FINANCIAL STATEMENTS AND REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

PAA-KO COMMUNITIES SEWER ASSOCIATION

December 31, 2008 and 2007

PRECISE. PERSONAL. PROACTIVE.

C O N T E N T S

Paa-Ko Communities Sewer Association

OFFICIAL ROSTER

December 31, 2008

BOARD OF DIRECTORS

William C. Nickell	President
Michael Fastiggi	Vice President
W. Bruce Franks	Secretary/Treasurer
David Wesley	Member
Nick Thompson	Member

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CERTIFIED PUBLIC ACCOUNTANTS | CONSULTANTS

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Mr. Hector H. Balderas
New Mexico State Auditor and
Board of Directors
Paa-Ko Communities Sewer Association

We have audited the accompanying financial statements of the business type activities of the Paa-Ko Communities Sewer Association (Paa-Ko or the Association), as of and for the years ended December 31, 2008 and 2007, which collectively comprise the Association's basic financial statements as listed in the table of contents. We have also audited the accompanying budgetary comparison for the year ended December 31, 2008 presented as supplementary information as listed in the table of contents. These financial statements and budgetary comparison are the responsibility of Paa-Ko's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and with 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 audits 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 audits provide a reasonable basis for our opinions.

In our opinion, the financial statements and budgetary comparison referred to above present fairly, in all material respects, the respective financial position of the business type activities of the Association, as of December 31, 2008 and 2007, and the respective changes in financial position and cash flows, for the years 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 May 28, 2009 on our consideration of Paa-Ko's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal controls over financial reporting and compliance and the results of the 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 audits.

Management's Discussion and Analysis on pages 5-7 is not a required part of the basic financial statements, but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements and the budgetary comparison statement. The Schedule of Individual Deposit Accounts and Pledged Collateral 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 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Atkinson & Co., Ltd.

Atkinson & Co., Ltd.

Albuquerque, New Mexico
May 28, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
Required Supplementary Information

December 31, 2008

OVERVIEW OF THE FINANCIAL STATEMENTS

The management of the Association offers readers of the Association's financial statements this narrative overview and analysis of the financial position of the Association as of December 31, 2008 and the results of its operations for the year then ended. Data as of December 31, 2007 has been provided for comparative purposes.

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, was adopted by the Association as of January 1, 2006.

BASIC FINANCIAL STATEMENTS

The Association is considered a local public body pursuant to statutes and legal rulings but does not employ fund accounting and therefore this format is not presented. The Association is reporting using the Business type activities (BTA) format pursuant to GASB 34 reporting model for the fiscal years ending December 31, 2008 and 2007.

The basic financial statements include statements of net assets, which reports the Association's assets, liabilities and net assets (equity), statements of revenues, expenses, and changes in net assets, and statements of cash flows. The statement of net assets is presented as of December 31, 2008 and 2007 while the latter two statements cover the years then ended.

CONDENSED COMPARATIVE FINANCIAL INFORMATION

The Association's assets, liabilities and net assets can be summarized as follows as of December 31, 2008 and 2007:

	2008	2007
Current assets	$ 386,033	$ 654,832
Non-current assets	4,882,308	4,266,573
Total assets	$ 5,268,341	$ 4,921,405
Current liabilities	$ 85,084	$ 346,683
Non-current liabilities	1,446,267	1,485,726
Total liabilities	1,531,351	1,832,409
Members' net assets	3,736,990	3,088,996
Total liabilities and unrestricted net assets	$ 5,268,341	$ 4,921,405

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
Required Supplementary Information

December 31, 2008

CONDENSED COMPARATIVE FINANCIAL INFORMATION - CONTINUED

The Association's revenues and expenses can be summarized as follows for the years ended December 31, 2008 and 2007:

	2008	2007
Operating revenues	$ 319,296	$ 323,431
Contribution from developer	824,332	1,122,296
Interest income	14,453	23,814
Total revenues	1,158,081	1,469,541
Operating expenses	472,724	270,765
Non-operating expenses	37,363	17,680
Change in net assets	$ 647,994	$ 1,181,096

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

The decrease in current assets for 2008, in this case, cash and certificate of deposits (CD's), resulted from the Association paying the balance of its share of the treatment plant construction costs which, in turn, reduced current liabilities from their 2007 level.

The net increase in non-current assets resulted from the developer's contribution of the collection system assets for a new subdivision as well as finishing costs of the treatment plant net of the 2008 depreciation allowances for the treatment plant and collection system.

Non-current liabilities decrease as scheduled payments were made on notes payable.

Operating revenues for 2008 were slightly less than in 2007. There was an increase in member assessments as memberships increased by 74 due to the inclusion of the new subdivision lots. However, sewer hook-up fees and member transfer fee revenues decreased to more than offset the increase in member assessments. Interest income was down as cash and CD balances decreased in early 2008.

Expenses increased substantially in 2008. The majority of the operating expense increase resulted from depreciation on the new treatment plant and the additional collection system. Other expense increases were related mainly to the startup of the treatment plant which should not be repeated next year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
Required Supplementary Information

December 31, 2008

BUDGETARY ANALYSIS

The budgetary basis is cash basis.

	(In thousands) Budget	(In thousands) Actual	Positive (Negative) Variance
Revenues	$ 362,423	$ 1,158,081	$ 795,658
Expenses	677,881	510,087	167,794
Excess (deficit) of revenues over expenses	$ (315,458)	$ 647,994	$ 963,452

The major differences between the budgeted and actual revenues are the developer contributions of $12,306 for the completion of the treatment plant and $812,026 for the addition to the collection system. These items were not budgeted.

The major differences between the budgeted and actual expenses were that the budget did not include the non-cash depreciation expense of $234,739. The budget did, however, include $25,000 for wetlands remediation liability costs, $320,381 to pay the remaining treatment plant construction liability, and $37,484 for principal payment on the long-term debt associated with the treatment plant that are not included in financial statement expenses.

CAPITAL ASSET ACTIVITY

During 2008, $38,448 additional funds were expended and capitalized to complete the new wastewater treatment plant of which the developer contributed $12,306. Also, $812,026 was capitalized for the addition to the collection system that serves the new subdivision. This cost was contributed by the developer.

DEBT ACTIVITY

In 2008, the Association drew down the remaining $22,261 of its 1.5 million dollar loans from the New Mexico Environment Department as part of the financing for the new Wastewater Treatment Plant. There were principal payments totaling $37,484 made as scheduled in 2008.

CURRENTLY KNOWN FACTS, DECISIONS AND CONDITIONS

The Association's membership expanded by 74 members in early 2008.

Paa-Ko Communities Sewer Association

STATEMENTS OF NET ASSETS - PROPRIETARY FUND

December 31, 2008 and 2007

ASSETS

	2008	2007
CURRENT ASSETS		
Cash and cash equivalents	$ 78,332	$ 95,613
Certificates of deposit	300,742	552,597
Accounts receivable	4,166	3,140
Other assets	2,793	3,482
Total current assets	386,033	654,832
PROPERTY AND EQUIPMENT		
Wastewater treatment plant	3,188,013	3,149,565
Wastewater collection system	2,642,632	1,830,606
Wetland treatment facilities	590,746	590,746
	6,421,391	5,570,917
Less accumulated depreciation and amortization	(1,539,083)	(1,304,344)
Net property and equipment	4,882,308	4,266,573
Total assets	$ 5,268,341	$ 4,921,405

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

LIABILITIES AND MEMBERS' NET ASSETS

	2008	2007
CURRENT LIABILITIES		
Accounts payable	$ 2,547	$ 1,942
Due to developer	-	289,577
Current maturities of long-term debt	57,710	37,484
Accrued interest payable	24,827	17,680
Total current liabilities	85,084	346,683
NON-CURRENT LIABILITIES		
Notes payable	1,425,277	1,460,726
Estimated closure costs payable	20,990	25,000
Total non-current liabilities	1,446,267	1,485,726
Total liabilities	1,531,351	1,832,409
COMMITMENTS	-	-
MEMBERS' NET ASSETS		
Invested in capital assets, net of related debt	3,399,321	2,768,363
Unrestricted	337,669	320,633
Total members' net assets	3,736,990	3,088,996
Total liabilities and members' net assets	$ 5,268,341	$ 4,921,405

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS - PROPRIETARY FUND

For the years ended December 31, 2008 and 2007

	2008	2007
OPERATING REVENUES		
Members' assessments	$ 302,296	$ 268,731
Sewer hookup fees	15,000	51,500
Sewer transfer fees	2,000	3,200
Total revenues	319,296	323,431
EXPENSES		
Depreciation and amortization	234,739	68,103
Maintenance fees	142,315	96,621
Treatment plant start up	43,217	7,001
Professional fees	18,592	28,815
Repairs and maintenance	13,683	37,239
Insurance	6,511	6,510
Utilities and telephone	6,279	4,155
Septic pumping	4,126	16,542
Licenses and permits	3,062	5,309
Postage	200	279
Office supplies	-	191
Total operating expenses	472,724	270,765
Operating (deficit) income	(153,428)	52,666
NONOPERATING REVENUES AND (EXPENSES)		
Contribution from developer	824,332	1,122,296
Interest income	14,453	23,814
Estimated closure costs	-	-
Interest expense	(37,363)	(17,680)
Total nonoperating revenues and (expenses)	801,422	1,128,430
Income before contributions and transfers	647,994	1,181,096
Contribution and transfers	-	-
Change in net assets	647,994	1,181,096
Members' net assets, beginning of year	3,088,996	1,907,900
Members' net assets, end of year	$ 3,736,990	$ 3,088,996

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

Paa-Ko Communities Sewer Association

STATEMENTS OF CASH FLOWS

For the years ended December 31, 2008 and 2007

Increase (Decrease) in Cash and Cash Equivalents

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from members	$ 318,270	$ 337,024
Cash paid to suppliers	(240,701)	(201,850)
Interest paid	(30,216)	-
Net cash provided by operating activities	47,353	135,174
CASH FLOWS FROM INVESTING ACTIVITIES		
Withdraw (purchase) of certificate of deposit	251,855	(110,347)
Additions to plant and equipment	(38,448)	(2,602,432)
Interest received	14,453	23,814
Net cash provided (used in) investing activities	227,860	(2,688,965)
CASH FLOWS FROM NON CAPITAL FINANCING ACTIVITIES	-	-
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES		
Cash (paid) received from developer	(277,271)	1,548,873
Proceeds from notes payable	22,261	1,056,435
Principal payments on notes payable	(37,484)	-
Net cash (used in) provided by financing activities	(292,494)	2,605,308
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(17,281)	51,517
Cash and cash equivalents, beginning of year	95,613	44,096
Cash and cash equivalents, end of year	$ 78,332	$ 95,613

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

STATEMENTS OF CASH FLOWS - CONTINUED

For the years ended December 31, 2008 and 2007

Increase (Decrease) in Cash and Cash Equivalents

	2008	2007
Reconciliation of the operating (deficit) income to net cash provided by operating activities		
Operating (deficit) income	$ (153,428)	$ 52,666
Adjustments to reconcile changes in net assets to net cash provided by operating activities		
Depreciation and amortization	234,739	68,103
Interest paid	(30,216)	
Changes in assets and liabilities		
Other assets	689	(796)
Receivables	(1,026)	13,593
Accounts payable	(3,405)	1,608
Total adjustments	200,781	82,508
Net cash provided by operating activities	$ 47,353	$ 135,174

SUPPLEMENTAL DISCLOSURES FOR NON-CASH FINANCING ACTIVITIES

	2008	2007
Property and equipment acquired under transfer agreement	$ 812,026	$ -

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

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Financial Reporting Entity

Paa-Ko Communities Sewer Association (Paa-Ko or the Association) is a not-for-profit sewer association formed to provide sewer service to its members-owned and operated sewer utility system and to develop adequate and sanitary sewer works, including the construction of sewage treatment facilities and other necessary improvements and expansion of its sewer system. The Association services only the Paa-Ko Communities, which are located in Sandia Park, New Mexico. The Association operates facilities located in Sandia Park. The Association has the authority to borrow money, to act as an agent or representative of any members, and to convey, assign, and transfer, all of its property and contractual rights to another association of other legal entity that is capable and willing to meet the purposes for which the Association is formed.

On February 13, 2004, the Paa-Ko Communities Sewer Cooperative, Inc., a cooperative association organized on September 1, 1993, acting under the authority granted by the provisions of the Sanitary Projects Act, Sections 3-29-1 through 3-29-19, New Mexico Statutes 1978 (Sanitary Projects Act), reorganized the cooperative association as an association under the Sanitary Projects Act under the new name of Paa-Ko Communities Sewer Association.

All persons who are bona fide owners of land in the service area of the Association, and who evidence their present or future need and desire for wastewater collection and treatment services provided by the Association shall be members. Each member is entitled to only one vote, regardless of the number of lots the member owns. Members owning the same lot will jointly have one vote. Membership is not transferable and terminates upon the conveyance of the last property owned by the member.

There are no component units of the Association as defined in governmental accounting principles.

2. Basic Financial Statements – GASB Statement No. 34

The financial statements of the Association have been prepared in conformity with accounting principles generally accepted in the United States of America (US GAAP) as applied to governmental units. The Governmental Account Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

In June 1999, the GASB unanimously approved Statement No. 34, *Basic Financial Statements—Management's Discussion and Analysis—For State and Local Governments*. This Statement provides for the most significant change in financial reporting in over twenty years.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

2. <u>Basic Financial Statements – GASB Statement No. 34 – Continued</u>

Per Attorney General Opinion 06-02, the Attorney General of the State of New Mexico ruled that mutual domestic water associations are local public bodies considered governmental nonprofit organizations, as such, are subject to certain state statutes and should present financial statements in a government format. The Association has a responsibility to abide by the following:

- Open Meeting Act
- Inspection of Public Records Act
- Procurement Code
- Per Diem and Mileage Act
- Section 6-6 NMSA 1978

As of January 1, 2006, the Association implemented the provisions of GASB No. 34, *Basic Financial Statements—Management's Discussion and Analysis—For State and Local Governments.* There was no financial impact to the Association from adopting GASB No. 34.

3. <u>Basis of Presentation</u>

The Association is considered a special purpose government engaged in a single business type activity and presents only financial statements required for enterprise funds. These financial statements and corresponding required supplementary information consist of:

- Statement of Net Assets
- Statement of Revenues, Expenses and Changes in Net Assets
- Statement of Cash Flows
- Notes to Financial Statement
- Management's Discussion and Analysis
- Information Required by the State Auditor Rules

4. <u>Basis of Accounting and Measurement Focus – Enterprise Fund</u>

The accompanying financial statements have been prepared on the accrual basis of accounting. The economic resource measurement focus is used for all assets (both financial and capital), liabilities, revenues, expenses, gains and losses. Revenues are recorded when earned and expenses are recorded when incurred regardless of the timing of the related cash flows. The Association has elected not to apply FASB pronouncements issued after November 30, 1989. The proprietary fund consists of one enterprise fund and as such does not employ any internal service funds.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

4. Basis of Accounting and Measurement Focus – Enterprise Fund – Continued

The fund distinguishes operating revenues and expenditures in the enterprise fund from non-operating items. Operating revenues and expenditures generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the fund are members' assessments, hookup fees, and sewer transfer fees. Operating expenditures include administrative expenditures required to manage and operate the fund. All revenues and expenditures not meeting this definition are reported as non-operating revenues and expenditures.

5. New Accounting Standards affecting the Association

The Association has adopted GASB Statement No 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, for the year ending December 31, 2007. It has accrued an estimated remediation liability in connection with its old plant. The balance at December 31, 2008 is $20,990.

6. Cash and Cash Equivalents

The Association maintains its cash in various bank deposit accounts in order to maximize FDIC insurance coverage. The Association has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

For the purposes of the statements of cash flows, the Association considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

In accordance with Section 6-10-17, NMSA, 1978 Compilation, the Association is required to obtain collateral in an amount equal to one-half of the deposited public money in excess of $250,000.

7. Receivables

Receivables represent amounts due for member assessments. The Association considers these amounts to be fully collectible; accordingly, no allowance is required. When receivables are determined to be uncollectible, they will be charged to operations when that determination is made.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

8. Capital Assets

Capital assets are tangible assets that are used in operations and that have initial useful lives that extend beyond a single reporting period. Capital assets are reported at historical cost. Capital assets are depreciated using the straight-line method over their estimated useful lives, which range from ten to twenty-five years. The Association capitalizes new asset additions greater than $5,000. The Association does not own or lease any vehicles or equipment. Useful lives of capital assets are included in the following table:

Asset Class	Useful Life
Collection system equipment	25
Wetlands system	10
Wastewater treatment plant	10 - 24

Repairs and maintenance expenses are charged to operations when incurred and major betterments and replacements are capitalized.

9. Components of Net Assets

Net assets are reported as restricted when constraints placed on net assets use are externally imposed by creditors, grantors, contributors or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The Association has no restricted net assets at December 31, 2008 and 2007.

The Association has significant assets invested in capital assets, net of related debt as reported on the statement of net assets-proprietary fund for 2008 and 2007. They consist principally of sewer facilities and the corresponding debt thereon. Capital assets are defined as those that are tangible or intangible assets that are used in operations and have a useful life extending beyond one reporting period.

10. Classification of Revenues

The Association has classified its revenues for the enterprise fund as either operating or non-operating according to the following criteria:

Operating revenues: Operating revenues include activities that have characteristics of exchange transactions, such as (1) annual association member fees, (2) sewer hook-up fees, and (3) transfer fees for changes in home ownership.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

10. Classification of Revenues - Continued

Non-operating revenues: Non-operating revenues include activities that have the characteristics of non-exchange transactions such as investment income and revenue sources that are defined as non-operating revenues by GASB Statement No. 9, *Reporting Cash Flows Proprietary and Nonexpendable Trust Funds and Governmental Entities that use Proprietary Fund Accounting*, and GASB Statement No. 34.

11. Use of Estimates

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make 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.

12. Budgetary Basis

The Association budgets on a cash basis. Depreciation is not budgeted. The Board of Directors is responsible for authorizing the Association's budget. The Association is statutorily required to submit a budget to the Department of Finance and Administration for approval. The Association was in compliance with these requirements for 2008 and 2009. The Association treats aggregate cash receipts disbursements as one fund. The level of budgetary control is at the fund level.

13. Reclassifications

Certain reclassifications of information have been made to the prior year financial statements so as to conform to the presentation for the current year.

NOTE B – RELATED PARTY TRANSACTIONS

Member assessments of $54,150 and $27,550 were paid by Mountain Ranch Limited Partnership (Partnership) during 2008 and 2007, respectively, for developed lots still owned by the Partnership.

NOTE B – RELATED PARTY TRANSACTIONS – CONTINUED

The majority of the officers of the Association's Board of Directors are employees of Roger Cox and Associates, Inc. or its affiliates. The Association paid Roger Cox and Associates, Inc. $7,837 and $7,657 during 2008 and 2007, respectively, for bookkeeping services. These amounts are included in professional fees on the accompanying statements of revenues, expenses and changes in net assets. Roger Cox and Associates, Inc. is currently providing secretarial and clerical assistance to the Association at no charge.

Treated wastewater is disposed of on the Paa-Ko Golf Course, which is owned by Paa-Ko Golf Venture, LLC, a member of the Association. Paa-Ko Golf Venture, LLC has paid for the pumping equipment, transmission line, and storage ponds necessary to move the treated wastewater to the golf course. Operating expenses associated with transporting the treated wastewater to the golf course is the responsibility of Paa-Ko Golf Venture, LLC.

<u>Transfer and Subsidy Agreement</u>

During 2004, Mountain Ranch Limited Partnership transferred ownership of the wastewater collection system, wetland treatment facilities, and the related wetland real estate to the Association. During 2007, the Association completed construction of the sewage treatment plant that replaced the existing wetland sewage treatment system that services Paa-Ko Communities.

Billing services are provided by Paa-Ko Homeowner's Association who bills and collects member assessments and transfers them intact to the Association. Lot owners are required to be members of both the Homeowner's Association and the Sewer Association.

The Partnership is obligated to reimburse the Association for 25% of the full costs and expenses, which the Association incurs in connection with the design and construction of the new wastewater treatment facility (facility) designed to treat 100,000 gallons per day (gpd). In addition, the partnership has agreed to pay for 100% of the costs associated with the increased capacity of the new treatment facility to 130,000 gpd from the initial capacity of 100,000 gpd. The Partnership is also obligated to pay all design, construction and related costs, but not annual operation and maintenance costs, required to provide wastewater collection and/or treatment service to portions of the Association's service area not developed as of September 2004. Construction of the treatment plant was substantially completed during 2007. Costs total approximately $3.1 million with Mountain Ranch contributing $1,548,873 including payment of the long-term receivable of $137,000 recorded in 2006. The contribution was in excess of their required portion leaving $289,577 due to Mountain Ranch at December 31, 2007 and was paid in 2008.

NOTE B – RELATED PARTY TRANSACTIONS – CONTINUED

The Partnership agreed to reimburse the Association, for each of 5 years commencing January 1, 2005, in the amount that the Association's annual costs and expenses, including but not limited to debt service and facility operation and maintenance costs, exceed the sum of the Association's total collected dues and other assessments for that year, plus any remaining surplus of collections over expenses for years prior to January 1, 2005. Such subsidies, if any, are due to the Association within three months after the end of the year for which the subsidy is owed.

The agreement is secured by a mortgage on one undeveloped lot owned by the Partnership.

NOTE C – PROPERTY AND EQUIPMENT

Property and equipment consists of the following as of December 31, 2008 and 2007:

	2008	2007
Wastewater treatment plant	$ 3,188,013	$ 3,149,565
Wastewater collection system	2,642,632	1,830,606
Wetland treatment facilities	590,746	590,746
Accumulated depreciation	(1,539,083)	(1,304,344)
	$ 4,882,308	$ 4,266,573
Land – Wetlands waste water treatment site	$ -	$ -

Construction on a new Wastewater Treatment Plant was completed in December 2007. The Wetlands Treatment Facilities is fully depreciated as of January 31, 2007. The Wetlands also consists of certain land transferred at no cost to the Association, not zoned for any alternative purpose and listed at no value by county records. Capitalized interest expense was $20,471 and $12,827 at December 31, 2008 and 2007, respectively. The Wetlands will be de-commissioned upon completion of the new wastewater treatment facility, and the process is expected to begin and be completed in 2009.

NOTE C – PROPERTY AND EQUIPMENT – CONTINUED

The rollforward of capital assets for the year ending December 31, 2008 is as follows:

Description	2007	Additions	Deletions	Reclass	2008
Nondepreciable					
Wetlands land	$ -	$ -	$ -	$ -	$ -
Depreciable					
Treatment plant	3,149,565	38,448	-	-	3,188,013
Wastewater collection system	1,830,606	812,026	-	-	2,642,632
Wetlands treatment facilities	590,746	-	-	-	590,746
Total	5,570,917	850,474	-	-	6,421,391
Accumulated depreciation - Treatment plant	(12,805)	(153,140)	-	-	(165,945)
Accumulated depreciation - Collection system	(700,793)	(81,599)	-	-	(782,392)
Accumulated depreciation - Wetlands	(590,746)	-	-	-	(590,746)
Total	(1,304,344)	(234,739)	-	-	(1,539,083)
Net capital assets	$ 4,266,573	$ 615,735	$ -	$ -	$ 4,882,308

Depreciation expense for years ended December 31, 2008 and 2007 was $234,739 and $68,103, respectively.

NOTE D – COMMITMENTS

1. <u>Agreements</u>

The Association entered into an agreement with New Mexico American Water, a New Mexico corporation, to provide certain operations and maintenance services in connection with the management, operations and maintenance of the wastewater system beginning November 1, 2007. The Association is required to pay a monthly service fee of $8,625, adjusted annually based on the change in the annual Consumer Price Index (CPI), plus a one time start fee relating to the new wastewater treatment plant of $32,170 paid at a monthly rate of $2,681, plus costs of additional services that are not included in the agreement, plus 10% of costs for administrative overhead. Such costs must be requested and authorized by the Association. The agreement has an initial term of three years; however, the Association can terminate the agreement, without cause, after October 31, 2007.

NOTE D – COMMITMENTS – CONTINUED

1. Agreements - Continued

The Association has also entered into an agreement with Souder, Miller & Associates, a New Mexico corporation, to provide engineering services in connection with the operation of the wastewater system beginning January 2008, one month after the completion of a full week of uninterrupted operation of the system. The Association is required to pay a monthly service fee of $1,000 plus gross receipts tax. The agreement has a term of three years.

2. Sewer Treatment Plant

The Association has substantially completed constructing a sewage treatment plant (STP) that will replace the existing wetland sewage treatment system that services Paa-Ko Communities. The Association has been approved for three $500,000 loans from the State of New Mexico Environment Department to help construct the treatment plant. The loans are for a period of twenty years and require annual principal and interest payments, including interest of 3%. The Association drew down $1,500,000 relating to these loans as of December 31, 2008. The developer, Mountain Ranch Limited Partnership, will pay 25% of total STP costs. The remaining funds needed to pay total construction costs will be from Association Reserve Funds. The total cost of construction was $3.188 million.

3. Legal Proceedings

From time to time, the Association is involved in claims and legal actions arising from the ordinary course of business and member relations. In the opinion of management, the ultimate disposition of the various claims and legal actions will not have a material adverse effect on the Association's financial statements. The Association carries standard insurance for risk purposes.

4. Discharge Permit

The Association's discharge permit expired in May of 2005 and was renewed in 2007. The State of New Mexico Environment Department has the authority to fine the Association for the expired discharge permit. The Association was granted permission by the New Mexico Environment Department to operate under the expired permit as long as it is compliant pursuant to the requirements of the expired permit. The Association has been in compliance and was issued a new discharge permit in October 2007.

NOTE E – DEBT

The Association has the following debt in connection with construction of new facilities:

Debt Depreciation	December 31, 2007	Additions	Payments	December 31, 2008	Amount due within one year
Loan # RIP 2004-11 with New Mexico Environment Department (NMED); 3% interest rate per annum; payment begins after final warrant for a period of 20 years at $33,895/year; option to pay all interest upon completion of construction	$ 504,275	$ -	$ (18,767)	$ 485,508	$ 19,330
Loan # RIP 2005-04 with New Mexico Environment Department (NMED); 3% interest rate per annum; payment begins after final warrant for a period of 20 years at $33,805/year; option to pay all interest upon completion of construction	502,934	-	(18,717)	484,217	19,279
Loan # RIP 2006-01 with New Mexico Environment Department (NMED); 3% interest rate per annum; payment begins after final warrant for a period of 20 years at $34,499/year; option to pay all interest upon completion of construction	491,001	22,261	-	513,262	19,101
Total	$ 1,498,210	$ 22,261	$ (37,484)	$ 1,482,987	$ 57,710

As stated in the loan agreements with New Mexico Environment Department, the Association has the option to include accrued interest in the loan amounts and amortized over 20 years for any interim draw downs made prior to construction being completed. As of December 31, 2007, accrued interest included in loan amounts is:

Loan Number	Accrued interest included in December 31, 2008 ending balance
Loan # RIP 2004-11	$ 4,275
Loan # RIP 2005-04	2,934
Loan # RIP 2006-01	17,618
Total accrued interest	$ 24,827

NOTE E – DEBT – CONTINUED

As of December 31, 2008, the Association has drawn down the entire amount of available loan funds. The debt service requirements would be as follows for all currently outstanding loans:

Years ending December 31:	Principal	Interest	Total
2009	$ 57,710	$ 44,490	$ 102,200
2010	59,441	42,759	102,200
2011	61,225	40,975	102,200
2012	63,061	39,139	102,200
2013	64,953	37,247	102,200
2014 - 2018	355,190	155,810	511,000
2019 - 2023	411,764	99,236	511,000
2024 - 2028	409,643	33,649	443,292
	$ 1,482,987	$ 493,305	$ 1,976,292

Under the loan agreement with the New Mexico Environment Department, the Association is not required to commence repayment of the loan until the construction phase is complete. As of December 31, 2007, the treatment plant was substantially complete. During 2008, the Association began making the schedule payments required for the debt service agreements.

The Wetlands sewage treatment system has been replaced by a sewage treatment plant near the end of 2007. Per Federal and state regulations, if facilities are closed or discharge of wastewater ceases, Paa-Ko shall take steps as defined by New Mexico Environment Department to remediate wetland cells. These steps include the following:

- Remove all lines leading to the wetlands cells so that a discharge can no longer occur;
- Drain and/or evaporate all liquids and dispose of any plant material in accordance with all regulations;
- Dispose of any sludge in accordance with all regulations;
- Perforate or remove wetland liners and fill the cells with dirt to match the surrounding topography in such a way for proper drainage preventing any ponding; and
- Notify NMED within 30 days of the closure.

Paa-Ko is liable for closure costs. Post closure costs are expected to be minimal. Closure costs are currently estimated to approximate $50,000. Based on expected closure in 2008, $25,000 or 50% of estimated closure costs are accrued in the financial statements at December 31, 2007. No additional accrued expenses were recorded in 2008 as management believes the original estimate is sufficient.

SUPPLEMENTARY INFORMATION

Paa-Ko Communities Sewer Association

SCHEDULE OF REVENUES AND EXPENSES – BUDGET AND ACTUAL

For the year ended December 31, 2008

	Original Budget	Final Budget	Actual	Positive (Negative) Variance
REVENUES				
Members' assessments	$ 307,500	$ 307,500	$ 302,296	$ (5,204)
Sewer hookup fees	15,000	15,000	15,000	-
Sewer transfer fees	2,000	2,000	2,000	-
Developer contributions	12,306	12,306	824,332	812,026
Loan proceeds	14,617	14,617	-	(14,617)
Interest income	11,000	11,000	14,453	3,453
Total revenues	362,423	362,423	1,158,081	795,658
Budgeted cash balance	315,458	315,458	-	(315,458)
Total revenues and budgeted cash balance	$ 677,881	$ 677,881	$ 1,158,081	$ 480,200
EXPENSES				
Debt service principal & interest	$ 67,700	$ 67,700	$ 74,847	$ (7,147)
Accounting and audit fees	17,000	17,000	16,666	334
36 month treatment plan monitoring contract	13,000	13,000	11,750	1,250
Monthly operations and maintenance contract	113,000	113,000	111,327	1,673
Administration fees	6,000	6,000	4,131	1,869
Testing and analysis	16,500	16,500	15,107	1,393
Repairs and maintenance	19,500	19,500	13,683	5,817
Septic pumping	6,000	6,000	4,126	1,874
Insurance	10,000	10,000	6,511	3,489
Start up costs	44,700	44,700	43,217	1,483
Property taxes	3,500	3,500	3,027	473
Professional fees	6,000	6,000	1,926	4,074
Utilities	8,000	8,000	6,279	1,721
License and permits	200	200	35	165
Postage and delivery	1,200	1,200	200	1,000
Office and misc.	200	200	-	200
Completion of treatment plant	320,381	320,381	320,177	204
Costs to close old wetlands	25,000	25,000	4,010	20,990
Total expenses	677,881	677,881	637,019	40,862
	$ -	$ -	521,062	$ 439,338
Debt service principal paid			37,484	
Loan proceed received for capital asset purchase			(14,617)	
Closure costs			4,010	
Capital outlay - treatment plant			30,600	
Prior year due to developer			289,577	
Depreciation			(234,739)	
Change in net assets, GAAP basis			$ 633,377	

OTHER SUPPLEMENTARY INFORMATION

Paa-Ko Communities Sewer Association

SCHEDULE OF INDIVIDUAL DEPOSIT ACCOUNTS AND PLEDGED COLLATERAL

December 31, 2008

	Bank Balance	Book Balance
ACCOUNT		
Compass Bank		
General checking account	$ 34,914	$ 13,098
Association savings account	65,234	65,234
	100,148	78,332
First Community Bank		
Certificate of deposit	90,000	90,000
NM Bank & Trust		
Certificate of deposit	75,000	75,000
Bank of America		
Certificate of deposit	101,375	101,378
Main Bank		
Certificate of deposit	34,364	34,364
Total	400,887	$ 379,074
FDIC coverage	400,887	
Total uninsured public funds	$ -	
Collateral requirements - 50% (Section 6-10-17)	$ -	
Amounts of pledged collateral - pledged inventory Compass Bank	190,745	
Total over uncollateralized	$ (190,745)	

Disclosure

Custodial credit risk is the risk that in the event of a bank failure the Association's deposits may not be returned to it. The Association has implemented a deposit policy to utilize multiple deposit accounts with different banks so as to maximize the protection of FDIC insurance coverage. As of December 31, 2008, bank balances were not exposed to custodial credit risk. Credit quality risk, securities custodial credit risk, and interest rate rise disclosures do not apply.

atkinson

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INDEPENDENT AUDITORS' 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*

Mr. Hector H. Balderas
New Mexico State Auditor and
Board of Directors
Paa-Ko Communities Sewer Association

We have audited the accompanying financial statements of the business-type activities of the Paa-Ko Communities Sewer Association (Paa-Ko or the Association) as of and for the years ended December 31, 2008 and 2007, which collectively comprise the Association's basic financial statements as listed in the table of contents. We have also audited the accompanying budgetary comparison for the year ended December 31, 2008 presented as supplemental information in the table of contents, and have issued our report thereon dated May 28, 2009. We conducted our audits 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 audits, 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, but not for the purpose of expressing 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 a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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 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 Association's financial statements that is more than inconsequential will not be prevented or detected by the Association's internal control. We consider the following deficiency described in the accompanying schedule of findings and responses to be a significant deficiency in internal control over financial reporting, and can be referenced as item 2007-01.

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 the Association's internal control.

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 the significant deficiency described above is not a material weakness.

<u>Compliance and Other Matters</u>

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 no instances of noncompliance or other matters that is required to be reported under *Government Auditing Standards.*

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 Association's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, others within the Association, The Office of the State Auditor, the New Mexico State Legislature, and Department of Finance and Administration, and is not intended to be and should not be used by anyone other than these specified parties.

Atkinson & Co. Ltd.

Atkinson & Co. Ltd.

Albuquerque, New Mexico
May 28, 2009

SCHEDULE OF FINDINGS AND RESPONSES

December 31, 2008

Prior Year – Financial Statement Finding

2007-01 Full Governmental GAAP Financial Statement Preparation Capability – Repeated
2007-02 Cash Not Properly Collateralized as Required by the Public Monies Act – Resolved
2007-03 Budgetary Compliance – Resolved

Current Year – Financial Statement Finding

2007-01 Full Governmental GAAP Financial Statement Preparation Capability (*Significant Deficiency)*

Condition
The Association currently does not have the capability to produce full financial statement reporting in accordance with generally accepted governmental accounting principles (GAAP), including required disclosures. Auditors were responsible for producing a complete financial statement.

Criteria
Statement on Auditing Standard No. 112 requires reporting to those in charge of governance of any control deficiencies noted including those relating to the ability to prepare GAAP financial statements.

Cause
The Association is a nonprofit organization and has many characteristics of enterprise funds. The outsourced accountant handles all interim financial and management needs during the year to run the organization but does not perform year-end work.

Effect
The fact the Association does not have the financial statement preparation capability diminishes the adequacy of their internal control structure as there is not adequate qualifications and training among the Board of Directors to apply GAAP. Full GAAP information is not available during the year.

Recommendation
The Association should consider employing outside accountants to assist in full GAAP financial statement reporting or develop financial templates supported by training in the needed areas.

Management's Response
The Association, through contracted services, prepares internal financial statements and all other necessary data for board and management purposes. It has only one compliance finding or other control deficiencies noted in the last few years' audits, including the current year. We are a small association and cost and benefit criteria will continue to be a strong consideration regarding the external CPA's recommendation.

Paa-Ko Communities Sewer Association

EXIT CONFERENCE

December 31, 2008

The basic financial statements have been prepared by Atkinson & Co., Ltd. with the assistance of the Association who is responsible for their content.

* * * * *

An Exit Conference was held on May 29, 2009 and attended by the following:

For Atkinson & Co., Ltd.:

Marty Mathisen	Shareholder/Audit Director

For the Paa-Ko Communities Sewer Association:

William Nickell	President
W. Bruce Franks	Secretary/Treasurer

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