutes*. The City's major operations include police and fire protection, parks, sanitation, streets, and general administrative services. In addition, the City owns and operates a water and sewer system.

The City's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) with the exception of the use of the modified cash basis of accounting. 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 City are discussed below.

A. REPORTING ENTITY

These financial statements present the City (the primary government) and its component unit, the Spencer Utility Authority (the "SUA"). As defined by GASB No. 14, component units are legally separate entities that are included in the City's in the City's reporting entity because of the significance of their operating or financial relationships with the City.

The purpose of the SUA is to operate and manage the City's water and sewer systems. The SUA is a title 60 trust under *Oklahoma Statutes*. The City Council serves as the SUA board of directors. Although legally separate, the SUA is reported as the business-type activities in the government wide financial statements, separate financial statements for the SUA are not issued.

B. BASIS FINANCIAL STATEMENTS-GOVERNMENT WIDE STATEMENTS

The City's basic financial statements include both government-wide (reporting the City as a whole) and fund financial statements (reporting the City's major funds). Both the government-wide and fund financial statements categorize primary activities as either governmental or business type. The City's police and fire protection, parks, sanitation, streets and general administrative services are classified as governmental activities. The City's water, sewer and sanitation services are classified as business-type activities.

In the government-wide Statement of Net Assets, both the governmental and business-type activities columns (a) are presented on a consolidated basis by column, (b) and are reported on the modified cash basis, economic resource basis, which recognized all long-term assets and wall as long-term debt obligations.

The government-wide Statement of Activities reports both the gross and net cost of each of the City's functions and business-type activities (police, fire, public works, etc.). The functions are also supported by general government revenues (sales, use, franchise, cigar taxes and certain intergovernmental revenues and taxes, etc.) The Statement of Activities reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. Program revenues must be directly associated with the function (police, fire streets, etc. or a business-type activity. Operating grants include operating-specific

and discretionary (either operating or capital) grants while the capital grants column report capital-specific grants.

The net costs (by function or business-type activity) are normally covered by general revenues (sales, use, franchise, cigar taxes, etc.) The City does not allocate indirect costs.

This government-wide focus is more on the sustainability of the City as an entity and the change in the City's net assets resulting from the current year's activities.

C. BASIC FINANCIAL STATEMENTS – FUND FINANCIAL STATEMENTS

The financial transactions of the City are reported in individual funds in the fund financial statements. Each fund is accounted for by providing a separate set of self-balancing accounts that comprises its assets, liabilities, fund equity, revenues and expenditures/expenses.

The emphasis in fund financial statements is on the major funds in either the governmental or business-type activities categories. Nonmajor funds by category are summarized into a single column. GASBS No. 34 sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of either fund category or the governmental and enterprise combined) for the determination of major funds. The nonmajor funds are combined in a column in the fund financial statements.

1. Governmental Funds:

The focus of the governmental funds' measurement (in the fund statements) is upon determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than upon net income. The City reports these major governmental funds and fund types:

- a. The general fund is the City's primary operating fund. It is used to account for and report all financial resources excepted those required to be accounted for in another fund.
- b. The court fund is used to account for court fines.

The activities reported in these funds are reported as governmental activities in the government-wide financial statements.

2. Proprietary Funds:

The focus of proprietary fund measurement is upon determination of operating income, changes in net assets, financial position, and cash flows. The generally accepted accounting principles applicable are those similar to businesses in the private sector. The City reports the following proprietary fund types:

- a. Enterprise funds are required to be used to account for operations for which a fee is charged to external users for goods or services and the activity is financed with debt that is solely secured by a pledge of the net revenues. The activities reported in these funds are reported as business-type activities in the government-wide financial statements.

D. BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues or expenditures/expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied.

1. Modified Cash Basis

Both the governmental and business-type activities in the government-wide financial statements and the proprietary financial statements are presented on the modified cash basis of accounting. Revenues are reported when received and expenses are reported when paid. Under the modified cash basis of accounting capital assets and depreciation are recorded as well as long term debt. In addition certain cash driven liabilities are also recorded such as payroll taxes payable and meter deposit liabilities.

The fund financial statements for the governmental funds use the modified cash basis as well but do not present capital assets or long term debts. The fund financial statements for the enterprise funds (SUA) use the modified cash basis but do present capital assets and long term debt.

E. FINANCIAL STATEMENT AMOUNTS

1. Cash and Cash Equivalents:

For purposes of the statement of cash flows, the City's cash and cash equivalents are consider to be cash on hand, demand deposits and short-term investments with original maturities of three months o less for the date of acquisition. The City had restricted cash of \$2,296,765 as of June 30, 2011 which represented monies held for capital projects and customer deposits.

2. Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditures of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the for all funds. Encumbrances are not recognized as the equivalent of expenditures; therefore, the reserve for encumbrances is reported as part of the fund balance on the statements of net assets. However, it should be noted that the City did not recognized any outstanding reserves as of June 30, 2011.

3. Budget

In accordance with Oklahoma Statutes, Title 68, Section 3002, the City Council formally adopts annual budget which include substantially all funds. These annual budgets are adopted on a basis consistent with the guidelines established by the Oklahoma Municipal Code.

4. Risk Management

Significant losses are coved by commercial insurance for all City operations.

5. Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

6. Defining Operating Revenues and Expenses:

The City's proprietary funds distinguish between operating and nonoperating revenues and expenses. Operating revenues and expenses of the City's water, sewer and sanitation funds consist of charges for services and the costs of providing those services, including depreciation and interest. All other revenues and expenses are reported as nonoperating.

7. Government-wide and Proprietary Fund Net Assets:

Government-wide and proprietary fund net assets are divided into three components:

- a. Invested in capital assets, net of related debt – consist of the historical cost of capital assets, loan proceeds that have not been spent less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
- b. Restricted net assets- consist of net assets that are restricted by the City's creditors, by the state enabling legislation, by grantors and by other contributors.
- c. Unrestricted- all other net assets are reported in this category.

8. Governmental Fund Balances

In the governmental fund financial statements, fund balance are classified as follows:

- a. Nonspendable- amounts that cannot be spent either because they are in a nonspendable form or because they are legally or contractually required to be maintained intact..
- b. Restricted-Amounts that can be spent only for specific purposes because of the City ordinances state or federal law, or externally imposed conditions by grantors or creditors.
- c. Committed-Amounts that can be used only for specific purposes determined by a formal action by City Council resolution.
- d. Assigned-Amounts that are designated by the City Council.
- e. Unassigned- All amounts not included in other spendable classifications.

9. Use of Restricted Resources

When an expense is incurred that can be paid using either restricted or unrestricted resources (net assets), the City's policy is to first apply the expense toward the restricted resources and then toward unrestricted resources. In governmental funds, the City's policy is to first apply the expenditure toward restricted fund balances then to the other, less- restrictive classifications- committed and then assigned fund balances before using unassigned fund balances.

NOTE TWO – DEPOSITS AND INVESTMENTS LAWS AND REGULATIONS

The accounts of the City are required by state law to be secured by collateral pledged by the financial institution and/or FDIC insurance. The City of Spencer is considered a separate entity from the Spencer Utility Authority for FDIC deposit insurance.

In accordance with GASB No. 3, deposits are to be classified into the following three categories:

1. Insured or collateralized with securities held by the entity or by its agent or in the entity's name. (Referred to as category 1)
2. Collateralized with securities held by pledging financial institution's trust department or in the agent's in the entity's name. (Referred to as category 2)
3. Uncollateralized, including any bank balance that is collateralized with securities held by the pledging institution, or by its trust department or agent but not in the entity's name. (Referred to as category 3)

Total Cash and Cash Equivalents	Category 1	Category 2	Category 3
\$ 3,593,753	\$ 776,534	\$ 2,212,398	\$ 604,821

The City of Spencer and the Spencer Utility Authority has FDIC coverage up to \$776,534, Category One. The Category Two monies are invested in money market funds backed by US Treasury securities. The Category Three monies are collateralized securities and letters of credit held by the financial institution.

NOTE THREE – CAPITAL ASSETS

Capital asset activity for the governmental funds for the year ending June 30, 2011 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
City Hall, Land and Equipment	259,624	-	-	259,624
Animal Control	3,400	-	-	3,400
Code Enforcement	16,504	-	-	16,504
Fire Equipment	459,406	-	-	459,406
Parks and Recreation	20,433	-	-	20,433
Police Equipment	308,594	-	-	308,594
Totals	1,067,961			1,067,961
Accumulated Depreciation	(615,850)	(51,897)	-	(667,747)
Net Capital Assets	\$ 452,111			\$ 400,214

As of June 30, 2011, the governmental funds had no capitalized assets that were not being depreciated or had not been depreciated. Depreciation is computed using the straight line method of depreciation over

the estimated useful lives of the assets. Assets are recorded at cost or their estimated fair market value for those assets where records were not available. The City allocated depreciation expense as follows:

Office and Administrative	5,000
Animal Control	340
Code Enforcement	633
Fire Department	16,059
Park Department	1,791
Police Department	28,073
Totals	\$ 51,896

Capital asset activity for the enterprise funds for the year ending June 30, 2011 was as follows:

	Beginning Balance	Increase	Decreases	Ending Balance
Construction in Process	1,555,394	420,429	-	1,975,823
Water System	688,441	36,004	-	724,445
Sewer System	573,735	-	-	573,735
Totals	2,817,570	456,433	-	3,274,003
Accumulated Depreciation	(563,120)	(38,019)	-	(601,139)
	\$ 2,254,450			\$ 2,672,864

As of June 30, 2011, the enterprise funds had no capitalized assets that were not being depreciated or had not been depreciated. During the year ending June 30, 2011 the SUA capitalized interest of \$200,994 into construction in process. Depreciation is computed using the straight line method of depreciation over the estimated useful lives of the assets. Assets are recorded at cost or their estimated fair market value for those assets where records were not available. The enterprise fund allocated depreciation expense as follows:

Water Department	26,591
Sewer Department	11,428
Totals	\$ 38,019

NOTE FOUR – REVENUE BONDS PAYABLE

Spencer Utility Authority

Long-term debt commitments payable from net revenues generated by the utility resources of other resources pledged to SUA, and their outstanding balances at June 30, 2011, include the following:

Utility System Refunding and Capital Improvement Revenue Bonds, Series 2007

During the year ending June 30, 2008 the Spencer Utility Authority issued revenue bonds for the upgrade and construction of water treatment facilities and repay the previously outstanding revenue bonds. The revenue bonds total \$4,000,000 and carry interest rates from 4.450% to 5.376%. Collateral for the bonds is the net revenues of the utility system. The Spencer Utility Authority is required to make monthly

deposits into a Bond Account of ½ of the annual principal and interest. The principal and interest due for the fiscal year ending June 30 2012 is estimated to be \$244,395. Interest is due semi-annually on December 1 and July 1 with the principal due annually on July 1. During the year ending June 30, 2011 the Authority paid \$210,336 in interest on the revenue bonds and principal of \$35,000. The bonds were sold at a discount of \$120,000. The bond issue discount will be amortized over the life of the bond issue. During the year ending June 30, 2011 the SUA recorded \$1,150 of discount. Discount amortization is recorded as interest expense in the financial statements. Principal and interest due till maturity is as follows:

	Principal	Interest	Note Balance	
2011/2012	35,000	208,454	Beginning Balance	3,930,000
2012/2013	40,000	206,438	Principal Paid	(35,000)
2013/2014	55,000	203,885	Ending Balance	3,895,000
2014/2015	60,000	200,794		
2015/2016	60,000	197,568	Bond Discount	
2016/2020	410,000	930,586	Beginning Balance	112,700
2020/2025	600,000	794,842	Principal Paid	(1,150)
2025/2030	800,000	605,069	Ending Balance	111,550
2030/2035	1,035,000	361,670	Net Balance	3,783,450
2035/2037	800,000	51,341	Current Portion	(35,000)
	<u>\$ 3,895,000</u>	<u>\$ 3,760,647</u>	Net Balance	<u>\$ 3,748,450</u>

The Spencer Utility Authority is required to at all times maintain a schedule of rates and charges for services rendered through the system which will provide annually a sum equal to not less than one and one-fourth (1.25) times the average amount required to be paid in cash into the bond account. For the year ending June 30, 2011 the Spencer Utility Authority was in compliance with this requirement.

NOTE FIVE – EMPLOYEE RETIREMENT PLAN PARTICIPATION

The City of Spencer participates in three pension retirement plans:

Oklahoma State Firefighter Pension System

The City of Spencer, as the employer, participates in a statewide cost-sharing multiple employer defined benefit pension plan through the Oklahoma Firefighters's Pension and Retirement System (OFPRS). The OFPRS defined benefit pension plan retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Pursuant to the requirement of Title 11, section 22-102, the City must participate in the plan if they employ fulltime or volunteer firefighters. OFPRS plan members are required to contribute 8% of their annual salary. The City is required by state law to contribute 13% of the members annual salary. The plan is funded by contributions from participants, employers, insurance premium taxes, and state appropriations, as necessary. For the year ended June 30, 2011, the City contributed \$23,328, the employees contributed \$14,356 on covered payroll of \$179,446.

A copy of the Firefighters Statewide Pension Plan financial statements can be obtained from the Oklahoma Firefighters Pension System, 4545 Lincoln Blvd., Suite 263, Oklahoma City, OK 73105-3707.

Oklahoma Police Pension and Retirement System

Pursuant to the requirements of Title 11, section 22-102, the City of Spencer participates in the statewide cost-sharing multi-employer defined benefit plan administered by the Oklahoma Police Pension and Retirement System (OPPRS). The paid police personnel contribute 8% to the plan. The City is required by state law to contribute 13% per year per paid police personnel to the statewide plan. The plan is funded by contributions from participants, employers, insurance premium taxes, and state appropriations, as necessary. For the year ended June 30, 2011, the City contributed \$24,530, the employees contributed \$15,096 on covered payroll of \$188,690.

The OPPRS issues a publicly available report that includes financial statements, which can be obtained from the Oklahoma Police Pension and Retirement System, 1001 N.W. 63rd Street, Oklahoma City, OK 73116-7335.

Oklahoma Municipal Retirement Fund

Plan Description: The City of Spencer contributes to the Oklahoma Municipal Retirement Fund, (the Fund), a cost-sharing multiple-employer defined benefit pension plan administered by the Trust Department of BankOne of Oklahoma City. The Fund provides retirement, death and disability benefits to plan members who are regular full-time employees of participating municipalities, except for employees covered under other retirement plans. The authority to establish and amend benefit provisions to the Fund rests with the Fund's board of directors. The Oklahoma Municipal Retirement Fund issues a publicly available financial report that includes financial statements and required supplementary information for the Fund, including 10 year historical information. That report may be obtained from the Fund administrator, Nation's Bank Trust Department.

Funding Policy – Plan employers are required to contribute 14.07% of gross monthly salary and employees 5.025% of gross salary. These rates are actuarially determined. These rates may be amended by the Fund's Board of Directors. The City's contributions to the Fund for the year ending June 30, 2011 were \$52,182. The employees' portion was \$18,636. Total covered payroll was \$370,880. These amounts were equal to the required contributions.

NOTE SIX –SUBSEQUENT EVENTS

Subsequent events have been evaluated through July 31, 2012, which is the date the financial statements were issued.

NOTE SEVEN –PRIOR PERIOD ADJUSTMENTS

During the year ending June 30, 2011 the general fund net assets and SUA net assets were adjusted to reflect corrections in cash accounts. The general fund was increased by \$53,735 and the SUA was increased by \$91,495.

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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*

To the Honorable Mayor,
Members of the City Council
City of Spencer, Oklahoma

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Spencer, Oklahoma as of and for the year ended June 30, 2011, which collectively comprise the City of Spencer, Oklahoma's basic financial statements and have issued our report thereon dated July 31, 2012. 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*.

Internal Control Over Financial Reporting

Management of the City of Spencer, Oklahoma, is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City of Spencer, Oklahoma's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Spencer, Oklahoma's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Spencer, Oklahoma's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 a 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 deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses. Items 2011-1, 2011-2, 2011-3 and 2011-6

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies. Items 2011-4, 2011-5, 2011-7 and 2011-8

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Spencer, Oklahoma'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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2011-9 and 2011-10

The City of Spencer, Oklahoma's response to the findings and identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City of Spencer, Oklahoma's response and accordingly, we express no opinion of it.

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



July 31, 2012

Schedule of Findings and Responses

2011-1 (Repeat Finding) – Bank Reconciliation

CONDITION: During our review of the accounting records we noted that the City's bank accounts were not being reconciled and the reconciled balance tied to the general ledger.

CRITERIA: Proper internal control and accounting procedures require that all bank accounts be reconciled on a regular basis. Proper reconciliation of the bank accounts helps insure accurate financial statements.

CAUSE OF CONDITION: The bank reconciliations were behind when current staff were hired. As a consequence due to the work load and learning process the current staff has been unable to reconcile the bank accounts on a regular basis.

EFFECT OF CONDITION: Due to the accounts not being reconciled the cash accounts and various revenue and expense accounts were incorrect. There were large numbers of checks that were written that were never released and subsequently written a second time. The doubling up of the checks written misstate the expense accounts.

RECOMMENDATION: All bank accounts be reconciled on a monthly basis.

CLIENT RESPONSE: The City staff has started reconciling all bank accounts on a monthly basis.

2011-2 (Repeat Finding) – Trust Accounts

CONDITION: There are significant transactions that are occurring in trust accounts that are not being recorded into the City's general ledger system.

CRITERIA: In order for the accounting records to be accurate all transactions should be recorded.

CAUSE OF CONDITION: The City has trust accounts that are used to hold debt money that is being used for utility projects. The transactions in these accounts are not always being recorded in the general ledger system. This was due to current staff not understanding the mechanics of the trust account transactions.

EFFECT OF CONDITION: The trust accounts as presented in the accounting records were not correct and associated capital asset accounts were also incorrect.

RECOMMENDATION: We recommend that the trust accounts be reconciled and the activity be recorded into the general ledger system monthly.

CLIENT RESPONSE: The trust accounts will be reconciled on a monthly basis and all transactions recorded.

2011-3 (Repeat Finding) – Funds Not Accounted For in the General Ledger

CONDITION: Currently the City is not using its computerized accounting system to track the activity in 18 of its 21 funds. The funds are minor funds and some activity is being tracked using Excel spreadsheets.

CRITERIA: In order for the accounting records to be accurate all transaction and activity should be accounted for in a common and centralized accounting system.

CAUSE OF CONDITION: The City has run through a series of Treasurers over the past several years. Each new hire has not had adequate time and training to adequately operate the accounting systems. With this situation each new Treasurer has inherited larger problems than her predecessor. This situation is compounded by the fact that the general ledger chart of accounts is overly large and convoluted and there are more funds and bank accounts than are necessary.

EFFECT OF CONDITION: The accounting records were incomplete and significant transactions are not being accounted for.

RECOMMENDATION: The smaller funds and bank accounts should be evaluated for usefulness and inactive funds and bank accounts should be eliminated and the remainder be accounted for inside the computerized general ledger system.

CLIENT RESPONSE: The funds in question will be accounted for in the City's general ledger system in the future

2011-4 – Separation of Duties

CONDITION: Currently the utility billing clerks not only input the monthly readings into the utility software but also collect the payments that come into the office and make any adjustments that are required to be made. The system as it is set up gives the utility billing clerks control over the assets and the records associated with the assets.

CRITERIA: Proper internal control requires a separation of the record keeping from the associated assets or a system of management oversight to compensate for the lack of separation.

CAUSE OF THE CONDITION: Separation of duties in an office with limited staff is often times difficult to achieve.

EFFECT OF THE CONDITION: The City is susceptible to having errors or fraud occur with regard to the utility billing monies.

RECOMMENDATION: The City should separate the billing function, collection function and the recording of payments received. The alternative would be for management to set up a system of oversight where daily collections would be reconciled to funds recorded as received into the utility software. A third alternative would be for the City to institute a policy of not accepting cash for utility payments at city hall. The last alternative would effectively separate the collection function from the record keeping function.

CLIENT RESPONSE: City management will investigate the alternatives to come to the solution.

2011-5 – Separation of Duties

CONDITION: Currently the court clerk keeps track of all traffic ticket activity and also handles all court fine monies.

CRITERIA: Proper internal control requires a separation of the record keeping from the associated assets or a system of management oversight to compensate for the lack of separation.

CAUSE OF CONDITION: Separation of duties in an office with limited staff is often times difficult to achieve.

EFFECT OF CONDITION: The City is susceptible to having errors or fraud occur with regard to the police fine monies.

RECOMMENDATION: Management develop a system of review of the funds collected to tickets marked as paid or separate the collection of ticket monies from the individual keeping track of the unpaid tickets.

CLIENT RESPONSE: City management will investigate the alternatives to come to the solution.

2011-6 – Accounts Payable Management

CONDITION: As of the year end the City had large numbers of checks that were written and not mailed out or listed in the accounts payable system as needing to be paid. Consequently, there were checks posted to the general ledger system that were never released and in some cases new checks written and released to the vendor. This results in a situation where vendors could have been paid twice and the general ledger being inaccurate.

CRITERIA: In order to have accurate records the management of the accounts payable system must be accurate. Management cannot manage the cash position of the organization if there are not accurate records as to what vendors have been paid and how much they were paid.

CAUSE OF THE CONDITION: There does not appear to have been adequate oversight of the accounts payable function.

EFFECT OF CONDITION: The general ledger system was incorrect and this situation makes the reconciliation of the cash accounts overly difficult.

RECOMMENDATION: Management should implement a system for review of unpaid invoices, paid invoices as well as monthly review of bank reconciliations.

CLIENT RESPONSE: Management is evaluating the recommendation.

2011-7- Utility Billing Input and Posting

CONDITION: During the year there were several months that contained hundreds of thousands of dollars of billing adjustments to customer's accounts that had equally large errors. The customer accounts were adjusted by City staff without management oversight.

CRITERIA: The utility billing revenues are a major source of revenues for the City, therefore their importance is self explanatory.

CAUSE OF THE CONDITION: Utility billing clerks are keying in incorrect meter readings.

EFFECT OF CONDITION: Extremely large keying errors distort the various reports that management should be reviewing.

RECOMMENDATION: Management should institute a policy of City staff reviewing the meter readings after they have been input into the utility billing software but before posting to customer accounts. In addition all adjustments to customer accounts should be approved by a member of management or at the very least a member of the City's staff that is not part of the utility bill process. It is further recommended that management review pass due accounts on a monthly basis.

CLIENT RESPONSE: Management is evaluating the issue and hopes to have processes in place soon.

2011-8 – Meter Deposit Cash Account

CONDITION: During the year ending June 30, 2011 there were operational expenses paid out of funds that were restricted for customer meter deposits.

CRITERIA: Customer meter deposit monies should be kept intact and not used for operational expenses.

EFFECT OF CONDITION: Monies that effectively do not belong to the City were used for City purposes.

RECOMMENDATION: In the future customer meter funds should only be used to refund customer's deposits or to pay final bills for customers who have left the City with an outstanding balance owed.

CLIENT RESPONSE: Management concurs with the recommendation.

2011-9 – Deposit Insurance

CONDITION: During the year ending June 30, 2011 the City did not have sufficient deposit insurance or securities pledged to secure its bank accounts as is required by state law.

CRITERIA: Oklahoma State law requires the all bank deposits be either covered by FDIC insurance or have collateral pledged to secure the deposits.

CAUSE OF CONDITION: When the last deposit collateral contracts expired the bank did not renew collateral contracts and City management was not aware of the situation.

RECOMMENDATION: City management take the steps necessary to be on compliance with state law.

CLIENT RESPONSE: Collateral has been obtained as of the date of the audit.

2011-10 – Payroll Tax Payments

CONDITION: The federal payroll tax report for the fourth quarter of the fiscal year ending June 30, 2011 was not filed in a timely fashion. In addition the payroll reports for subsequent quarters of fiscal year 2012 were not filed on time. The monies that were withheld and the matching payroll obligations for several quarters were not remitted on time.

CRITERIA: Payroll tax reports and the resulting taxes that have been withheld are required by law to be filed and remitted in a timely fashion.

CAUSE OF CONDITION: The former treasurer was not sufficiently trained to handle the specifics payroll compliance.

RECOMMENDATION: The City management make certain the proper reports are filed on a timely fashion and that the resulting taxes are paid on time. City staff should be properly trained to handle the payroll function or the City should consider outsourcing the payroll function to payroll processing company.

CLIENT RESPONSE: City management will evaluate the situation and at the very least bring the City into compliance.