

AUDIT REPORT
CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
FOR THE YEAR ENDED DECEMBER 31, 2018

AUDITED BY
ALAN CHAPMAN
CERTIFIED PUBLIC ACCOUNTANT
104 S. Muskogee Ave.
TAHLEQUAH, OKLAHOMA

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INDEPENDENT AUDITOR'S REPORT

Board of Directors

Cherokee County Rural Water District No.11

Report on the Financial Statements

I have audited the accompanying financial statements activities of Cherokee County Rural Water District No.11 (the District), as of and for the year ended December 31, 2018, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of business-type activities of Cherokee County Rural Water District No. 11. as of December 31, 2018 and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

(Continued)

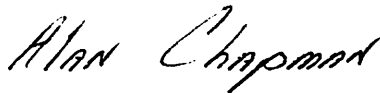
Required Supplementary Information

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who consider it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued my report dated February 20, 2019, on my consideration of Cherokee County Rural Water District No. 11's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Cherokee County Rural Water District No.11 internal control over financial reporting and compliance.

February 20, 2019

A handwritten signature in cursive script that reads "Alan Chapman".

Alan Chapman, CPA

CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF NET POSITION
DECEMBER 31, 2018

ASSETS

CURRENT ASSETS

PETTY CASH	\$ 650
CIB O & M	116,268
CIB DEBIT CARD	627
CIB CERTIFICATE OF DEPOSIT	50,000
INVENTORY	63,200
PREPAID INSURANCE	19,751
RESTRICTED CASH	188,373
ACCOUNTS RECEIVABLE	<u>85,959</u>

TOTAL CURRENT ASSETS \$ 524,828

CAPITAL ASSETS

DISTRIBUTION SYSTEM	\$ 6,419,557
LAND	10,000
BUILDING	53,232
MACHINERY & OFFICE EQUIPMENT	648,168
LESS ACCUMULATED DEPRECIATION	<u>(3,121,871)</u>

TOTAL (NET) CAPITAL ASSETS 4,009,087

OTHER ASSETS

ORWA RESERVE CERTIFICATE	<u>\$ 1,000</u>
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TOTAL OTHER ASSETS 1,000

TOTAL ASSETS \$ 4,534,915

The accompanying notes and auditors report are an integral part of these financial statements.

**CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF NET POSITION
DECEMBER 31, 2018**

LIABILITIES

CURRENT LIABILITIES

ACCOUNT PAYABLE	\$ 34,885
PAYROLL TAXES PAYABLE	3,948
ACCRUED EMPLOYEE BENEFITS	1,539
CURRENT PORTION LONG-TERM DEBT	63,763
ACCRUED INTEREST	<u>33,893</u>

TOTAL CURRENT LIABILITIES \$ 138,027

LONG TERM LIABILITIES

LONG TERM NOTE	<u>\$ 1,434,752</u>
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TOTAL LONG TERM LIABILITIES 1,434,752

TOTAL LIABILITIES 1,572,779

NET POSITION

DONATED CAPITAL NET OF RELATED DEBT	\$ 2,510,572
RESTRICTED FOR DEBT RESERVE	188,373
NET ASSETS: UNRESTRICTED	<u>263,191</u>

TOTAL NET POSITION 2,962,136

TOTAL LIABILITIES AND NET POSITION \$ 4,534,915

The accompanying notes and auditors report are an integral part of these financial statements.

**CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2018**

INCOME

WATER	\$ 836,527
SERVICE CHARGES	2,730
PENALTIES	<u>13,149</u>

TOTAL INCOME **\$ 852,405**

EXPENSES

PAYROLL AND EMPLOYEE RELATED EXPENSES	\$ 451,567
CONTRACT LABOR	1,810
MATERIALS AND SUPPLIES	45,748
REPAIRS AND MAINTAINENCE	41,049
WATER TESTING AND REGULATORY FEES	16,609
AUTOMOBILE EXPENSE	31,819
WATER PURCHASED	41,108
UTILITIES	83,583
OFFICE EXPENSES	20,693
PROFESSIONAL FEES	2,300
INSURANCE	38,662
LICENSES/SUBSCRIPTIONS/DUES	2,263
ADVERTISING	-
BANK SERVICE CHARGES	7,823
BAD DEBT EXPENSE	3,458
MISCELLANEOUS EXPENSE	2,709
DEPRECIATION EXPENSE	<u>163,541</u>

TOTAL EXPENSE **\$ 954,742**

NET OPERATING PFT/ LOSS **\$ (102,337)**

NON-OPERATING INCOME & EXPENSE

INCOME-INTEREST	\$ 1,791
GAIN ON SALE OF ASSET	2,500
MEMBERSHIP CONNECT	35,950
BILLING AND ACCOUNTING	57,170
EXPENSE- INTEREST	<u>(81,354)</u>

TOTAL NON-OPERATING INCOME- EXPENSE **16,056**

CHANGE IN NET POSITION **(86,281)**

NET POSITION, BEGINNING OF YEAR **3,048,417**

NET POSITION, END OF YEAR **\$ 2,962,136**

The accompanying notes and auditors report are an integral part of these financial statements.

**CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF CASH FLOWS FOR THE YEAR ENDED
DECEMBER 31, 2018**

CASH FLOW FROM OPERATING ACTIVITIES

CASH INFLOWS:

PAYMENTS RECEIVED FROM CUSTOMERS \$ 865,237

CASH OUTFLOWS:

PAYMENTS TO SUPPLIERS FOR GOODS & SERVICES (782,197)

NET CASH PROVIDED USED BY OPERATING ACTIVITIES 83,040

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

NOTES PAYABLE PROCEEDS (63,764)

DONATED CAPITAL -

INTEREST PAYMENTS ON BONDS (81,354)

NET CASH PROVIDED (USED) FOR CAPITAL AND RELATED FINANCING ACTIVITIES (145,118)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

MISC. INCOME 57,356

MEMBERSHIPS 35,950

GAIN ON SALE OF ASSET 2,500

PURCHASE OF CAPITAL ASSETS (5,893)

NET CASH PROVIDED USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES 89,912

CASH FLOWS FROM INVESTING ACTIVITIES

INTEREST RECEIVED FROM INVESTMENTS 1,791

NET CASH INFLOW (OUTFLOW) FROM ALL ACTIVITIES 29,624

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 326,294

CASH AND CASH EQUIVALENTS AT END OF YEAR 355,919

CASH AND CASH EQUIVALENTS

UNRESTRICTED CASH AND CASH EQUIVALENTS 167,546

RESTRICTED CASH AND CASH EQUIVALENTS 188,373

355,919

RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:

OPERATING INCOME (LOSS) (102,337)

DEPRECIATION 163,541

(INCREASE) DECREASE IN INVENTORY (568)

(INCREASE) DECREASE IN ACCOUNTS & GRANTS RECEIVABLE 13,400

INCREASE (DECREASE) IN PREPAID EXPENSES 475

INCREASE (DECREASE) IN PAYABLES 8,529

NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES \$ 83,040

The accompanying notes and auditors report are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2018

Note 1 - The Reporting Entity

Cherokee County Rural Water District No. 11 was incorporated under the Rural Water District Act of Oklahoma, for the purpose of acquiring water rights, and to build and acquire pipelines and other facilities and to operate the same for the purpose of furnishing water to serve the need of owners and occupants of land located within the district. The District is exempt from federal and state income tax.

The membership consists of approximately 1,430 accounts; each entitles to one vote. The board of Directors consists of 5 members serving 3-year terms. The vacant Board seats are elected at the annual meeting, and following, the Board of Directors meet and elect a chairman, Vice chairman, and Secretary-Treasurer.

Note 2 - Significant Accounting Policies

Basis of Accounting

The accrual basis of accounting is followed for all accounts. Revenues are recorded when earned and expenses are recognized when incurred. This policy is in accordance with generally accepted accounting principles.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, the district considers all unrestricted highly liquid investments with an initial maturity of less than three months to be cash equivalents.

Inventory

The District's inventory consists of water line parts and supplies as well as chemicals used to treat the water. The District maintains inventory on the first-in, first-out basis.

Accounts Receivable

Accounts receivable consists primarily of charges for water sales. Management has not established a provision for uncollectible accounts. Such amounts are written off the month in which management determines they are uncollectible.

<u>Current</u>	<u>1-30 Days</u>	<u>31-60 Days</u>	<u>Over 60 Days</u>	<u>Prepayments</u>	<u>Total</u>
75,561	11,072	4,382	1,990	(7,046)	85,959

Restricted Assets

The terms of the loan agreement with the Rural Development require that the District maintain funds for the use of servicing debt in the amount of 125% of the total annual payment. The deposits with the Bank of Oklahoma (BOK) trust accounts are sufficient to fulfill this requirement.

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2018

Fixed Assets

Fixed assets are valued at cost, and depreciation is computed using the straight line method. The estimated useful life of these assets is detailed as follows:

Equipment	5 years
Water System	40 years
Water System Additions	20 years
Buildings	15 years

Income Taxes

The District is exempt from federal and state income taxes.

Note 3—Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the District considers all cash on hand, demand deposits, and highly liquid investments, with a maturity of six months or less when purchased, to be cash and cash equivalents.

B. Investments

At December 31, 2018, the District held deposits of approximately \$355,919 at financial institutions. The District's cash deposits, including interest-bearing certificates of deposit, are entirely covered by Federal Depository Insurance (FDIC) or direct obligation of the U.S. Government insured or collateralized with securities held by the District or by its agent in the District's name

The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates

The investments held at December 31, 2018, are as follows:

<u>Type</u>	<u>Weighted Average Maturity (Months)</u>	<u>Credit Rating</u>	<u>Market Value</u>	<u>Cost</u>
Investments Cert. Cert. of Deposit	6	N/A	<u>\$ 50,000.00</u>	<u>\$ 50,000.00</u>
Total Investments			<u>\$ 50,000.00</u>	<u>\$ 50,000.00</u>

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2018

Note 4 – Long Term Debt

The District had the following Bonds payable at December 31, 2018:

Cherokee County Rural Water District No. 11 executed a note payable to Rural Development on June 15, 1994 in the principal amount of \$560,000 and a maturity date of 06/15/2034. The Note is secured by a pledge of revenues and other resources of the District and by all property now owned by the District and any replacements. The note has a forty-year term and bears interest at 5% with monthly installments of \$2,708. A debt service reserve account as part of the loan agreement must maintain a minimum balance of 125% of the maximum annual amount required for debt service.

The district entered into a lease purchase contract with Government Capital Corporation on March, 2014. The lease total is 239,884 with payments of 30,298.58 per year with an option to purchase after three years. The imputed interest rate is 4.493% payable over 10 years.

The District issued Capital Improvement Bonds in the amount of \$1 with a thirty (30) year term bearing interest at 5.0% for years 2008-2021, 5.5% for years 2022-2030 and 5.75% for years 2031-2038. The Bonds are secured by a pledge of revenues and other resources of the District and by all property now owned by the district and any replacements. The Bonds are issued pursuant to a resolution of the District adopted on June 9, 2008, (the "Authorizing Resolution"). The Bonds are issued under and are subject to the terms of that certain Bond Indenture dated as of July 1, 2008, by and between the District and RCB Bank, Claremore, Oklahoma, as trustee. The Bonds are issued as fully registered bonds, and registered in the name of Cede & Co., as nominee of the Depository Trust Company (DTC) New York, New York, without coupons, in denominations of \$5,000 or any integral multiple thereof. The Bonds, when originally issued, will be dated July 1, 2008 and will bear interest from such date, payable on January 1, and July 1 of each year commencing January 1, 2010. The Bonds are special obligations of the District, payable from and secured by a mortgage upon the facilities and lien on the gross revenues of the District's water facilities. However, this mortgage and lien is subordinate to the District's Promissory Note to the United States of America acting through Rural Development, United States Department of Agriculture, dated June 15, 1994. The District has covenanted In the Indenture to fix and maintain rates for water services which shall provide gross revenues in an amount adequate to maintain the facilities in good repair and condition and (i) pay all operation and maintenance expenses related to the Facilities, (if) pay all amounts required to be paid by the District under the terms of the indenture to Rural Development and the Series 1994, (iii) generate on an annual basis an amount equal to 125% of the annual debt service on the Bonds and the Series 1994 Note for that year after payment of the amounts required in (i) and (ii) and (iv) provide any other amounts which may be require under the terms of the Indenture.

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2018

Note 4 – Long Term Debt Continued

Annual debt service on these notes over the life of the loans is as follows:

Current Portion	\$ 63,763
2020	70,543
2021-2025	363,156
2026-2030	331,202
2031-2035	370,987
2036-2038	<u>298,864</u>
TOTAL	<u>\$1,498,515</u>

CHANGES IN GENERAL LONG-TERM DEBT

Long-term debt consists of notes payable. The following is a summary of the changes in general long-term debt, including the current part, of the District for the fiscal year.

	BEGINNING OF YEAR	BORROWING	REDUCTION	END OF YEAR
2018 Notes Payable	<u>1,560,524</u>	-	62,009	<u>1,498,515</u>
Total	<u>1,560,524</u>	-	62,009	<u>1,498,515</u>

Note 5 – Commitments and Contingencies

Cherokee County Rural Water District No. 11 currently participates in various grant programs. These grants are subject to audit by the grantor agency or their representatives. Such audits could lead to requests for reimbursement to the grantor agency for services disallowed under the terms of the contract. Presently Cherokee County Rural Water District No. 11 is not aware of any pending requests, and in the opinion of management, any such amounts would not be considered material.

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2018

Note 6 – Assets

	BEGINNING OF YEAR	ADDITIONS	DELETIONS	END OF YEAR
CAPITAL ASSETS				
LAND	10,000	-	-	10,000
DISTRIBUTION SYSTEM	6,419,557	-	-	6,419,557
BUILDINGS	48,198	5,035	-	53,232
OFFICE FURNITURE & SUPPLIES	108,649	859	-	109,508
MACHINERY & EQUIPMENT	<u>538,660</u>	<u>-</u>	<u>-</u>	<u>538,660</u>
 TOTAL CAPITAL ASSETS	 7,125,064	 5,894	 -	 7,130,957
 LESS: ACCUMULATED DEPRECIATION	 <u>2,958,330</u>	 <u>163,540</u>	 <u>-</u>	 <u>3,121,870</u>
 NET BOOK VALUE	 <u>4,166,734</u>	 <u>(157,647)</u>	 <u>-</u>	 <u>4,009,087</u>

Note 7 - Insurance

The District purchases commercial insurance policies covering property casualty loss, public liability, board member and administrator liability, and workers compensation. The District also purchases surety bonds for employees in all positions required by state law to be bonded.

Note 8 – Accrued Compensated Absences

The organization accrues a liability for compensated absences once the leave time is both earned and payable to the employees.

Note 9 – Employee Retirement

The District allows employees to participate in a tax deferred Simple Individual Retirement Account after ninety days of employment. The District will match up to three percent of employee contributions.

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2018

Other Information

A. Risk Management

The District is exposed to various risk of loss related to torts: theft of, damage to, and destruction of assets: errors and omissions: injuries to employees and natural disaster. The District purchases commercial insurance to cover these risks, including general and auto liability, property damage, and public officials liability. There were no significant reductions in insurance coverage from the prior year. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

B. Arbitrage Agreement

The District should monitor their obligation related to the arbitrage agreement signed when they obtained their loan from the USDA Rural Development. The arbitrage calculations are normally due every five years.

C. Evaluation of Subsequent Events

The District should monitor their obligation related to the arbitrage agreement signed when they obtained their loan from the USDA Rural Development. The arbitrage calculations are normally due every five years. Subsequent events have been evaluated through February 20, 2018, which is when the financial statements were available for issue.

D. Stewardship, Compliance and Accountability

As a local government unit, the District is subject to various federal, state, and local laws and contractual regulations. In accordance with Government Auditing Standards, the auditor has issued a report on his consideration of the District's internal control over financial reporting and tested its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in compliance with Government Auditing Standards and should be read in conjunction with this report in considering the results of the audit.

E. Finance — Related Legal and Contractual Provisions

The terms of the loan agreements require Reserve Accounts as shown in Note D. All of the requirements have been met.

F. Employee Retirement Plan

The District offers a voluntary retirement plan for employees in the amount of five percent of gross wages. The plan is maintained by Edward D. Jones Co. The total amount paid into the retirement fund in year 2018 was 17,136.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
COMBINED FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Cherokee County Rural Water District No. 11

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the business-type activities Cherokee County Rural Water District No. 11, as of and for the year ended December 31, 2018 and have issued our report thereon dated February 20, 2019. Cherokee County Rural Water District No. 11 did not present the Management's Discussion and Analysis required by Governmental Accounting Standards Board.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Cherokee County Rural Water District No. 11 internal control over financial reporting as a basis for designing my audit procedures for the purpose of expressing my opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cherokee County Rural Water District No. 11 internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the District's internal control.

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses, or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Cherokee County Rural Water District No. 11 financial statements are free of misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could

Report on Compliance (continued)

have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

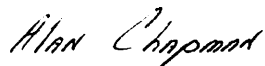
District's Response to Findings

The Cherokee County Rural Water District No. 11 response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The Cherokee County Rural Water District No. 11 response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

February 20, 2019



Alan Chapman, CPA

**CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
P.O. BOX 190
HULBERT, OK 74441**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2018**

Criteria: The District's management is responsible for internal controls over financial reporting. This include controls over the fair and complete presentation of the District's annual financial statements in accordance with GAAP. The preparation of financial statement in accordance with GAAP requires internal controls over both (1) recording, processing and summarizing accounting data (i.e., maintaining books and records), and (2) reporting government-wide and fund financial statements, including the related footnotes (i.e., external financial reporting). Professional audit standards clearly indicate that the external financial statement auditor cannot take the responsibility for any part of managements control activities or be a component of the internal controls over financial reporting.

Condition: Management is responsible for the preparation and fair presentation of the financial statement in accordance with applicable financial reporting. Accordingly, the District's ability to prepare financial statements in accordance with (GAAP). The Size of the District's accounting and administrative staff preclude certain internal controls that would be preferred if the office staff were large enough to provide optimum segregation of duties. This situation dictates that the Board remain involved in the financial affairs of the organization to provide oversight and independent review functions.

Finding: It does not appear that the district generated the required amount of adjusted net income (110% of the annual debt service requirement) to comply with the terms of the bond agreement. A rate study or cost cutting measures may be needed in order to comply with this requirement.

Recommendation: I recommend that the district consider designing and implementing sufficient internal controls over financial reporting by obtaining the necessary knowledge, expertise and continuing education to prepare financial statements in accordance with generally accepted accounting principles without assistance from the external financial statement auditor. This could be achieved through employment of qualified accounting staff or the outsourcing of these control activities to a qualified accounting firm other than the external auditor.

Responsible Official's Response: The District concurs with the recommendation and will strive to expand their knowledge and understanding of the presentation and disclosure of the financial statements.