

**CITY OF FRIENDSHIP, TENNESSEE**

**FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION**

**FOR THE YEAR ENDED JUNE 30, 2012**

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## **INTRODUCTORY SECTION**

**CITY OF FRIENDSHIP, TENNESSEE**

June 30, 2012

**MAYOR**

Casey Burnett

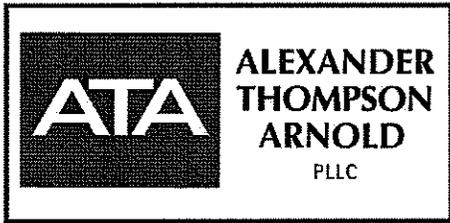
**BOARD OF ALDERMEN**

John Marvin  
Johnny Elmore  
James Roberson  
Bobby Garrett

**CITY RECORDER**

Debra Butler

## **FINANCIAL SECTION**



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## Independent Auditor's Report

The Honorable Mayor and Board of Aldermen  
City of Friendship, Tennessee

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 Friendship, Tennessee (the City), as of and for the year ended June 30, 2012, 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 opinions 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 for our opinions.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Friendship, Tennessee, as of June 30, 2012, and the respective changes in financial position and, where applicable, cash flows thereof and the budgetary comparison for the general fund and state street aid fund for the year 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 December 28, 2012, on our consideration of the City of Friendship's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. 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 considered in assessing the results of our audit.

The Honorable Mayor and Board of Aldermen  
City of Friendship, Tennessee

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 8 and the schedule of funding progress on page 37 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements. The other supplementary information except that which has been marked unaudited is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. This 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 financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section and other supplementary information which has been marked "unaudited" are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

*Alexander Thompson Arnold PLLC*

Dyersburg, Tennessee  
December 28, 2012

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

As management of the City of Friendship, Tennessee we offer readers of the City of Friendship's financial statements this narrative overview and analysis of the financial activities of the City of Friendship for the fiscal year ended June 30, 2012. We encourage readers to consider the information presented in conjunction with additional information that we have furnished in the basic financial statements and the accompanying notes to those financial statements. All amounts, unless otherwise indicated, are expressed in actual dollars. Comparative analyses of key elements of total governmental funds and total enterprise funds have been provided.

### **FINANCIAL HIGHLIGHTS**

Management believes the City of Friendship's financial condition is good. The following are key financial highlights.

- The assets of the City of Friendship exceeded liabilities at the close of the most recent fiscal year by \$2,765,609. Of this amount, \$91,276 (unrestricted net assets) may be used to meet the government's ongoing obligation to citizens and creditors.
- At June 30, 2012, the City's governmental funds reported combined ending unassigned fund balances of \$58,672.
- The City's total debt decreased by \$103,473 during the year ended June 30, 2012. Of this amount, governmental activity debt decreased by \$53,723, and proprietary fund long-term debt decreased by \$49,750.
- The City's net capital assets decreased by \$119,562 during the year ended June 30, 2012.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the financial statements and supplementary information. The MD&A represents management's examination and analysis of the City's financial condition and activities. Summary financial statement data, key financial and operational indicators, budget and other management tools were used for this analysis. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains required and other supplementary information in addition to the basic financial statements themselves.

#### **Government-wide financial statements**

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents the financial position of the City on a full accrual, historical cost basis. The statement of net assets provides information on all the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial positions of the City are improving or deteriorating.

The *Statement of Activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave.)

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, highways and streets, drug enforcement and parks and recreation. The business-type activities of the City include the operations of the water and sewer facilities and gas facilities.

The government-wide financial statements can be found on pages 9-10 of this report.

### **Fund financial statements**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into two categories: governmental funds and proprietary funds.

### **Governmental funds**

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains three individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, and state street aid fund which are considered to be major funds.

The City adopts an annual appropriations budget for its general and special revenue funds. A budgetary comparison statement has been provided for the general fund and special revenue funds to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 11-18 of this report.

### **Proprietary funds**

The City maintains one type of proprietary fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses an enterprise fund to account for its Gas, Water, and Sewer activities.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide information for the Gas, Water and Sewer activities of the City, which are considered to be major funds.

The basic proprietary fund financial statements can be found on pages 19-21 of this report.

## Notes to the financial statements

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of material data provided in the government-wide and fund financial statements. The notes present information about the City's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any. The notes to the financial statements can be found on pages 22-36 of this report.

## Other information

In addition to the basic financial statements and accompanying notes, this report also presents information concerning the City's progress in funding its obligation to provide pension benefits to its employees. The pension information can be found on page 37 of this report.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Friendship, assets exceeded liabilities by \$2,765,609 at the close of the most recent fiscal year.

By far the largest portion of the City's net assets reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment) less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to pay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

### City of Friendship, Tennessee - Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Current and other assets	\$ 241,764	\$ 232,173	\$ 51,914	\$ 61,670	\$ 293,678	\$ 293,843
Capital assets	722,057	755,360	2,489,454	2,575,713	3,211,511	3,331,073
Total assets	<u>963,821</u>	<u>987,533</u>	<u>2,541,368</u>	<u>2,637,383</u>	<u>3,505,189</u>	<u>3,624,916</u>
Long-term liabilities outstanding	239,180	292,903	297,998	347,748	537,178	640,651
Other liabilities	136,430	133,214	65,972	41,889	202,402	175,103
Total liabilities	<u>375,610</u>	<u>426,117</u>	<u>363,970</u>	<u>389,637</u>	<u>739,580</u>	<u>815,754</u>
Net Assets:						
Invested in capital assets, net of related debt	482,877	462,457	2,191,456	2,227,965	2,674,333	2,690,422
Unrestricted	105,334	98,959	(14,058)	19,781	91,276	118,740
Total net assets	<u>\$ 588,211</u>	<u>\$ 561,416</u>	<u>\$ 2,177,398</u>	<u>\$ 2,247,746</u>	<u>\$ 2,765,609</u>	<u>\$ 2,809,162</u>

At year end \$91,276 of the City's net assets represented resources that may be used to meet the government's ongoing obligations to citizens and creditors.

### City of Friendship, Tennessee - Changes in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
<b>Revenues:</b>						
<b>Program Revenues:</b>						
Charges for services	\$ 48,828	\$ 52,961	\$ 470,754	\$ 483,460	\$ 519,582	\$ 536,421
Operating grants and contributions	36,604	30,925			36,604	30,925
Capital grants and contributions		265,867		184,625		450,492
<b>General Revenues:</b>						
Local taxes	111,003	111,131			111,003	111,131
Intergovernmental	119,445	90,685			119,445	90,685
Other taxes		12,853				12,853
Interest on investments	113	296	182	278	295	574
Other	14,662	10,232			14,662	10,232
<b>Total revenues</b>	<b>330,655</b>	<b>574,950</b>	<b>470,936</b>	<b>668,363</b>	<b>801,591</b>	<b>1,243,313</b>
<b>Expenses:</b>						
General government	74,629	131,322			74,629	131,322
Public safety	66,538	60,132			66,538	60,132
Highways and streets	88,321	49,040			88,321	49,040
Industrial Park	19,691	2,808			19,691	2,808
Recreation	9,806	399			9,806	399
Sanitation	44,875	44,849			44,875	44,849
Debt service		9,966				9,966
Gas			240,204	254,270	240,204	254,270
Sewer			138,858	125,479	138,858	125,479
Water			162,222	164,230	162,222	164,230
<b>Total expenses</b>	<b>303,860</b>	<b>298,516</b>	<b>541,284</b>	<b>543,979</b>	<b>845,144</b>	<b>842,495</b>
<b>Increase in net assets</b>	<b>26,795</b>	<b>276,434</b>	<b>(70,348)</b>	<b>124,384</b>	<b>(43,553)</b>	<b>400,818</b>
Net assets - beginning	561,416	296,230	2,247,746	2,123,362	2,809,162	2,419,592
Prior period adjustment		(11,248)				(11,248)
Net assets - beginning - restated	561,416	284,982	2,247,746	2,123,362	2,809,162	2,408,344
<b>Net assets - ending</b>	<b>\$ 588,211</b>	<b>\$ 561,416</b>	<b>\$ 2,177,398</b>	<b>\$ 2,247,746</b>	<b>\$ 2,765,609</b>	<b>\$ 2,809,162</b>

The City's net assets decreased by \$43,553 during the current fiscal year. The decrease is mainly a result of decrease in grant revenues.

#### **Governmental activities**

Governmental activities increased the City of Friendship's net assets by \$26,795.

#### **Business-type activities**

Business type activities decreased the City's net assets by \$70,348.

#### **Financial Analysis of the Government's Funds**

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

### Governmental funds

The focus of the City's governmental funds is to provide information on near-term inflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported ending fund balances of \$78,970 an increase of \$8,565 in comparison with the prior year. Of the total amount of governmental fund balances presented, \$58,672 constitutes unassigned fund balance, which is available for spending at the government's discretion.

The unassigned fund balance of the City's General Fund increased \$11,861 during the current fiscal year.

### Proprietary funds

The City's Proprietary Fund provides the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the Gas, Water and Sewer Fund at the end of the year amounted to \$(14,058).

### Capital Asset and Debt Administration

At the end of fiscal year 2012, the City had \$3,211,511 (net of accumulated depreciation) invested in a broad range of capital assets. This investment includes land and land improvements, buildings, utility system, equipment and infrastructure. The total net decrease in the City's investment in capital assets for the current period amounted to \$119,562.

The following table summarizes the City's capital assets, and changes therein, for the year ended June 30, 2012.

#### City of Friendship, Tennessee - Capital Assets (net of depreciation)

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	\$ 73,214	\$ 73,214	\$ 16,750	\$ 16,750	\$ 89,964	\$ 89,964
Buildings	51,944	53,675			51,944	53,675
Infrastructure	501,893	528,308	-	-	501,893	528,308
Vehicles and equipment	95,006	100,163			95,006	100,163
Utility system			2,472,704	2,558,963	2,472,704	2,558,963
Total	\$ 722,057	\$ 755,360	\$ 2,489,454	\$ 2,575,713	\$ 3,211,511	\$ 3,331,073

Additional information on the City's capital assets can be found in the *Statement of Net Assets*. See Note 4-C on pages 30-31 of this report.

### Long-term debt

At the end of the current fiscal year, the City had total debt outstanding of \$537,178. The City's total debt decreased \$103,473 during the current fiscal year. Additional information on the City's long-term debt can be found in Note 4-F on pages 33-34 of this report.

### **Economic Factors and Next Year's Rates**

Factors considered in preparing the City's budget for the 2013 fiscal year include the following:

- State and local tax revenues are expected to remain constant for fiscal year 2013.
- Inflation in employee health care costs and energy fuels will no doubt result in increased expenditures in all funds.

The property tax rate remained at \$1.86 per \$100 of assessed value of property.

### **CONTACTING THE CITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any information provided in this report or requests for any additional information should be directed to the Office of the City Manager, City of Friendship, 555 S. Main Street, Friendship, Tennessee 38034.

**CITY OF FRIENDSHIP, TENNESSEE**  
**STATEMENT OF NET ASSETS**  
June 30, 2012

	<b>Governmental Activities</b>	<b>Business-Type Activities</b>	<b>Total</b>
<b>ASSETS</b>			
Current assets			
Cash in bank	\$ 45,767	\$ 29,277	\$ 75,044
Taxes receivable (net)	135,888	--	135,888
Accounts receivable (net)	6,555	26,806	33,361
Other taxes receivable	16,806	--	16,806
Other receivable	6,000	--	6,000
Inventory	--	26,579	26,579
Internal balances	30,748	(30,748)	--
Capital assets not being depreciated:			
Land	73,214	16,750	89,964
Capital assets (net of accumulated depreciation):			
Buildings	51,944	--	51,944
Infrastructure	501,893	--	501,893
Equipment	95,006	--	95,006
Utility plant in service	--	2,472,704	2,472,704
<b>Total assets</b>	<b>963,821</b>	<b>2,541,368</b>	<b>3,505,189</b>
<b>LIABILITIES AND NET ASSETS</b>			
Liabilities			
Accounts payable	23,199	20,559	43,758
Other accrued liabilities	3,707	6,842	10,549
Customer deposits	--	38,571	38,571
Deferred revenue - property tax	109,524	--	109,524
Noncurrent liabilities			
Due within one year	125,285	49,750	175,035
Due in more than one year	113,895	248,248	362,143
<b>Total liabilities</b>	<b>375,610</b>	<b>363,970</b>	<b>739,580</b>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	482,877	2,191,456	2,674,333
Unrestricted	105,334	(14,058)	91,276
<b>Total net assets</b>	<b>\$ 588,211</b>	<b>\$ 2,177,398</b>	<b>\$ 2,765,609</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**

**STATEMENT OF ACTIVITIES**

For the year ended June 30, 2012

Functions/Programs	Expenses	Program Revenues			Net (Expenses)/Revenues and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total
<b>Governmental activities:</b>							
General government	\$ 74,629	\$ 1,200	\$ --	\$ --	\$ (73,429)	\$ --	\$ (73,429)
Public safety	66,538	591	17,999	--	(47,948)	--	(47,948)
Highways and streets	88,321	--	18,605	--	(69,716)	--	(69,716)
Industrial park	19,691	--	--	--	(19,691)	--	(19,691)
Recreation	9,806	--	--	--	(9,806)	--	(9,806)
Sanitation	44,875	47,037	--	--	2,162	--	2,162
<b>Total governmental activities</b>	<b>303,860</b>	<b>48,828</b>	<b>36,604</b>	<b>--</b>	<b>(218,428)</b>	<b>--</b>	<b>(218,428)</b>
<b>Business-type activities:</b>							
Gas department	240,204	237,176	--	--	--	(3,028)	(3,028)
Sewer system	138,858	108,853	--	--	--	(30,005)	(30,005)
Water department	162,222	124,725	--	--	--	(37,497)	(37,497)
<b>Total business-type activities</b>	<b>541,284</b>	<b>470,754</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>(70,530)</b>	<b>(70,530)</b>
<b>Total</b>	<b>\$ 845,144</b>	<b>\$ 519,582</b>	<b>\$ 36,604</b>	<b>\$ --</b>	<b>\$ (218,428)</b>	<b>\$ (70,530)</b>	<b>\$ (288,958)</b>

<b>General revenues:</b>			
Property taxes		111,003	111,003
Sales tax		79,303	79,303
Alcoholic beverage taxes		18,519	18,519
Business taxes		9,729	9,729
Income taxes		4	4
Excise taxes		4,130	4,130
TVA in lieu of taxes		7,723	7,723
Telecom sales taxes		37	37
Franchise fee		--	--
Interest		113	295
Miscellaneous		14,662	14,662
<b>Total general revenues</b>		<b>245,223</b>	<b>245,405</b>
<b>Change in net assets</b>		<b>26,795</b>	<b>(43,553)</b>
<b>Net assets - beginning</b>		<b>561,416</b>	<b>2,809,162</b>
<b>Net assets - ending</b>		<b>\$ 588,211</b>	<b>\$ 2,765,609</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**BALANCE SHEET**  
**GOVERNMENTAL FUNDS**  
June 30, 2012

	<u>General</u>	<u>State Street Aid Fund</u>	<u>Total Governmental Funds</u>
<b>ASSETS</b>			
Unrestricted current assets			
Cash in banks	\$ 40,537	\$ 5,230	\$ 45,767
Taxes receivable, net	135,888	--	135,888
Accounts receivable, net	6,555	--	6,555
Other taxes receivable	14,002	2,804	16,806
Other receivable	6,000	--	6,000
Due from other funds	228,887	5,883	234,770
<b>Total assets</b>	<b>\$ 431,869</b>	<b>\$ 13,917</b>	<b>\$ 445,786</b>
<b>LIABILITIES AND FUND BALANCE</b>			
Current liabilities			
Accounts payable	\$ 23,199	\$ --	\$ 23,199
Other accrued liabilities	3,707	--	3,707
Due to other funds	150,362	53,660	204,022
Deferred revenue - property tax	135,888	--	135,888
Total current liabilities	313,156	53,660	366,816
<b>Total liabilities</b>	<b>313,156</b>	<b>53,660</b>	<b>366,816</b>
Fund balance (deficit)			
Assigned			
Sanitation	20,298	--	20,298
Unassigned	98,415	(39,743)	58,672
<b>Total fund balance</b>	<b>118,713</b>	<b>(39,743)</b>	<b>78,970</b>
<b>Total liabilities and fund balance</b>	<b>\$ 431,869</b>	<b>\$ 13,917</b>	<b>\$ 445,786</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS**  
**TO THE STATEMENT OF NET ASSETS**  
June 30, 2012

Amounts reported for governmental activities in the statement of net assets are different because:

Total Fund Balance of Governmental Funds	\$ 78,970
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	722,057
Receivables not available to pay for current expenditures and, therefore, are deferred in the funds	26,364
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds.	<u>(239,180)</u>
Net Assets of Governmental Activities	<u>\$ 588,211</u>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES**  
**IN FUND BALANCES (DEFICITS) - GOVERNMENTAL FUNDS**  
For the year ended June 30, 2012

	<u>General Fund</u>	<u>State Street Aid Fund</u>	<u>Total Governmental Funds</u>
<b>Revenues</b>			
Taxes	\$ 169,594	\$ --	\$ 169,594
Licenses and permits	1,928	--	1,928
Intergovernmental revenue	81,655	17,239	98,894
Charges for services	47,037	--	47,037
Fines, forfeitures and penalties	591	--	591
Other revenues	14,801	--	14,801
<b>Total revenues</b>	<b>315,606</b>	<b>17,239</b>	<b>332,845</b>
<b>Expenditures</b>			
General government	69,967	--	69,967
Public safety	72,379	--	72,379
Highways and streets	41,371	20,535	61,906
Industrial park	2,630	--	2,630
Recreation	1,833	--	1,833
Sanitation	44,875	--	44,875
<b>Total expenditures</b>	<b>233,055</b>	<b>20,535</b>	<b>253,590</b>
<b>Excess (deficit) of revenues over (under) expenditures before other financing sources</b>	<b>82,551</b>	<b>(3,296)</b>	<b>79,255</b>
<b>Other financing sources (uses)</b>			
Debt service	(70,690)	--	(70,690)
<b>Net change in fund balance</b>	<b>11,861</b>	<b>(3,296)</b>	<b>8,565</b>
Fund balance (deficit) - July 1, 2011	106,852	(36,447)	70,405
<b>Fund balance (deficit) - June 30, 2012</b>	<b>\$ 118,713</b>	<b>\$ (39,743)</b>	<b>\$ 78,970</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND**  
**CHANGES IN FUND BALANCES (DEFICITS) OF GOVERNMENTAL FUNDS**  
**TO THE STATEMENT OF ACTIVITIES**  
For the year ended June 30, 2012

Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balance (deficits) of governmental funds	\$ 8,565
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlay in the current period.	(33,303)
Some taxes will not be collected for several months after the City's fiscal year ends; therefore, they are not considered "available" revenues in the governmental funds. Deferred revenues decreased by this amount this year.	(2,190)
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of long-term debt consumes financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.	53,723
Change in Net Assets of Governmental Activities	<u>\$ 26,795</u>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**GENERAL FUND**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES**  
**IN FUND BALANCE - BUDGET AND ACTUAL**  
For the year ended June 30, 2012

	Original Budget	Final Budget	Actual	Over (Under) Budget
<b>Revenues</b>				
<b>Taxes</b>				
Real estate taxes	\$ 110,000	\$ 110,000	\$ 114,349	\$ 4,349
Penalties and interest	3,000	3,000	3,983	983
Local county sales tax	25,000	25,000	33,071	8,071
Local beer tax	18,000	18,000	18,191	191
<i>Total taxes</i>	<u>156,000</u>	<u>156,000</u>	<u>169,594</u>	<u>13,594</u>
<b>Licenses and Permits</b>				
Gross receipts privilege licenses	1,430	1,430	1,928	498
<b>Intergovernmental Revenues</b>				
State of Tennessee income tax	100	100	4	(96)
State of Tennessee beer tax	350	350	328	(22)
State of Tennessee sales tax	40,000	40,000	46,232	6,232
State of Tennessee street maintenance	1,300	1,300	1,366	66
State of Tennessee business tax	2,100	2,100	4,130	2,030
State of Tennessee excise tax	3,500	3,500	3,873	373
State of Tennessee TVA replacement tax	6,700	6,700	7,723	1,023
City/County fire protection	10,000	10,000	13,000	3,000
Grant proceeds	5,000	5,000	4,999	(1)
<i>Total intergovernmental revenues</i>	<u>69,050</u>	<u>69,050</u>	<u>81,655</u>	<u>12,605</u>
<b>Fines, Forfeitures and Penalties</b>				
Fines and cost	210	210	591	381
<b>Miscellaneous Revenues</b>				
Cablecom franchise fee	3,600	3,600	3,928	328
Rent	3,200	3,200	1,200	(2,000)
Interest earnings	200	200	72	(128)
Miscellaneous revenues	5,550	5,550	9,560	4,010
<i>Total miscellaneous revenues</i>	<u>12,550</u>	<u>12,550</u>	<u>14,760</u>	<u>2,210</u>
<b>Total revenues</b>	<u>239,240</u>	<u>239,240</u>	<u>268,528</u>	<u>29,288</u>
<b>Expenditures</b>				
<b>General Government</b>				
Salaries	51,559	51,559	8,402	(43,157)
Payroll taxes	12,800	12,800	5,767	(7,033)
Utilities and telephone	7,750	7,750	7,887	137
Professional fees	4,500	4,500	4,192	(308)
General insurance and bonds	17,500	17,500	(5,316)	(22,816)
Dues and subscriptions	1,125	1,125	929	(196)
Office equipment	4,000	4,000	16,128	12,128
Employee benefits	27,700	27,700	26,918	(782)
Miscellaneous expense	6,150	6,150	5,060	(1,090)
<i>Total general government</i>	<u>133,084</u>	<u>133,084</u>	<u>69,967</u>	<u>(63,117)</u>

The notes to the financial statements are an integral part of this statement.

**CITY OF FRIENDSHIP, TENNESSEE**  
**GENERAL FUND**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES**  
**IN FUND BALANCE - BUDGET AND ACTUAL**  
For the year ended June 30, 2012

	Original Budget	Final Budget	Actual	Over (Under) Budget
<b>Police Administration</b>				
Salaries	39,000	39,000	39,146	146
Automobile expense	1,000	1,000	373	(627)
Radio services	619	619	1,138	519
Uniforms	50	50	--	(50)
Equipment expense	2,250	2,250	6,254	4,004
Utilities	8,750	8,750	8,853	103
Drug fund expense	150	150	--	(150)
Grant expense	2,900	2,900	(108)	(3,008)
Miscellaneous	1,314	1,314	975	(339)
<i>Total police administration</i>	<u>56,033</u>	<u>56,033</u>	<u>56,631</u>	<u>598</u>
<b>Fire Department</b>				
Utilities	2,200	2,200	2,281	81
Truck expense	200	200	10	(190)
Gasoline, diesel and oil	--	--	1,586	1,586
Repairs and maintenance	1,750	1,750	86	(1,664)
Insurance	500	500	1,322	822
Supplies	500	500	387	(113)
Capital outlay	--	--	9,000	9,000
Miscellaneous	2,000	2,000	1,076	(924)
<i>Total fire department administration</i>	<u>7,150</u>	<u>7,150</u>	<u>15,748</u>	<u>8,598</u>
<b>Highways and Streets</b>				
Salaries	73,985	73,985	34,200	(39,785)
Equipment	900	900	806	(94)
Repairs and maintenance	5,000	5,000	4,954	(46)
Debt service	5,300	5,300	--	(5,300)
Miscellaneous	650	650	1,411	761
<i>Total highways and streets</i>	<u>85,835</u>	<u>85,835</u>	<u>41,371</u>	<u>(44,464)</u>
<b>Industrial Park</b>				
Debt service	--	--	--	--
Miscellaneous	650	650	2,630	1,980
<i>Total industrial park</i>	<u>650</u>	<u>650</u>	<u>2,630</u>	<u>1,980</u>
<b>Recreation</b>				
Utilities	300	300	352	52
Repair and maintenance	50	50	1,481	1,431
<i>Total recreation</i>	<u>350</u>	<u>350</u>	<u>1,833</u>	<u>1,483</u>
<b>Total expenditures</b>	<u>283,102</u>	<u>283,102</u>	<u>188,180</u>	<u>(94,922)</u>
<b>Excess (deficit) of revenues over (under) expenditures</b>	<b>(43,862)</b>	<b>(43,862)</b>	<b>80,348</b>	<b>124,210</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**GENERAL FUND**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES**  
**IN FUND BALANCE - BUDGET AND ACTUAL**  
For the year ended June 30, 2012

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Other financing sources (uses)				
Debt service	(15,000)	(15,000)	(70,690)	(55,690)
<b>    Net change in fund balance</b>	<b>(58,862)</b>	<b>(58,862)</b>	<b>9,658</b>	<b>68,520</b>
Fund balance - July 1, 2011	88,757	88,757	88,757	--
<b>Fund balance - June 30, 2012</b>	<b>\$ 29,895</b>	<b>\$ 29,895</b>	<b>\$ 98,415</b>	<b>\$ 68,520</b>
Reconciliation to fund financial statements:				
Excess (deficit) of revenues and other financing sources over (under) expenditures and other financing uses - budgetary			\$ 9,658	
Revenues and expenditures not included in budgetary statements:				
Sanitation - revenues			47,078	
Sanitation - expenditure			(44,875)	
Net change in fund balance - (page 13)			<u>\$ 11,861</u>	
Fund balance - budgetary			\$ 98,415	
Assets related to sanitation operations			36,616	
Liabilities related to sanitation operation			(16,318)	
Fund balance - June 30, 2012 (page 13)			<u>\$ 118,713</u>	

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**STATE STREET AID**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES**  
**IN FUND BALANCE - BUDGET AND ACTUAL**  
For the year ended June 30, 2012

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
<b>Revenues</b>				
<i><b>Intergovernmental Revenues</b></i>				
State of Tennessee gasoline and motor fuel tax	\$ 12,300	\$ 12,300	\$ 11,799	\$ (501)
State of Tennessee gasoline 3 cent	3,600	3,600	3,535	(65)
State of Tennessee gasoline 1989	2,000	2,000	1,905	(95)
<b>Total revenue</b>	<b>17,900</b>	<b>17,900</b>	<b>17,239</b>	<b>(661)</b>
<b>Expenditures</b>				
Street lighting	11,000	11,000	13,350	2,350
Street equipment	6,000	6,000	6,423	423
Materials	500	500	588	88
Repair and maintenance	--	--	174	174
<b>Total expenditures</b>	<b>17,500</b>	<b>17,500</b>	<b>20,535</b>	<b>3,035</b>
<b>Net change in fund balance</b>	<b>400</b>	<b>400</b>	<b>(3,296)</b>	<b>(3,696)</b>
Fund deficit - July 1, 2011	(36,447)	(36,447)	(36,447)	--
<b>Fund deficit - June 30, 2012</b>	<b>\$ (36,047)</b>	<b>\$ (36,047)</b>	<b>\$ (39,743)</b>	<b>\$ (3,696)</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**STATEMENT OF NET ASSETS**  
**PROPRIETARY FUNDS**  
June 30, 2012

	Gas Department Fund	Sewer System Fund	Water Department Fund	Total
<b>ASSETS</b>				
Current assets:				
Cash in bank	\$ 15,043	\$ 6,958	\$ 7,276	\$ 29,277
Accounts receivable (net)	5,806	9,076	11,924	26,806
Due from other funds	278,735	500	23,200	302,435
Inventory	5,509	2,345	18,725	26,579
Total current assets	<u>305,093</u>	<u>18,879</u>	<u>61,125</u>	<u>385,097</u>
Noncurrent assets:				
Capital assets (net of accumulated depreciation):				
Land easements	430	4,820	11,500	16,750
Utility plant in service	162,250	1,539,322	771,132	2,472,704
Total capital assets	<u>162,680</u>	<u>1,544,142</u>	<u>782,632</u>	<u>2,489,454</u>
<b>Total assets</b>	<b><u>467,773</u></b>	<b><u>1,563,021</u></b>	<b><u>843,757</u></b>	<b><u>2,874,551</u></b>
<b>LIABILITIES AND NET ASSETS</b>				
Liabilities				
Accounts payable	--	--	20,559	20,559
Sales tax payable	(213)	--	(165)	(378)
Due to other funds	18,533	205,385	109,265	333,183
Accrued interest payable	3,154	--	4,066	7,220
Customer deposits	18,719	19,852	--	38,571
Total current liabilities	<u>40,193</u>	<u>225,237</u>	<u>133,725</u>	<u>399,155</u>
Noncurrent liabilities				
Due within one year	--	31,000	18,750	49,750
Due in more than one year	--	214,973	33,275	248,248
Total noncurrent liabilities	<u>--</u>	<u>245,973</u>	<u>52,025</u>	<u>297,998</u>
<b>Total liabilities</b>	<b><u>40,193</u></b>	<b><u>471,210</u></b>	<b><u>185,750</u></b>	<b><u>697,153</u></b>
Net assets				
Invested in capital assets, net of related debt	162,680	1,298,169	730,607	2,191,456
Unrestricted	264,900	(206,358)	(72,600)	(14,058)
<b>Total net assets</b>	<b><u>\$ 427,580</u></b>	<b><u>\$ 1,091,811</u></b>	<b><u>\$ 658,007</u></b>	<b><u>\$ 2,177,398</u></b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS**  
**PROPRIETARY FUNDS**

For the year ended June 30, 2012

	Gas Department Fund	Sewer System Fund	Water Department Fund	Total
<b>Operating Revenues</b>				
Sale of water	\$ --	\$ --	\$ 123,055	\$ 123,055
Sale of gas	226,029	--	--	226,029
Sewer fees	--	108,103	--	108,103
Late charges	10,326	--	--	10,326
Miscellaneous revenues	821	750	1,670	3,241
<b>Total revenues</b>	<b>237,176</b>	<b>108,853</b>	<b>124,725</b>	<b>470,754</b>
<b>Operating Expenses</b>				
Salaries	60,607	13,995	8,612	83,214
Gas and water purchased	79,162	--	78,865	158,027
Operation and maintenance	14,329	20,903	22,306	57,538
Utilities	--	16,232	--	16,232
Supplies	--	8,806	--	8,806
Depreciation	5,874	49,301	31,084	86,259
Professional fees	15,321	650	6,123	22,094
Insurance	15,000	5,000	5,000	25,000
Truck and equipment expenses	26,530	--	3,158	29,688
Office supplies and expense	6,605	--	--	6,605
Miscellaneous	2,776	7,970	3,307	14,053
Data processing	14,000	--	--	14,000
Travel	--	--	90	90
<b>Total operating expenses</b>	<b>240,204</b>	<b>122,857</b>	<b>158,545</b>	<b>521,606</b>
<b>Operating income (loss)</b>	<b>(3,028)</b>	<b>(14,004)</b>	<b>(33,820)</b>	<b>(50,852)</b>
<b>Non-Operating Revenues (Expenses)</b>				
Interest Income	123	26	33	182
Interest Expense	--	(16,001)	(3,677)	(19,678)
<b>Total non-operating revenues (expenses)</b>	<b>123</b>	<b>(15,975)</b>	<b>(3,644)</b>	<b>(19,496)</b>
<b>Change in net assets</b>	<b>(2,905)</b>	<b>(29,979)</b>	<b>(37,464)</b>	<b>(70,348)</b>
Net assets - July 1, 2011	430,485	1,121,790	695,471	2,247,746
<b>Net assets - June 30, 2012</b>	<b>\$ 427,580</b>	<b>\$ 1,091,811</b>	<b>\$ 658,007</b>	<b>\$ 2,177,398</b>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**STATEMENT OF CASH FLOWS**  
**PROPRIETARY FUNDS**  
For the year ended June 30, 2012

	Gas Department Fund	Sewer System Fund	Water Department Fund	Total
<b>Cash flows from operating activities</b>				
Cash received from customers	\$ 200,942	\$ 109,057	\$ 125,322	\$ 435,321
Cash payments to suppliers	(166,508)	(49,042)	(95,327)	(310,877)
Cash payments to employees for services	(60,607)	(13,995)	(8,612)	(83,214)
Net cash provided (used) by operating activities	<u>(26,173)</u>	<u>46,020</u>	<u>21,383</u>	<u>41,230</u>
<b>Cash flows from non-capital financing activities</b>				
Decrease in advances to other funds	<u>28,767</u>	<u>--</u>	<u>--</u>	<u>28,767</u>
<b>Cash flows from capital and related financing activities</b>				
Payments on principal of long-term debt	--	(31,000)	(18,750)	(49,750)
Interest payments on long-term debt	--	(16,001)	(3,677)	(19,678)
Net cash provided (used) by capital and related financing activities	<u>--</u>	<u>(47,001)</u>	<u>(22,427)</u>	<u>(69,428)</u>
<b>Cash flows from investing activities</b>				
Interest received	<u>123</u>	<u>26</u>	<u>33</u>	<u>182</u>
Net increase (decrease) in cash and cash equivalents	2,717	(955)	(1,011)	751
Cash and cash equivalents - July 1, 2011	<u>12,326</u>	<u>7,913</u>	<u>8,287</u>	<u>28,526</u>
<b>Cash and cash equivalents - June 30, 2012</b>	<u><b>\$ 15,043</b></u>	<u><b>\$ 6,958</b></u>	<u><b>\$ 7,276</b></u>	<u><b>\$ 29,277</b></u>
<b>Cash flows from operating activities</b>				
Operating income (loss)	\$ (3,028)	\$ (14,004)	\$ (33,820)	\$ (50,852)
<i>Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities</i>				
Depreciation	5,874	49,301	31,084	86,259
(Increase) decrease in accounts receivable	4,981	204	597	5,782
(Increase) decrease in due from other funds	(41,215)	--	--	(41,215)
Increase (decrease) in accounts payable	--	--	20,560	20,560
Increase (decrease) in due to other funds	5,566	8,494	3,112	17,172
Increase in sales tax payable	(2)	--	(150)	(152)
Decrease in customer deposits	1,651	2,025	--	3,676
Total adjustments	<u>(23,145)</u>	<u>60,024</u>	<u>55,203</u>	<u>92,082</u>
Net cash provided (used) by operating activities	<u><b>\$ (26,173)</b></u>	<u><b>\$ 46,020</b></u>	<u><b>\$ 21,383</b></u>	<u><b>\$ 41,230</b></u>

*The notes to the financial statements are an integral part of this statement.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2012

**NOTE 1 - Summary of Significant Accounting Policies**

The City of Friendship, Tennessee, accounts for its financial position and results of operations in accordance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant accounting policies of the City are described below.

**A. Reporting Entity**

The City's financial statements include the accounts of all City operations. The criteria for including organizations as component units within the City's reporting entity, as set forth in Section 2100 of GASB's Codification of Governmental Accounting and Financial Reporting Standards, include whether:

- the organization is legally separate (can sue and be sued in their own name)
- the City holds the corporate powers of the organization
- the City appoints a voting majority of the organization's board
- the City is able to impose its will on the organization
- the organization has the potential to impose a financial benefit/burden on the City
- there is fiscal dependency by the organization on the City

Based on the aforementioned criteria, the City of Friendship has no component units.

**B. Government-wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

**CITY OF FRIENDSHIP, TENNESSEE**  
**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2012

**C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and the fiduciary fund financial statements. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flow. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

In general, taxes, licenses, federal and state grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The City reports the following major governmental funds:

The general fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The state street aid fund accounts for the activities of the government's highways and street operations.

The City reports the following major proprietary funds:

The gas department fund accounts for the activities associated with the government's gas distribution operations.

The water department fund accounts for the activities associated with the water distribution system.

The sewer system fund accounts for the activities associated with the City's collection, transportation, treatment and disposal of wastewater.

The financial statements of the City are prepared in accordance with generally accepted accounting principles. The City's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The City's reporting entity does not apply FASB pronouncements issued after November 30, 1989.

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As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of tax and other charges between the government's utility divisions and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principle ongoing operations. The principle operating revenues of all of the City's enterprise funds are charges to customers for sales and services. The water and sewer fund also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the systems. The utility funds recognize income based on cycle billings. This results in recognizing as income the water usage through each respective cycle each month, which may not coincide with the last day of the fiscal year. Non-recognition of income from water sales as a result of cycle billing is a common industry practice. Operating expenses for the proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The cost of purchased water is accrued based on the final meter reading of the fiscal year. This may result in unrecognized expenses for the period between the final billing and the end of the fiscal year. This practice is consistent with industry guidelines and does not differ significantly from generally accepted accounting principles.

#### **D. Assets, Liabilities and Net Assets or Equity**

##### ***Deposits and Investments***

The City considers all temporary cash investments with an original maturity of three months or less to be cash equivalents.

State statutes authorize the City to invest in certificates of deposit, obligations of the U.S. Treasury, agencies and instrumentalities, obligations guaranteed by the U.S. Government or its agencies, repurchase agreements and the state's investment pool.

##### ***Receivables and Payables***

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

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Property taxes are levied in October of each year and attach as an enforceable lien on property as of March 1 after the year assessed. The City is permitted by the Municipal Finance Law of the State to levy taxes up to \$2 per \$100 of assessed valuation for general government services. The City's property tax rate is \$1.86. The City bills and collects its own property taxes, and tax revenues are recognized when levied to the extent that they result in current receivables.

***Inventories***

Inventory records are not maintained on a perpetual basis. The City takes a physical inventory at fiscal year-end, which is recorded at cost using the first-in/first-out (FIFO) method.

***Capital Assets***

Capital assets, including property, plant, vehicles, equipment, infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) and construction in progress are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 for building, equipment and machinery. Such assets are recorded at cost except for assets obtained prior to the physical inventory taken during the fiscal year ended June 30, 1975. Assets obtained prior to this physical inventory are recorded at actual or estimated historical cost.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. For the year under examination, there was no interest costs capitalized.

Capital assets are depreciated over the following useful lives:

Buildings	39 years
Equipment	5 - 10 years
Infrastructure	20 years
Plant	40 - 50 years

***Compensated Absences***

The City has established vacation and sick leave policies according to which a full-time employee is awarded a day of vacation and one-half day of sick leave for each month worked in each calendar year. This results in each employee being allowed twelve working days vacation and six working days sick leave each year. Unused vacation time may be accumulated and carried forward up to a maximum of twenty days, while unused sick leave may be accumulated and carried forward without limit. No accrual has been made for these compensated absences as of June 30, 2012.

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***Long-term Obligations***

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets.

***Fund Balance***

Effective July 1, 2010, the City adopted the provisions of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. The objective of the statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying governmental fund type definitions.

As prescribed by GASB Statement No. 54, governmental funds report fund balance in classifications based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the funds can be spent. Fund balance for governmental funds can consist of the following:

**Nonspendable fund balance**

This classification includes amounts that are (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, for example: inventories, prepaid amounts, and long-term notes receivable.

**Restricted fund balance**

This classification includes amounts that are restricted for specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Restrictions may effectively be changed or lifted with the consent of resource providers.

**Committed fund balance**

This classification includes amounts that can only be used for the specific purposes determined by a formal action of the Town's highest level of decision-making authority, the Board of Alderman of the City of Friendship. Commitments may be changed or lifted only by the City taking the same formal action that imposed the constraint originally (for example: resolution).

**Assigned fund balance**

This classification includes amounts intended to be used by the City for specific purposes that are neither restricted nor committed. The Board and its designees (of which there are none) have the authority to assign amounts to be used for specific purposes. Assigned amounts also include all residual amounts in governmental funds (except negative amounts) that are not classified as nonspendable, restricted, or committed.

**Unassigned fund balance**

This fund balance is the residual classification for the General Fund. It is also used to report negative fund balances in other governmental funds.

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In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, fund balance is depleted in the order of restricted, committed, assigned, and unassigned.

***Use of 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.

**NOTE 2 – Reconciliation of Government-Wide and Fund Financial Statements**

**A. Explanation of Certain Differences between the Governmental Fund Balance Sheet and the Government-wide Statement of Net Assets**

The governmental fund balance sheet includes reconciliation between fund equity – total governmental funds and net assets – governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that “capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.” The details of the \$722,057 difference are as follows:

Governmental funds capital assets	\$ 1,331,756
Less: Accumulated depreciation	<u>(609,699)</u>
 Net adjustment to increase fund equity -- total governmental funds to arrive at net assets -- governmental activities	 \$ <u>722,057</u>

**B. Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities**

The governmental fund statement of revenues, expenditures, and changes in fund equity includes a reconciliation between net changes in fund equity – total governmental funds and changes in net assets of governmental activities as reported in the government-wide statement of activities. One element of that reconciliation explains that “governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlay in the current period.” The details of this \$(33,303) difference are as follows:

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Capital outlay	\$ 9,000
Depreciation expense	<u>(42,303)</u>
Net adjustment to decrease net changes in fund equity -- total governmental funds to arrive at changes in net assets of governmental activities	<u>\$ (33,303)</u>

Another element of that reconciliation explains that “the issuance of long-term debt provides current financial resources to governmental funds, while the repayment of long-term debt consumes financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities.” The details of this \$53,723 difference are as follows:

Payments on long-term debt	\$ 53,723
Loan proceeds	<u>-</u>
Net adjustment to increase net changes in fund equity -- total governmental funds to arrive at changes in net assets of governmental activities	<u>\$ 53,723</u>

**NOTE 3 – Stewardship, Compliance and Accountability**

**A. Budgetary Information**

Municipalities are required by state statute to adopt budgets for the general fund and special revenue funds. The City utilizes the following procedures in establishing the budgetary data reflected in the financial statements:

1. The Mayor is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the Board of Aldermen.
2. Formal budgetary integration is employed as a management control device during the year for the general and special revenue funds.
3. Budgets for the general and special revenue funds are adopted on a basis consistent with generally accepted accounting principles (GAAP).
4. The City’s policy is to not allow expenditures to exceed budgetary amounts at the total fund expenditure level without obtaining additional appropriation approval from the Board of Aldermen. This policy reflects the legal level of control at which expenditures may not exceed appropriations.

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Under TCA 68-211-874, the City is required to account for its solid waste activities in a separate fund. The City accounts for these activities in a separate sanitation fund which does not qualify as a special revenue fund under generally accepted accounting principles. Accordingly, for fund reporting, the sanitation fund is included as part of the general fund. Page 17 includes a reconciliation of the general fund budgetary reporting to the general fund reporting on page 13 under generally accepted accounting principles.

**B. Excess of Expenditures over Appropriations**

For the year ended June 30, 2012, expenditures exceeded appropriations in the state street aid fund by \$3,035.

**C. Deficit Fund Equity**

The State Street Aid fund had a deficit fund balance of \$39,743.

**NOTE 4 – Detailed Notes on All Funds**

**A. Deposits and Invested Funds**

*Custodial Credit Risk* – The City's policies limit deposits and investments to those instruments allowed by applicable state laws as described in Note 1. State statute required that all deposits with financial institutions must be collateralized by securities whose market value is equal to 105% of the value of uninsured deposits. The deposits must be insured by federal depository insurance or the Tennessee Bank Collateral Pool, or collateralized by collateral held by the City's agent in the City's name, or by the Federal Reserve Banks acting as third party agents. State statutes also authorize the City to invest in bonds, notes or treasury bills of the United States or any of its agencies, certificates of deposit at Tennessee state chartered banks and savings and loan associations and federally chartered banks and savings and loan associations, repurchase agreements utilizing obligations of the United States or its agencies as the underlying securities, the state pooled investment fund, and mutual funds. Statutes also require that securities underlying repurchase agreements must have a market value at least equal to the amount of funds invested in the repurchase transaction. As of June 30, 2012, all bank deposits were fully collateralized or insured.

**B. Receivables**

Receivables as of June 30, 2012 for the City's individual major funds and nonmajor funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

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	General	State Street Aid	Gas Department	Sewer System	Water Department	Total
Receivables:						
Property taxes	\$ 135,888	\$ --	\$ --	\$ --	\$ --	\$ 135,888
Accounts	6,555	--	18,893	9,076	11,924	46,448
Other taxes	14,002	2,804	--	--	--	16,806
Other	6,000	--	--	--	--	6,000
Gross receivables	<u>162,445</u>	<u>2,804</u>	<u>18,893</u>	<u>9,076</u>	<u>11,924</u>	<u>205,142</u>
Less: Allowance for doubtful accounts	--	--	(13,087)	--	--	(13,087)
Net receivables	<u>\$ 162,445</u>	<u>\$ 2,804</u>	<u>\$ 5,806</u>	<u>\$ 9,076</u>	<u>\$ 11,924</u>	<u>\$ 192,055</u>

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue reported in the governmental funds were as follows:

Property taxes receivable - unavailable      \$ 135,888

**C. Capital Assets**

Capital asset activity for the year ended June 30, 2012 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental activities:				
Capital assets, not being depreciated				
Land	\$ 73,214	\$ -	\$ -	\$ 73,214
Capital assets, being depreciated				
Buildings	133,628	-	-	133,628
Infrastructure	528,308	-	-	528,308
Equipment	587,606	9,000	-	596,606
Total capital assets, being depreciated	<u>1,249,542</u>	<u>9,000</u>	<u>-</u>	<u>1,258,542</u>
Less accumulated depreciation for:				
Buildings	79,953	1,731	-	81,684
Infrastructure	-	26,415	-	26,415
Equipment	487,443	14,157	-	501,600
Total accumulated depreciation	<u>567,396</u>	<u>42,303</u>	<u>-</u>	<u>609,699</u>
Total capital assets being depreciated, net	<u>682,146</u>	<u>(33,303)</u>	<u>-</u>	<u>648,843</u>
Governmental activities capital assets, net	<u>\$ 755,360</u>	<u>\$ (33,303)</u>	<u>\$ -</u>	<u>\$ 722,057</u>

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	Beginning Balance	Increases	Decreases	Ending Balance
Business-type activities:				
Capital assets, not being depreciated				
Land	\$ 16,750	\$ --	\$ --	\$ 16,750
Capital assets, being depreciated				
Equipment	77,955	--	--	77,955
Organization	16,262	--	--	16,262
Gas plant in operation	383,387	--	--	383,387
Water plant in operation	1,236,720	--	--	1,236,720
Sewer plant in operation	2,457,436	--	--	2,457,436
Total capital assets, being depreciated	<u>4,171,760</u>	<u>--</u>	<u>--</u>	<u>4,171,760</u>
Less accumulated depreciation for:				
Equipment	77,955	--	--	77,955
Organization	7,992	406	--	8,398
Gas plant in operation	217,626	5,762	--	223,388
Water plant in operation	440,413	30,790	--	471,203
Sewer plant in operation	868,811	49,301	--	918,112
Total accumulated depreciation	<u>1,612,797</u>	<u>86,259</u>	<u>--</u>	<u>1,699,056</u>
Total capital assets, being depreciated, net	<u>2,558,963</u>	<u>(86,259)</u>	<u>--</u>	<u>2,472,704</u>
Business-type activities capital assets, net	<u>\$ 2,575,713</u>	<u>\$ (86,259)</u>	<u>\$ --</u>	<u>\$ 2,489,454</u>

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities	
General	\$ 3,825
Public safety	4,090
Parks	7,973
Highways and streets	26,415
Total depreciation expense - governmental activities	<u>\$ 42,303</u>
Business-type activities:	
Gas department	\$ 5,874
Sewer system	49,301
Water department	31,084
Total depreciation expense - business - type activities	<u>\$ 86,259</u>

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**D. Interfund receivables, payables, and transfers**

The composition of interfund balances as of June 30, 2012, is as follows:

Due to / from other funds	Fund Due From	Fund Due to	Amount
	General (major)	Gas Department (major)	\$ 150,362
	State Street Aid (major)	General (major)	53,160
	State Street Aid (major)	Sewer System (major)	500
	Water Department (major)	General (major)	43,949
	Water Department (major)	State Street Aid (major)	4,883
	Water Department (major)	Gas Department (major)	60,433
	Gas Department (major)	State Street Aid (major)	1,000
	Gas Department (major)	General (major)	17,533
	Sewer System (major)	General (major)	109,245
	Sewer System (major)	Water Department (major)	23,200
	Sewer System (major)	General (major)	5,000
	Sewer System (major)	Gas Department (major)	67,940
	<b>Total</b>		<u><u>\$ 537,205</u></u>

The outstanding balances due from Gas Department to other funds are due to timing differences between the dates utilities are billed and the payments between funds are made and the City expects these balances to be repaid within the next fiscal year. Other outstanding balances developed as a result of shortfalls in operations during current and prior years. The City continues to explore ways to repay these balances in a timely manner.

**E. Leases**

The City of Friendship entered into a lease agreement with CableOne for a tract of land to be used by the lessee for the erection and maintenance of a cable television tower and related facilities. The lease was effective October 14, 2004, and terminates October 14, 2019. In consideration of the lease the lessee agrees to pay the City a sum equal to five percent of lessee's gross annual receipts per year. The amount shall be payable quarterly and no later than the 20<sup>th</sup> of the month following the end of the quarter. The agreement states that renewals shall be accomplished as provided for in Federal law and regulations.

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**F. Long-Term Debt**

Governmental Activities:

General Fund

Note payable, Farmers Home Administration – payable to Farmers Home Administration for improvements made to the Industrial Park. This note is being paid in semi-annual installments of \$1,742 including interest of 5.00%. The balance of this note at June 30, 2012, was \$25,942.

Note payable, Bank of Friendship – payable to Bank of Friendship for improvements made in Downtown Renovation. This note is being paid in two annual installments of \$6,667 in 2012 and \$73,333 in 2013 plus interest of 5.75%. The balance of this note at June 30, 2012, was \$73,333.

Note payable, Bank of Friendship – payable to Bank of Friendship for improvements made in Downtown Renovation. This note is being paid in annual installments of \$5,264 plus interest of 4.50%. The balance of this note at June 30, 2012, was \$41,609.

Note payable, Bank of Crockett – payable to Bank of Crockett for improvements made in Downtown Renovation. This note is being paid in annual installments of \$52,000 plus interest of 5.75%. The balance of this note at June 30, 2012, was \$98,296.

Business Activities:

Sewer System Fund

Bonds payable of \$300,000 were issued to complete financing for the sewer plant which was placed in service May 1, 1982. It is to be paid in six annual installments of \$10,000 beginning January 1, 2004, seven annual installments of \$15,000 beginning January 1, 2010, four annual installments of \$20,000 beginning January 1, 2017. Interest is also payable annually at 5%. The balance of this payable at June 30, 2012, was \$140,000.

Note payable to the Clayton Bank and Trust for sewer system improvements. The original note was dated May 24, 2004 in the amount of \$72,000 and required two annual installments of \$6,000 plus interest of 3.95% with a maturity date of May 24, 2007. This note was renewed as of June 22, 2007 in the amount of \$35,556 and requires four annual principal payments of \$6,000 and interest at 5.95% per annum with a maturity date of May 24, 2016. The balance of this note at June 30, 2012, was \$29,556.

Note payable to the Clayton Bank and Trust for sewer system improvements. The original note was dated September 30, 2005 in the amount of \$48,000 and required annual installments of \$4,000 including interest of 4.50% with a maturity date of September 30, 2014. The balance of this note at June 30, 2012, was \$28,417.

Note payable to the Clayton Bank and Trust for sewer system improvements. The original note was dated May 9, 2008 in the amount of \$72,000 and required two annual installments of \$6,000 plus interest of 5.11% with a maturity date of May 1, 2014. The balance of this note at June 30, 2012, was \$48,000.

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Water Department Fund

Capital outlay note payable to Bank of Friendship for water system improvements. The original note was dated March 19, 2002, for \$225,000 with an interest rate of 4.25%. The note was renewed March 2011 for \$70,775 and requires two annual installments of \$18,750 including interest of 5.11% with a maturity date of March 19, 2014. The balance of this note at June 30, 2012, was \$52,025.

The following is a summary of total future debt service requirements for the City:

Year ending June 30,	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2013	\$ 125,285	\$ 13,013	\$ 49,750	\$ 14,417
2014	57,816	4,374	120,692	11,865
2015	6,146	2,602	21,000	5,813
2016	6,436	2,312	26,556	4,706
2017	6,739	2,009	20,000	3,500
2018-2022	36,758	4,959	60,000	4,500
	<u>\$ 239,180</u>	<u>\$ 29,269</u>	<u>\$ 297,998</u>	<u>\$ 44,801</u>

**Changes in Long-Term Liabilities**

Long-term liability activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities:</b>					
Farmers Home Administration	\$ 28,050	\$ --	\$ 2,108	\$ 25,942	\$ 2,214
Bank of Friendship	80,000	--	6,667	73,333	73,333
Bank of Friendship	44,853	--	3,244	41,609	3,390
Bank of Crockett	140,000	--	41,704	98,296	46,348
Totals	<u>\$ 292,903</u>	<u>\$ --</u>	<u>\$ 53,723</u>	<u>\$ 239,180</u>	<u>\$ 125,285</u>
<b>Business-type Activities:</b>					
Bank of Friendship - Water	\$ 70,775	\$ --	\$ 18,750	\$ 52,025	\$ 18,750
1980 Revenue Bond - Sewer	155,000	--	15,000	140,000	15,000
Clayton Bank and Trust - Sewer	54,000	--	6,000	48,000	6,000
Clayton Bank and Trust - Sewer	35,556	--	6,000	29,556	6,000
Clayton Bank and Trust - Sewer	32,417	--	4,000	28,417	4,000
Totals	<u>\$ 347,748</u>	<u>\$ --</u>	<u>\$ 49,750</u>	<u>\$ 297,998</u>	<u>\$ 49,750</u>

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**NOTE 5 – Other Information**

**A. Risk Management**

The City joined the Tennessee Municipal League Management Pool, which is a public entity risk pool established to provide insurance coverage to local governments in Tennessee. The City pays an annual premium to the pool for workmen's compensation insurance. The creation of Tennessee Municipal League Management Pool provides for it to be self-sustaining through member premiums. Tennessee Municipal League Management Pool reinsures through commercial insurance companies for claims in excess of \$130,000 for each insured event. The City continues to carry commercial insurance for all other risks of loss through Hughes Insurance Service, which is also a public entity risk pool. These risks include automobile liability, property insurance, comprehensive general liability and public officials' liability. Settled claims from these losses have not exceeded commercial insurance coverage in any of the past three fiscal years and there has been no significant reductions in coverage.

**B. Commitments**

On November 16, 1989, the City of Friendship agreed with Friendship Water Company (a private company) to buy a distribution system and three tracts of land from the Company for \$13,500. The City also agreed to buy water from the Company for 99 years at a minimum annual fee of \$32,346 payable monthly at \$2,696 plus additional amounts computed according to rates set forth in the contract.

**C. Economic Dependency**

The City of Friendship bills local property owners for property taxes and utility customers for services rendered. At June 30, 2012, these customers and property owners are indebted to the City as noted on the balance sheets of the General and Proprietary Funds. The majority of the property owners and customers consist of local individuals and businesses. Assessed property is subject to foreclosure in the event taxes go unpaid. Utility services are sold to customers with no collateral required, although customer deposits are required in certain situations.

**D. Retirement Plan**

***Plan Description***

Employees of the City of Friendship are members of the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with 5 years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the system after July 1, 1979, become vested after 5 years of service and members joining prior to July 1, 1979, were vested after 4 years of service. Benefit provisions are established in state statute found in Title 8, Chapter 34-37 of the Tennessee Code Annotated (TCA). State statutes are amended by the

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Tennessee General Assembly. Political subdivisions such as the City of Friendship participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. That report may be obtained by writing to Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230 or can be accessed at <http://www.tn.gov/treasury/tcrs/PS/>.

***Funding Policy***

The City of Friendship requires employees to contribute 5 percent of earnable compensation.

The City of Friendship is required to contribute at an actuarially determined rate; the rate for the fiscal year ending June 30, 2012, was 7.39% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for the City of Friendship is established and may be amended by the TCRS Board of Trustees.

***Annual Pension Cost***

For the year ending June 30, 2012, the City of Friendship's annual pension cost of \$9,153 to TCRS was equal to the City of Friendship's required and actual contributions. The required contribution was determined as part of the July 1, 2009 actuarial valuation using the frozen entry age actuarial cost method. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 7.5% a year compounded annually, (b) projected 3.0% annual rate of inflation, (c) projected salary increases of 4.75% (graded) annual rate (no explicit assumption is made regarding the portion attributable to the effect of inflation on salaries), (d) projected 3.5% annual increase in the Social Security wage base, and (e) projected post retirement increases of 2.5% annually.

The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the market value of total investments over a five-year period. The City of Friendship's unfunded actuarial accrued liability is being amortized as a level dollar amount on a closed basis. The remaining amortization period at July 1, 2009 was 7 years. An actuarial valuation was performed as of July 1, 2011, which established contribution rates effective July 1, 2012.

Trend Information

Trend Information			
Fiscal Year	Annual Pension	Percentage	Net Pension
Ending	Cost (APC)	of APC Contributed	Obligation
6/30/12	\$ 9,153	100.00%	\$ -
6/30/11	\$ 8,989	100.00%	\$ -
6/30/10	\$ 8,176	100.00%	\$ -

**REQUIRED SUPPLEMENTARY INFORMATION**

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF FUNDING PROGRESS – EMPLOYEE RETIREMENT SYSTEM**  
**REQUIRED SUPPLEMENTARY INFORMATION**  
For the year ended June 30, 2012

**Schedule of Funding Progress for Friendship**

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) -Entry age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
	(a)	(b)	(b) - (a)	(a/b)	(c)	((b-a)/c)
7/1/11	\$ 477	\$ 497	\$ 19	96.12%	\$ 121	15.87%
7/1/09	\$ 432	\$ 458	\$ 25	94.48%	\$ 159	15.85%
7/1/07	\$ 397	\$ 428	\$ 31	92.76%	\$ 132	23.48%

The above schedule is designed to show the extent to which a pension plan has been successful over time in setting aside assets sufficient to cover its actuarial accrued liability.

*See independent auditor's report*

## **Other Supplementary Information**

**CITY OF FRIENDSHIP, TENNESSEE**  
**SANITATION FUND**  
**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES**  
**IN FUND BALANCE - BUDGET AND ACTUAL**  
For the year ended June 30, 2012

	Budgeted Amounts		Actual	Over (Under) Budget
	Original	Final		
<b>Revenues</b>				
Garbage collection fees	\$ 47,000	\$ 47,000	\$ 47,037	\$ 37
Miscellaneous revenue	50	50	41	(9)
<b>Total revenues</b>	<b>47,050</b>	<b>47,050</b>	<b>47,078</b>	<b>28</b>
<b>Expenditures</b>				
Solid waste disposal service	46,000	46,000	44,875	(1,125)
<b>Total expenditures</b>	<b>46,000</b>	<b>46,000</b>	<b>44,875</b>	<b>(1,125)</b>
<b>Net change in fund balance</b>	<b>1,050</b>	<b>1,050</b>	<b>2,203</b>	<b>1,153</b>
Fund balance - July 1, 2011	18,095	18,095	18,095	--
<b>Fund balance - June 30, 2012</b>	<b><u>\$ 19,145</u></b>	<b><u>\$ 19,145</u></b>	<b><u>\$ 20,298</u></b>	<b><u>\$ 1,153</u></b>

*See independent auditor's report.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF DEBT SERVICE REQUIREMENTS TO MATURITY**  
 June 30, 2012

**SEWER SYSTEM FUND**

	Revenue Bond Series 1980		Note Payable Clayton Bank And Trust				Total Sewer
	Principal	Interest	Principal	Interest	Principal	Interest	
2013	\$ 15,000	\$ 6,625	\$ 6,000	\$ 1,402	\$ 4,000	\$ 1,279	\$ 42,759
2014	15,000	5,875	6,000	1,045	24,417	1,099	97,582
2015	15,000	5,125	6,000	688			26,813
2016	15,000	4,375	11,556	331			31,262
2017	20,000	3,500					23,500
2018	20,000	2,500					22,500
2019	20,000	1,500					21,500
2020	20,000	500					20,500
	<u>\$ 140,000</u>	<u>\$ 30,000</u>	<u>\$ 29,556</u>	<u>\$ 3,466</u>	<u>\$ 28,417</u>	<u>\$ 2,378</u>	<u>\$ 286,416</u>

**WATER DEPARTMENT FUND**

Year Ended	Note Payable Clayton Bank And Trust		Total Water
	Principal	Interest	
2013	\$ 18,750	\$ 2,658	\$ 21,408
2014	33,275	1,700	34,975
<b>Totals</b>	<u>\$ 52,025</u>	<u>\$ 4,358</u>	<u>\$ 56,383</u>

*See independent auditor's report.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF DEBT SERVICE REQUIREMENTS TO MATURITY**  
 June 30, 2012

(continued)

Year Ended	Farmers Home Administration		Note Payable Bank of Friendship dated 11/27/09, 5.75% annum		Note Payable Bank of Friendship dated 11/27/09, 4.50% annum		Note Payable Bank of Crockett dated 9/14/10, 5.75% annum		General Fund Total	Total Debt Service Primary Government
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest		
2013	\$ 2,214	\$ 1,270	\$ 73,333	\$ 4,217	\$ 3,390	\$ 1,874	\$ 46,348	\$ 5,652	\$ 125,285	\$ 138,298
2014	2,326	1,158	--	--	3,542	1,722	51,948	1,494	57,816	62,190
2015	2,444	1,040	--	--	3,702	1,562	--	--	6,146	8,748
2016	2,568	916	--	--	3,868	1,396	--	--	6,436	8,748
2017	2,697	787	--	--	4,042	1,222	--	--	6,739	8,748
2018	2,834	650	--	--	4,224	1,040	--	--	7,058	8,748
2019	2,977	507	--	--	4,414	850	--	--	7,391	8,748
2020	3,128	356	--	--	4,613	651	--	--	7,741	8,748
2021	3,287	197	--	--	4,820	444	--	--	8,107	8,748
2022	1,467	37	--	--	4,994	227	--	--	6,461	6,725
<b>Totals</b>	<b>\$ 25,942</b>	<b>\$ 6,918</b>	<b>\$ 73,333</b>	<b>\$ 4,217</b>	<b>\$ 41,609</b>	<b>\$ 10,988</b>	<b>\$ 98,296</b>	<b>\$ 7,146</b>	<b>\$ 239,180</b>	<b>\$ 268,449</b>

*See independent auditor's report.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF PROPERTY TAXES**  
 June 30, 2012

Year of Levy	Balance July 1, 2011	Assessments/ Adjustments	Collections	Balance June 30, 2012
2011	\$ --	\$ 110,343	\$ 98,560	\$ 11,783
2010	13,421	--	8,604	4,817
2009	4,264	--	1,072	3,192
2008	2,869	--	1,116	1,753
2007	2,544	--	1,214	1,330
2006	2,104	--	1,021	1,083
2005	1,522	--	523	999
2004	820	--	--	820
2003	587	--	--	587
2002	423	(423)	--	--
<b>Total</b>	<b>\$ 28,554</b>	<b>\$ 109,920</b>	<b>\$ 112,110</b>	<b>26,364</b>

2012 levy due October 1, 2012  
 considered as deferred revenue  
**Total taxes receivable**

109,524  
**\$ 135,888**

Year of Levy	Assessed Valuation	Tax Rate Per \$100	Assessments
2011	\$5,919,864	\$1.86	\$110,346
2010	\$5,873,512	\$1.86	\$109,482
2009	\$5,442,030	\$1.91	\$103,943
2008	\$5,032,723	\$1.91	\$96,125
2007	\$4,993,351	\$1.91	\$95,373
2006	\$4,948,332	\$1.91	\$94,513
2005	\$5,118,160	\$1.82	\$93,151
2004	\$4,967,418	\$1.82	\$90,407
2003	\$4,329,584	\$2.00	\$86,592
2002	\$4,297,600	\$2.00	\$85,952

**Delinquent Property Taxes**

*The City of Friendship has filed delinquent property taxes in the amount of \$14,541 with the Chancery Court.*

*See independent auditor's report.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF UTILITY RATES**  
 June 30, 2012

Water Rates

First 3,000 gallons	\$19.50
Over 3,000 gallons	4.00 per 1,000 gallons

The City had 363 water customers as of June 30, 2012.

Sewer Rates

Residential

First 3,000 gallons	\$19.50
Over 3,000 gallons	4.00 per 1,000 gallons

\$29.50 maximum charge

Commercial, Non-Profit, and Industrial

First 3,000 gallons	\$19.50
Over 3,000 gallons	4.00 per 1,000 gallons

The City had 379 sewer customers as of June 30, 2012.

Gas Rates

Per 100 cubic feet	\$7.00 min. \$1.5900
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The City had 291 gas customers as of June 30, 2012.

Sanitation Rates

Class 22: Residential		\$12.00
Class 35: Commercial and Non-Profit	One Pick-up	12.00
	Two Pick-ups	24.00
Dumpster		Various

The City had 338 sanitation customers as of June 30, 2012.

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF UNACCOUNTED FOR WATER - UNAUDITED**  
**June 30, 2012**

(All amounts in gallons)

<b>A</b>	<b>Water Treated and Purchased:</b>		
<b>B</b>	Water pumped (potable)	41,910,000	
<b>C</b>	Water purchased	0	
<b>D</b>	<b>Total Water Treated and Purchased</b>		41,910,000
	(Sum Lines B and C)		
<b>E</b>	<b>Accounted for Water:</b>		
<b>F</b>	Water sold	19,657,200	
<b>G</b>	Metered for consumption (in house usage)	9,175,000	
<b>H</b>	Fire department usage	630,000	
<b>I</b>	Flushing	640,000	
<b>J</b>	Tank cleaning/filling	1,947,200	
<b>K</b>	Street cleaning	66,000	
<b>L</b>	Bulk sales	2,895,900	
<b>M</b>	Water bill adjustments/plus or (minus)	38,198	
<b>N</b>	<b>Total accounted for water</b>		35,049,498
	(Sum Lines F thru M)		
<b>O</b>	<b>Unaccounted for water</b>		6,860,502
	(Line D minus Line N)		
<b>P</b>	<b>Percent unaccounted for water</b>		16.370%
	(Line O divided by Line D times 100)		
<b>Q</b>	<b>Other (explain)</b>	See below	0

Explain Other:

Chemical Feed
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All amounts included in this schedule are supported by documentation on file at the water system. If no support is on file for a line item or if the line item is not applicable, a "0" is shown.

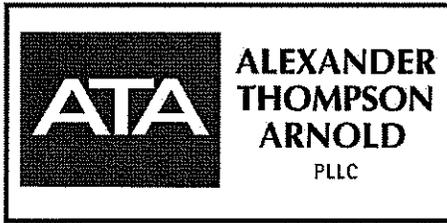
*See independent auditor's report.*

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF BONDS OF PRINCIPAL OFFICIALS**  
June 30, 2012

<u>Name</u>	<u>Position</u>	<u>Bond</u>
Casey Burnett	Mayor	\$ -
Debra Butler	City Recorder	150,000
John Marvin	Alderman	-
Johnny Elmore	Alderman	-
James Roberson	Alderman	-
Bobby Garrett	Alderman	-

Unless otherwise noted, all officials served for the entire fiscal year.

## **Internal Control and Compliance**



Certified Public Accountants

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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***

The Honorable Mayor and Board of Aldermen  
City of Friendship, Tennessee

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 Friendship, Tennessee (the City), as of and for the year ended June 30, 2012 which collectively comprise the City's basic financial statements and have issued our report thereon dated December 28, 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*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the City is responsible for establishing and maintaining effective internal controls over financial reporting. In planning and performing our audit, we considered City of Friendship'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 City of Friendship's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City'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 no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and an other deficiency that we consider to be a significant deficiency.

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 deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: 08-1, 05-1, 04-1, 04-2, 99-2, 98-3 and 97-3.

The Honorable Mayor and Board of Aldermen  
City of Friendship, Tennessee

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 deficiency described in the accompanying schedule of findings and responses to be a significant deficiency: 99-6

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether City of Friendship'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 responses as items 08-1, 05-1, 04-1, 04-2, 03-1, 99-2, 98-3, and 97-3. We also noted certain immaterial instances of noncompliance, which we have reported to the management of the City of Friendship in the accompanying schedule of findings and responses as item 99-6.

City of Friendship's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit City of Friendship's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Mayor and Board of Aldermen, management, the State of Tennessee Comptroller's Office, Division of Local Government and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Alexander Thompson Arnold PLLC*

Dyersburg, Tennessee  
December 28, 2012

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
For the year ended June 30, 2012

**FINANCIAL STATEMENT FINDINGS**

**08-1 Utility Accounts Receivable and Customer Deposit Reconciliation Not Performed - Utility Billing – Material Weakness and Noncompliance**

Condition: The municipality's records did not include documentation of a monthly reconciliation of utility accounts receivable as reflected in the utility billing register to the general ledger control account. The municipality's records also did not include adequate documentation of a monthly reconciliation of utility customer deposits as reflected in the utility customer deposit register to the general ledger control account.

Criteria: Monthly accounts receivable and customer deposits reconciliations should be performed to ensure that accounts are correctly stated. *The Internal Control and Compliance Manual for Tennessee Municipalities, Title 3, Chapter 3, Section 10*, states: "Municipal officials should ensure that the total amount of unpaid individual accounts on the utility billing sheet is reconciled to applicable general ledger control account total at the end of each month."

Effect: Failure to perform monthly reconciliations of accounts receivables and customer deposits can lead to undetected errors and irregularities in these accounts.

Recommendation: To detect errors or irregularities promptly, municipal officials should ensure that a monthly reconciliation of the detail listing of accounts receivable in the billing register to the general ledger control account is performed and documented. In addition municipal officials should ensure that a monthly reconciliation of customer deposits to the general ledger control account is performed and documented.

Response: We will comply with your recommendations.

**05-1 Cash Receipts - Utility Billing – Material Weakness and Noncompliance**

Condition: The City should review cash receipts procedures relating to utility billing collections and the associated application of penalties for late payments received from customers. We have noted instances in which customers have utility billing balances that are carried forward for several months and we have also noted that penalties are not consistently applied on collections received after the due date.

Criteria: Policies and procedures established relating to the assessment of penalties for late payment and cutoff procedures for non-payment should be adhered to.

Effect: The utility billing procedures should be applied consistently on a monthly basis and for each customer to insure that all customer accounts are treated fairly and equally and that the City is collecting all revenue that is due relating to late or non-payment of services.

Recommendation: The City should verify that procedures are in place to collect customer balances in full each month and also to assess penalties on late payments in a timely and consistent manner. The adequate collection of utility billing and the assessment of penalties should be conducted based upon City policy.

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
For the year ended June 30, 2012

Response: For the budget year 2012-2013, the City will make every effort to collect customer balances in full and assess and collect penalties consistently.

**04-1 Deficit Fund Balance – Material Weakness and Noncompliance**

Condition: The State Street Aid fund had a deficit fund balance. The deficit along with the interfund borrowings seems to indicate a cash flow problem.

Criteria: The funds should operate independently and not encounter deficit balances.

Effect: The funds do not have sufficient revenue to cover the expenditures and therefore are not self-supporting.

Recommendation: The City should investigate ways to increase revenue or reduce expenditures to improve cash flow and reduce the deficit fund balance.

Response: For the budget year 2012-2013, the City will monitor expenditures and reduce when possible to improve financial performance of the fund.

**04-2 Dual Signatures – Material Weakness and Noncompliance**

Condition: The City does not obtain dual signatures on checks that are issued to satisfy payment of expenditures incurred.

Criteria: The “Internal Control and Compliance Manual for Tennessee Municipalities” issued by the Comptroller’s Office addresses the requirement regarding dual signatures on checks.

Effect: The absence of dual signatures on checks could result in the City being exposed to increased risks of fraudulent activity and the additional potential for misappropriation of City assets.

Recommendation: Disbursements should only be made after two signatures are obtained on checks. This is a control that needs to be in place and is especially important given the small size of the office staff. The second signature should be the mayor or a board member.

Response: We have not been able to comply with this finding because our mayor and board members have jobs that make them unavailable much of the time. We welcome any ideas or suggestions that would make this possible without delaying bills that need to be paid on time.

**03-1 Budget Exceeded – Noncompliance**

Condition: During the year ended June 30, 2012, expenditures exceeded appropriations in the State Street Aid Fund by \$3,035.

Criteria: TCA 6-56-205 states that “the governing body shall not make any appropriations in excess of estimated available funds, except to provide for an actual emergency threatening the health, property, or lives of inhabitants of the municipality and declared by a two-thirds (2/3) vote of all members of the governing body present, when there is a quorum”.

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
For the year ended June 30, 2012

Effect: Expenditures were not properly authorized by the City's board and state law was not followed relating to the budgeting of expenditures.

Recommendation: We recommend that expenditures be compared to the budget on a regular basis and that the budget is amended when necessary so that all expenditures are adequately approved within the City's budgeting process.

Response: In the past, the City's board has been making a motion to amend or adjust the budget as was deemed necessary. For the budget year 2012-2013, the City will be more specific in stating the amendments to be made to the budget.

**99-2 General Accounting Functions – Material Weakness and Noncompliance**

Condition: As in the prior year, during the course of the audit performed as of June 30, 2012, we noted instances in which cash receipts were not deposited into the City's bank accounts in a timely manner.

Criteria: State law requires that all cash received by the City be deposited within 3 banking days.

Effect: By not following state law regarding the timeliness of the deposits, the City is incurring additional risks relating to misappropriation of assets held at City Hall.

Recommendation: The City should deposit all funds received within 3 banking days.

Response: Every effort is being made to ensure that cash received is deposited within three banking days.

**99-6 Adequate Accounting of Vacation and Sick Leave – Significant Deficiency and Immaterial Noncompliance**

Condition: The City does not currently maintain adequate records regarding vacation and sick leave for each employee.

Criteria: The records should be maintained so that accruals can be made when necessary regarding potential amounts owed to City employees for unused vacation time.

Effect: In the absence of adequate accounting records the City does not have the ability to adequately monitor the amount of leave taken by employees and the amount of liability in which the City may be exposed.

Recommendation: The Board should review applicable policies and procedures regarding vacation and sick leave so that the appropriate amount of time can be allocated to each employee.

Response: The City is currently looking into a procedure that allows the payroll clerk to enter and update vacation and sick leave with each payroll process.

**CITY OF FRIENDSHIP, TENNESSEE**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
For the year ended June 30, 2012

**98-3 Temporary Loans – Material Weakness and Noncompliance**

Condition: As noted in prior years, the City has continued to make interfund loans between enterprise funds and governmental funds. Any loans from enterprise fund operations must be approved by the Comptroller's Office.

Criteria: State law prohibits a municipality from relying on enterprise funds to support general government operations.

Effect: The temporary loans prevent the City from taking necessary measures to work towards all funds to be self-supporting.

Recommendation: The interfund loans should be repaid and the City should discontinue this practice.

Response: The debt on the City's enterprise and street improvement loans will be paid off within the next two or three years which will free up a substantial amount of money and eliminate the need for temporary loans in order to pay a debt on time.

**97-3 Segregation of Duties – Material Weakness and Noncompliance**

Condition: During the year ended June 30, 2012, as was also the case in the prior year, the City of Friendship had inadequate segregation of duties due to the fact that only two employees perform the accounting functions.

Criteria: Internal controls are important in any organization in order to properly safeguard assets. Segregation of duties is an integral part of internal controls.

Effect: Inadequate segregation of duties could cause errors or misappropriations to go undetected.

Recommendation: The accounting function should be segregated as much as possible to promote adequate internal controls over the financial transactions of the entity.

Response: The City can only afford two employees for accounting functions. The only instances of inadequate segregation of duties occur when one of the two employees takes a vacation or sick day or days.

**CITY OF FRIENDSHIP, TENNESSEE**  
**SUMMARY SCHEDULE OF PRIOR FINDINGS**  
June 30, 2012

**PRIOR FINDINGS RELATIVE TO THE AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

- 08-1 Utility Accounts Receivable and Customer Deposit Reconciliation Not Performed - Utility Billing - repeated**
- 05-1 Cash Receipts – Utility Billing - repeated**
- 04-1 Deficit Fund Balance - repeated**
- 04-2 Dual Signatures - repeated**
- 03-1 Budget Exceeded - repeated**
- 99-2 General Accounting Functions - repeated**
- 99-6 Adequate Accounting of Vacation and Sick Leave - repeated**
- 98-3 Temporary Loans - repeated**
- 97-3 Segregation of Duties - repeated**