

AUDIT REPORT
CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
FOR THE YEAR ENDED DECEMBER 31, 2016

AUDITED BY
ALAN CHAPMAN
CERTIFIED PUBLIC ACCOUNTANT
401 S. Water St.
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, 2016, 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

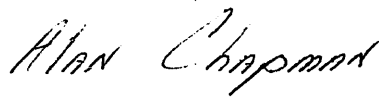
In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of business-type activities of Cherokee County Rural Water District No. 11. as of December 31, 2016 and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

(Continued)

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued my report dated February 15, 2017, 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 15, 2017

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

Alan Chapman, CPA

**CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF NET ASSETS
DECEMBER 31, 2016**

	ASSETS	
	CURRENT ASSETS	
	CIB O & M	86,858
	CIB METER	50,000
	INVENTORY	56,215
	PREPAID INSURANCE	20,294
	BOND RELATED	183,278
	ACCOUNTS RECEIVABLE	86,167
	TOTAL CURRENT ASSETS	\$ 482,812
	FIXED ASSETS	
	DISTRIBUTION SYSTEM	\$ 6,313,238
	LAND	10,000
	BUILDING	45,598
	MACHINERY & OFFICE EQUIPMENT	628,332
	LESS ACCUMULATED DEPRECIATION	(2,795,463)
	TOTAL (NET) CAPITAL ASSETS	4,201,705
	OTHER ASSETS	
	ORWA RESERVE CERTIFICATE	\$ 1,000
	TOTAL OTHER ASSETS	1,000
	TOTAL ASSETS	\$ 4,685,517

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

**CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF NET ASSETS
DECEMBER 31, 2016**

	LIABILITIES AND NET WORTH	
	<u>CURRENT LIABILITIES</u>	
	ACCOUNT PAYABLE	38,930
	PAYROLL TAXES PAYABLE	1,422
	ACCUMULATED EMPLOYEE BENEFITS	1,589
	CURRENT PART LONG-TERM DEBT	60,291
	ACCUMULATED INTEREST	38,276
	TOTAL CURRENT LIABILITIES	140,508
	<u>LONG TERM LIABILITIES</u>	
	LONG TERM NOTE	1,560,567
	TOTAL LONG TERM LIABILITIES	1,560,567
	TOTAL LIABILITIES	1,701,075
	<u>EQUITY</u>	
	DONATED CAPITAL NET OF RELATED DEBT	2,580,847
	RESTRICTED FOR DEBT RESERVE	183,278
	NET ASSETS: UNRESTRICTED	220,317
	TOTAL EQUITY	2,984,442
	TOTAL LIABILITIES AND NET WORTH	4,685,517

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

CHEROKEE COUNTY RURAL WATER DISTRICT NO. 11
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2016

INCOME

WATER	\$ 851,438	
SERVICE CHARGES	3,875	
PENALTIES	<u>14,687</u>	
TOTAL INCOME		\$ 870,000

EXPENSES

PAYROLL	\$ 387,174	
CONTRACT LABOR	6,103	
MATERIALS AND SUPPLIES	34,472	
REPAIRS AND MAINTAINENCE	72,714	
WATER TESTING	6,794	
AUTOMOBILE EXPENSE	20,649	
WATER PURCHASED	40,430	
UTILITIES	56,512	
OFFICE EXPENSES	56,452	
PROFESSIONAL FEES	3,000	
INSURANCE	85,366	
LICENSES/SUBSCRIPTIONS/DUES	8,228	
ADVERTISING	5,476	
BANK SERVICE CHARGES	6,834	
BAD DEBT EXPENSE	3,257	
DEPRECIATION EXPENSE	<u>155,800</u>	
TOTAL EXPENSE		\$ <u>949,261</u>
NET OPERATING PFT/ LOSS		\$ (79,261)

NON-OPERATING INCOME & EXPENSE

INCOME-INTEREST	\$ 549	
MEMBERSHIP CONNECT	42,076	
BILLING AND ACCOUNTING	50,391	
EXPENSE- INTEREST	<u>(88,534)</u>	
TOTAL NON-OPERATING INCOME- EXPENSE		<u>4,482</u>
NET PROFIT/ LOSS		\$ <u>(74,779)</u>

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, 2016**

CASH FLOW FROM OPERATING ACTIVITIES

CASH INFLOWS:

PAYMENTS RECEIVED FROM CUSTOMERS 882,125

CASH OUTFLOWS:

PAYMENTS TO SUPPLIERS FOR GOODS & SERVICES (787,132)

NET CASH PROVIDED USED BY OPERATING ACTIVITIES 94,993

CASH FLOWS FROM NO-CAPITAL FINANCING ACTIVITIES

NOTES PAYABLE PROCEEDS (58,736)

DONATED CAPITAL 5,401

INTEREST PAYMENTS ON BONDS (88,534)

NET CASH PROVIDED (USED) FOR CAPITAL AND RELATED FINANCING ACTIVITIES (141,869)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

MISC. INCOME 50,391

METER DEPOSITS 42,076

PURCHASE OF CAPITAL ASSETS (71,304)

NET CASH PROVIDED USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES 21,163

CASH FLOWS FROM INVESTING ACTIVITIES

INTEREST RECEIVED FROM INVESTMENTS 549

NET CASH INFLOW (OUTFLOW) FROM ALL ACTIVITIES (25,164)

PRIOR PERIOD ADJUSTMENT

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 345,300

CASH AND CASH EQUIVALENTS AT END OF YEAR 320,136

CASH AND CASH EQUIVALENTS

UNRESTRICTED CASH AND CASH EQUIVALENTS 136,858

RESTRICTED CASH AND CASH EQUIVALENTS 183,278

320,136

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

OPERATING INCOME (LOSS) (79,261)

DEPRECIATION 155,800

INCREASE (DECREASE) IN INVENTORY 11,468

INCREASE (DECREASE) IN ACCOUNTS & GRANTS RECEIVABLE 657

(INCREASE) DECREASE IN PREPAID EXPENSES (3,919)

(INCREASE) DECREASE IN PAYABLES 10,248

NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES 94,993

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, 2016

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 1,411 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>0-30 Days</u>	<u>31-60 Days</u>	<u>Over 60 Days</u>	<u>Prepayments</u>	<u>Total</u>
72,353	10,479	3,857	3,713	(9,957)	80,445

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, 2016

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 , 2016, the District held deposits of approximately \$320,135 at financial institutions. The Districts 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, 2016, are as follows:

Type	Weighted Average Maturity (Months)	Credit Rating	Market Value	Cost
Cert. of Deposit	6	N/A	50,000	50,000
Total Investments			50,000	50,000

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2016

Note 4 – Long Term Debt

The District had the following Bonds payable at December 31, 2016:

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, 2016

Note 4 – Long Term Debt Continued

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

Current Portion	60,291	85,739
2018	61,956	82,817
2019	63,708	79,815
2020	70,543	76,726
2021-2025	363,156	329,218
2026-2030	331,202	240,628
2031-2035	370,987	142,971
2036-2038	<u>299,120</u>	<u>39,387</u>
TOTAL	1,620,963	1,077,300

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
2016 Notes Payable	<u>1,679,594</u>	-	58,631	<u>1,620,963</u>
Total	<u>1,679,594</u>	-	58,631	<u>1,620,963</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, 2016

Note 6 – Assets

	BEGINNING OF YEAR	ADDITIONS	DELETIONS	END OF YEAR
CAPITAL ASSETS				
LAND	10,000	-	-	10,000
DISTRIBUTION SYSTEM	6,262,438	50,800	-	6,313,238
BUILDINGS	45,598	-	-	45,598
OFFICE FURNITURE & SUPPLIES	102,593	6,056	-	108,649
MACHINERY & EQUIPMENT	<u>505,236</u>	<u>14,448</u>	-	<u>519,684</u>
TOTAL CAPITAL ASSETS	6,925,865	71,304	-	6,997,169
LESS: ACCUMULATED DEPRECIATION	<u>2,639,664</u>	<u>155,800</u>	-	<u>2,795,464</u>
NET BOOK VALUE	<u>4,286,201</u>	<u>(84,496)</u>	-	<u>4,201,705</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 employee contributions.

CHEROKEE COUNTY RURAL WATER DISTRICT #11
Hulbert, Oklahoma
Notes to the Financial Statements
December 31, 2016

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.

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 2016 was 18,127 respectively.

GOVERNMENTAL AUDITING STANDARDS

**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, 2016 and have issued our report thereon dated February 15, 2017.

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 over financial reporting.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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 over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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 have a direct and material effect on the determination of financial statement amounts. However,

Report on Compliance (continued)

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

This report is intended solely for the information and use of the Board of Directors, management, and all applicable federal and state agencies, and is not intended to be and should not be used by anyone other than these specified parties.

February 15, 2017



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, 2016**

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.