

ARKANSAS MUNICIPAL LEAGUE

# THE CIVILPEDIA HANDBOOK

A GUIDE TO MUNICIPAL  
GOVERNMENT IN ARKANSAS

## SECTION 2

### MUNICIPAL FINANCE

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## INTRODUCTION

Welcome to the first edition of the *Arkansas Municipal Civilpedia: A Guide to Municipal Government in Arkansas*. The primary purpose of the *Civilpedia* is to provide a practical guide to assist elected officials, newly elected and incumbent alike, in learning everything you need to know about your municipal government. While the *Civilpedia* will not replace the need to consult an attorney every now and then, it will provide you with the fundamental information you need regarding your statutory duties and responsibilities, how to pass ordinances and resolutions, municipal boards and commissions, revenue sources for municipalities, human resource issues, and much more. Further, it includes checklists, charts and timelines to provide practical guidance for municipal officials. The *Civilpedia* provides real-world examples and cites Arkansas statutes and case law, and it is designed to be updated on a regular basis as the Arkansas Code is amended and to reflect any changes in case law.

Before diving in, it is important to note that Arkansas statutes are laws passed by the Arkansas General Assembly and are codified into the Arkansas Code Annotated of 1987 as amended. The *Civilpedia* cites many statutes in the Arkansas Code and throughout it you will see Arkansas Code Annotated (abbreviated as A.C.A.) followed by pairs of numbers. When you see, for example, A.C.A. § 14-42-102, it means that the statute can be found in Title 14 – Chapter 42 – Subchapter 1. In this example, Title 14 references “Local Government,” Chapter 42 references “Government of Municipalities Generally” and Subchapter 1 references “General Provisions.” The *Civilpedia* will help you become familiar with the layout of the code, and you’ll learn to recognize that when you see something like A.C.A. § 14-43-104, you know that Chapter 43 pertains predominantly to cities of the first class.<sup>1</sup>

## DISCLAIMER

The information contained within this handbook is not intended as legal advice for any specific issue that may arise. The *Civilpedia* is meant to be used as a resource to learn more about municipal government in Arkansas. As you know, or will soon find out, many of the issues and challenges municipal governments face on a day-to-day basis are very fact specific. Elected officials are responsible for consulting with legal counsel when questions arise concerning the application of the law to a particular set of facts. This handbook is intended solely for educational and informational purposes.

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<sup>1</sup> There will also be times you read citations with the word “et seq.” after them, such as A.C.A. § 14-44-101 et seq. “Et seq.” is an abbreviated form of a range of Latin words that simply means “to follow.” So, if you see A.C.A. § 14-44-101 et seq., it will reference not only A.C.A. § 14-44-101, but every other statute in subchapter one, which in this case would be A.C.A. § 14-44-101 through A.C.A. § 14-44-117 (which is the last statute in this particular subchapter).

## SECTION II. MUNICIPAL FINANCE

### Chapter 1. Introduction

In the world of finance, municipal finance is unique. Finance can generally be broken down into three categories: personal, corporate and public. Everyone is familiar with personal finance, which is the management of personal savings, spending and investments. Corporate finance, as the name implies, focuses on how corporations address funding sources, capital structuring, accounting and investment decisions, much of which is motivated by profit. Public finance, including at the local government level, focuses predominantly on revenues, expenditures, debt (depending on the relevant laws) and assets, and it is motivated by public service rather than profit. Arkansas cities and towns focus on providing the best services at the lowest, reasonable cost to the citizenry.

Section II covers an array of concepts about municipal finance, including budgeting process, purchasing, the auditing process, deficit spending, revenue sources and municipal accounting generally. We will go over all the pertinent laws covering each aspect of municipal finance and present checklists and graphs to help better visualize a lot of these processes. We will also work through a handful of real-world problems and common questions that arise in municipalities on a regular basis. Whether you are the mayor, clerk, treasurer, recorder, council member, or municipal employee, everything you need to know about municipal finance should be detailed here in Section II. We may not cover every hypothetical scenario or question that might appear, but even a basic understanding of Section II should put you in the position to effectively manage your city's finances.

### Chapter 2. The Municipal Budget

#### A. The Budget Process

Arkansas municipalities are directed to assure that municipal expenditures are in accordance with an annual budget submitted by the mayor on or before December 1 of each year and approved by the city council or board of directors on or by February 1 of the following year.<sup>2</sup> Unlike the state government, which operates on a fiscal year that starts on July 1 and ends June 30, the fiscal year for municipalities is the calendar year. Therefore, the budget the mayor submits on or before December 1 is the budget for the next calendar year starting January 1 and ending December 31.<sup>3</sup>

The budget appropriates funds for municipal services, goods and activities. Consequently, the mayor, city clerk, treasurer and all others involved in purchasing, expenditures and decisions affecting expenditures, must act in accordance with the governing body's approved budget for the operation of the municipality. In other words, everyone involved in purchasing must be aware of how much has been appropriated and for what said funds have been appropriated for so that the municipality doesn't spend more money than has been appropriated and that funds are used for the purposes they have been appropriated. The annual operating budget should be the principal policy management tool for governing the municipality. It should be the mechanism to evaluate city services, set priorities and balance public service demands against the tax revenues required to furnish them. With that said, it is important that all municipal officials participate in the decision making that goes into building your municipal budget.

Municipal budgets may be adopted by either an ordinance or resolution.<sup>4</sup> The budget is not set in stone for the year and may be amended from time to time as needed. However, the budget must be amended in the same manner in which it was adopted. If the budget was adopted by ordinance, then it would take an ordinance to amend it. If the budget was adopted by resolution, then it would take a resolution to amend it. It is recommended to adopt your budget by resolution as it is easier and more practical to amend when the need arises.

#### B. Deficit Spending

Deficit spending is, barring specific exceptions, prohibited by state law. Article 12, § 4 of the Arkansas Constitution provides in part, "The fiscal affairs of counties, cities, and incorporated towns shall be conducted on a sound

<sup>2</sup> A.C.A. §§ 14-58-201 - 202

<sup>3</sup> A.C.A. § 14-71-102

<sup>4</sup> A.C.A. § 14-58-202

financial basis [...] nor shall any city council, board of alderman, board of public affairs, or commissioners, of any city of the first or second class, or any incorporated town, enter into any contract or make any allowances for any purpose whatsoever, or authorize the issuance of any contract or warrants, scrip or other evidences of indebtedness in excess of the revenue for such city or town for the current fiscal year [...]”. In short, a municipality generally cannot spend funds it doesn’t have or promise future funds that it does not currently have budgeted. However, the Arkansas Constitution has been amended since the original passage of Article 12, § 4. These amendments provide exceptions to the general rule that deficit spending is prohibited.

It is important to note here that when a constitutional amendment is passed, the amendment rarely establishes a framework or a procedure to follow. Instead, amendments tend to grant authority to the General Assembly to establish the framework in which the amendment is to operate. Take revenue bonds for example, which we detail below. Amendment 65 to the Arkansas Constitution authorizes revenue bonds. However, Amendment 65 grants explicit discretion to the General Assembly for purposes of determining for what purposes revenue bonds may be used and the conditions which must be followed.<sup>5</sup> As such, for the purposes of Amendment 65, the General Assembly passed the Revenue Bond Act of 1987 (Act 852 of 1987), which is codified in A.C.A. § 19-9-601 *et seq.*, the purpose being only to provide a procedural framework and to supplement Amendment 65.<sup>6</sup> Compare this with the Local Government Bond Act (Act 871 of 1985), codified in A.C.A. 14-164-301 *et seq.*, which was enacted after Amendment 62 (Capital Improvement Bonds). Again, Amendment 62 provided the General Assembly with authority to define and prescribe certain matters in respect to the exercise of the power granted in Amendment 62.<sup>7</sup>

## Amendment 62—Capital Improvements

Amendment 62 of the Arkansas Constitution authorizes municipalities to issue bonds for capital improvements of a public nature, as defined by the General Assembly. However, the governing body of a municipality alone cannot issue such bonds. An election must be held on the issue and a majority of the qualified electors voting must approve of the issuance and amount of the bond. The tax to retire the bond may be an *ad valorem* tax on real and personal property, or other taxes authorized by the General Assembly or the legislative body to retire the bonds. Finally, there is a limit on the principal amount of bonded indebtedness that a municipality may have outstanding and unpaid. For municipalities, this limit is set at 20% of the total assessed value for tax purposes of real and personal property in the municipality, as determined by the last tax assessment. Let’s look more closely at each of these steps.

Municipalities may issue bonds for capital improvements of a public nature. Bonds can look different depending on if it is a government or corporation issuing the bond. Nevertheless, a municipal bond is issued by a municipality when the municipality needs to raise money. In other words, it is similar to a loan. When someone buys a municipal bond, that person is essentially giving the municipality a loan and, depending on the details of the bond, the person buying the bond will get paid the face value of the bond plus interest—again, very similar to a loan. With that said, under Amendment 62, municipalities are authorized to issue bonds for the purpose of “capital improvements of a public nature.” This term is broadly defined in A.C.A. § 14-164-303(2), which also lists allowable capital improvements. The list includes, to name a few, the purchase, lease, construction, reconstruction, restoration, improvement, alteration or repair of things like city halls, courthouses, public offices, jails, police stations, stadiums and arenas, water pollution control facilities, storm sewers, and more.

As mentioned above, the governing body alone cannot issue bonds. The issue must go before the voters for approval. As with levying a general, citywide sales tax, it is ultimately the voters who approve the issuance of the bond and the amount issued. The legislative body will pass an ordinance specifying the principal amount of bonds to be issued, the purpose or purposes for which the bonds are to be issued, and the maximum rate of any *ad valorem* tax to be levied and pledged to the retirement of the bonds.<sup>8</sup> The question of the issuance of the bonds is then submitted to the electors of the municipality at the general election or at a special election.<sup>9</sup> An election is always required on the issuance of bonds. For example, if a city has a 1% sales tax in place for general municipal

5 Ark. Const. Amend. 65, § 1

6 See A.C.A. § 19-9-603. While the General Assembly cannot substantively change the meaning of Amendment 65, it can supplement and provide a procedural framework in which Amendment 65 is to be utilized.

7 A.C.A. § 15-164-302

8 A.C.A. § 14-164-308

9 A.C.A. § 14-164-309

purposes, the council can't pass an ordinance issuing a bond simply because it already has a sales tax in place.<sup>10</sup> The issuance of the bond itself must be approved by the voters.

Bonds will always be backed by some source of funding. In the instance of Amendment 62 bonds, the source is taxes. Under Amendment 62, municipalities are authorized to levy five mills on the dollar of the taxable real and personal property in the municipality to go toward retiring the bond.<sup>11</sup> More commonly, however, municipalities may levy a local sales tax in the amount of 0.125%, 0.25%, 0.5%, 0.75%, 1% or any combination of the amounts to retire the bonds.<sup>12</sup>

To recap, Amendment 62 provides the first exception to the general prohibition on deficit spending through the issuance of a bond for capital improvements of a public nature. The bond will be backed by an *ad valorem* or sales tax dedicated to retiring the bond. The issuance of the bond and sales tax must be submitted to the voters for approval in order to issue the bond.

## **Amendment 65—Revenue Bonds**

Amendment 65 provides the second exception to the rule against deficit spending. Amendment 65 permits municipalities to issue “revenue bonds.” Revenue bonds may be issued for the purpose of financing all or a portion of the costs of capital improvements of a public nature, facilities for the development of industry or agriculture, and for such other purposes as may be authorized by the General Assembly.<sup>13</sup> Again, the amendment refers to “capital improvements of a public nature” and the enabling statutes determine what is authorized.<sup>14</sup> Revenue bonds mean “bonds, notes, certificates or other instruments or evidences of indebtedness the repayment of which is secured by rents, user fees, charges, or other revenues (other than assessments for local improvements and taxes) derived from the project or improvements financed in whole or in part by such bonds [...]”<sup>15</sup> In other words, revenue bonds are bonds that are backed by a specific revenue source, whether that source is rents, user fees, charges or other revenues derived from the project or improvement that is being financed. Unlike capital improvement bonds under Amendment 62, revenue bonds are not backed by *ad valorem* or sales taxes. In fact, it is explicitly prohibited. Another distinction is that while Amendment 65 grants the General Assembly the authority to require an election on the issuance of a revenue bond, the General Assembly has not yet done so. Therefore, an election for the issuance of a revenue bond under Amendment 65 is not required.<sup>16</sup> However, a public hearing is required before the issuance of the bond.<sup>17</sup>

One of the most common utilizations of revenue bonds is in the scope of water and wastewater projects. Making capital improvements to a water system can be very costly and almost always requires the issuance of bonds to fund improvements. Revenue bonds are popular for capital improvements of this nature because, thanks to customers of the municipal water system, a revenue source is already established to pay for the bond.

## **Amendment 78—Short-Term Finance**

Amendment 78 provides the final major exception to the general rule prohibiting deficit spending. Amendment 78 authorizes municipalities to incur short-term financing obligations maturing over a period, or having a term, not to exceed five years.<sup>18</sup> Cities may incur short-term financing obligations for the purpose of acquiring, constructing, installing or renting real property or tangible personal property having an expected useful life of more than one year.<sup>19</sup> The aggregate principal amount of short-term financing obligations incurred by a municipality cannot exceed 5% of the assessed value of taxable property located within the municipality, as determined by the last tax assessment completed before the last obligation was incurred by the municipality. Short-term financing does not require approval from the voters before the municipality enters into a short-term financing agreement, nor does the financing have to be backed by any specific source of funds.

<sup>10</sup> Ark. Op. Atty. Gen. No. 2011-014

<sup>11</sup> Ark. Const. Amend. 62, § 2

<sup>12</sup> A.C.A. § 14-164-327

<sup>13</sup> Ark. Const. Amend. 65, § 1

<sup>14</sup> A.C.A. § 19-9-604(2)

<sup>15</sup> Ark. Const. Amend. 65, § 3

<sup>16</sup> Ark. Const. Amend. 65, § 1 and A.C.A. § 19-9-606

<sup>17</sup> A.C.A. § 19-9-607

<sup>18</sup> Ark. Const. Amend. 78, § 2

<sup>19</sup> Ark. Const. Amend. 78, § 2



## Chapter 3. Arkansas Municipal Accounting Law

The Arkansas Municipal Accounting Law, codified in A.C.A. §§ 14-59-101 through 14-59-119, provides the rules by which cities and towns are to handle municipal funds. It guides disbursements, bank reconciliations, record retention and other aspects of municipal bookkeeping.

### A. Duties of the Municipal Treasurer

Before examining the Arkansas Municipal Accounting Law, let's briefly revisit the duties of the treasurer. The treasurer is ultimately responsible for ensuring compliance with the law.<sup>20</sup> However, it should never be the treasurer's burden alone. It is up to every official to ensure your municipality is in compliance.

First and foremost, treasurers are required to maintain the accounting records prescribed in the Arkansas Municipal Accounting Law.<sup>21</sup> The treasurer or designated representative that has been approved by the governing body must submit a monthly financial report to the council or board of directors.<sup>22</sup> If the treasurer does not comply with the Arkansas Municipal Accounting Law or requests that specific duties be assigned to another employee or contracting entity, the governing body of a municipality may assign specific duties outlined in this chapter to another employee, or it may contract for the services to be performed by a private, qualified person or entity.<sup>23</sup> However, before the governing body assigns or contracts with a person or entity for the disbursement of funds, the governing body of a municipality shall establish by ordinance a method that provides for internal accounting controls and documentation for audit and accounting purposes.<sup>24</sup> The treasurer shall approve the disbursement of funds before the private, qualified person or entity disburses the funds. The governing body of a municipality shall ensure that the person or entity is adequately insured and bonded and conforms to best practices and standards in the industry. However, the governing body may not assign duties relating to the collecting of funds to anyone other than an employee of the municipality.

### B. Applicability and Bank Accounts

The Arkansas Municipal Accounting Law applies to all funds under the budgetary control of the governing bodies of the municipalities of this state, with the exception of water and sewer departments.<sup>25</sup> As for bank accounts, any municipality receiving state aid in the form of general turnback or highway revenues is required to maintain all funds in depositories approved for such purposes by law.<sup>26</sup> Further, cities are required to maintain separate bank accounts for general funds and street funds.<sup>27</sup> This requirement is very important and compliance tends to be a frequent finding from Legislative Audit. This statute will be covered in more detail later in this section.

### C. Disbursements

Disbursements generally must be made by prenumbered checks drawn upon the bank account of the municipality. The checks are the normal checks provided by commercial banking institutions and are required to contain, at a minimum, the following information: date of issue, check number, payee, amount, and the signatures of two authorized disbursing officers of the city.<sup>28</sup>

There are a couple of exceptions to the requirement to disburse funds by prenumbered checks. In a few situations, cities are authorized to utilize electronic fund transfers. Disbursements of funds used for payment of salaries and wages of municipal officials and employees may be made by electronic funds transfer provided that the municipal employee or official responsible for disbursements maintains a ledger containing, at a minimum: (1) name, address and SSN of the employee receiving payment of salary or wages; (2) routing number of the bank in which the funds are held; (3) account number; (4) accounts clearing house trace number pertaining to the transfer;

20 A.C.A. §§ 14-59-115 and 14-59-118

21 A.C.A. § 14-59-115(b)(1)

22 A.C.A. § 14-59-115(a)

23 A.C.A. § 14-59-115(b)(2)

24 A.C.A. § 14-59-115(b)(2)

25 A.C.A. § 14-59-102. Water and Sewer Departments are covered under the Municipal Water and Sewer Department Accounting Law codified in A.C.A. § 14-237-101 et seq.

26 A.C.A. § 14-59-104(a). See Chapter 4.

27 A.C.A. § 14-59-104(b)

28 A.C.A. § 14-59-105(a)-(b). Typically, the mayor and the clerk/recorder/treasurer are signatories on checks. However, it is important to have someone else, like a council member, authorized to sign checks in the event that the mayor or clerk/recorder/treasurer is unable to sign.

(5) date and amount transferred; and (6) proof that the employee has been notified of the direct deposit of their salary or wages by electronic funds transfer.<sup>29</sup>

Cities may also utilize electronic fund transfers when making payments to federal or state governmental entities.<sup>30</sup> Beyond these two key exceptions, A.C.A. § 14-59-105(e) provides a framework to expand what cities may use electronic fund transfers for, but it is important to read the statute and understand everything that is required before using electronic fund transfers for additional disbursements not mentioned above.<sup>31</sup>

Municipalities are also authorized, with council approval, to establish petty cash funds under A.C.A. § 14-59-106. In establishing such a fund, a check is to be drawn upon the general fund of the municipality payable to “petty cash.”<sup>32</sup> A paid-out slip is to be maintained with the petty cash and when the fund becomes depleted, the municipality may then draw another check payable to “petty cash” in an amount which equals the total paid-out slips issued.<sup>33</sup>

## D. Fixed Asset Records

All municipalities are required to keep a record of the municipality’s fixed assets. Fixed assets are simply assets that are purchased for long-term use and are not likely to be converted quickly into cash. Examples of fixed assets include land, buildings and equipment. The governing body is required to adopt a policy defining fixed assets and, at a minimum, the policy must set forth the dollar amount and useful life necessary to qualify something as a fixed asset. Further, cities are required to establish by major category and maintain, at a minimum, a listing of all fixed assets owned by the municipality. The categories of fixed assets must include the major types, such as land, buildings, motor vehicles (by department), equipment (by department) and other assets. The listing must be totaled by each category with a total for all categories. The listing must contain the following: (1) property item number, if used by the municipality; (2) brief description; (3) serial number, if available; (4) date of acquisition; and (5) cost of property.

These records detailing the fixed assets of the municipality may need to be updated from time to time as land is sold or as vehicles and equipment are sold and replaced.

## E. Bank Reconciliations

Every month, all municipalities are required to reconcile their cash receipts and disbursement journals to the amount on deposit in banks. Again, this is required to be done every month. The monthly reconciliation must be approved by a municipal official or employee other than the person preparing the reconciliation, as designated by the chief executive officer of the municipality. So, if the treasurer or clerk/treasurer prepares the reconciliation, then the treasurer or clerk/treasurer cannot be the person to also approve the reconciliation. It must be approved by someone designated by the chief executive officer and who did not prepare the reconciliation.

## F. Prenumbered Receipts

All funds received by the municipality must be formally receipted at the time of collection or the earliest opportunity by the use of prenumbered receipts or mechanical receipting devices.<sup>34</sup> If using prenumbered receipts, there are some minimum standards that must be met. If manual receipts are used, receipts must be prenumbered by the printer and a printer’s certificate obtained and retained for audit purposes.<sup>35</sup> The printer certificate must state the date printing was done, the numerical sequence of receipts printed and the name of the printer. Further, the prenumbered receipts must contain the following information: (1) date, (2) amount of receipt, (3) name of person or company from whom money was received, (4) purpose of payment, (5) fund to which receipt is to be credited, and (6) identification of employee receiving money. If manual receipts are used, then the original receipt should be given to the party making payment and a duplicate copy of the receipt shall be maintained in numerical

29 A.C.A. § 14-59-105(c)

30 A.C.A. § 14-59-105(d)

31 A.C.A. § 14-59-105(e) in short requires municipalities to: (1) establish by ordinance an electronic funds payment system directly into payees’ accounts in financial institutions in payment of any account allowed against the municipality; (2) establish written policies and procedures to ensure that the electronic funds payment system provides for internal accounting controls and documentation for audit and accounting purposes; and (3) comply with the information systems best practices approved by the Legislative Joint Auditing Committee before implementation by the municipality.

32 A.C.A. § 14-59-106(b)

33 A.C.A. § 14-59-106(c)

34 A.C.A. § 14-59-109(a)

35 A.C.A. § 14-59-106(b)(1)(A)

order in the receipt book and made available to the auditors during the course of the annual audit. Additional copies of the receipt are optional and may be used for any purposes the municipality deems fit. If using an electronic receipting system, the system must be in compliance with the Information Systems Best Practices Checklist provided by the Legislative Joint Auditing Committee.

## **G. Cash Receipts Journals**

Municipalities must establish a cash receipts journal or an electronic receipt listing that shall indicate: (1) the receipt number, (2) the date of the receipt, (3) the payor, (4) the amount of the receipt, (5) classification or general ledger account. The classification of the receipts shall include the major sources of revenue, such as state revenues; property taxes; sales taxes; fines, forfeitures and costs; and franchise fees.

All items of receipts must be posted to and properly classified in the cash receipts journal or electronic receipts listing. The journal shall be properly balanced and totaled monthly and on a year-to-date basis. The journal shall be reconciled monthly to total bank deposits as shown on the municipality's bank statements. The electronic receipts listing shall be posted to the general ledger at least monthly. The general ledger shall be reconciled monthly to total bank deposits as shown on the municipalities' bank statements.

## **H. Cash Disbursement Journals**

Municipalities must also establish a cash disbursements journal or electronic check register that shall indicate the date, payee, check number or transaction number, amount of each check written or transaction, and classification or general ledger account. The classifications of expenditures shall include the major type of expenditures by department, such as personal services; supplies; other services and charges; capital outlay; debt service; and transfers out. The cash disbursements journal shall be properly balanced and totaled monthly and on a year-to-date basis. The cash disbursements journal shall be reconciled monthly to total bank disbursements as indicated on the monthly bank statements. The electronic check register shall be posted to the general ledger at least monthly. The general ledger shall be reconciled monthly to total bank disbursements as indicated on the monthly bank statements.

## **I. Debit Card and Credit Card Payments**

Municipalities are authorized to accept a legal payment and any associated costs through a debit card or credit card in accordance with applicable state and federal law.<sup>36</sup> Municipalities may enter into a contract with a credit card or debit card company and pay any fee normally charged by the credit card or debit card company for allowing the municipality to accept the credit card or debit card as payment. When a payment is made through a credit card or debit card, the municipality shall assess a transaction fee equal to the amount charged to the municipality by a credit card or debit card company. However, a municipality shall not assess a transaction fee for payments made through a credit card or debit card if the governing body of the municipality determines that the transaction fee is included in the amount charged for the service or product for which a credit card or debit card payment is made.

## **J. Annual Publication of Financial Statement**

Every year the governing body is required to publish a financial statement of the municipality, including receipts and expenditures for the period and a statement of the indebtedness and financial condition of the municipality. The financial statement must be published one time in a newspaper published in the municipality, but if there is no newspaper published in the municipality, then the financial statement must be posted in two of the most public places in the municipality. The financial statement shall be at least as detailed as the minimum record of accounts as provided in this chapter and it must be published by April 1 of the following year.

## **K. Accounting Record Retention**

Municipal accounting records can be divided into three groups: (1) support documents, (2) semipermanent records and (3) permanent records.

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<sup>36</sup> A.C.A. § 14-59-119(a)

Support documents consist primarily of canceled checks, invoices, bank statements, receipts, deposit slips, bank reconciliations, checkbook register or listing, receipt listing, monthly financial reports, payroll records, budget documents, and bids, quotes and related documentation. Support documents must be maintained for a period of at least four years and in no event shall they be disposed of before being audited for the period in question.

Semipermanent records consist of fixed assets and equipment detail records; investment and certificate of deposit records; journals, ledgers and subsidiary ledgers; and annual financial reports. Semipermanent records must be maintained for a period of not less than seven years and in no event shall be disposed of before being audited for the period in question. For investment and certificate of deposit records, the seven years of required maintenance begins on the date of maturity.

Permanent records consist of city or town council minutes, ordinances, resolutions, employee retirement documents and annual financial audits. Permanent records shall be maintained permanently.

When documents are destroyed, the municipality shall document the destruction by the following procedure. First, an affidavit must be prepared stating which documents are being destroyed, the period of time to which they apply and the method of destruction. The affidavit is to be signed by the municipal employee performing the destruction and one council member. Next, the council must approve the destruction of documents and there must be an appropriate note of the approval indicated in the council minutes along with the destruction affidavit. Council approval must be obtained before destruction.

## **L. Withholding Turnback and Penalty**

When Legislative Audit audits a municipality's financials, if there is a finding of a municipality being in substantial noncompliance with the Municipal Accounting Law, then the municipality is referred to the Legislative Joint Auditing Committee (LJAC). Once Legislative Audit notifies LJAC of the noncompliance, then the LJAC will in writing notify the mayor and the city or town council that the municipality's accounting records do not substantially comply with this chapter.

The municipality will have 60 days after the date of notification to bring the accounting records into substantial compliance with the Municipal Accounting Law. After the 60 days allowed for compliance or upon request by the appropriate municipal officials, Legislative Audit shall review the records to determine if the municipality substantially complies with this chapter. If Legislative Audit still finds substantial noncompliance with the Municipal Accounting Law, then they will notify the LJAC, which in turn may notify the Treasurer of State. If reported to the Treasurer of State, the Treasurer of State will place 50% of the municipality's turnback in escrow until the LJAC committee reports that the municipality has substantially complied. If Legislative Audit has not received a request for a review of the records from the municipality before the end of the 120-day period after the first date of notification of noncompliance, the LJAC may notify the municipality and the Treasurer of State of the continued noncompliance. Upon notice by the LJAC, the Treasurer of State will then withhold all turnback until such time that the accounting records have been reviewed and determined by Legislative Audit to be in substantial compliance with the Municipal Accounting Law. If after six months Legislative Audit has still not received a request for a review of the records, then LJAC may notify the Treasurer of State that the municipality has forfeited all escrowed funds, and the Treasurer of State will redistribute all escrow turnback funds applicable to the municipality among all other municipalities receiving turnback.

Failure to comply with the Municipal Accounting Laws can lead to a municipality having its turnback funds withheld. However, it does not end there. If the LJAC concludes the process under A.C.A. § 14-59-117, detailed above, and in the immediately subsequent three-year period the LJAC concludes the process a second time, the LJAC may notify the Attorney General and the Governor of its actions. The Attorney General may then file pleadings in the circuit court of the Sixth Judicial District to revoke the charter of the municipal corporation. The municipality would then consolidate back into the county.

# Chapter 4. Municipal Accounting Handbook

## A. Accounting System

Before you can set up or understand your accounting records, dive into your day-to-day transactions, and get your books ready for end-of-month or end-of-year reporting, you must gain an understanding of some basic accounting concepts.

Accounting is the method in which financial information is gathered, processed and summarized into financial statements and reports. An accounting system is represented by the following graphic, which is further explained below.

1	2	3	4	5
Business Transactions (Source)	Journal Entry	General Ledger	Trial Balance	Fund Statements (Financial Statements)

Every accounting entry is based on a business transaction, which is always evidenced by a business document, such as a check, invoice or travel form. A journal is a place to record the transaction of a municipality. The typical journals used to record the chronological, day-to-day transactions, such as revenue and expenditures, are cash receipts journals and cash disbursements journals. While a journal records transactions as they happen, a ledger groups transactions according to their *type*, based on the accounts they affect. A general ledger is a collection of all balance sheets, revenue and expense accounts used to keep municipal accounting records. At the end of an accounting period—a calendar month—all journal entries are summarized and transferred to the general ledger accounts. This procedure is called “posting.”

A trial balance is prepared at the end of an accounting period by adding up all the account balances in your general ledger. The sum of the debit balances should equal the sum of your credit balances. If total debits do not equal total credits, then you must track down the errors. Finally, financial statements, which are fund statements consisting of balance sheets and income statements, are prepared from the information in your trial balance.

Basic accounting records are required by Arkansas law and are important because the resulting financial statements and reports assist you, your mayor and city council in planning and making sound financial decisions.

## B. Accounting Basics (Assets = Liabilities + Fund Balance)

If you understand the definition and goals of an accounting system, you are ready to learn the following accounting concepts and definitions.

- Assets—Items of value held by the municipality. Assets are balance sheet accounts. Examples of assets are cash, investments, fixed assets, etc.
- Liabilities—This is what your municipality owes to creditors. Liabilities are also balance sheet accounts. Examples include payroll, taxes payable, loans and bonds payable, money due to other governmental agencies, etc.
- Fund Balances—The net worth of each of your funds. An accumulation of revenues received less expenses incurred. Assets, liabilities and fund balances are **permanent** accounts. In other words, they **do not** close at the end of the accounting period. Fund balances are reported in the following classifications:
  - Nonspendable—Fund balances that are either not in spendable form or legally or contractually required to be maintained intact.
  - Restricted—Fund balances which have constraints, or restrictions, on the use of resources that are either:
    - ◆ A) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or
    - ◆ B) imposed by law.
  - Committed—Fund balances that can only be used for specific purposes pursuant to constraints imposed by ordinances.



- Assigned—Fund balances that are constrained by the city’s intent to be used for specific purposes, but are neither restricted nor committed. Assigned fund balances include all remaining amounts (except negative fund balances) that are reported in governmental funds, other than the general fund, that are not classified as nonspendable, restricted nor committed, and amounts in the general fund that are intended to be used for a specific purpose. Cities should not report an assigned fund balance if the assignment would result in a negative unassigned fund balance.
- Unassigned—Unassigned fund balance is the residual classification of the general fund. The general fund should be the only fund that reports a positive unassigned fund balance amount. In other governmental funds, if expenditures incurred for specific purposes exceeded the amounts restricted, committed or assigned to those purposes, it may be necessary to report a negative unassigned fund balance.

The accounting equation: **Assets = Liabilities + Fund Balance**. It is important to note that the assets are on the left-hand side of the equation, and liabilities and fund balances are on the right-hand side of the equation. Once you master the above accounting terms and concepts, you are ready to learn about the following day-to-day accounting terms.

- Debits—At least one component of every accounting transaction (journal entry) is a debit amount. Debits increase assets and decrease liabilities and fund balance. In bookkeeping texts, examples and ledgers, you may see the word “Debit” abbreviated as “**Dr.**”
- Credits—At least one component of every accounting transaction (journal entry) is a credit amount. Credits increase liabilities and fund balances and decrease assets. In bookkeeping texts, examples and ledgers, you may see the word “Credit” abbreviated as “**Cr.**”

**Assets = Liabilities + Equity (Fund Balance) Revenues – Expenditures**

<b>Assets</b>	<b>(Increase = Debit) (Decrease = Credit)</b>
<b>Liabilities</b>	<b>(Increase = Credit) (Decrease = Debit)</b>
<b>Fund</b>	<b>(Increase = Credit) (Decrease = Debit)</b>
<b>Revenue</b>	<b>(Increase = Credit) (Decrease = Debit)</b>
<b>Expenditures</b>	<b>(Increase = Debit) (Decrease = Credit)</b>

**C. Arkansas Self-Insured Fidelity Bond Program**

All Arkansas municipalities participate in the Self-Insured Fidelity Bond Program administered by the Governmental Bonding Board. This program covers actual losses sustained by the participating entity through any fraudulent or dishonest act or acts committed by any of the officials or employees, acting alone or in collusion with others, during the bond period to an amount not exceeding the lesser of \$300,000 or the amount of the bond. Premiums for coverage are determined by the State Risk Manager and approved by the board. These premiums are paid by the State Treasurer from funds withheld from the Municipal Aid Fund. There is a \$2,500 deductible per occurrence. A certificate of coverage may be obtained by contacting the Risk Management Division at 501-371-2690 or via email at [insurance.risk.management@arkansas.gov](mailto:insurance.risk.management@arkansas.gov). Copies of the bond policy may be obtained at [www.insurance.arkansas.gov/risk.htm](http://www.insurance.arkansas.gov/risk.htm). All Proof of Loss notices must be submitted to the Arkansas Governmental Bonding Board by the Division of Legislative Audit. Coverage is provided for funds audited in compliance with

Section 4 of the Bond policy. Private audits—those not performed by Legislative Audit—must be completed within 18 months of each participating governmental entity’s fiscal year end.

## D. Accounting and Budgeting

### Fund Accounting.

A fund is an accounting entity with a set of self-balancing accounts. It is used to record financial information associated with the specific activities of that entity. Sounds simple enough, right? It is a bunch of account numbers or names that tell the financial story of an activity. Self-balancing means Debits = Credits. Every time a financial transaction takes place, at least one account is debited and one account is credited.

### How many funds should a government have?

There is no set number of funds that a government should have. The number depends on the size and complexity of the government. A practical accounting rule states that a government should use the smallest number of funds possible that will allow the government to meet legal and sound financial administration requirements. However, we do know that we are required to maintain at least two different funds and bank accounts: (1) General Fund and (2) Street Fund.<sup>37</sup>

### What are fund types and classifications?

Every general purpose government (municipal, county, state, etc.) should have a general fund. A general fund means one, and only one, general fund. There are three types of funds that a government may use: (1) governmental fund, (2) proprietary fund types and (3) fiduciary fund types. The chart below shows all of the fund types and fund classifications. Don’t panic! The list is here just to let you know that these things exist. You will probably not have to use all of them.

<b>Fund Type:</b>	<b>Governmental</b>	<b>Proprietary</b>	<b>Fiduciary</b>
<b>Fund Classifications:</b>	<b>General Fund</b>	<b>Enterprise Funds (2)</b>	<b>Pension Funds (3)</b>
	Special Revenue (1)	Internal Service	Investment Trust
	Debt Service Capital		Private Purpose
	Projects Permanent Funds		Trust Agency Funds(4)
<b>Examples:</b>	General Fund	Water Fund (2)	Fire Pension (3)
	Street Fund (1)	Sewer Fund (2)	Admin. of Justice (4)

### Which funds will I have to use?

Most cities and towns in Arkansas will use two fund types and three fund classifications. The governmental funds are used to account for activities primarily supported by taxes, grants and similar revenue sources. Under the governmental fund type, there is the (1) general fund, (2) debt service fund, (3) permanent fund (e.g. municipal cemetery fund) and (4) special revenue fund (e.g. street fund). The fiduciary funds are used to account for activities that cannot be used to support the government’s own programs. Under the fiduciary fund type, there is the (1) agency fund (e.g. the Administration of Justice fund) and (2) the pension fund (e.g. the Police Pension and Relief Fund). The proprietary funds are used to account for activities supported form fees and charges (e.g. water fund or sewer fund).

<sup>37</sup> See A.C.A. § 14-59-101 et seq.

## **E. General Payroll and Tax Reporting Information**

### **Payroll Taxes**

Payroll involves numerous types of taxes and deductions, all with specific rules and deadlines. Both taxes and deductions can be fully paid by the employee, fully paid by the employer, or both parties pay a part of it. The most common taxes are (1) Social Security Tax (FICA), (2) Federal Withholding, (3) State Withholding, (4) Federal Unemployment and (5) State Unemployment.

### **Social Security Tax (FICA)**

This includes Social Security and Medicare Tax. A portion is deducted from the employee and the employer also pays a portion. Currently, Social Security is 12.4% with ½ (6.2%) paid by both the employee and the employer. Medicare, on the other hand, is 2.9% with ½ (1.45%) paid by both the employee and employer.

Social Security has a wage base limit, but Medicare does not. Therefore, when the employee's gross taxable salary reaches the base limit, no more Social Security tax is deducted. However, Medicare is calculated on 100% of taxable salary. It is important to remember that the wage base limit changes every year so it is recommended that you verify this annually.

Payment is made monthly or with each payroll, depending on the size of the annual payroll. The payment method is determined by the IRS and is subject to change. It is recommended this tax is paid within three working days of the payroll date to ensure compliance and to eliminate fees for non-payment or late payments. IRS fees can be very hefty.

### **Federal Withholding and State Withholding**

Federal Withholding is only paid by the employee. The amount withheld is the amount remitted to the IRS. This tax is remitted with the Social Security Tax. State Withholding is also only paid by the employee. The amount withheld is the amount remitted to the State of Arkansas. Payment is made monthly by the 15th of the next month. Use Form AR-941M to remit the payment to the Department of Finance and Administration (DFA). The State usually sends a packet in January of each year with 12 monthly reports, an annual reconciliation and address labels. Reports can also be filed online at [atap.arkansas.gov](http://atap.arkansas.gov). This is the recommended method of filing. Annual reconciliation should be filed using Form AR 3MAR and this is due by February 28 of the year immediately following the tax year you are filing.

### **Federal Unemployment and State Unemployment Tax**

Federal Unemployment Tax (FUTA) is not currently required by municipalities. FUTA supplements state unemployment if state unemployment runs out of funds for benefits. State Unemployment Tax (SUTA) is fully paid by the employer. Every January you should receive notification of the annual rate. The unemployment insurance tax is computed on the wages paid to each employee on a calendar quarter basis. The current taxable wage base that Arkansas employers are required by law to pay unemployment insurance tax on is \$12,000 per employee, per calendar year.

Payment of SUTA is made quarterly by the end of the month following the end of each calendar quarter. Therefore, SUTA reports are due by January 31 (for the fourth quarter of the previous calendar year), April 30, July 31 and October 31.

### **Other Payroll Deductions and Common Payroll Errors to Avoid**

There are many different types of deductions and expenses that must be remitted. These range from health insurance, child support, garnishments or savings accounts. It is common that health insurance is paid by both parties. Garnishments and child support would only be paid by the employee. Retirement plans are usually paid by both parties, but long-term employees may not be required to contribute. Deductions should be processed according to the specific rules for that deduction. For example, health insurance is usually paid monthly through an accounts payable check. Retirement payments are also paid monthly, LOPFI ([www.lopfi-prb.com](http://www.lopfi-prb.com)) and APERS ([www.apers.org](http://www.apers.org)) both require online processing. Child



support and garnishments are usually paid every payroll, but the specific requirements can be found in the court order.

Some of the most common payroll errors noted in municipal audit reports are: (1) failure to file federal and state payroll reports, (2) federal and state payroll reports or forms improperly filed, (3) failure to properly report compensation to the IRS and the Arkansas Department of Finance and Administration, (4) failure to properly remit payroll taxes and withholdings to the IRS and DFA, and (5) failure to reconcile amounts on payroll reports and forms filed with IRS and DFA to city records.

## Important General Payroll Information

**New Hire Reporting:** All employers must report their new and rehired employees to the state directory of new hires. Federal law mandates the new hires be reported within 20 days of the date of hire. For information contact the Arkansas New Hire Reporting Center at 800-259-2095 or 501-376-2125.

**I-9 Forms:** I-9 Forms verify that all new employees are eligible to work in the United States. Each employee must fill one out and provide the necessary documentation within three days of employment.

**W-4 Forms:** The IRS requires a completed W-4 Withholding Allowance Certificate before any employee is entitled to claim withholding allowances. All new employees and those employees whose withholding status has changed should file a new W-4.

**Arkansas State Withholding:** This form is used to claim withholdings for state tax.

**Applications and Job Postings:** Applications should remain on file for one year. Job postings and advertisements should be on file for one year. Employers must treat medical records as confidential information; they must be kept separate from the employee's general personnel file. Access should be limited to individuals with a need-to-know basis. All employee files must contain an application, W-4 and an I-9.

**Withholdings:** For child support, remit money immediately. For bankruptcy, remit as per direction of the court. For wage garnishment, remit as per direction of the court.

**Employee Termination:** For a worker who quits, pay the next regular payday. For a worker who is fired, pay within seven days.

**Postings:** Federal laws require every covered employer to post specific labor information. If your city has any branch offices or separate locations, each must display a complete set of postings. State laws require postings for minimum wage, right to know, unemployment insurance, worker's compensation and sexual harassment.

**W-2:** Send W-2s to each employee by January 31. Reports must be filed with a W-3 by February 28 to the Social Security Administration. (These forms should be ordered in October or November.)

**W-9:** A request for taxpayer identification number and certification, Form W-9 is used to get the correct TIN (taxpayer identification number) to report, for example, real estate transactions, transactions with vendors, etc.

**1099:** Form 1099 is used to report income of vendors that are not incorporated to whom you have paid over \$600, and the form must be sent out by January 31. Reports must be filed with the IRS with a recap Form 1096. (These forms should be ordered in October or November.)

## Chapter 5. Sources of Revenue

### A. Overview

Municipalities in Arkansas have several ways to generate revenue in order to provide the necessary services that municipalities offer. Municipalities are not for-profit entities, nor do they derive any type of revenue from the sale of goods or anything similar. Instead, municipalities predominantly receive revenue to operate through taxes and services provided. In this chapter, we will cover the major sources of revenues that municipalities have at their disposal.

## B. City and County Local Sales Taxes

The most typical source of revenue for municipalities in Arkansas is a sales tax. A sales tax is a consumption tax imposed by the government on the sale of goods and services. The state of Arkansas, counties and municipalities are all authorized to have sales taxes. For municipalities, the beginning of the authority to levy a sales tax comes from A.C.A. § 14-43-606(a), which provides: “No municipality shall levy any sales, which includes gross receipts or gross proceeds, use, payroll, or income tax other than those authorized by law.” Municipalities cannot simply levy a sales tax in whatever manner or amount that they so choose. Instead, we must look at the specific operating authorities that authorize municipalities to levy sales taxes

### City Sales Tax

Municipalities in Arkansas have two operating authorities in which they may levy a sales tax under A.C.A. § 26-75-201 *et seq.* and 26-75-301 *et seq.* Although both subchapters are nearly identical, it is important to note that they authorize separate taxes.<sup>38</sup> Under both operating authorities, the governing body may adopt an ordinance levying a local sales and use tax in the amount of 0.125%, 0.25%, 0.5%, 0.75%, 1%, or any combination of these amounts for the benefit of the city.<sup>39</sup> These two provisions were amended by Act 1561 of 2001 to add the language “or any combination [of these amounts].” What is the maximum tax rate that can be levied? The Attorney General has opined that the plain wording of the statutes would suggest that the fractional amounts can be combined, which could yield a sales tax of 2.625%, assuming voter approval is obtained.<sup>40</sup>

The sales tax is levied on the receipts from the sale at retail of all items and services that are subject to taxation under the Arkansas Gross Receipts Act of 1941 (A.C.A. § 26-52-101 *et seq.*) and the Arkansas Compensating Tax Act of 1949 (A.C.A. § 26-53-101 *et seq.*).<sup>41</sup> In other words, the sales tax is levied on what the state of Arkansas authorizes to be taxed. If the state passes a tax exemption on a particular item, then that item will also be exempt from local sales taxes. Therefore, under both subchapters 2 and 3, a municipality could levy a sales tax of up to 2.625% with voter approval. Revenues generated from the levying of a sales tax under these two subchapters may be used for general revenue,<sup>42</sup> special revenue (if the ballot title restricts the use of funds)<sup>43</sup> or pledged to bonds (if done by a separate vote).<sup>44</sup>

Broadly speaking, there are five steps to levying a sales tax: (1a) the levying ordinance, (1b) the levying petition, (2) the ordinance calling for the special election, (3) the election, (4) mayor’s proclamation and (5) notification to the Arkansas Department of Finance and Administration (DF&A). In order for the municipality to initiate the process of levying a sales tax, it must adopt an ordinance levying the sales tax. This is the ordinance that will provide the percentage being levied, the expiration of the tax if needed, the effective date and purpose of the tax (whether for general purposes or a dedicated purpose).<sup>45</sup>

Citizens may also initiate the levying of a sales tax. A legal voter of the municipality may file a petition with the governing body requesting a special election on the question of levying a local sales tax.<sup>46</sup> The petition must be signed by a number of the legal voters in the city that is no less than 15% of the number of votes cast for the office of mayor at the last preceding general election. On the date of the filing of a petition or on the date of adoption of an ordinance levying a local sales tax for the benefit of the city, the city by ordinance shall provide for the calling of a special election on the question in accordance with A.C.A. § 7-11-201 *et seq.*<sup>47</sup> Note: If the municipality is the one initiating the levy of the sales tax, then the municipality should pass two ordinances at the council or director meeting, (1) the levying ordinance and (2) the ordinance calling for the special election.

The special election will be called on the next special election date under A.C.A. § 7-11-205. It is important to note that the law surrounding special elections has changed in previous years. Prior to the 2021 Arkansas legislative session, municipalities could have special elections on the second Tuesday of any month, unless the election

38 See Ark. Op. Atty. Gen. Nos. 2008-036, 97-087, 96-093, 94-058, 93-078.

39 A.C.A. §§ 26-75-207 and 26-75-307

40 Ark. Op. Atty. Gen. No. 2008-036

41 A.C.A. §§ 26-75-212 and 26-75-312

42 A.C.A. §§ 26-75-201(c)(2) and 26-75-301(c)(2)

43 A.C.A. §§ 26-75-206 and A 26-75-306

44 A.C.A. §§ 26-75-204-205 and 26-75-304-305

45 A.C.A. §§ 26-75-207 and 26-75-307

46 Id.

47 A.C.A. §§ 26-75-208 and 26-75-308

would be held in the month in which the preferential primary or general election was scheduled. There are now only two dates a year in which municipalities can have special elections: either the second Tuesday of March or November in a year when a presidential election is held, or the second Tuesday of May or November in all other years.

Following the election, the mayor must issue a proclamation of the results of the election with reference to the local sales tax, and the proclamation must be published one time in a newspaper having general circulation in the city.<sup>48</sup> The mayor must also notify the secretary of DF&A of the rate change after publication of the proclamation has occurred and 90 days before the effective date of the tax.<sup>49</sup> This notification allows DF&A to notify the retailers of the change in rates.

## County Sales Tax

The operating authorities for the county sales tax is codified in A.C.A. § 26-74-201 *et seq.* and 26-74-301 *et seq.* County sales taxes may also affect the cities and towns within them. If the county has levied a sales tax pursuant to one of these two subchapters, then the municipalities within the county receive a per capita share of the levied sales tax.<sup>50</sup> However, if the county has levied a sales tax pursuant to A.C.A. § 26-74-401 *et seq.*, then the municipality may or may not receive a share depending on whether the municipality has its own sales tax.<sup>51</sup>

## C. Ad Valorem General Fund Property Tax

Article 12, Section 4 of the Arkansas Constitution authorizes the governing body of a municipality to levy up to five (.005) mills.<sup>52</sup> Voter approval is not required, and the revenue generated from this millage may be used for general or specific purposes.

A city can have an additional millage up to one mill (.001) each for police and fire pensions.<sup>53</sup> However, these specific mills must be approved by the voters. It is only the five general mills that the governing body of the municipality may levy without having an election. Most importantly, municipalities must certify the millage amount each year with the county clerk on or before the time fixed by law for levying county taxes.<sup>54</sup>

Cities and towns may also receive a portion of certain mills levied by the county. Pursuant to A.C.A. § 26-79-104, of the amount collected from the county's annual three-mill road tax, the county courts must apportion one half, except when a greater amount is allowed by law, of the amount collected upon property within the corporate limits of any city or town for use in making and repairing the streets and bridges in the respective cities or towns.

## D. State Turnback and Municipal Aid

One of the key revenue sources for municipalities in Arkansas is the Municipal Aid Fund, also known as state turnback. The Municipal Aid Fund consists of general revenues made available to the Municipal Aid Fund by the Revenue Stabilization Law (A.C.A. § 19-5-101 *et seq.*) and such special revenues derived from highway user imposts by the Arkansas Highway Revenue Distribution Law, (A.C.A. § 27-70-201 *et seq.*) These two items are generally referred to as general turnback and street turnback respectively. General turnback is established through the Arkansas Revenue Stabilization Law and is an appropriation of state revenue to municipalities. The amount of the appropriation is set by the state legislature.

Street turnback, however, includes a variety of taxes on fuel, gas and diesel in which municipalities get 15%, counties get 15% and the state gets 70% of the taxes collected.

General turnback and street turnback make up the Municipal Aid Fund. These funds are divided on a per capita basis among the municipalities in Arkansas. While general turnback may be used for any municipal purposes, there are limitations on what street turnback funds may be used for. Remember: Street funds must be

<sup>48</sup> A.C.A. §§ 26-75-209 and 26-75-309

<sup>49</sup> Id.

<sup>50</sup> A.C.A. §§ 26-74-214(b)(2) and 26-74-313(d)(1)

<sup>51</sup> A.C.A. § 26-74-409(a)(3) provides, "Furthermore, the Treasurer of State shall determine which cities or towns within the county do not levy a local sales tax and remit to those cities or towns a percentage of the tax based upon the population of the city or town versus the population of the county."

<sup>52</sup> See also A.C.A. § 26-25-102.

<sup>53</sup> A.C.A. § 24-11-404 and 24-11-812

<sup>54</sup> A.C.A. § 26-73-202. See also A.C.A. § 14-14-904(b), which provides, "the quorum court at its regular meeting in November or December of each year shall levy the county taxes, municipal taxes, and school taxes for the current year." Therefore, you should have your certification to the county by the end of October.

maintained in a separate bank account and cannot be commingled with the general fund account.<sup>55</sup> Further, street turnback funds may only be used for the purposes authorized in A.C.A. § 27-70-207(c)(1). The purposes include: (1) the maintenance, construction and reconstruction of streets that are not continuations of state highways and for other surface transportation; (2) any public transportation; and (3) any other transportation system improvement or service within the political subdivision, including without limitation those projects defined as a transportation system under A.C.A. § 27-76-103<sup>56</sup>, regardless of whether or not the political subdivision is a member of a regional mobility authority.

## E. Franchise Fees

Franchise fees are fees paid by a utility to a municipality for using public rights of way for the utility's lines. Rights of way typically include municipally owned water lines, sewer lines and, for some cities, electric lines. However, not every municipality owns all the utilities. Therefore, when private utilities, like electricity providers, are needed in a municipality, then a private utility company will lay its utility lines in the municipality's right of way. In return, the municipality may receive compensation in the form of franchise fees for that usage.

For the purposes of franchise fees on public utilities, the term "public utility" means electric, gas, sewer, water, or telephone company or utility, and any company or utility providing similar services.<sup>57</sup> Franchise fees are authorized to be set by either ordinance or resolution.<sup>58</sup> If a franchise fee has no end date or time period, then it would be of a general or permanent nature and should therefore be established by ordinance. If, on the other hand, the franchise fee is for a limited time, then it may be appropriate to enact a franchise fee through a resolution. The franchise fee established cannot exceed 4.25% of revenue collected by the public utility, unless the city has come to an agreement with the utility for a larger amount.

## F. Solid Waste/Sanitation Fees

Arkansas law requires municipalities to provide solid waste management systems that adequately provide for the collection and disposal of all solid wastes generated or existing within the municipality. A municipality may enter into an agreement with another municipality, county or regional solid waste management district, private persons, or any combination thereof to provide this service.

The municipality is authorized to levy and collect fees and charges and require such licenses as necessary to fulfill the purposes set out in A.C.A. § 8-6-201 *et seq.* If fees and service charges billed are more than 90 days delinquent, then the bill may be entered on the tax records of the county as a delinquent periodic fee or service charge and may be collected by the county with personal property taxes.

## G. Fines and Forfeitures

Municipalities may pass ordinances that are enforced through the imposition of fines, forfeitures and penalties on violators of city ordinances. Recall from Section I Chapter 3 that ordinances must be reasonable and not oppressive nor ambiguous. These factors should also be considered in the setting of fines for the violation of an ordinance. For example, a fine set at \$1,000,000 for jaywalking would very likely be held to be unreasonable. Also recall that ordinances imposing a penalty are not effective until they have been published as to put everyone on notice of the prohibited conduct.

## H. Business Licenses

Municipalities are charged with protecting and promoting the safety and health of the public. One of the ways cities accomplish this is through the issuance of business licenses, which allows them to keep track of businesses operating within the corporate limits of the municipality and helps ensure businesses are operating properly.

<sup>55</sup> A.C.A. § 14-59-104(c).

<sup>56</sup> A.C.A. § 27-76-103 defines "Transportation project" as (a) any part of a transportation system; (b) construction on or of any part of a transportation system; (c) maintenance on or operation of any part of a transportation system; or (d) preservation of any part of a transportation system. It further defines "Transportation system" to mean "infrastructure that provides mobility for people or goods in a region, including without limitation: (a) roads; (b) streets; (c) highways; (d) bridges; (e) tunnels; (f) sidewalks; (g) bicycle paths; (h) trails; (i) toll facilities; (j) pedestrian ways; (k) intermodal facilities; (l) port authorities; (m) waterways; (n) railroads; (o) parking facilities; (p) public transit systems; (q) traveler information systems; (r) intelligent transportation systems; (t) traffic signal systems; (u) safety improvements; or (v) any other means of surface or water transportation.

<sup>57</sup> A.C.A. § 14-200-101(a)

<sup>58</sup> A.C.A. § 14-200-101(b)(1)

Municipalities are authorized, by an ordinance passed by 2/3 vote of the governing body, to require any person, firm, individual or corporation engaging in any trade, business, profession, vocation or calling to pay a license fee or tax.<sup>59</sup> However, a person, firm, individual or corporation is not required to pay a license fee in more than one city unless such person, firm, individual or corporation maintains a place of business in more than one city.<sup>60</sup>

## I. Water and Wastewater Rates

Revenue generated from water and wastewater system rates tend to be the major funding sources for those municipal services. The process for setting those rates is similar for each, with some key differences.

### Water Systems

Municipalities are authorized to charge rates for resident and nonresident consumers of municipal waterworks systems. The rates must be fixed by the legislative body of the municipality. This is true regardless of whether the municipality has a separate water commission. The governing body has the ultimate say in the setting of rates.<sup>61</sup> However, the rates that are charged must be adequate to: (1) pay the principal of and interest on all revenue bonds and revenue promissory notes as they mature, (2) make such payments into a revenue bond sinking fund as may be required by ordinance or trust indenture, and (3) provide an adequate depreciation fund and to prove the operating authority's estimated cost of operating and maintaining the waterworks system.<sup>62</sup>

If water rates generate a surplus, A.C.A. § 14-234-214(e) requires that the municipality treat the surplus accordingly:

1. If any surplus is accumulated in the operation and maintenance fund that is in excess of the operating authority's estimated cost of maintaining and operating the plant during the next fiscal year, then the excess may be transferred to either (a) the depreciation account or (b) to the bond and interest redemption account;
2. If any surplus is accumulated in the depreciation account over and above what the operating authority finds necessary for probable replacements needed during the current fiscal year and the next fiscal year, then the excess may be transferred to the bond and interest redemption account;
3. If a surplus shall exist in the bond and interest redemption account, it then may be applied as authorized to (a) the payment of bonds that may later be issued for additional betterments and improvements; (b) to the purchase or retirement, in so far as possible, of outstanding unmatured bonds payable from the bond and interest redemption account, at no more than fair market value therefore; (c) the payment of any outstanding unmatured bonds payable from the bond and interest redemption account that may be subject to call for redemption before maturity; or (d) any other municipal purpose.<sup>63</sup>

The intent of water rates is to ensure the system is operating sufficiently, that it is sufficiently maintained, and that any indebtedness is being addressed. Only after a city funds these purposes may the remaining surplus funds be used for general municipal purposes.

Two recent changes to state law on water systems, Act 605 of 2021 and Act 545 of 2023,<sup>64</sup> have the intent of improving water systems across the state and ensuring water systems are bringing in sufficient funds through their rates to cover the operation and maintenance of the water systems. Providers of retail water services are required have rate studies conducted in accordance with the following schedule: By July 1, 2024, and every five years thereafter for a provider that serves 500 or fewer customers; by July 1, 2025, and every five years thereafter for a provider that serves 501 to 1,000 customers; and by July 1, 2026, and every five years thereafter for a provider that serves more than 1,000 customers.<sup>65</sup>

Rate increase recommendations from the rate study must be implemented within one year of the receipt of the rate study. However, if the recommended rates would increase the provider's rates by 50% or more, then the

59 A.C.A. § 26-77-102(a)

60 A.C.A. § 26-77-102(b)

61 A.C.A. § 14-234-214(a)

62 A.C.A. § 14-234-214(b)(1)-(3)

63 A.C.A. § 14-234-214(e)

64 Act 605 of 2021 and Act 545 of 2023 are now codified in A.C.A. § 14-234-801 et seq. Act 545 amended sections of the code that Act 605 previously enacted.

65 A.C.A. § 14-234-802(c)



provider may phase in the rate increase over a two-year period.<sup>66</sup> Providers are also required to deposit a minimum of 5% per annum of gross revenues in a dedicated refurbishment and replacement account.<sup>67</sup> Of course, a city may spend any amount of its cash savings at any time for refurbishment and replacement of its water system facilities. The laws' requirements are intended to ensure all water systems are fiscally, and physically, sound.

If a municipal provider services customers outside of the municipal boundaries of the provider and the number of those customers outside the municipal boundaries and in unincorporated areas equals or exceeds 20% of the total customer base of the municipal provider, then a nonvoting advisory committee to the municipal provider must be established by the governing body of the municipality.<sup>68</sup> The makeup and duties of this advisory committee is determined by the governing body that creates the committee. However, there must be at least two nonresident customers from the area being served outside the municipal boundaries serving on the committee.<sup>69</sup>

## Wastewater Systems

There are two main differences between the supervision of wastewater systems and water systems. First, wastewater systems are required to be supervised by a sewer committee.<sup>70</sup> For water systems, the governing body may establish a separate commission at their discretion or serve in that capacity themselves. The wastewater committee is charged with the construction, acquisition, improvement, equipment, custody, operation and maintenance of any works for the collection, treatment or disposal of sewage and the collection of revenue from it for the service rendered. While the day-to-day operations of a wastewater system are overseen by the wastewater commission, it is the governing body of the municipality that has the authority to establish and maintain just and equitable rates or charges for the use and services rendered by the wastewater system.<sup>71</sup>

The second main difference between the two systems is that in order to adjust the rates for wastewater systems, there must be a public hearing in which all users of the system and owners of property served or to be served by the system shall have the opportunity to be heard concerning the proposed rate changes.<sup>72</sup>

## Chapter 6. Purchasing and Procurement

### A. Overview

When spending funds, city officials should ask, "Am I following the law and the budget? Am I protecting the public's funds by using a good process?" State law does not always provide a clear answer on how to spend municipal funds. Therefore, it is important to have a strong grasp on the statutes governing purchasing and procurement in order to have a good process in place. This chapter covers who has the authority to spend funds, make purchases and enter into contracts, examines which purchases and procurements require competitive bidding and other essential procedures.

### B. Mayor-Council Form of Government

As covered in Section 1, the mayor in a mayor-council form of government makes purchases on behalf of their municipality. The law describes the mayor's power to "make purchases of all supplies, apparatus, equipment, materials, and other things requisite for public purposes" as "exclusive," meaning the authority is exclusive to the mayor.<sup>73</sup> The law does authorize the governing body to set procedures for making all purchases that do not exceed the threshold for bidding, and occasionally the council may need to regulate the purchasing power of the mayor.<sup>74</sup> However, any regulation must not divest the mayor of the "exclusive" power to make purchases. The safest way for a council to regulate purchasing is through the budgeting process. This method allows the council to appropriate the funds for specific purposes and the council can always amend or update the budget as needed. Cities of the second class and incorporated towns do not have default rules on making purchases like a city of the first class, but

66 A.C.A. § 14-234-802(c)(B)

67 A.C.A. § 14-234-802(e)

68 A.C.A. § 14-234-802(c)

69 A.C.A. § 14-234-804(c)

70 A.C.A. § 14-235-206(a)

71 A.C.A. § 14-235-223(a)

72 A.C.A. § 14-235-223(d)

73 A.C.A. § 14-58-303(a)

74 See A.C.A. § 14-58-303(b) for cities of the first class.

they are required to set their own procedures by ordinance. The rules that are applicable to cities of the first class provide a great starting point.

### **Knowledge Check**

*The city of Morgan is a city of the first class. The city needs a snowplow to clear the parking lot at city hall and nearby municipal buildings. The bidding threshold in Arkansas for a purchase of this type is \$35,000. The mayor purchases a snowplow for \$32,000. The average cost of snowplows, however, is \$10,000. Unhappy with the expenditure, the city council wishes to regulate the mayor's purchasing power.*

- *Can the council pass an ordinance requiring the mayor to come before the council to get permission before the mayor purchases anything over \$10,000. Is this proper?<sup>75</sup>*
- *Can the council pass an ordinance requiring bids on anything over \$5,000? Is this proper?<sup>76</sup>*

### **Purchasing Commodities**

By law, cities of the first class must bid out purchases exceeding \$35,000. Purchases under this \$35,000 threshold do not require bidding, but cities should follow the procedure that the council has set for purchases under this threshold. Processes Having a procedure in place is highly recommended. It can include requirements for bids, minimum quotes or other reasonable processes. Many municipalities do not set any procedures and leave it up to the mayor. However, having a written, agreed-upon procedure ensures everyone knows what is required and ensures consistency when there is turnover in office.

As mentioned above, purchases for cities of the first class over \$35,000 must go out for bid. The mayor or the mayor's authorized representative will take bids through legal advertisement in any local newspaper. Bids received will be opened and read on the date set for receiving bids, and they must be read in the presence of the mayor or the mayor's representative. All municipalities can accept bids through writing or electronic media. Currently, there is no specific law on what a mayor must do to "authorize" a representative, but again, putting it in writing is recommended.

### **Lowest Responsible Bidder**

Prior to Act 208 of 2023, the law just provided for the bid to be awarded to the "lowest responsible bidder." Act 208 provides some legislative clarity. Now, the law specifically authorizes municipalities to base its award on the following methods of evaluation: (1) the lowest immediate costs, (2) the lowest demonstrated life cycle costs, (3) the lowest demonstrated term costs or (4) a combination of any of the above. The "lowest demonstrated life cycle costs" refers to the cost of an asset as determined by the mayor to be credibly established by a bidder over the life cycle of the asset, taking into consideration the asset's initial capital costs, maintenance costs, operating costs and residual value at the end of the life of the asset. The "lowest demonstrated term costs" refers to the costs of an asset as determined by the mayor to be credibly established by a bidder over a portion of the life cycle of the asset, again

75 No. Remember, the mayor is the exclusive contractor or purchaser. If the mayor is required to go before the council to get permission to purchase something that: (1) already has funds appropriated and (2) is below the bidding threshold, then it is likely the council has divested the mayor of his exclusive authority to purchase. Under this scenario, the mayor couldn't purchase anything above \$10,000 without council approval.

76 Yes. Here, the council is not preventing the mayor from making specific purchases or spending funds. Instead, the council is simply setting a procedure asking for purchases over \$5,000 to be bid.

taking into consideration the asset's initial capital costs, maintenance costs and operating costs during the portion of the life cycle of an asset.

## **C. City Administrator Form of Government**

In the city administrator form of government, the city administrator serves as the contractor or purchaser, but the board of directors may regulate the process more than a council can in the mayor-council form of government. Recall, in the city administrator form of government, the board constitutes the executive and legislative branch, which is why the board has more authority to regulate than a council in the mayor-council form of government.

The board is required to set the maximum bidding threshold for the municipality. In other words, the board sets the limit at which the city administrator must solicit bids. The board may also dictate the extent of the city administrator's power and set reasonable regulations on the process. The board may also appoint a committee or create a department of personnel to assist the city administrator with purchasing and contracting. Prior to entering a contract or purchase that exceeds the maximum bidding threshold, the agreement must receive approval by the city administrator and the board.

## **D. City Manager Form of Government**

Under the city manager form of government, the city manager serves as the contractor or purchaser. As in the city administrator form of government, the board of directors may regulate the process more than the council in a mayor-council form of government.

The board is required to set the maximum bidding threshold in this form of government. In other words, the board may limit when the city manager must solicit bids. The board may also set the extent of the city manager's power and adopt reasonable regulations on the process. The board may also appoint a committee or create a department of the city manager's office to assist with purchasing and contracting.

## **E. Bid Waivers**

In some instances, municipalities may need to waive competitive bidding for purchases that would normally require it. For mayor-council forms of government, bidding may be waived by resolution in "exceptional situations" or where the bidding procedure is deemed "not feasible or practical." In the city manager and city administrator forms of government, the board may waive bidding by ordinance (not by resolution as in mayor-council cities) in "exceptional situations where this procedure is not feasible." Little guidance exists on what constitutes "exceptional" situations or feasibility. The Arkansas Supreme Court has offered an opinion deferring to the governing bodies in these situations. In short, the court has indicated that it would uphold a bid waiver as long as the municipality followed the appropriate rules and passed the requisite resolution or ordinance.<sup>77</sup>

Waiving bidding should always be a last option and not the starting point of procurement. It should be limited to emergency situations when the city needs something quickly, when known supplies are dwindling or to realize good savings.

## **F. Bid Exemptions**

Arkansas law exempts many services and commodities from the bidding process completely. A non-exhaustive list of 21 bid exemptions is codified in A.C.A. § 14-58-104. Some key exemptions include: any commodities needed in instances in which an unforeseen and unavoidable emergency has arisen in which human life, health or public property is in jeopardy; used motor vehicles, machinery or equipment (including a leased vehicle with more than 5,000 miles of use, leased to the municipality, and including new vehicles that are purchased from a licensed car dealership in Arkansas as long as the price is less than the fleet price awarded on state contract); and motor fuels, oil, asphalt, asphalt oil and natural gas.

Many exemptions listed in the statute were added only recently, and the courts have not yet analyzed the specifics of the law. While these provisions exist to give municipalities flexibility in procurement, it is important to proceed with care.

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<sup>77</sup> See *Klinger v. City of Fayetteville*, 293 Ark. 128, 732 S.W.2d 859 (1987); and see Ark. Op. Atty. Gen. No. 95-255.



## G. Public Improvement Contracts—Construction Purchases

Public improvement contracts require bidding more often than normal purchases and have much fewer bid waiver provisions. All municipalities must take bids for any public improvement that exceeds \$50,000. Public improvements include the major repair, alteration or erection of buildings, structures or other permanent improvements. The person who awards contracts for general purchases for your municipality will also award contracts for public improvement contracts.

Municipalities may further negotiate an award of a public improvement contract with the apparent lowest responsible bidder if all bids exceed the amount appropriated for the contract if (1) bidding on alternates was not required and (2) the low bid is within 25% of the appropriated amount. The apparent lowest responsible bidder may be determined by deducting the alternates in numerical order. After the deductions are made, the cost must be less than 25% of the amount appropriated before an award with the lowest responsible bidder may be negotiated.

Cities must put people on notice that the municipality is accepting bids. Cities are required to publish notice to receive bids one time each week for not less than two consecutive weeks in a newspaper of general circulation published in the county in which the proposed improvements are to be made. Cities may also publish notice in a trade journal reaching the construction industry. The notice must contain: (1) a brief description of the type of work contemplated; (2) the approximate location of the work contemplated; (3) the place at which prospective bidders may obtain plans and specifications; (4) the date, time and place at which sealed bids shall be received; (5) the amount, which may be stated in a percentage, of the bid bond required; (6) a statement of the taxing unit's reservation of the right to reject any or all bids and to waive any formalities; and (7) other pertinent facts or information that may appear necessary or desirable.

## H. Real and Personal Property

Municipalities are authorized to sell, convey, lease, rent, let or dispose of any real estate or personal property owned by the municipality, including real estate or personal property that is held by the municipality for public or governmental purposes.<sup>78</sup> Municipalities may also buy any real estate or personal property.<sup>79</sup> The mayor is charged with executing contracts and conveyances and lease contracts when the mayor is authorized by a resolution in writing and approved by a majority vote of the governing body present and participating.<sup>80</sup> Note that while the mayor acts as executor, the council has the final say over the buying and selling of contracts concerning real estate or personal property of the municipality.

Cities may sell real property without requesting bids.<sup>81</sup> There are two reasons for this. First, real property should be appraised to determine its worth before being put up for sale. Second, Article 12, Section 5 of the Arkansas Constitution prohibits municipalities from not only becoming stockholders in any corporation, but also prohibits municipalities from obtaining or appropriating money for, or loaning its credit to any corporation, association, institution or individual. In other words, Article 12, Section 5 prohibits direct donations to private individuals and corporations. To be clear, Article 12, Section 5 does not prevent contracts between municipalities and private parties, so long as the agreements are supported by adequate consideration.<sup>82</sup> What constitutes “adequate consideration” is the subject of much case law, but the takeaway is that there must be some type of *quid pro quo*, or something for something. When selling municipal property, the city must receive something in return, like cash for real property. It is important to note that “adequate consideration” does not have to be fully monetary. Public advantage can constitute consideration.<sup>83</sup> Municipalities may receive consideration in the form of money but may also receive consideration in the form of a nonfinancial benefit to the municipality.

78 A.C.A. § 14-54-302(a)(1)

79 A.C.A. § 14-54-302(a)(2)

80 A.C.A. § 14-54-302(b)

81 See Act 575 of 2019, amending A.C.A. § 14-54-302 to strike “real estate” from bidding requirement.

82 See Ark. Op. Atty. Gen. No. 2017-088 for further analysis of Article 12, § 5.

83 *City of Blytheville v. Parks*, 221 Ark. 734, 255 S.W.2d 962 (1953)

## Knowledge Check

*The city of Nash has a very bad stray cat and dog problem. The city does not have an animal shelter, nor does it have the funds to establish an animal shelter, staff it and board animals. A nonprofit animal shelter wants to set up shop in the city to help alleviate this problem. The city has a piece of property that is not being used by the municipality that the animal shelter wants to utilize. The appraisal shows the property to be worth approximately \$20,000. Can the city sell the property to the animal shelter for the much lower amount of \$5,000?<sup>84</sup>*

Personal property is treated slightly differently than real property. The mayor or the mayor's authorized representative may sell or exchange any municipal personal property with a value of \$20,000 or less, unless the governing body has, by ordinance, established a lower amount.<sup>85</sup> However, if the personal property exceeds \$20,000 (or the maximum provided by resolution), then it must go through competitive bidding.<sup>86</sup> If personal property of the municipality becomes obsolete or is no longer used by the municipality, the personal property may: (1) sold at public or internet auction, (2) sent to the Marketing and Redistribution Section, (3) transferred to another governmental entity within the state or (4) donated under this section.<sup>87</sup> "This section" refers to A.C.A. § 14-54-302, which authorizes municipalities to donate real estate or personal property, or any part of the real estate or personal property, to the United States Government or any agency of the United States Government, for any purpose under A.C.A. § 14-54-302(a)(3). Since the United States Government is not a private individual or corporation, this statute does not run afoul of Article 12, Section 5 of the Arkansas Constitution.

## I. Professional Services

There are some services for which municipalities are prohibited from using the competitive bidding process. Cities are prohibited from using competitive bidding in the procurement of legal, financial advisory, architectural, engineering, construction management and land surveying professional consultant services. State law provides this leeway so cities may hire the professional that would be best suited for the job. Further, the list above is not exhaustive. Municipalities may elect to not use competitive bidding for other professional services not listed above with a 2/3 vote of the governing body. The law defines "other professional services" as "professional services not included [above] as defined by a political subdivision with a 2/3 vote of the governing body." In other words, the governing body gets to dictate to some degree what a professional service is.

Although cities are not required to submit for bidding for these services, they must follow a process to obtain these professional services. The law indicates that cities are to send out a request for qualifications (RFQs) in order to evaluate candidates for the work to be done. When evaluating the candidates' qualifications, cities must consider: (1) the specialized experience and technical competence of the firm with respect to the type of professional services required; (2) the capacity and capability for the firm to perform the work in question, including specialized services within the time limitations fixed for the completion of the project; (3) the past record of performance of the firm with respect to such factors as control of costs, quality of work and ability to meet schedules and deadlines; and (4) the firm's proximity to and familiarity with the area in which the project is located. This process allows cities to pick the firm that is best qualified and capable of performing the desired work and negotiate a contract for the project.

<sup>84</sup> Yes, more than likely. If the city sells the property, they are receiving monetary consideration to the tune of \$5,000, but it is also receiving a non-financial benefit, or a public advantage, in the form of the animal shelter picking up the stray animals in the city and providing shelter. It is critical for the sale to be lawful that the written sales agreement outlines the public advantage and purpose as being additional consideration to the tendered cash.

<sup>85</sup> A.C.A. § 14-54-302(c)

<sup>86</sup> A.C.A. § 14-54-302(d)

<sup>87</sup> A.C.A. § 14-54-302(e)

## J. Cooperative Purchasing

The State of Arkansas allows municipalities to purchase from joint procurement entities provided the item is a commodity or service and the particular commodity or service bid specification is in compliance with Arkansas procurement law. Commodity includes goods, leases, insurance and equipment. It does not include a lease or interest in real property, exempt commodities and capital improvements. Exempt commodities include items bought for resale, advertising, livestock and livestock products, maintenance on office equipment, perishable foods, postage, printed materials for use in a library, travel expenses, works of art for museums or public display, and utility services or equipment. It is important to note that the law does not authorize municipalities to utilize cooperative purchasing for public improvements or capital works projects. It is limited to commodities and services. Cooperative purchasing can be very beneficial for municipalities that may benefit from lower prices and potentially a more streamlined administrative procedure.

To determine whether bid specifications are in accordance with Arkansas law, check to determine whether the bid specs are: (1) advertised for the proper amount of time, (2) performance time period has not expired and (3) the purchaser is following the contract terms. The National Institute for Public Procurement maintains a listing of cooperative purchasing programs online at [nigp.org/our-profession/cooperative-purchasing-programs](http://nigp.org/our-profession/cooperative-purchasing-programs). Among the more well-known cooperative purchasing entities are: National IPA, NJPA, TCPN, TIPS/TAPS, US Communities and Sourcewell.

To utilize cooperative purchasing, there must be a cooperative purchasing agreement. This is an agreement entered into as the result of a procurement conducted by or on behalf of more than one public procurement unit or by a public procurement unit with an external activity.<sup>88</sup> Public procurement unit includes municipalities in Arkansas, state agencies and other subdivisions of the state.<sup>89</sup> For example, City A may enter into a cooperative purchasing agreement with City B in order for City A to utilize a contract without having to bid it out because City B has already bid it out. With cooperative purchasing, the competitive bidding process is in place, but it is streamlined.

Most cooperative purchasing services and commodities are not bid with the federal requirements included in the advertisement, bid specs and contracts. However, some are. It is up to the municipality to determine whether the proper language has been included in the contract. Some federal agencies, such as FEMA, will allow the contract to be reformed to meet the requirements.

## Chapter 7. Audits

### A. Overview

By now, you know just how important municipal finance is to your city or town. It is so important, in fact, that municipal finances have state legislative oversight. While the Arkansas General Assembly doesn't dictate how your municipality spends municipal funds, they do make sure that your municipality is compliant with the law in the way your municipality handles funds and spends funds.

### B. Legislative Audit

The mission of Arkansas Legislative Audit is to serve the General Assembly, the Legislative Joint Auditing Committee and the citizens of the State of Arkansas by promoting sound financial management and accountability of public resources entrusted to various governmental entities. Arkansas Legislative Audit assists the legislature in oversight of state and local government, and it is responsible for over 1,000 engagements, including audits, financial and compliance reports and special reports.<sup>90</sup>

Every municipality is required to have an annual audit or agreed-upon procedures engagement of municipal finances. This audit or agreed-upon procedures engagement may be performed by Arkansas Legislative Audit or you may procure the services of an independent person licensed and in good standing to practice accounting by the Arkansas State Board of Public Accountancy.<sup>91</sup> It is important to note that Arkansas Legislative Audit does

88 External procurement activity includes any buying organization not located in this state which, if located in this state, would qualify as a public procurement unit.

89 Other subdivisions of the state include fire protection districts, regional water distribution districts, rural development authorities ....

90 Preparing for a Legislative Audit: Mission Statement. [arklegaudit.gov/resources](http://arklegaudit.gov/resources)

91 A.C.A. § 14-58-101

not audit municipal utilities. However, municipalities that provide sewer services and water services are required to obtain an annual financial audit of the system if the system has at least 2,000 service connections during a fiscal year.<sup>92</sup> If there are less than 2,000 service connections but more than 100 connections, then an annual audit or annual agreed-upon procedures and compilation report must be completed.<sup>93</sup> The audits on water and sewer systems must be completed within one year following each system's fiscal year end.<sup>94</sup> Within 30 days of completion of the audit report or the agreed-upon procedures and compilation report, the accountant performing the audit or agreed-upon procedures and compilation report must submit the report to the legislative auditor.<sup>95</sup> Finally, the audit report or agreed-upon procedures and compilation report must be reviewed by the appropriate board at the next regularly scheduled open meeting after receiving the report.<sup>96</sup> If the report for a municipal water or sewer system is not submitted to the legislative auditor on behalf of the municipality within 18 months after the end of a fiscal year that the report covers, the Legislative Joint Auditing Committee (LJAC) may give notice of that fact to the Treasurer of State, who will be required to withhold any turnback funds due to the municipality in escrow until notified by LJAC that all reports covering periods through the most recent fiscal year have been filed, at which time the withheld turnback funds will be released back to the municipality.

### C. The Legislative Audit

Legislative Audit goes beyond making sure debits match credits and noting any discrepancies. Legislative Audit checks to see if municipalities are in compliance with various state laws, including the Municipal Accounting Law, the Arkansas District Courts Accounting Laws, and the laws governing municipal budgets, purchasing and payments of claims among others.<sup>97</sup>

The best way a municipality can prepare for a legislative audit is to ensure all the necessary records that Legislative Audit requires are easily accessible. Legislative Audit has available a great resource on their website called "Preparing for a Legislative Audit of a Municipality." The link to that page A PDF is available at [arklegaudit.gov/resources](http://arklegaudit.gov/resources). It includes a list of the records Legislative Audit needs.

### D. Audit Findings

After Legislative Audit has conducted an audit, they will send the municipality the audit report. The report details the municipality's receipts and disbursements. More importantly, the report contains "findings," which detail any statutory compliance issues. A finding will look like the one below.<sup>98</sup>

**Mayor and Recorder/Treasurer**

1. Restricted Street Fund monies were spent in a manner inconsistent with Ark. Code Ann. § 27-70-207 for 2021 and 2020 of \$2,800 and \$1,709, respectively. Additionally, adequate supporting documentation was not maintained for a transfer of \$332 from Street Fund to General Fund in 2020.

After reviewing the findings, the governing body should take appropriate action to address each finding and recommendation contained in the audit report. It is important to note that audit findings do not include the solution to fixing the issue, but instead point out the issue that was not in compliance. For the example above, the city can reference A.C.A. § 27-70-207 to ensure that it spends street funds for the statutorily authorized purposes and to prevent repeat findings of the same issues.

### E. Federal Grant

If a municipality expends more than a certain amount of federal funds in a fiscal (calendar) year, the federal government will require what is known as a single or compliance audit. Preparation for an audit should begin at the time the award is received. It is best to document as you proceed. There are specific requirements that must be

92 A.C.A. § 14-234-119(a)

93 A.C.A. § 14-234-119 (b)

94 A.C.A. § 14-234-119(c)

95 A.C.A. § 14-234-120

96 A.C.A. § 14-234-121

97 See A.C.A. § 14-58-103(b) for a list of laws for which Legislative Audit is checking compliance.

98 A.C.A. § 10-4-418 requires audit reports to be reviewed by the governing body at the first regularly scheduled meeting following receipt of the audit report.

met when managing grants and they are usually set forth in the grant award or in the Office of Management and Budget's Uniform Grants Guidance (UGG) 2 CFR 200. Questioned costs during a grantor audit can lead to a city or town having to reimburse an amount improperly paid. Further, municipal personnel should respond promptly to auditor requests. Most of the compliance audits are primarily conducted virtually, which helps to cut down on the costs.

## **Federal Single Audit Act and Expenditure Threshold**

Federal audit and annual reporting requirements are located in 2 CFR Part 225. Municipalities that expend \$750,000 or more in a year in federal awards are required to have a single compliance audit conducted for that year. The amount is determined by adding all of the grant expenditures (not revenue or receipts) of all of the federal grants that the city has for the year. Audits are performed by an outside auditor. Legislative Audit does not do this type of audit. The Grants Division of the Arkansas Municipal League maintains a list of Arkansas auditors who perform these services. Consequently, if expenditures are over the audit threshold in one year, it will be necessary to budget for the cost to pay for this audit. Audit findings made during the compliance audit are provided to the granting agency via an upload into the Single Audit Clearinghouse, which could prompt an audit by the federal granting agency. Audit findings may also keep the city from being awarded additional grant funds.

To determine which grant or loan programs will be audited, city personnel will prepare a Schedule of Expenditure of Federal Assistance (SEFA). Grant information is grouped by federal department and includes the names of the grants, amount of the expenditures and the federal Assistance Listing numbers (for grants like the Dewey Decimal system for libraries). Depending upon whether the city is a low-risk auditee or a high-risk auditee, a certain percentage of the total expenditures must be audited. The Office of Management and Budget prepares a protocol for the auditors to follow. It is called the Cumulative Supplement and it is usually available by June of each year at [www.whitehouse.gov](http://www.whitehouse.gov). It is suggested that grant managers download the audit protocol for the grants for which the most funding was expended and check it to be sure that the city has followed the rules.

## **Audit Timing**

Single audits are required to be completed and uploaded into the Single Audit Clearinghouse by September 30 of each year. Due to the limited number of auditors that offer these services, be sure to hire the auditor much earlier in the year.

## **Copies of Compliance Audits**

Although the Single Audit Clearinghouse has copies of the audit available on that website and the city's website, most state pass-through granting agencies still require copies of audits. To meet this expectation, it is recommended that you email granting agencies the single audit section along with a link to the entire audit document on the city's website. This saves the city the cost of sending a large document in the mail.

## **Record Retention for Grants**

In addition to the record retention requirements under state law, the federal government also requires that recipients of federal awards retain records and supporting documents for at least three years after submitting the final expenditure report or, for an award that is renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report.<sup>99</sup> There are exceptions to this rule. The federal government can now notify recipients in writing to retain documents longer. Sometimes, this requirement can be found in a grant award document such as the American Rescue Plan Act, which requires municipalities to keep the records for five years after the grant ends. Further, records should be retained until all litigation, claims or audit-related issues have been resolved.

Records for real property and equipment acquired with federal funds must be retained for three years after final disposition. In instances where federal grants result in program income after the end of the grant, the retention period starts from the end of the municipality's fiscal year in which the program income is earned. If records are retained after the retention period has expired, then federal auditors have the right to go back through them and recover any improper costs.

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99 2 CFR S 200.334







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Section II. Municipal Finance

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