STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2007
WITH
INDEPENDENT AUDITORS' REPORT

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INTRODUCTORY SECTION

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STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

OFFICIAL ROSTER
December 31, 2007

Board of Directors

Donel Owen	President
Earnest Smith	Vice President
Bennie Brown	Secretary/Treasurer
Loren Linville	Member
Doyle W. Bradford	Member

Administrative Employees

Lloyd Ayliffe	General Manager
Gayle Willett	Administrative Assistant

Field Employees

Nathan Yarbro	Lead Operator
Cecil J. Sanchez	Operator

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STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

TABLE OF CONTENTS
December 31, 2007

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FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

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INDEPENDENT AUDITORS' REPORT

Hector H. Balderas, State Auditor
and the Board of Directors,
North Star DWC & MSW Cooperative, Inc.

We have audited the accompanying financial statements of the business-type activities of North Star DWC & MSW Cooperative, Inc. as of and for the year ended December 31, 2007, which collectively comprise the Company's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Company'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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of North Star DWC & MSW Cooperative, Inc., as of December 31, 2007, and the respective changes in financial position and cash flows of the Company 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 our report dated August 28, 2008, on our consideration of North Star DWC & SWC Cooperative, Inc's internal control over financial reporting and 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.

North Star DWC & MSW Cooperative, Inc. has not presented a Management's Discussion and Analysis required by GASB Statement No. 34 that the Governmental Standards Board 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 financial statements that collectively comprise the North Star DWC & MSW Cooperative, Inc. basic financial statements. The accompanying supplemental schedule of pledged collateral is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Keystone Accounting, LLC

August 28, 2008

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BASIC FINANCIAL STATEMENTS

STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

PROPRIETARY FUND
STATEMENT OF NET ASSETS
December 31, 2007

ASSETS	
Current assets:	
Cash and equivalents	$ 363,520
Accounts receivable	63,871
Interest receivable	111
Total current assets	427,502
Capital assets:	
Land	7,436
Buildings and system	2,052,704
Improvements other than buildings	454,543
Equipment	2,981,256
Water rights	708,641
	6,204,580
Less accumulated depreciation	(2,669,773)
Net capital assets	3,534,807
Other assets:	
Restricted cash and equivalents	80,205
Debt issuance cost	17,798
Less accumulated amortization	(3,277)
Total other assets	94,726
Total assets	$ 4,057,035
LIABILITIES	
Current liabilities:	
Accounts payable	$ 9,378
Accrued liabilities	17,185
Interest payable	7,438
Current maturities of capital lease	12,360
Current maturities of long-term debt	117,531
Total current liabilities	163,892
Long-term liabilities:	
Capital lease payable, less current maturities	14,838
Loans payable, less current maturities	2,262,864
Total long-term liabilities	2,277,702
Total liabilities	2,441,594
NET ASSETS	
Invested in capital assets, net of related debt	1,127,214
Restricted for debt service	80,205
Unrestricted net assets	408,022
Total net assets	1,615,441
Total liabilities and net assets	$ 4,057,035

See accompanying notes.

STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

PROPRIETARY FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
Year ended December 31, 2007

	2007
Operating revenue:	
Charges for service	$ 755,914
Operating expenses:	
Salaries and wages	179,863
Benefits	37,994
Payroll taxes	14,542
System operations	75,341
Plant operations	60,928
Office expense	26,405
Legal	2,329
Accounting	7,717
Professional services	822
Insurance	23,918
Telephone	8,480
Equipment rental	8,600
Travel	3,432
Miscellaneous	4,489
Depreciation	232,297
Total operating expenses	687,157
Income from operations	68,757
Non-operating revenues (expenses):	
Interest income	15,547
Interest expense	(67,480)
Total non-operating revenues (expenses)	(51,933)
Change in net assets	16,824
Net assets at beginning of year	1,598,617
Net assets at end of year	$ 1,615,441

See accompanying notes.

STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

PROPRIETARY FUND
STATEMENT OF CASH FLOWS
Year ended December 31, 2007

Cash flows from operating activities:	
Cash received from customers	$ 748,133
Cash payments to employees	(174,468)
Cash payments for employee benefits	(38,549)
Cash payments for taxes	(15,433)
Cash payments for goods and services	(237,245)
Net cash provided by operating activities	282,438
Cash flows from capital and related financing activities:	
Payments for capital acquisitions	(9,581)
Payments on capital-related debt	(195,712)
Net cash used in financing activities	(205,293)
Cash flows from investing activities:	
Receipts of interest	17,048
Net increase in cash and equivalents	94,193
Cash and equivalents at beginning of year	349,532
Cash and equivalents at end of year (including $80,205 reported as restricted cash)	$ 443,725
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 68,757
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization expense	233,039
Increase in customer receivables	(2,305)
Decrease in accounts payable	(14,784)
Increase in accrued liabilities	1,971
Decrease in interest receivable	1,501
Decrease in deferred revenue	(5,476)
Decrease in interest payable	(265)
Net cash provided by operating activities	$ 282,438

See accompanying notes.

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The North Star DWC & SWC Cooperative, Inc. (Company) is a not-for-profit Mutual Domestic Association established for the purpose of construction, maintaining, and operating a water and wastewater system for members of the Company in rural San Juan County. The Company was incorporated as a Cooperative Company under the provisions of the New Mexico Cooperative Corporation Act. The Board of Directors changed its form of organization from a not-for-profit cooperative to a not-for-profit company under the Sanitary Projects Act, NMSA 3-29-1 through 3-29-20. The Company has no component units.

Under the Sanitary Projects Act, the Association remains a not-for-profit organization owned and governed by its members. It is also eligible to receive certain loans and grants from the State of New Mexico.

The New Mexico State Auditor has determined, based upon the AG opinions, that mutual domestic water associations are governmental nonprofit organizations. As a result of this conclusion, as of fiscal year 2006, the Company has changed their reporting format from the nonprofit format to the governmental format required by Governmental Accounting Standards Board (GASB) Statement 34. There was no effect on net assets as a result of implementing this format.

B. Measurement focus, basis of accounting and financial statement presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The proprietary fund financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The company uses a proprietary fund to record all of its transactions.

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Measurement focus, basis of accounting, and financial statement presentation (continued)

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the Company enterprise fund is charges to customers for sales and services. Operating expenses for the enterprise fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

C. Assets, Liabilities, and Net Assets or Equity

1. Deposits and investments

The company's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

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

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 Company. 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 asked price on United States Treasury bills of the same maturity on the day of deposit.

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

C. Assets, liabilities, and net assets or equity (continued)

1. Deposits and investments (continued)

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.

Investments for the Company are reported at fair value.

2. Accounts receivable

The receivables in the statement of net assets are considered fully collectable, and therefore, no allowance for doubtful accounts has been recorded. Receivables are recognized when services have been rendered and revenue has been earned.

3. Capital assets

The Company's policy is to capitalize all disbursements for equipment in excess of $5,000. Property and equipment are recorded at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated services lives using the straight-line method. Improvements are capitalized, while expenditures for maintenance and repairs are charged to expenses as incurred. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related costs and accumulated depreciation. The resulting gains and losses are reflected in the statements of activities. The Association assets have the following estimated useful lives:

	Years
Buildings and systems	40
Furniture and fixtures	5-15
Improvements other than buildings	15-30
Machinery and equipment	5-20

Water rights or $708,641 are not depreciated or amortized because water rights reflect renewable resources that do not deplete through use or deterioration. The Company evaluates the water rights each reporting period to determine whether events or circumstances continue to support an indefinite useful life.

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

C. Assets, liabilities, and net assets or equity (continued)

4. Accumulated compensated absences

The Company permits certain employees to accumulate a limited amount of earned but unused vacation leave. The cost of earned but unpaid vacation leave is normally recognized in proprietary funds when the benefit vests to the employee and becomes a legal liability to the Company.

	December 31, 2007	Increases	Decreases	December 31, 2007	Due within one year
Compensated absences	$ 5,938	$ 4,983	$ -	$ 10,291	$ 10,921

5. Accrued liabilities

Accrued liabilities consist of the following at December 31, 2007:

Accrued salaries and wages	$ 2,617
Accrued leave	10,921
State withholding payable	321
Federal and state unemployement taxes	75
Pension plan contributions	608
Gross receipts tax payable	2,605
Other	38
Total	$ 17,185

6. Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

D. Income taxes

North Star DWC & SWC Cooperative, Inc., is exempt from Federal Income Taxes under the provisions of section 501(a) of the Internal Revenue Code as an entity described in section 501(c)(3). Therefore, no provision for income taxes has been made.

II. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Budgetary information

The Company does not legally adopt a budget. Therefore, no comparison is made between the budget and actual expenditures.

III. DETAILED NOTES ON ALL FUNDS

A. Cash and temporary investments

At December 31, 2007, the carrying amount of the Company's deposits was $443,725 and the bank balance was $453,592. Of this balance $346,194 was covered by federal depository insurance. NM 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 Company for at 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 and uninsured portion of deposits.

	Citizens Bank	Bank of Albuquerque	Gallup Federal Savings Bank	Four Corners Connumity Bank
Cash on deposit	$ 103,267	$ 25,382	$ -	$ -
Certificates of deposit	29,223	-	88,322	100,000
Cash invested in money market funds	-	-	-	60,846
FDIC coverage	(132,490)	(25,382)	(88,322)	(100,000)
Total uninsured and uncollateralized	$ -	$ -	$ -	$ 60,846

	New Mexico Finance Authority
Cash on deposit with State Treasurer	$ 46,552
Collateralized in State Treasurer accounts	(46,552)
Total uninsured and uncollateralized	$ -

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

III. DETAILED NOTES ON ALL FUNDS (continued)

A. Cash and temporary investments (continued)

According to the Federal Deposit Insurance Authority, public unite deposits are funds owned by the Company. 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 $100,000 in aggregate and separate from the $100,000 coverage for public unit demand deposits at the same institution.

Custodial credit risk-deposits:

Custodial Credit risk is the risk that in the event of bank failure, the Company deposits may not be returned. The Company does not have a deposit policy for custodial credit risk. As of December 31, 2007, $60,846 of the Company bank balance of $453,592 was exposed to custodial credit risk as follows:

Uninsured and uncollarteralized	$ 60,846
Uninsured and collateralized by Federal Depository Insurance Authority (FDIC)	346,194
Uninsured and collateralized in State Treasurers Accounts	46,552
Total	$ 453,592

III. DETAILED NOTES ON ALL FUNDS (continued)

B. Capital Assets

Capital asset activity for the year ended June 30, 2007 was as follows:

Buildings and systems	2,052,704	-	-	$ 2,052,704
Improvements other than buildings	444,962	9,581	-	$ 454,543
Equipment	2,981,256	-	-	2,981,256
Total capital assets, being depreciated	5,478,922	9,581	-	5,488,503
Less accumulated depreciation for:				
Buildings and systems	(112,348)	(51,317)	-	(163,665)
Improvements other than buildings	(102,054)	(27,524)	-	(129,578)
Equipment	(2,223,074)	(153,456)	-	(2,376,530)
	-	-	-	-
Total accumulated depreciation	(2,437,476)	(232,297)	-	(2,669,773)
Total capital assets being depreciated, net	$ 3,041,446	$ (222,716)	$ -	$ 2,818,730
Total capital assets, net	$ 3,757,523	$ (222,716)	$ -	$ 3,534,807

III. DETAILED NOTES ON ALL FUNDS (continued)

C. Long-Term Debt

A summary of loans payable at December 31, 2007

	Beginning Balance	Increase/ (Decrease)	Ending Balance	Amount Due Within One Year
3% Rural Infrastructure Program loan to New Mexico Environmental Department, payable in yearly installments of $11,571 each, beginning October 2002, including interest, due October 2014, secured by water chargers, present and future contract rights and accounts recievable arising in connection with the Company.	$ 81,228	$ (9,135)	$ 72,093	$ 9,409
3% Rural Infrastructure Program loan to New Mexico Environmental Department, payable in yearly installments of $4,683 each, beginning October 2002, including interest due October 2007, secured by water charges present and future contract rights and accounts receivable arising in connection with the Company.	4,547	(4,547)	-	-
1.462% long-term debt to NMFA, payable in unequal installments of various amounts beginning October 2003, including interest, due April 2028, secured by the water system, easement, leases, water rights, water charges, accounts receivable, inventories, permits, and right of ways, and income of all kinds derived from operations of the Company	1,653,195	(47,764)	1,605,431	48,973
4.93% long-term debt to NMFA, payable in unequal installments of various amounts beginning May 2003, including interest, due April 2028, secured by the water system, easement, leases, water rights, water charges, accounts receivable, inventories, permits, and right of ways, and income of all kinds derived from operations of the Company	210,945	(13,559)	197,386	14,223

III. DETAILED NOTES ON ALL FUNDS (continued)

C. Long-Term Debt (continued)

	Balance	(Decrease)	Balance	Within One Year
6.875% long-term debt to Rural Utility Services, payable in monthly installments of $2,087, beginning August 1991 including interest, due August 2031, secured by present and future contract rights, accounts receivable, and general intangibles arising in connection with the Company.	$ 281,884	$ (5,847)	$ 276,037	$ 6,261
5.00% long-term debt to Rural Utility Services, payable in monthly installments of $1,650, beginning November 2001 including interest, due November 2021, secured by present and future contract rights, accounts receivable, and general intangibles arising in connection with the Company.	205,474	(9,644)	195,830	10,137
6.00% long-term debt to Cleatice and Barbara Beaty, payable in monthly installments of $2,492, beginning March 2004 including interest, due March 2009, secured by the water rights purchased with the loan.	60,623	(27,005)	33,618	28,528
Total	$ 2,497,896	$ (117,501)	$ 2,380,395	$ 117,531

III. DETAILED NOTES ON ALL FUNDS (continued)

C. Long-Term Debt (continued)

Principal maturities of loans payable are as follows:

December 31,		
2008	$	117,531
2009		97,276
2010		94,660
2011		97,263
2012		99,167
2013-2017		546,270
2018-2022		604,541
2023-2027		602,394
2028		121,293
	$	2,380,395

The New Mexico Finance Authority loans require the Company to maintain reserve accounts, which consist of $80,205 for the year ended December 31, 2007, in restricted cash on the accompanying statement of financial position. Associated with the loans, there is a loan origination fee that is being amortized over the life of the loan.

Capital leases payable are as follows:

During fiscal year 2005, the Company entered into a capital lease agreement to purchase a backhoe for $57,511. The term of the lease is five years with monthly payments of $1,207 and an implicit interest rate of 9.8%. At the end of the lease term, the Company has the option to purchase the equipment for the residual value of $1.

	Balance	Increase	Decrease	Balance
Capital lease payable	$ 38,406	$ -	$ 11,208	$ 27,198

III. DETAILED NOTES ON ALL FUNDS (continued)

C. Long-Term Debt (continued)

The minimum future lease payments at December 31, 2007 are as follows:

December 31,		
	2008	$ 14,484
	2009	14,484
	2010	1,207
Total minimum lease payments		30,175
Less: implicit interest		(2,977)
Present value of net minimum lease payments		$ 27,198

IV. WORKMAN'S COMPENSATION

Every employee of the North Star DWC & SWC Cooperative, Inc. is covered by workman's compensation insurance as provided by State law. The Company pays the entire insurance cost. Any employee who is injured or becomes ill from a cause arising in the course of his/her employment is eligible for benefits under workmen's compensation in accordance with State Workmen's Compensation Law. Such illness or injury must be reported to the supervisor or General Manager immediately.

V. GRANTS

The Company was approved for five grants from the New Mexico Environment Department. The grants were in the amounts of $50,000, $150,000, $50,000, $100,000 and $90,000, and were awarded March 19, 2004, September 30, 2004, October 18, 2004, February 24, 2006, and February 24, 2006, respectively. The funds were available for reimbursement of expenditures incurred for the upgrade of water lines during the years ended December 31, 2006 and 2005. The 2004 grants are available until June 30, 2009, and the 2006 grants are available until June 30, 2010. The funds have not yet been used.

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SUPPLEMENTAL INFORMATION

STATE OF NEW MEXICO
NORTH STAR DWC & SWC COOPERATIVE, INC.

SCHEDULE OF PLEDGED COLLATERAL
December 31, 2007

	Citizens Bank	Bank of Albuquerque	Gallup Federal Savings Bank	Four Corners Community Bank	New Mexico Finance Authority
Cash on deposit	$ 103,267	$ 25,382	$ -	$ -	$ 46,552
Certificates of deposit	29,223	-	88,322	100,000	-
Money market account	-	-	-	60,846	-
Total deposits	132,490	25,382	88,322	160,846	46,552
Less FDIC coverage	(132,490)	(25,382)	(88,322)	(100,000)	-
Total uninsured funds	-	-	-	60,846	46,552
Less amounts collateralized in State Treasurer accounts	-	-	-	-	(46,552)
Total uninsured and uncollateralized	$ -	$ -	$ -	$ 60,846	$ -

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

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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

Hector H. Balderas, State Auditor
and the Board of Diretors
North Star DWC & SWC Cooperative, Inc.

We have audited the financial statements of the business-type activities of North Star DWC & SWC Cooperative, Inc., as of and for the year ended December 31, 2007, and have issued our report thereon dated August 28, 2008. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered North Star DWC & SWC Cooperative Inc.'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, but not for the purpose of expressing an opinion of the effectiveness of North Star DWC & SWC Cooperative, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of North Star DWC & SWC Cooperative, Inc.'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 combination of control deficiencies, that adversely affects North Star DWC & SWC Cooperative, Inc.'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 North Star DWC & SWC Cooperative, Inc's financial statements that is more than inconsequential will not be prevented or detected by the North Star DWC & SWC Cooperative, Inc.'s internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting. Finding 2007-2 and 2007-4.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by North Star DWC & SWC Cooperative, Inc.'s internal control..

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Hector H. Balderas, State Auditor
and the Board of Directors
North Star DWC & SWC Cooperative, Inc.

Our consideration of the 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 the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and other matters

As part of obtaining reasonable assurance about whether North Star DWC & SWC Cooperative Inc.'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 three instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and responses as items 2007-1, 2007-3, and 2007-5.

The North Star DWC & SWC Cooperative, Inc.'s responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the North Star DWC & SWC Cooperative, Inc.'s response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Directors, the State Auditor, Department of Finance and Administrative Local Government Division, and the New Mexico Legislature, and is not intended to be and should not be used by anyone other than these specified parties.

Keystone Accounting, LLC

August 28, 2008

AUDIT FINDINGS AND RESPONSES

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SCHEDULE OF AUDIT FINDINGS AND RESPONSES

Year Ended December 31, 2007

PRIOR YEAR AUDIT FINDINGS

2006-1 A DETAILED LISTING OF FIXED ASSETS INVENTORY IS NOT AVAILABLE

Condition: A fixed asset inventory listing has not been prepared by the Company

Recommendation: A physical inventory of all capitalized assets should be made and depreciation accounted for by item. An identification system should be put into place to allow items in the asset listing to be specifically identified. Coordination among all personnel to obtain any necessary pricing information and/or tagging requirements as set by policy should be implemented immediately to properly account for acquisitions and disposals.

Current Status: Unresolved. Repeated in current year.

2006-2 BILLS WERE CALCULATED INCORRECTLY

Condition: The billing system was calculating water bills incorrectly for customers using more than ten thousand gallons of water per month. The error caused the billed revenue to be less than it should have been according to the fee schedule. Additionally, for nine of twenty-five bills selected for testing the billing detail was unavailable and could not be recalculated.

Recommendation: The billing system should be tested periodically to ensure that the fees are being calculated correctly. Detailed records should be kept on file to provide evidence of correct billing.

Current Status: Resolved. Not repeated in current year.

2006-3 COLLATERAL FOR PUBLIC MONIES

Condition: The Company's cash balance that was invested in money market funds at Morgan Stanley, $146,068, was not insured or collateralized.

Recommendation: It is the responsibility of management to ensure that adequate safekeeping of the Company's assets is maintained. As part of its fiscal responsibility, management should work closely with its depository institutions to closely monitor types and amounts of collateral to meet the state requirements.

Current Status: Unresolved. Repeated in current year.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

Year Ended December 31, 2007

A. FINDINGS – FINANCIAL STATEMENT AUDIT

2007-1 FAILURE TO FILE AUDIT REPORT BY REQUIRED DUE DATE

Condition: The December 31, 2007 audit report was not submitted to the New Mexico State Auditor's Office by the due date of May 30, 2008. The audit was submitted to the New Mexico State Auditor's Office on October , 2008.

Criteria: The New Mexico, Office of the State Auditor has issued NMAC 2.2.2 Requirements for Contracting and Conducting Audits of Agencies, setting due dates for audits to be in the office by May 30, 2008.

Effect of condition: The report was not available for the Department of Finance and Administration Local Government Division and other state agencies to review on a timely basis.

Cause of condition: The cause for late filing was the year end of the entity in the contract was June 30, 2008 instead of December 31, 2007. Also, the contract was submitted late by the entity.

Recommendation: The audit contract should be signed by the due date required by the State Auditor in the future.

Management Response: Contract will be submitted earlier to prevent this.

2007-2 UNTIMELY DEPOSITS OF RECEIPTS

Condition: Two out of Twenty-five receipts tested showed that payments collected were not deposited within one week of receipt.

Criteria: All receipts should be deposited in a timely manner.

Effect of condition: Receipts are left on the premises for extended periods of time, susceptible to misuse and interest income is lost on the bank account.

Cause of condition: Bank deposits are not made often enough.

Recommendation: Receipts should be deposited within one week.

Management response: Deposits will be done in less than one week or earlier.

A. FINDINGS – FINANCIAL STATEMENT AUDIT (continued)

2007-3 A DETAILED LISTING OF FIXED ASSETS INVENTORY IS NOT AVAILABLE
(Original Finding # 2006-1)

Condition: A fixed asset inventory listing has not been prepared by the Company

Criteria: A detailed listing of capitalized assets is needed for proper management of both depreciable and intangible items on the balance sheet.

Effect of Condition: There is no listing of capitalized assets with which to reconcile the amounts reflected on the balance sheet. The lack of any tracking system for assets and depreciation inhibits the proper recording of assets disposed of or sold, and also, allows for a higher risk of misappropriation of asset inventory.

Cause of Condition: The nature of the assets involved makes it difficult in giving nomenclature to individual pieces that make up the pipeline network in addition to requiring time that is not readily available.

Recommendation: A physical inventory of all capitalized assets should be made and depreciation accounted for by item. An identification system should be put into place to allow items in the asset listing to be specifically identified. Coordination among all personnel to obtain any necessary pricing information and/or tagging requirements as set by policy should be implemented immediately to properly account for acquisitions and disposals.

Management's response: This inventory is in progress of being completed as soon as possible.

2007-4 PREPARATION OF THE FINANCIAL STATEMENTS

Condition: The financial statements were prepared by the auditor.

Criteria: Management is required to have an internal control system of financial reporting including the preparation of the financial statements.

Effect of condition: Management's ability to ascertain the accuracy and completeness of the financial statements has been diminished.

Cause of condition: Management does not have internal controls in place that are necessary for the preparation of the financials.

Recommendation: Management should develop a plan and system of controls that enables them to review the accuracy and completeness of the financial statements.

Management response: A system of controls will be developed and implemented that allow management to determine the accuracy and fair presentation of the financial statements.

A. FINDINGS – FINANCIAL STATEMENT AUDIT (continued)

2007-5 COLLATERAL FOR PUBLIC MONIES
(Original Finding # 2005-5)

Condition: The Company's cash balance that was invested in money market funds at Four Corners Community Bank, $146,068, was not insured or collateralized.

Criteria: According to New Mexico State Statute (NMSA 1978) 6-10-16, "Deposits of public money shall be secured by (1) securities of the United States…(2) securities of the State of New Mexico…(3) securities that are guaranteed by the United States or the State of New Mexico, (4) revenue bonds that are underwritten by a member of the National Association of Securities Dealers (NASD) and are rated "BAA", (5) letters of credit issued by a federal home loan bank."

Effect of Condition: The lack of securities as collateral of public monies that do not meet the state statute requirements has resulted in leaving the Company's deposits inadequately guaranteed in the event of a bank failure.

Cause of Condition: Management became aware of the requirement at the end of 2006 and had not corrected the problem as of the audit date.

Recommendation: It is the responsibility of management to ensure that adequate safekeeping of the Company's assets is maintained. As part of its fiscal responsibility, management should work closely with its depository institutions to closely monitor types and amounts of collateral to meet the state requirements.

Management's response: In October of 2008, adequate collateralization was obtained from Four Corners Community Bank for the money invested in the money market funds.

REQUIRED DISCLOSURE

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REQUIRED DISCLOSURES

Year Ended December 31, 2007

REQUIRED DISCLOSURE

The financial statements were prepared by the independent public accountants.

An exit conference was held October 2, 2008, during which the audit findings were discussed. The exit conference was attended by the following individuals:

NORTH STAR DWC & SWC COOPERATIVE, INC.

Donel Owen, President
Bennie Brown, Member
Lloyd Ayliffe, General Manager
Gayle Willett, Administrative Assistant

KEYSTONE ACCOUNTING, LLC

Phil Rasband, CPA
Felicia Stone Staff Auditor