

Town of Paonia, Colorado



Report to Governance



for the year ended
December 31, 2016

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Introduction

Town of Paonia, Colorado

The Honorable Mayor and Board of Trustees
Town of Paonia, Colorado

We are pleased to have the opportunity to present to you the results of our audit engagement of the Town of Paonia, Colorado (the Town), for the year ended December 31, 2016. The accompanying report presents information regarding the scope of our audit and other matters, which summarizes the results of our audit engagement.

We have audited the financial statements of the Town. Our audit was performed in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement and presented in accordance with accounting principles generally accepted in the United States of America. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. We also assessed the accounting principles used by the Town and the significant estimates made by the Town's management, as well as evaluated the overall financial statement presentation.

This information is intended solely for the use of the Mayor, the Board of Trustees and management of the Town and is not intended to be, and should not be, used by anyone other than these specified parties.

Engagement Team

ENGAGEMENT MEMBER	ROLE	TELEPHONE	EMAIL
Russell White	Engagement Partner	303.952.1247	russell.white@rubinbrown.com
Mitch McFarland	Manager	303.952.1274	mitch.mcfarland@rubinbrown.com
Matthew Torrez	Auditor	303.952.1203	matthew.torrez@rubinbrown.com
Kelly Marsh	Auditor	303.952.1249	kelly.marsh@rubinbrown.com

KEY PARTNERS	ROLE	TELEPHONE	EMAIL
Rodney Rice	Partner-In-Charge, Denver Assurance Services	303.952.1233	rodney.rice@rubinbrown.com
Michael T. Lewis	Managing Partner	303.952.1213	michael.lewis@rubinbrown.com

Objective And Scope Of Services

Objective of Engagement:

Independent Auditors' Report On Financial Statements

Auditors' Responsibility:

- Conducting the audit in accordance with generally accepted auditing standards
- Ensuring that those charged with governance are aware of internal control-related matters that are required to be communicated

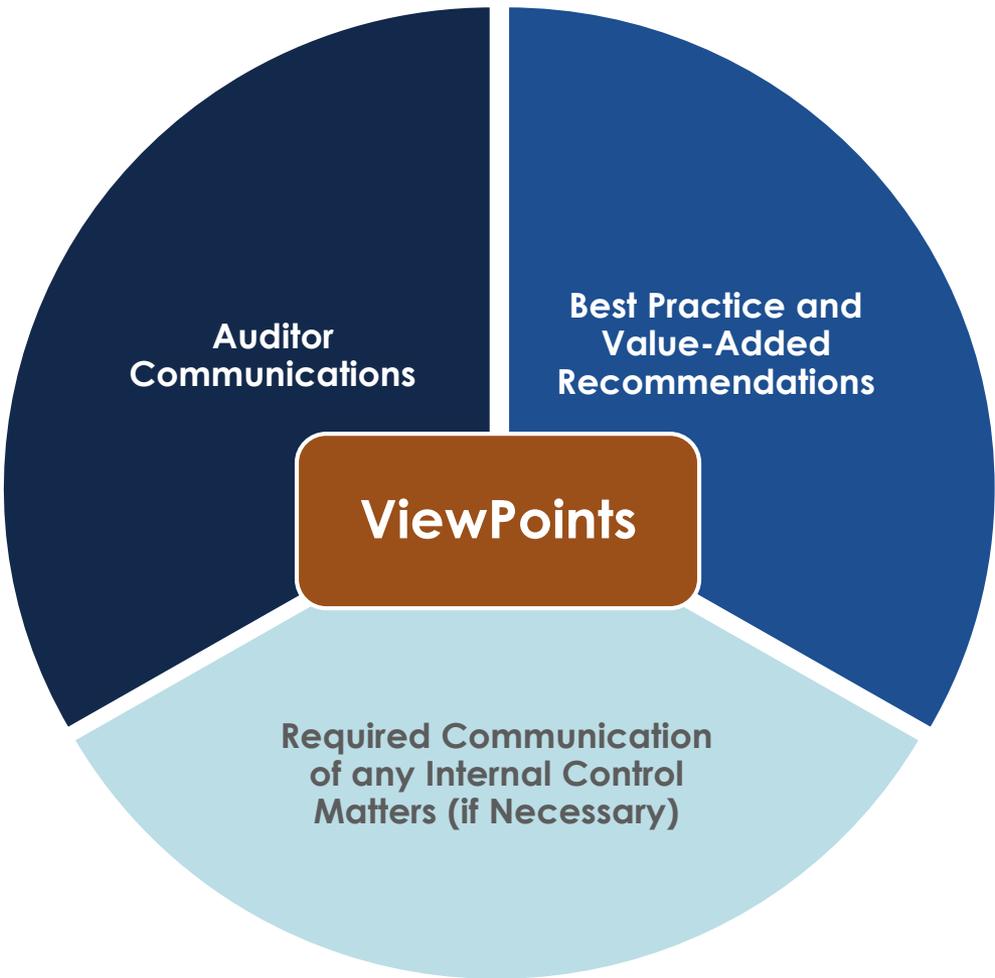
Limitations of the Engagement:

- An audit is designed to obtain reasonable, not absolute, assurance about whether the financial statements are free from material misstatement.
- An audit is not designed to detect immaterial errors or fraud.
- An audit is not designed to provide assurance about internal controls or to identify deficiencies in internal controls.

Management's Responsibility:

- Selecting and applying accounting policies
- Establishing and maintaining effective internal controls
- Identifying and ensuring compliance with applicable laws and regulations
- Designing and implementing controls to prevent and detect fraud
- Informing auditors regarding any known, suspected or alleged frauds
- Making all financial records available

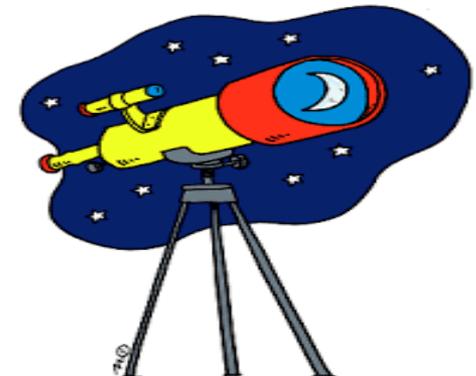
Other Audit Deliverables



Foresights: Financial Accounting And Reporting

Town of Paonia, Colorado

- GASB Statement No. 84, *Fiduciary Funds*
 - Effective for 2018 Town year end
 - Establishes specific criteria for identifying activities that should be reported fiduciary activities and clarifying whether and how business-type activities should report their fiduciary activities
 - Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position.
- GASB Statement No. 87, *Leases*
 - Effective for 2019 Town year end
 - Establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset
 - Application of this standard would go beyond the previous guidance related to the recording of leased assets and additional leased items on the books as an intangible right-to-use assets and related liabilities.



Auditor Communications

AREA	COMMENTS
<p>Our Responsibility Under U.S. Generally Accepted Auditing Standards, Government Auditing Standards And Uniform Guidance</p> <p>Our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your assistance are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of responsibility for the accuracy of the financial statements.</p>	<p>Reports issued by RubinBrown:</p> <ul style="list-style-type: none">■ We have issued an unmodified report on the Town's financial statements for the year ended December 31, 2016.■ ViewPoints, including required communications, analysis of the District, a management letter and other financial information.

Auditor Communications (Continued)

AREA	COMMENTS
<p>Other Information In Documents Containing Audited Financial Statements</p>	<p>None</p>
<p>Planned Scope And Timing Of The Audit</p>	<p>We performed the audit according to the planned scope and timing communicated in our letter dated September 29, 2017.</p>
<p>Qualitative Aspects Of Accounting Practices</p> <p>Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application.</p>	<ul style="list-style-type: none"> ■ Significant accounting policies are described in Note 2. ■ No new accounting policies were adopted, and the application of existing policies was not changed, except for the implementation of Governmental Accounting Standards Board (GASB) Statement No. 72, <i>Fair Value Measurement and Application</i>, and GASB Statement No. 77, <i>Tax Abatement Disclosures</i>. ■ We noted no transactions entered into during the year for which there was a lack of authoritative guidance or consensus. ■ No significant transactions have been recognized in a different period than when the transactions occurred.

Auditor Communications (Continued)

AREA	COMMENTS
<p>Management Judgments And Accounting Estimates</p> <p>The preparation of the financial statements requires the use of accounting estimates. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's expectations.</p>	<p>The most sensitive estimates affecting the financial statements are:</p> <ul style="list-style-type: none"> ■ Depreciation expense is based upon management's estimated useful lives of capital assets. We evaluated the key factors and assumptions used to develop the depreciable lives used to calculate depreciation in determining that it is reasonable in relation to the financial statements taken as a whole.
<p>Financial Statement Disclosures</p>	<p>The disclosures are neutral, consistent and clear. The following disclosures are particularly sensitive because of their significance to the financial statement users:</p> <ul style="list-style-type: none"> ■ Note 6 - Long-Term Liabilities ■ Note 7 - Lease Agreements ■ Note 8 - Employee Benefit Plans

Auditor Communications (Continued)

AREA	COMMENTS
<p>Difficulties Encountered In Performing The Audit</p>	<p>Except for the following audit areas:</p> <ul style="list-style-type: none"> ■ The Town needs to use the accounting software module to properly record interfund activity. This was not performed during 2016, which caused the Towns governmental funds to not be in balance and required seven audit correction entries, totaling approximately \$585,000 to correct. ■ The schedule of expenditures of federal awards (the SEFA) expenditures did not reconcile to the general ledger, which caused additional procedures to determine if a single audit was needed in 2016. The initial SEFA received on April 24, 2017 displayed federal expenditures of \$658,006. The last SEFA received on May 10, 2017 displayed federal expenditures of \$498,000. This resulted in a net change in the reported expenditures of \$160,006. ■ Revenue recognition related to the Water and Power Authority loan caused a restatement of the grant receivable and equity for the year 2015 in the amount of \$825,000, plus an audit correction entry of \$898,000 in 2016. The WPA loan accounting was originally treated as an reimbursement grant as revenues were recorded when expenditures occurred instead of a reduction in the receivable when expenditures occurred. ■ The Town did not review capital asset activity or capital outlay activity during the year to determine if the capital asset and capital outlay listing reconciled to the general ledger or determine if all capital asset activity was included on that listing. <p>The identified difficulties noted above relate to the lack of dedicated resources in maintaining the Town’s governmental fund trial balances during the year and year-end close process for the audit.</p> <p>With exceptions noted above, we are pleased to report that there were no abnormal difficulties encountered in performing the audit.</p>

Auditor Communications (Continued)

AREA	COMMENTS
<p>Corrected And Uncorrected Misstatements</p>	<p>We have attached a listing of the corrected misstatements, which also includes journal entries prepared by the Town.</p> <p>We have also attached reclassifying journal entries.</p> <p>See the Adjusting Journal Entries And Reclassifying Journal Entries Reports in Appendix A.</p>
<p>Disagreements With Management</p>	<p>None</p>
<p>Management Representations</p>	<p>Management representation letter dated _____*, which is in Appendix B.</p>
<p>Management Consultations With Other Independent Accountants</p>	<p>None</p>

Auditor Communications (Continued)

AREA	COMMENTS
Other Audit Findings Or Issues	There were no matters of significant discussion that affected our retention as the Town's auditors.
Other Matters	With respect to the supplementary information (other budgetary comparison information) accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with U.S. generally accepted accounting principles, the methods of preparing it have not changed from the prior period and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Management Letter

Town of Paonia, Colorado

In planning and performing our audit of the financial statements in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Town's financial statements will not be prevented, or detected and corrected, on a timely basis. 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.

Management Letter (Continued)

We consider the following to be material weaknesses to the Town's financial reporting process:

- Fund level transfers in and transfers out did not reconcile to one another in the current fiscal year. The Town needs to use the accounting software module to properly record interfund activity. This was not performed during 2016, which caused the Town's governmental funds to not be in balance and required seven audit correction entries totaling approximately \$585,000 to correct. This deficiency creates a pervasive risk that items may be double booked in different funds. Such an instance was initially observed with regard to capital outlay in the Grant Projects Fund also being capitalized in the Water Fund.
 - *It is recommended that the Town implement a control process (use the automated accounting software) to ensure that all fund-level transfers balance to each other at the close of each month and fiscal year end.*
- Grant revenue was improperly accounted for in the current year. Revenue recognition related to the WPA loan caused a restatement of the grant receivable and equity for the year 2015 in the amount of \$825,000, plus an audit correction entry of \$898,000 in 2016. The WPA loan accounting was originally treated as an reimbursement grant as revenues were recorded when expenditures occurred instead of a reduction in the receivable when expenditures occurred and cash draws were received. The grant revenue was not applied properly against the loan amount receivable in the Water Fund and instead was recognized as revenue in the Grant Projects Fund.
 - *It is recommended that the Town implement a control process to determine if grant revenue is being recognized in accordance with generally accepted accounting principles.*

Management Letter (Continued)

Town of Paonia, Colorado

We consider the following deficiency in internal control to be a control deficiency:

- The Town does not have enough resources dedicated to maintaining the governmental fund trial balances of the Town during the year and year-end close process which are accurate and timely. During the year-end audit process, we noted the SEFA, capital asset and outlay schedule, interfund transfers between the governmental funds, and revenue recognition accounting associated with WPA loan was not correct. We requested corrections related to the SEFA, capital asset and outlay schedule and interfund transfers between the governmental funds several times and received multiple revisions that also were not accurate or correct.

We recommend the Town dedicate more resources to the maintenance of the Town's governmental trial balances and implement a formalized month-end closing process.

Management Letter (Continued)

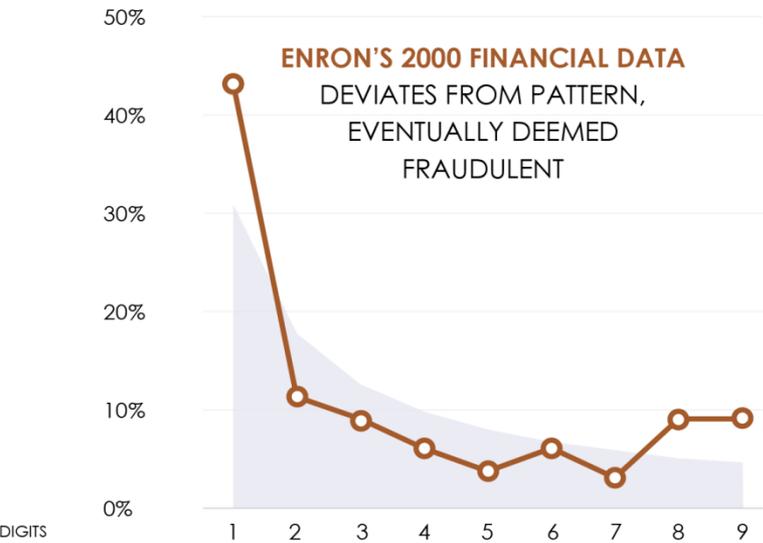
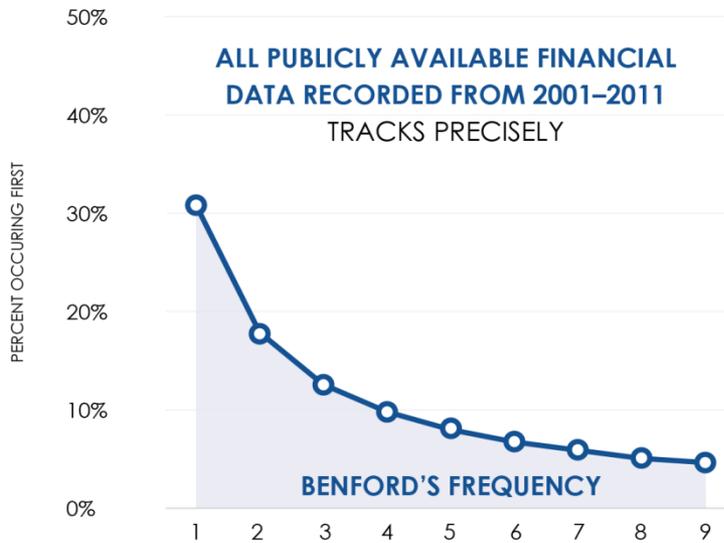
We consider the following to be value-added recommendations to the Town's financial reporting process:

- It is recommended that the Town implement stronger controls over water purchases at the Public Works station. Existing controls do not enable the Town to monitor the amount of cash collected related to the amount of water sold as a monitoring control.
- It is recommended that the Town separate the Sanitation Fund into separate trash and sewer funds. Separating these funds will facilitate the measurement of financial performance of both enterprise functions of the Town.
- It is recommended that the Town implement a new process of organization with regard to building permit revenue. It was communicated to us during our examination that there was no uniform process to documenting permits. Building permits are the largest revenue for license and permits within the General Fund. The revenue increased 20% in the current year; however, the Town's staff appeared unaware of what caused the increase. We recommend the Town implement a control to analytically determine if the revenue is reasonable.
- It is recommended that the Town consider creating a Transportation Fund. By moving all transportation-related infrastructure assets and all the activity of the Sidewalk Fund into a Transportation Fund, the Town could facilitate its ability to obtain transportation-related grant funding for transportation-related projects in the Town. It has been observed that transportation is an important issue among the tax payers of the Town.
- It is recommended that Town implement a formalized review process to determine if the Town is eligible for a Single Audit under the Uniform Guidance. This review process should be performed by a person who is not responsible for preparing a SEFA. This process is performed by determining if the Town has spent over \$750,000 of federally awarded funds. It has been observed over that last couple years that the Town appeared unsure at the commencement of fieldwork whether a single audit was required.

Status Of Prior-Year Observations And Suggestions

PRIOR-YEAR INTERNAL CONTROL OBSERVATIONS DETERMINED TO BE A SIGNIFICANT DEFICIENCY	STATUS
<p>Omission Of The Samuel Way Road Bridge</p> <p>We noted in the current year that governmental capital assets were misstated, specifically due to the omission of the Samuel Way Road Bridge. RubinBrown adjusted the financials to include the bridge for the current year.</p> <p>RubinBrown also adjusted for current-year activity relating to disposals and additions and adjusted to include the capital lease for police vehicles.</p>	<p>During the 2016 financial statement audit, we observed a similar omission with regard to leased police vehicles. We did, however, observe the Samuel Way Road Bridge was included in the current-year fixed asset listing, even though it was incorrectly labeled as Airport.</p>
<p>Federal Share Percentage For SEFA</p> <p>The Town had material federal funding, which required a Single Audit. The Town did not report the appropriate federal share percentage of the Colorado Water Resources & Power Development Authority, due to the granting agency changing the federal share percentage during the year. In addition, one of the grant reimbursements was not included in the SEFA.</p>	<p>During the 2016 financial statement audit, we observed that invoice detail spreadsheet did apply the correct federal share percentage.</p>

Data Analytics - Benford's Curve

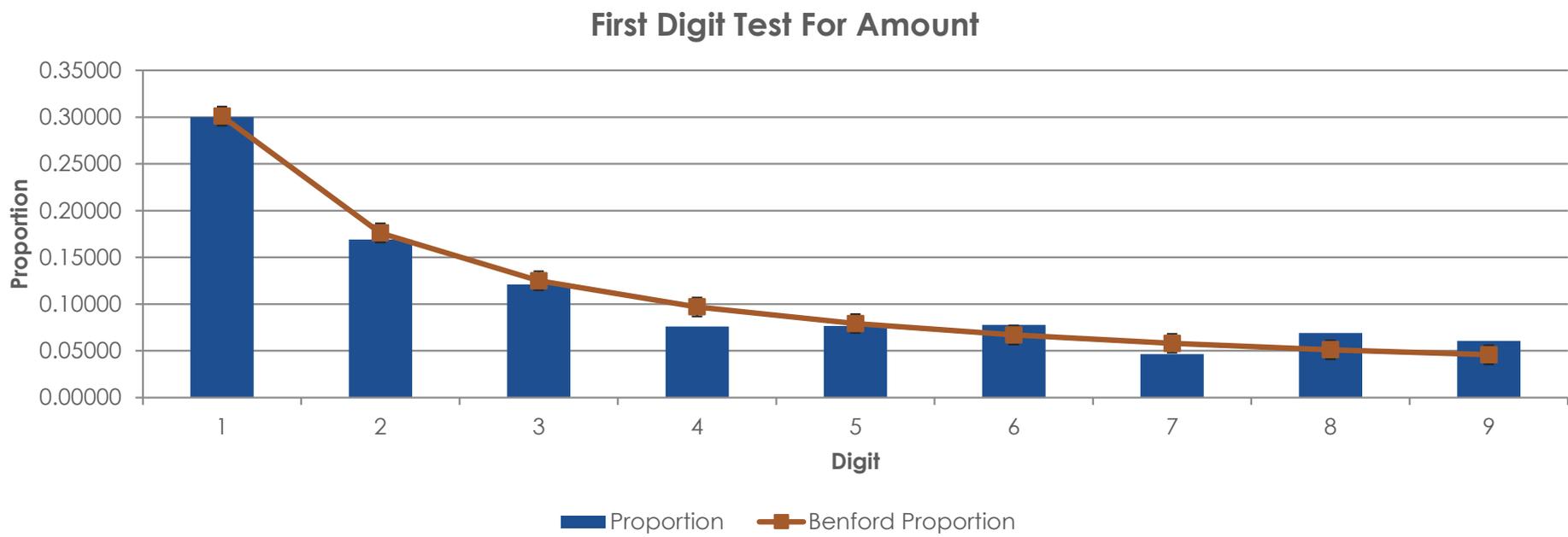


Source: Dan Ariaram, Columbia University, The Wall Street Journal

Benford's Law was established by Frank Benford in the 1930s. The law expects 30.1% of numbers in a list of financial transactions to begin with "1." Each successive digit should represent a progressively smaller proportion.

When digits stray from the pattern, fraud may be to blame. As volumes of data continue to grow, it has become a valuable tool in analyzing data sets for potential irregular activity.

Data Analytics - Benford's Curve (Continued)



We performed Benford's Curve on cash disbursements during the year to detect any anomalous activity during the year and determine if those expenses fall within the scope of providing services to the residents of the Town. Note that we performed this test on a two-digit analysis. This graph depicts a one-digit test.

The digit 6 was above the curve, due to recurring payments to the Mutual Bank of Omaha for the retirement plan. The digit 8 is above the curve, due to payments to FPPA for Death & Disability. The digit 9 is above the curve because of recurring payments to Casselle, Inc. for the monthly amount of \$989.

Data Analytics (Continued)

■ Other Data Analytics Performed:

- We reviewed all duplicate cash disbursements and determined that recurring amounts paid were reasonable and within the scope of serving the residents of the Town.
- We summarized the top 10 vendors (see next page) of the Town and drilled down into those expenses to determine if they fall within the scope of serving the residents of the Town. Nothing unusual came to light in our analysis.
- We reviewed gaps in the sequence of check numbers for the Town's operating bank account and noted only four missing checks in the initial analysis. The Town was able to locate those as voided checks. The check sequence was preserved without exception, and that is a credit to the Finance Director for her organization and accuracy with regard to her work.

Data Analytics - Top Ten Vendors By Amount And By Count (Continued)

Town of Paonia, Colorado

PAYEE	CHECKS WRITTEN	PAYMENT TOTAL
First State Bank of Colorado	17	\$ 1,477,922
WestWater Engineering Inc	9	177,706
Pitt Construction Co. LLC	1	167,087
IRS Tax Deposit	130	113,496
Delta Montrose Electric Assn.	20	97,242
Rocky Mountain HMO	23	73,577
CIRSA	12	66,051
David A Marek	12	63,302
C&N Construction, Inc.	2	58,524
Roop Excavating LLC	7	53,498

PAYEE	CHECKS WRITTEN	PAYMENT TOTAL
IRS Tax Deposit	130	\$ 113,496
FPPA - Fire & Police Pension	78	16,297
Mutual of Omaha	77	33,131
Colorado Dept of Labor	28	1,638
Aflac	24	2,566
Rocky Mountain HMO	23	73,576
Delta Montrose Electric Assn.	20	97,242
First State Bank of Colorado	17	1,477,922
Phonz +	16	8,770
Winwater Corp	15	46,102

Payments to the top vendor (First Bank of Colorado) are primarily attributed to payments for the lease and line of credit.

Independent Auditors' Report On Additional Information

Town of Paonia, Colorado

Our report on our audit of the financial statements of the Town as of December 31, 2016 appears in the financial statements of the Town. That audit was conducted for the purpose of forming opinions on the financial statements taken as a whole. The additional information in this report is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion on it.

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Appendix A

Adjusting Journal Entries Report And Reclassifying Journal Entries Report

Appendix B

Management Representation Letter