

**COTTONWOOD RURAL
WATER ASSOCIATION**

Financial Statements
With Independent Auditor's Report Thereon
December 31, 2009

INTRODUCTORY SECTION

COTTONWOOD RURAL WATER ASSOCIATION

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COTTONWOOD RURAL WATER ASSOCIATION

Board of Directors
December 31, 2009

<u>Name</u>	<u>Board of Directors</u>	<u>Title</u>
Roby Zumwalt		President
Vance Riggs		Secretary/Treasurer
Dan Dolan		Member
Jack Callaway		Member
Randy Bristow		Member
	<u>Administrative Official</u>	
Jan Waldrip		Office Manager

FINANCIAL SECTION

Ronald L. Miller, CPA/ABV, CVA
Ryan L. Miller, CPA
Robert C. Castillo, CPA



Members
American Institute of
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Cottonwood Rural Water Association
Artesia, New Mexico
and
Mr. Hector H. Balderas, State Auditor:

We have audited the accompanying financial statements of the business-type activities of the Cottonwood Rural Water Association (the "Association"), as of and for the year ended December 31, 2009, which collectively comprise the Association's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Association's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of Cottonwood Rural Water Association as of December 31, 2009, and the changes in financial position, and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 27, 2010 on our consideration of Cottonwood Rural Water Association'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 our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Cottonwood Rural Water Association has not presented a management's discussion and analysis that accounting principles accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the Association's financial statements. The accompanying financial information listed as supplemental information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

Miller & Associates, CPA, P.C.

Miller & Associates, CPA, P.C.
May 27, 2010

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Statement of Net Assets
December 31, 2009

ASSETS

Current assets:	
Cash and cash equivalents (Note 2)	\$ 130,793
Restricted assets (Note 3)	19,885
Accounts receivable, net (Note 4)	31,972
Inventory	5,789
Prepaid expenses	<u>8,155</u>
Total current assets	196,594
Non-current assets:	
Capital assets (Note 5)	1,756,527
Other assets (Note 6)	<u>273,163</u>
Total assets	<u>\$ 2,226,284</u>

LIABILITIES AND NET ASSETS

Current liabilities:	
Current maturities, long-term debt	\$ 434,005
Accounts payable	4,616
Accrued liabilities	<u>12,429</u>
Total current liabilities	451,050
Non-current liabilities:	
Long-term debt, less current maturities (Note 7)	562,750
Deposits held for others (Note 8)	<u>10,357</u>
Total liabilities	<u>1,024,157</u>
Net Assets:	
Invested in capital assets, net of related debt	759,772
Restricted for debt service	19,885
Unrestricted	<u>422,470</u>
Total net assets	<u>1,202,127</u>
Total liabilities and net assets	<u>\$ 2,226,284</u>

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

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended December 31, 2009

Operating revenues:		
Charges for services	\$	<u>284,946</u>
Total operating revenues		<u>284,946</u>
Operating expenses:		
Personnel services		88,434
Utilities		15,737
Repairs and maintenance		19,564
Other supplies and expenses		76,634
Depreciation and amortization		<u>31,938</u>
Total operating expenses		<u>232,307</u>
Operating income (loss)		<u>52,639</u>
Non-Operating Revenues:		
Interest income		<u>2,343</u>
Total non-operating revenues		<u>2,343</u>
Change in net assets		54,982
Total net assets - beginning of year		<u>1,147,145</u>
Total net assets - end of year	\$	<u><u>1,202,127</u></u>

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

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION**

Statement of Cash Flows

For the Year Ended December 31, 2009

Cash flows from operating activities:	
Cash received from customers	\$ 276,321
Cash paid to suppliers	(116,623)
Cash paid to employees	(88,367)
Net cash provided (used) by operating activities	<u>71,331</u>
Cash flows from capital and related financing activities:	
Payment on long-term debt	(47,320)
Payment on acquisition of capital assets	(113,238)
Proceeds from loan	85,762
Net cash (used) by capital and related financing activities	<u>(74,796)</u>
Cash flows from investing activities:	
Interest revenue received	<u>2,343</u>
Net cash provided (used) by investing activities	<u>2,343</u>
Net increase (decrease) in cash	(1,122)
Cash - beginning of year	<u>131,915</u>
Cash - end of year	<u>\$ 130,793</u>
Reconciliation of net operating income (loss) to net cash provided (used) by operating activities:	
Operating income (loss)	\$ 52,639
Adjustments to reconcile net operating income (loss) to net cash (used) by operating activities:	
Depreciation and amortization expense	31,938
Changes in assets and liabilities:	
Receivables, net	(9,303)
Deposits held for others	678
Accounts payable	(4,687)
Accrued liabilities	66
Net cash provided (used) by operating activities	<u>\$ 71,331</u>

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

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION

Notes to the Financial Statements

December 31, 2009

NOTE 1. Summary of Significant Accounting Policies

This summary of significant accounting policies of Cottonwood Rural Water Association (the "Association") is presented to assist in understanding the Association's financial statements. These financial statements and notes are representations of the Association's management and Board of Directors who are responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

A. Nature of Business

Cottonwood Rural Water Association was incorporated on January 4, 1979 for the purpose of constructing, maintaining, and operating a water system for the supply and distribution of water for domestic use to its' members. There are approximately 502 members. The water service delivery area is restricted to Cottonwood rural district in northern Eddy County, New Mexico.

B. Reporting Entity

In evaluating how to define the Association for financial reporting purposes, management has considered all potential component units. The decision to include any potential component units in the financial reporting entity was made by applying the criteria set forth in GASB-14. Blended component units, although legally separate entities, are in substance part of the Association's operations. Each discretely presented component unit is reported in a separate column in the financial statements to emphasize that it is legally separate from the Association.

The basic, but not the only, criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations, and accountability for fiscal matters. A second criterion used in evaluating potential component units is the scope of public service. Application of this criterion involves considering whether the activity benefits the Association and/or its members. A third criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the Association is able to exercise oversight responsibilities. Based upon the application of these criteria, the Association has no component units, and is not a component unit of any other entity.

C. Measurement Focus and Basis of Accounting

The accounts of the Association are organized on the basis of fund type, of which there is only one fund which is considered an enterprise fund.

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Notes to the Financial Statements
December 31, 2009

NOTE 1. Summary of Significant Accounting Policies (continued)

Enterprise Funds: (Unrestricted Funds)

Unrestricted funds are used to account for operations of the Association that are financed and operated in a manner similar to private business enterprises where the intent is that the costs, including depreciation, of providing goods and services to the members on a continuing basis, be financed or recovered primarily through user charges.

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting.

The unrestricted funds (enterprise funds) are accounted for using the full accrual basis of accounting. Their revenues are recognized when the related service is completed and billed. Expenses are recorded when an item is utilized or a liability is incurred.

D. Operating and Non-operating Revenues

Operating revenue consists of charges for services for water sales and includes activities that have the characteristics of exchange transactions. Revenue from grants and similar items is recognized as soon as all eligibility requirements imposed by the provider have been met.

Non-operating revenue includes activities that have the characteristics of non-exchange transactions, such as investment income and exchange transactions, such as rental revenue. These revenue streams are recognized under GASB Statement No. 33 *Accounting and Financial Reporting for Nonexchange Transactions*.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, then unrestricted resources as they are needed.

E. Assets, Liabilities and Equity

Cash and Cash Equivalents: For purposes of the statement of cash flows, the Association considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Inventory: Inventories consist of water system pipe, valves and operating supplies and are stated at historical cost determined by the first-in, first-out method.

Accounts Receivable: Trade accounts receivables are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION

Notes to the Financial Statements
December 31, 2009

NOTE 1. Summary of Significant Accounting Policies (continued)

based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

Prepaid expenses: Prepaid expenses include insurance premiums paid or incurred prior to year-end for the following year.

Accrued liabilities: Accrued liabilities consist of accrued payroll and accrued interest.

Capital Assets: State law requires capitalization threshold to include only assets with a cost of \$5,000 or more. The Association's policy is to capitalize all expenditures for capital assets in excess of \$250. Purchased capital assets are carried at cost. Depreciation is computed using the straight-line method. The range of estimated useful lives by type of asset is as follows:

Furniture and fixtures (including software)	5-7 years
Automobiles	5 years
Plant and Water System	5-50 years

The Association completed construction of a new water well in 2003. As of the date of this report, the well was still not in use. Therefore, no depreciation has been recorded on the well as of December 31, 2009. Management expects the well to be in use in the near future and does not expect any impairment of the well.

Water rights: The Association annually reviews the impairment of all water rights and adjusts the carrying values as necessary.

Estimates: The preparation of financial statements in conformity with account principles general accepted in the United States of America required management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

F. Use of FASB Pronouncements

Cottonwood Rural Water Association has elected to utilize alternative #2 under GASB No. 20 *Accounting and Financial reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. Under alternative #2, the government entities using proprietary fund accounting must follow 1) all GASB pronouncements and 2) all FASB Statements and Interpretations issued after November 30, 1989, APB Opinions, and ARB's, no matter when issued, except those that conflict with a GASB pronouncement.

NOTE 2. Cash and Cash Equivalents

State statutes authorize the investment of the Association's funds in a wide variety of instruments including certificates of deposit and other similar obligations, state investment pool, and money market accounts. The Association is also allowed to invest in United States Government obligations. All funds of the Association must follow the following investment policies.

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION**

Notes to the Financial Statements

December 31, 2009

NOTE 2. Cash and Cash Equivalents (continued)

Deposits of funds may be made in interest or non-interest bearing checking accounts in one or more banks or savings and loan associations within the geographical boundaries of the Association. Deposits may be made to the extent that they are insured by an agency of the United States or by collateral deposited as security or by bond given by the financial institution.

The rate of interest in non-demand interest-bearing accounts shall be set by the State Board of Finance, but in no case shall the rate of interest be less than one hundred percent of the asking price on United States treasury bills of the same maturity on the day of deposit.

Excess funds may be temporarily invested in securities which are issued by the State or by the United States government, or by their departments or agencies, and which are either direct obligations of the State or the United States or are backed by the full faith and credit of those governments.

New Mexico State Statutes require collateral pledged for deposits in excess of the federal deposit insurance to be delivered, or a joint safekeeping receipt be issued, to the Association for a least one half of the amount on deposit with the institution. The schedule listed below will meet the State of New Mexico Office of the State Auditor's requirements in reporting the insured portion of the deposits.

	First American Bank	Western Bank	
Total checking deposits	\$ -	\$ 81,170	
Total savings deposits	42,986	8,254	
FDIC coverage	(42,986)	(89,424)	
 Total uninsured public funds	 \$ -	 \$ -	
 Collateral requirement (50% of uninsured public funds)	 \$ -	 \$ -	
Pledged security	-	-	
 Over (under) collateralization	 \$ -	 \$ -	

The types of collateral allowed are limited to direct obligations of the United States Government and all bonds issued by any agency, district or political subdivision of the State of New Mexico.

According to the Federal Deposit Insurance Corporation, public unit deposits are funds owned by the Association. Time deposits, savings deposits and interest bearing NOW accounts of a public unit in an institution in the same state will be insured up to \$250,000 in aggregate and separate from the \$250,000 coverage for public unit demand deposits at the same institution.

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION**

Notes to the Financial Statements
December 31, 2009

NOTE 2. Cash and Cash Equivalents (continued)

Custodial Credit Risk – Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the Association's deposits may not be returned to them. The Association does not have a deposit policy for custodial credit risk. As of December 31, 2009, \$0 of the District's bank balance of \$132,410 was exposed to custodial credit risk because it was fully insured.

NOTE 3. Restricted Assets

Restricted assets are as follows:

	2009
Cash:	
Payment of long-term debt	\$ 19,885
	\$ 19,885

All restricted cash is held and collateralized at the New Mexico Finance Authority as of December 31, 2009.

NOTE 4. Accounts Receivable

The following is a summary of the accounts receivable:

	December 31, 2009
Water Billings	\$ 18,729
Meters	13,884
Returned Checks	-
	32,613
Less: Allowance for Uncollectible Accounts	(641)
	\$ 31,972

The vast majority of all receivables are concentrated in one geographical region, specifically Eddy County.

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION

Notes to the Financial Statements
December 31, 2009

NOTE 5. Capital Assets

The following is an analysis of capital assets and changes during the year:

	December 31, 2008	Additions	Deletions	December 31, 2009
Capital Assets, Not Being Depreciated:				
Land	\$ 7,590	\$ -	\$ -	\$ 7,590
Construction in Process	-	109,238	-	109,238
Total Capital Assets, Not Being Depreciated:	7,590	109,238	-	116,828
Capital Assets, Being Depreciated:				
Automobiles	17,172	4,000	-	21,172
Furniture & Fixtures	9,543	-	-	9,543
Plant & Water System	2,121,222	-	-	2,121,222
Total Capital Asset Being Depreciated	2,147,937	4,000	-	2,151,937
Less Accumulated Depreciation:				
Automobiles	(3,148)	(5,501)	-	(8,649)
Furniture & Fixtures	(9,543)	-	-	(9,543)
Plant & Water System	(468,008)	(26,038)	-	(494,046)
	(480,699)	(31,539)	-	(512,238)
	<u>\$ 1,674,828</u>	<u>\$ 81,699</u>	<u>\$ -</u>	<u>\$ 1,756,527</u>

Depreciation expense for the year ended December 31, 2009 was \$31,539.

NOTE 6. Other Assets

The following is an analysis of the other assets and changes during the year:

	December 31, 2008	Additions	Deletions	December 31, 2009
Other Assets, Being Amortized:				
Water Rights	\$ 381,041	\$ -	\$ -	\$ 381,041
Loan Costs	8,462	-	-	8,462
Total Capital Asset Being Depreciated	389,503	-	-	389,503
Less Accumulated Amortization:				
Water Rights	(113,394)	-	-	(113,394)
Loan Costs	(2,547)	(399)	-	(2,946)
	(115,941)	(399)	-	(116,340)
	<u>\$ 273,562</u>	<u>\$ (399)</u>	<u>\$ -</u>	<u>\$ 273,163</u>

Amortization expense for the year ended December 31, 2009 was \$399.

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION**

Notes to the Financial Statements

December 31, 2009

NOTE 7. Long-term Debt

Long-term Debt consists of:

	Original Amount	Interest Rates	Balance 12/31/09
GMAC Loan, dated April 3, 1981 in the original amount of \$271,000, payable in annual installments of \$16,068 maturing on April 3, 2021.	\$ 271,000	5%	\$ 138,979
New Mexico Finance Authority Loan, dated May 1, 2002, payable in monthly installments varying from \$2,500 to \$3,500 maturing on May 1, 2021.	703,586	1.47%	463,531
Western Bank Loan, dated February 8, 2008, payable in interest only payments for 18 months, payable upon receipt of Rural Utility Services grant.	300,000	9%	300,000
Rural Community Assistance Corporation, dated April 23, 2009, payable upon receipt of Rural Utility Services grant.	85,762	5.5%	85,762
Western Bank Auto Loan, dated February 25, 2008, payable in monthly installments of \$357.78, maturing on February 20, 2012.	14,672	8%	8,483
Total General Obligation Bonds	\$ 1,375,020		\$ 996,755

The annual requirements to amortize the notes payable as of December 31, 2009, including interest payments are as follows:

Year Ending December 31,	Principal	Interest	Total Requirements
2010	\$ 434,005	\$ 47,041	\$ 481,046
2011	49,586	13,008	62,594
2012	47,273	11,808	59,081
2013	47,707	10,780	58,487
2014	48,860	9,721	58,581
2015-2019	231,140	28,400	259,540
2020-2024	138,184	3,462	141,646
Total	\$ 996,755	\$ 124,220	\$ 1,120,975

Changes in long-term liabilities – During the year ended December 31, 2009 the following changes occurred in long-term debt.

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION**

Notes to the Financial Statements

December 31, 2009

NOTE 7. Long-term Debt (continued)

	Balance 12/31/08	Additions	Retirements	Balance 12/31/09	Due Within One Year
GMAC Loan	\$ 147,836	\$ -	\$ 8,857	\$ 138,979	\$ 8,953
New Mexico Finance Authority Loan	498,506	-	34,975	463,531	35,542
Western Bank Loan	300,000	-	-	300,000	300,000
Western Bank Auto Loan	11,971	-	3,488	8,483	3,748
RCAC Loan	-	85,762	-	85,762	85,762
Total	\$ 958,313	\$ 85,762	\$ 47,320	\$ 996,755	\$ 434,005

NOTE 8. Deposits Held for Others

The Association holds water and meter deposits for all members, which may be refunded only if requested by members upon termination of the water service agreement. The balance held on behalf of the members of the Association is \$10,357.

NOTE 9. Subsequent Event

In April 2009, the Association closed on a note in the amount of \$114,243 at 5.50% interest per annum to pay for costs of predevelopment work required to satisfy the conditions of funding contained in United States Department of Agriculture Rural Development Letter of Conditions dated July 29, 2008. During 2009, the Association received \$85,762 of this loan. The remainder is expected to be received in 2010. The interest is payable on the last day of each month in arrears. All principal and all accrued unpaid interest is due and payable not later than (1) the close of the Association's grant and loan for construction of water system improvements or (2) November 1, 2010, whichever is earlier. The Association is expecting to receive \$989,000 in grant and \$511,000 in loan monies from the Rural Utilities Services and will repay the loan with these monies.

NOTE 10. Subsequent Accounting Standard Pronouncements

In December 2006, the Governmental Accounting Standards Board (GASB) issued Statement No. 49, *Pollution Remedial Obligations*. This statement is effective for financial statements for the periods beginning after December 15, 2007. This statement establishes accounting standards for the recognition and reporting of liabilities related to environmental clean-up efforts. The Association believes it will have no significant effect on the financial statements for the upcoming year.

In June 2008, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Statement 53 is intended to improve how state and local governments report information

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Notes to the Financial Statements
December 31, 2009

NOTE 10. Subsequent Accounting Standard Pronouncements (continued)

about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged. The Association is analyzing the effect that this standard will have on its financial statements, and currently believes it will have no significant effect on the financial statements for the upcoming year.

In November 2007, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. The statement improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. Reporting those investments at fair value provides more decision-useful information about their composition, current value, and recent changes in value. GASB Statement No. 52 is effective for financial statements for periods beginning after June 15, 2008. The Association is analyzing the effect that this standard will have on its financial statements, and currently believes it will have no significant effect on the financial statements for the upcoming year.

In June 2008, the Governmental Accounting Standards Board (GASB) issued Statement No. 52, *Derivative Instruments*. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2009. Earlier application is encouraged. This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Derivative instruments are often complex financial arrangements used by governments to manage specific risks or to make investments. By entering into these arrangements, governments receive and make payments based on market prices without actually entering into the related financial or commodity transactions. Derivative instruments associated with changing financial and commodity prices result in changing cash flows and fair values that can be used as effective risk management or investment tools. Derivative instruments, however, can also expose governments to significant risks and liabilities. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward contracts, and futures contracts.

SUPPLEMENTAL INFORMATION

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER CO-OPERATIVE
Schedule of Deposit Accounts and Cash on Hand
December 31, 2009

<u>Name of Depository</u>	<u>Account Name</u>	<u>Account Type</u>	<u>Bank Balance</u>	<u>Reconciled Balance</u>
Western Bank	General	Checking	\$ 81,170	\$ 79,478
Western Bank	Water Rights	Savings	8,254	8,254
First American Bank	Reserve	Savings	<u>42,986</u>	<u>42,986</u>
Bank Total			<u>\$ 132,410</u>	
Cash on Hand				<u>75</u>
				<u>\$ 130,793</u>

COMPLIANCE SECTION

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

To the Board of Directors
Cottonwood Rural Water Association
Artesia, New Mexico
and
Mr. Hector H. Balderas, State Auditor:

We have audited the accompanying financial statements of the business-type activities of the Cottonwood Rural Water Association (the "Association"), as of and for the year ended December 31, 2009, which collectively comprise the Association's basic financial statements as listed in the table of contents. We have issued our report thereon dated May 27, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Association's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the Association's internal control. We consider the deficiencies described in the accompanying schedule of findings

and responses as items 2006-2, 2006-3, and 2007-1 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Association's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that we also considered to be material weaknesses. However, we do not believe that any of the control deficiencies described are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Association's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*, which is described in the accompanying Schedule of Findings and Responses as item 2007-1 .

The Association's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the agency's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Association's Board of Directors, the Association's management, the New Mexico State Legislature, and the State of New Mexico Office of the State Auditor and is not intended to be and should not be used by anyone other than these specified parties.

Miller & Associates, CPA, P.C.

Miller & Associates, CPA, P.C.
May 27, 2010

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Schedule of Findings and Responses
December 31, 2009**

A. FINDINGS – FINANCIAL STATEMENT AUDIT

2006-2 Segregation of Duties

Condition:

There is a lack of segregation of duties within the office. There are only two employees in the office and in some cases only one employee will collect daily payments, make deposits, post deposits to the billing system, and write checks.

Criteria:

Segregation of conflicting duties within accounting functions is a basic internal control that mitigates the risk of significant misstatement.

Cause:

The cause of the lack of segregation of duties is due to the small size of the office.

Effect:

The effect of the lack of segregation of duties is opportunity for either intentional or unintentional errors.

Recommendation:

We recommend that there be a segregation of duties whenever possible. Having an independent accountant prepare the monthly financial statements helps to mitigate the potential problems, but that alone is not sufficient to prevent errors. We recommend board involvement in the review of accounts receivable on a regular basis and that other employees be cross-trained on some of the accounting functions.

Client Response:

Of the two or three days a week that Cyndy Case is in the office, she does the deposit plus other office duties. The board members all live in the area and drop in randomly. Also, they are given financial reports, bill statements, director's reports, etc. at the monthly meetings.

2006-3 Deficiencies in Internal Controls Over Financial Reporting

Condition:

Management lacks the qualifications and training to apply generally accepted accounting principles in preparing the financial statements.

Criteria:

According to SAS No. 112 management is responsible for maintaining controls over the preparation of the financial statements in accordance with GAAP.

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Schedule of Findings and Responses
December 31, 2009**

A. FINDINGS – FINANCIAL STATEMENT AUDIT (continued)

Cause:

Management has not obtained the expertise or knowledge to prepare the financial statements.

Effect:

The Association was not in compliance with State Audit Rule 2.2.2.8.J.(4) in regards to SAS 112 and the ability of the Association to be able to prepare its own financial statements. In addition, by not being able to prepare its own financial statements could keep management and the board from being able to make timely decisions.

Recommendation:

We recommend that management obtain the proper training to prepare the financial statements.

Client Response:

We disagree with this finding due to the fact that we pay our auditors to prepare the financial statements.

2007-1

Budget Preparation

Condition:

The Cottonwood Rural Water Association is considered to be a governmental non-profit entity and did not prepare an annual budget.

Criteria:

In accordance with NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, and State Audit Rule 2.2.2.10 O governmental entities must annually prepare a budget. In addition NMSA 1978 6-3-7 requires each state agency to submit a budget to the state budget division.

Cause:

During the year the Association had no employee with the proper knowledge or training in preparing an annual budget.

Effect:

The Association is not in compliance with state law and not preparing a budget could affect state and federal funding.

**STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Schedule of Findings and Responses
December 31, 2009**

A. FINDINGS – FINANCIAL STATEMENT AUDIT (continued)

Recommendation:

We recommend that a budget be prepared on an annual basis, be updated when there is an adjustment to the budget and that the Department of Finance and Administration be contacted to obtain their budgetary approval process. Also, we recommend that an employee receive some training on how to prepare a budget.

Client Response:

Tom Dixon, Executive Budget Analyst from the Department of Finance and Administration, has been working with Jan on preparing a budget. During the May 11, 2010 board meeting, a resolution approving an interim budget was passed. Mr. Dixon picked this up on May 12, 2010.

B. PRIOR YEAR AUDIT FINDINGS

2006-2	<u>Segregation of Duties</u> Revised and Repeated
2006-3	<u>Deficiencies in Internal Controls Over Financial Reporting</u> Revised and Repeated
2007-1	<u>Budget Preparation</u> Revised and Repeated
2008-1	<u>Disposition of Property</u> Resolved and Not Repeated

STATE OF NEW MEXICO
COTTONWOOD RURAL WATER ASSOCIATION
Schedule of Findings and Responses
December 31, 2009

Financial Statement Preparation

The financial statements together with the related footnotes and supporting schedules were prepared by Miller & Associates, CPA, P.C. for the Association as of and for the year ended December 31, 2009.

Exit Conference

An exit conference was held on May 27, 2010 to discuss the financial statements and this report. Ryan Miller, Shareholder represented Miller & Associates, CPA, PC. Jan Waldrip, Office Manager and Roby Zumwalt, President of the Board of Directors represented Cottonwood Rural Water Association.