

**WATER DEPARTMENT OF THE
CITY OF TONTITOWN, ARKANSAS**

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

For the Years Ended December 31, 2005 and 2004

**Water Department of the City of Tontitown, Arkansas
December 31, 2005 and 2004**

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To the Honorable Mayor and City Council
City of Tontitown
Tontitown, Arkansas

We have audited the accompanying financial statements of the Water Department of the City of Tontitown, Arkansas, a component unit of the City of Tontitown, Arkansas as of December 31, 2005 and 2004 and for the years then ended. These component unit financial statements are the responsibility of the City of Tontitown, Arkansas' management. Our responsibility is to express an opinion on these financial statements based upon our audits.

We conducted our audits in accordance with generally accepted auditing standards 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 component unit 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 audits provide a reasonable basis for our opinion.

The component unit financial statements present only the Water Department and are not intended to present fairly the financial position and results of operations of the City of Tontitown, Arkansas in conformity with generally accepted accounting principles in the United States of America.

In our opinion, the component unit financial statements referred to above present fairly, in all material respects, the financial position of the Water Department of the City of Tontitown, Arkansas as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated October 19, 2006, on our consideration of the Water Department of the City of Tontitown, Arkansas' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Daniel R. McCormick, C.P.A., P.A.

Daniel R. McCormick, C.P.A., P.A.

October 19, 2006

WATER DEPARTMENT OF THE CITY OF TONTITOWN, ARKANSAS
BALANCE SHEETS
December 31, 2005 and 2004

<u>ASSETS</u>	<u>2005</u>	<u>2004</u>
CURRENT ASSETS		
Petty Cash	\$ 1,200	\$ -
General Revenue Fund	303,792	239,685
Operations and maintenance fund	-	33,948
Accounts receivable-net of allowance for losses of \$700 and \$700, respectively	18,420	22,493
Sales taxes receivable	125,109	44,796
Inventory	<u>27,601</u>	<u>500</u>
Total current assets	<u>476,122</u>	<u>341,422</u>
RESTRICTED ASSETS		
Meter deposits		
Cash	24,230	19,193
Certificates of deposit	4,922	-
Depreciation fund		
Cash	25,753	15,856
Certificates of deposit	71,244	69,590
Capital improvements fund		
Cash	8,490	24,448
Certificates of deposit	28,667	28,092
Construction fund	5,708,792	-
Cost of issuance fund	27,632	-
Debt service fund	194,766	-
Sales & use tax fund	56,420	-
Water and sewer fund cash	<u>2,187,802</u>	<u>874,847</u>
Total restricted assets	<u>8,338,718</u>	<u>1,032,026</u>
Investment in Osage Basin Wastewater District	<u>85,000</u>	<u>85,000</u>
FIXED ASSETS		
Equipment	6,893	-
Sewer system	322,912	242,245
Water system	3,141,706	2,958,668
Less: Accumulated Depreciation	<u>(614,791)</u>	<u>(539,427)</u>
Total fixed assets	<u>2,856,720</u>	<u>2,661,486</u>
OTHER ASSETS		
Unamortized bond issue cost-net of accumulated amortization	34,915	-
Unamortized underwriter discount-net of accumulated amortization	89,196	-
Other assets	<u>3,550</u>	<u>750</u>
Total other assets	<u>127,661</u>	<u>750</u>
TOTAL ASSETS	<u><u>\$ 11,884,221</u></u>	<u><u>\$ 4,120,684</u></u>

See accompanying notes to financial statements.

<u>LIABILITIES, CONTRIBUTIONS AND NET ASSETS</u>	<u>2005</u>	<u>2004</u>
CURRENT LIABILITIES		
Accounts payable	\$ 112,859	\$ 8,253
Accrued liabilities	<u>93,622</u>	<u>2,012</u>
Total Current Liabilities	<u>206,481</u>	<u>10,265</u>
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS		
Meter deposits	29,306	16,409
Water revenue bonds payable	<u>139,206</u>	<u>3,967</u>
Total current liabilities payable from restricted assets	168,512	20,376
LONG-TERM DEBT		
Water & sewer revenue bonds payable	<u>6,118,363</u>	<u>257,569</u>
TOTAL LIABILITIES	<u>6,493,356</u>	<u>288,210</u>
CONTRIBUTIONS AND NET ASSETS		
Contributions	<u>881,710</u>	<u>881,710</u>
Net assets		
Invested in capital assets, net of related debt	2,599,151	2,399,951
Restricted for debt service	194,767	83,071
Unrestricted	<u>1,715,237</u>	<u>467,742</u>
Total net assets	<u>4,509,155</u>	<u>2,950,764</u>
Total contributions and net assets	<u>5,390,865</u>	<u>3,832,474</u>
TOTAL LIABILITIES, CONTRIBUTIONS AND NET ASSETS	<u><u>\$ 11,884,221</u></u>	<u><u>\$ 4,120,684</u></u>

See accompanying notes to financial statements.

WATER DEPARTMENT OF THE CITY OF TONTITOWN, ARKANSAS
STATEMENTS OF INCOME
For the Years Ended December 31, 2005 and 2004

	2005	2004
OPERATING REVENUE		
Water revenue	\$ 357,430	\$ 289,668
Connection fees	33,356	48,100
Tapping fees	9,425	7,150
Sales tax revenue	742,199	625,976
Contributions from the City of Tontitown	800,000	-
Other income	24,675	10,534
Total operating revenue	1,967,085	981,428
OPERATING EXPENSES		
Water purchases	168,041	135,750
Amortization	1,118	-
Depreciation	75,364	68,059
Salaries	51,258	29,148
Payroll taxes	5,024	2,450
Advertising	867	-
Auto expense	1,433	-
Bank service charges	1,041	-
Bond processing fees	380	-
Computer support	8,714	-
Dues & subscriptions	4,866	-
Office supplies and postage	6,233	7,812
Materials and supplies	22,532	35,838
Machine hire and labor	2,175	1,178
Insurance, taxes and bonds	27,668	20,064
Professional fees	12,839	-
Travel & education	4,194	-
Utilities	975	-
Miscellaneous	4,270	14,784
Total operating expenses	398,992	315,083
OPERATING INCOME	1,568,093	666,345
NON-OPERATING REVENUES (EXPENSES)		
Interest Income	68,623	9,176
Interest Expense	(78,325)	(15,597)
Total non-operating revenues	(9,702)	(6,421)
EXCESS OF REVENUES OVER EXPENSES	1,558,391	659,924
NET ASSETS, JANUARY 1	2,950,764	2,290,840
NET ASSETS, DECEMBER 31	\$ 4,509,155	\$ 2,950,764

See accompanying notes to financial statements.

WATER DEPARTMENT OF THE CITY OF TONTITOWN, ARKANSAS
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2005 and 2004

	2005	2004
OPERATING ACTIVITIES:		
Operating Income	\$ 1,568,093	\$ 666,345
Adjustments to reconcile net income to cash:		
Amortization	1,118	
Depreciation	75,363	68,059
Changes in assets and liabilities:		
Accounts receivable	4,073	(2,118)
Sales taxes receivable	(80,313)	(44,796)
Other assets	(128,029)	
Inventory	(27,101)	-
Accrued interest	(2,603)	(1,486)
Customer deposits	12,896	1,407
Accounts payable and accrued expenses	196,217	(313,106)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,619,714	374,305
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Additions to water system	(183,038)	(405,093)
Additions to sewer system	(80,667)	(15,570)
Additions to equipment	(6,892)	
2005 Revenue bond	6,000,000	-
Principal paid on revenue bonds	(3,967)	(3,743)
Interest expense	(78,325)	(15,597)
NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES	5,647,111	(440,003)
INVESTING ACTIVITIES:		
Interest earned on cash deposits	68,623	9,176
Purchase of investments	(4,548)	-
NET CASH USED IN INVESTING ACTIVITIES	64,075	9,176
NET INCREASE (DECREASE) IN CASH AND RESTRICTED CASH	7,330,900	(56,522)
CASH AND RESTRICTED CASH, BEGINNING OF YEAR	1,207,977	1,264,499
CASH AND RESTRICTED CASH, END OF YEAR	\$ 8,538,877	\$ 1,207,977
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest Paid	\$ 78,325	\$ 15,597

See accompanying notes to financial statements.

WATER DEPARTMENT OF THE CITY OF TONTITOWN, ARKANSAS
NOTES TO FINANCIAL STATEMENTS
Years Ended December 31, 2005 and 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Water Department is a component unit of the City of Tontitown, Arkansas. Our engagement did not include an audit of the other funds maintained by the City.

The Water Department utilizes the accrual basis of accounting. Accordingly, revenue is recognized when earned rather than when received, and expenditures are recognized when incurred rather than when paid.

Water customers' ability to honor their obligations to the Water Department is dependent upon the general economic conditions in the areas surrounding the City of Tontitown.

Additions to the water system are recorded at cost and depreciated using the straight-line method over an estimated forty-year life.

The Water Department capitalizes net interest costs and interest earned as part of the cost of constructing various water projects when those costs are material.

2. CASH AND CERTIFICATES OF DEPOSIT

At December 31, 2005, the carrying amount and bank balance of the Water Department's bank accounts and certificates of deposit were approximately \$8,643,709. Of the bank balances, \$200,000 was covered by federal depository insurance and \$8,443,709 was covered by collateral pledged by the depository institutions.

All certificates of deposit have one-year maturities. Cost and market values were approximately equal at December 31, 2005.

Cash and restricted cash for cash flow reporting purposes are composed of the following:

	<u>2005</u>	<u>2004</u>
Petty Cash	\$ 1,200	\$ -
General revenue fund	-	239,685
Operations and maintenance fund	303,792	33,948
Depreciation fund cash	25,753	15,856
Meter deposits	24,230	19,193
Capital improvements fund cash	8,490	24,448
Construction fund	5,708,792	-
Cost of issuance fund	27,632	-
Debt service fund	194,766	-
Sales & use tax fund	56,420	-
Water and sewer fund cash	<u>2,187,802</u>	<u>874,847</u>
	<u>\$ 8,538,877</u>	<u>\$ 1,207,977</u>

3. INVESTMENTS

The City of Tontitown Water Department has invested in an entity, the Osage Basin Wastewater Treatment District, which has been created to develop and build a wastewater treatment facility. The cities of Cave Springs and Highfill, Arkansas are partners in the project. This project is in the development stage. The Board approved the city's withdrawal from the Osage Basin Wastewater District on December 6, 2005 and the \$85,000 investment was received in March 2006.

4. WATER AND SEWER SYSTEMS

The City of Tontitown Water Department paid \$183,038 and \$405,093 towards the purchase and installation of new water lines and \$80,667 and \$15,570 for engineering and other services related to the development and construction of the wastewater collection system for the year ended 2005 and 2004 respectively.

5. WATER REVENUE BONDS PAYABLE

Water revenue bonds payable consisted of the following at December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Water System Revenue Bond, serviced by Regions Bank and payable to the Arkansas Soil and Water Conservation Commission. Semi-annual installments of principal plus accrued interest are due each June 1 and December 1 until the scheduled maturity on June 1, 2032. Interest rate is fixed at 5.9%. Bond is collateralized by the water system and its related revenues.	\$ 257,569	\$ 261,536
Sewer System Revenue Bonds, serviced by Bank of the Ozarks and payable to Cede and Company. Installments of accrued interest are due each April and installments of principal plus accrued interest are due each October until the final scheduled maturity on October 1, 2032. Interest rates are fixed and vary from 2.95% to 4.7%.	<u>6,000,000</u>	<u>-</u>
	6,257,569	261,536
Less current maturities	<u>(139,206)</u>	<u>(3,967)</u>
	<u>\$ 6,118,363</u>	<u>\$ 259,569</u>

Debt service requirements at December 31, 2005 were as follows:

<u>Year Ended</u> <u>December 31,</u>	<u>Principal</u>	<u>Interest</u>
2006	139,206	308,485
2007	144,455	261,986
2008	149,723	257,317
2009 to 2013	828,211	1,204,085
2014 to 2018	992,730	1,032,345
2019 to 2023	1,225,460	804,684
2024 to 2028	1,512,486	505,332
2029 to 2032	<u>1,265,298</u>	<u>128,081</u>
Total	<u>\$6,257,569</u>	<u>\$4,502,314</u>

6. CONTINGENCIES

Significant losses are covered by commercial insurance for all major programs for which the Water Fund retains risk loss. For insured programs, there have been no significant reductions in insurance coverage.

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

DANIEL R. McCORMICK, C.P.A., P.A.

Certified Public Accountant

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To the Honorable Mayor and City Council
City of Tontitown
Tontitown, Arkansas

We have audited the balance sheets of the Water Department of the City of Tontitown, Arkansas as of December 31, 2005 and 2004 and the related statements of income, contributions and retained earnings, and cash flows for the year then ended and have issued our report thereon dated October 19, 2006. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance that the component unit financial statements of the Water Department of the City of Tontitown are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Water Department's internal control over financial reporting in order to determine our opinion on the component unit financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned function. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the audit committee, management, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

Daniel R. McCormick, C.P.A., P.A.

Daniel R. McCormick, C.P.A., P.A.
October 19, 2006