



Certified Public Accountants

ricci&company llc

**PAA-KO COMMUNITIES SEWER
ASSOCIATION**

FINANCIAL STATEMENTS

DECEMBER 31, 2009



PAA-KO COMMUNITIES SEWER ASSOCIATION

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PAA-KO COMMUNITIES SEWER ASSOCIATION

Official Roster

Board of Directors

<u>Name</u>	<u>Title</u>
Ken Lundy, Sr.	President
Patrick Hall	Vice President
W. Bruce Franks	Secretary/Treasurer
David Wesley	Member
Nick Thompson	Member

Independent Auditors' Report

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

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 year ended December 31, 2009, which collectively comprise the Association's basic financial statements as listed in the table of contents. We also have audited the accompanying budgetary comparisons for the year ended December 31, 2009 presented as supplementary information as listed in the table of contents. These financial statements and budgetary comparisons are the responsibility of Paa-Ko's management. Our responsibility is to express opinions on these financial statements based on our audit. The financial statements of Paa-Ko Communities Sewer Association as of December 31, 2008 were audited by other auditors whose report dated May 28, 2009, expressed an unqualified opinion on those statements.

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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the agency's internal control over financial reporting. Accordingly, we express no such opinion. 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 the Association, as of December 31, 2009, and the respective changes in financial position and cash flows, thereof and the respective budgetary comparisons 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 May 14, 2010 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 grant 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 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.

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

The management's discussion and analysis on pages 4 through 6 are not a required part of the basic financial statements, but are supplementary 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 audit was 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.

Ricci & Company LLC

Albuquerque, New Mexico
May 14, 2010

**PAA-KO COMMUNITIES SEWER ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2009**

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, 2009 and the results of its operations for the year then ended. Data as of December 31, 2008 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, 2009 and 2008.

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, 2009 and 2008 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, 2009 and 2008:

	2009	2008
Current assets	\$ 380,516	386,033
Noncurrent assets	<u>4,644,559</u>	<u>4,882,308</u>
Total assets	<u>\$ 5,025,075</u>	<u>5,268,341</u>
Current liabilities	\$ 83,928	85,084
Noncurrent liabilities	<u>1,371,908</u>	<u>1,446,267</u>
Total liabilities	<u>1,455,836</u>	<u>1,531,351</u>
Members' net assets	<u>3,569,239</u>	<u>3,736,990</u>
Total liabilities and unrestricted net assets	<u>\$ 5,025,075</u>	<u>5,268,341</u>

**PAA-KO COMMUNITIES SEWER ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2009**

The Association's revenues and expenses can be summarized as follows for the years ended December 31, 2009 and 2008:

	2009	2008
Operating revenues	\$ 329,700	319,296
Contribution from developer	-	824,332
Interest income	<u>6,012</u>	<u>14,453</u>
 Total revenues	 335,712	 1,158,081
 Operating expenses	 459,942	 472,724
Nonoperating expenses	<u>43,521</u>	<u>37,363</u>
 Change in net assets	 <u>\$ (167,751)</u>	 <u>647,994</u>

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

Current assets decreased slightly from the prior year mainly due to the write off of approximately \$4,100 in accounts receivable caused by bankruptcies and foreclosures of members. Current liabilities also were down slightly by about \$1,200. We completed the construction and start-up phase of the new treatment plant in 2008 and in 2009 we are now in the maintenance phase of our system.

The net decrease in non-current assets is almost entirely due to the current year's depreciation provision. The decrease in non-current liabilities was the result of the Association paying its scheduled loan payments and planned expenditures toward completion of the decommissioned wetlands remediation liability.

Operating revenues for 2009 were slightly more than in 2008. There was an increase in the number of members paying the slightly higher dues rate for completed homes and there was one more commercial rate payer in 2009. Hook-up fee revenue was also up by \$4,500 over 2008 revenue. Interest income was down in 2009 as rates paid by banks on deposits have continued to decrease. There were no new lots added to the membership during 2009, thus no contribution by the developer of any new collection system assets.

Expenses for 2009 are down some from 2008. Operating expenses are down as we are no longer incurring some of the start-up costs associated with the new treatment plant. We are now experiencing higher utility costs which should begin to level off after 2009. We did pump more residential septic tanks in 2009 which was as scheduled.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2009**

BUDGETARY ANALYSIS

The budgetary basis is cash basis.

	Original Budget	Final Budget	Actual	Positive (Negative) Variance
Revenues	\$ 362,400	407,463	405,335	(2,128)
Expenses	<u>359,400</u>	<u>394,365</u>	<u>334,165</u>	<u>60,199</u>
Excess of revenues over expenses	<u>\$ 3,000</u>	<u>13,098</u>	<u>71,170</u>	<u>58,071</u>

The difference between the original budget and final budget revenues was the increase in the transfer from savings of \$34,965 and the increase in budget cash balance of \$10,098. There was no significant difference between the final budget revenues and actual budget results.

The differences between the original budget expenses and the final budget expenses was the \$8,400 increase in utilities and \$5,575 increase in completion of treatment plant expense, and the \$20,990 increase in costs to close the wetlands. The differences in final budget expenses and actual budget results were primarily related to significant decreases in repairs and maintenance and septic pumping expenses.

CAPITAL ASSET ACTIVITY

During 2009, a \$5,575 credit refund related to utility charges was capitalized to the wastewater treatment plant. Current depreciation in the amount of \$243,324 was recorded.

DEBT ACTIVITY

There were principal payments totaling \$57,709 made as scheduled in 2009.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
STATEMENTS OF NET ASSETS - PROPRIETARY FUND
December 31, 2009 and 2008**

ASSETS

	2009	2008
Current Assets		
Cash and cash equivalents	\$ 9,998	78,332
Certificates of deposit	356,006	300,742
Accounts receivable	11,727	4,166
Prepaid insurance	2,785	2,793
Total current assets	<u>380,516</u>	<u>386,033</u>
Property and Equipment		
Wastewater treatment plant	3,193,588	3,188,013
Wastewater collection system	2,642,632	2,642,632
Wetland treatment facilities	590,746	590,746
Total, at cost	<u>6,426,966</u>	<u>6,421,391</u>
Accumulated depreciation	(1,782,407)	(1,539,083)
Net property and equipment	<u>4,644,559</u>	<u>4,882,308</u>
Total assets	<u>\$ 5,025,075</u>	<u>5,268,341</u>

LIABILITIES AND MEMBERS' NET ASSETS

	2009	2008
Current Liabilities		
Accounts payable	\$ 628	2,547
Current maturities of long-term debt	59,442	57,710
Accrued interest payable	23,858	24,827
Total current liabilities	<u>83,928</u>	<u>85,084</u>
Noncurrent Liabilities		
Notes payable	1,365,836	1,425,277
Estimated closure costs payable	6,072	20,990
Total noncurrent liabilities	<u>1,371,908</u>	<u>1,446,267</u>
Total liabilities	<u>1,455,836</u>	<u>1,531,351</u>
Commitments		
Members' Net Assets		
Invested in capital assets, net of related debt	3,219,281	3,399,321
Unrestricted	349,958	337,669
Total members' net assets	<u>3,569,239</u>	<u>3,736,990</u>
Total liabilities and members' net assets	<u>\$ 5,025,075</u>	<u>5,268,341</u>

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

**PAA-KO COMMUNITIES SEWER ASSOCIATION
 STATEMENTS OF REVENUES, EXPENSES AND
 CHANGES IN NET ASSETS - PROPRIETARY FUND
 For the Years Ended December 31, 2009 and 2008**

	2009	2008
Operating Revenues		
Members' assessments	\$ 308,800	302,296
Sewer hookup fees	19,500	15,000
Sewer transfer fees	1,400	2,000
	<hr/>	<hr/>
Total revenues	329,700	319,296
	<hr/>	<hr/>
Operating Expenses		
Depreciation and amortization	243,324	234,739
Maintenance fees	133,463	142,315
Septic pumping	28,687	4,126
Professional fees	17,706	18,592
Utilities and telephone	14,469	6,279
Repairs and maintenance	11,068	13,683
Insurance	5,698	6,511
Bad debts	4,176	-
Office supplies	706	-
Licenses and permits	356	3,062
Postage	289	200
Treatment plant start up	-	43,217
	<hr/>	<hr/>
Total operating expenses	459,942	472,724
	<hr/>	<hr/>
Operating deficit	(130,242)	(153,428)
	<hr/>	<hr/>
Nonoperating Revenues and (Expenses)		
Contribution from developer	-	824,332
Interest income	6,012	14,453
Estimated closure costs	-	-
Interest expense	(43,521)	(37,363)
	<hr/>	<hr/>
Total nonoperating (expenses) and revenues	(37,509)	801,422
	<hr/>	<hr/>
(Deficit) income before contributions and transfers	(167,751)	647,994
	<hr/>	<hr/>
Contributions and transfers	-	-
	<hr/>	<hr/>
Change in net assets	(167,751)	647,994
	<hr/>	<hr/>
Members' net assets, beginning of year	3,736,990	3,088,996
	<hr/>	<hr/>
Members' net assets, end of year	\$ 3,569,239	3,736,990
	<hr/> <hr/>	<hr/> <hr/>

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, 2009 and 2008

	2009	2008
Cash Flows From Operating Activities		
Cash received from members	\$ 322,139	318,270
Cash paid to suppliers	(233,447)	(240,701)
Interest paid	(44,490)	(30,216)
	<hr/>	<hr/>
Net cash provided by operating activities	44,202	47,353
	<hr/>	<hr/>
Cash Flows From Investing Activities		
Withdrawal (purchase) of certificate of deposit	(55,264)	251,855
Additions to plant and equipment	(5,575)	(38,448)
Interest received	6,012	14,453
	<hr/>	<hr/>
Net cash (used) provided by investing activities	(54,827)	227,860
	<hr/>	<hr/>
Cash Flows From Capital Financing Activities		
Cash received (paid) from developer	-	(277,271)
Proceeds from note payable	-	22,261
Principal payments on notes payable	(57,709)	(37,484)
	<hr/>	<hr/>
Net cash used by financing activities	(57,709)	(292,494)
	<hr/>	<hr/>
Net decrease in cash and cash equivalents	(68,334)	(17,281)
	<hr/>	<hr/>
Cash and cash equivalents, beginning of the year	78,332	95,613
	<hr/>	<hr/>
Cash and cash equivalents, end of the year	\$ 9,998	78,332
	<hr/> <hr/>	<hr/> <hr/>

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

**PAA-KO COMMUNITIES SEWER ASSOCIATION
STATEMENTS OF CASH FLOWS (CONTINUED)
For the Years Ended December 31, 2009 and 2008**

	2009	2008
Reconciliation of Operating Income (Deficit) to Net Cash Provided by Operating Activities		
Operating deficit	\$ (130,242)	(153,428)
Adjustments to reconcile changes in net assets to net cash provided by operating activities		
Depreciation and amortization	243,324	234,739
Bad debt expense	4,176	-
Interest paid	(44,490)	(30,216)
Changes in assets and liabilities		
Other assets	8	689
Receivables	(11,737)	(1,026)
Accounts and estimated closure costs payable	(16,837)	(3,405)
Total adjustments	<u>174,444</u>	<u>200,781</u>
Net cash (used) provided by operating activities	\$ 44,202	47,353
Supplemental Disclosures for Noncash Financing Activities		
Property and equipment acquired under transfer agreement	<u>\$ -</u>	<u>812,026</u>

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

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 or 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.

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 Accounting 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.

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 and, 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:

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

- 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.

Basis of Presentation. 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 Statements
- Management's Discussion and Analysis
- Information Required by the State Auditor Rules

Basis of Accounting and Measurement Focus - Enterprise Fund. 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.

The fund distinguishes operating revenues and expenditures in the enterprise fund from nonoperating 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.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

New Accounting Standards Affecting the Association. The Association has adopted GASB Statement No 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, as of the year ending December 31, 2007. It has accrued an estimated remediation liability in connection with its old plant. The balance at December 31, 2009 and 2008 was \$6,072 and \$20,990 respectively.

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.

Receivables. Receivables represent amounts due for member assessments. The Association considers these amounts to be fully collectible; accordingly, no allowance is deemed necessary. When receivables are determined to be uncollectible, they are charged to operations when that determination is made. Member assessments are billed in January of each year, and reminder notices are sent throughout the year for delinquent accounts. At year end, the association files liens on large outstanding balances. No interest or late fees are currently being charged on outstanding balances that have liens filed; however, a \$100 lien release fee is charged as applicable.

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
Wastewater treatment plant	10 - 24
Wastewater collection system	25
Wetland treatment facilities	10

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

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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, 2009 and 2008.

The Association has significant assets invested in capital assets, net of related debt as reported on the statement of net assets - proprietary fund for 2009 and 2008. 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.

Classification of Revenues. The Association has classified its revenues for the enterprise fund as either operating or nonoperating 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.

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of non-exchange transactions such as investment income and revenue sources that are defined as nonoperating 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.

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.

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.

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.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 2. RELATED PARTY TRANSACTIONS

Member assessments of \$54,250 and \$54,150 were paid by Mountain Ranch Limited Partnership (Partnership) during 2009 and 2008, respectively, for developed lots still owned by the Partnership.

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. \$7,417 and \$7,837 during 2009 and 2008, 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.

Transfer and Subsidy Agreement

During 2004, the 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.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 2. RELATED PARTY TRANSACTIONS (CONTINUED)

The Partnership agreed to reimburse the Association, for each of five 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 3. PROPERTY AND EQUIPMENT

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 \$0 and \$20,471 at December 31, 2009 and 2008, respectively. The Wetlands was decommissioned upon completion of the new wastewater treatment facility, and the process was nearly complete in 2009.

The rollforward of capital assets for the year ending December 31, 2009 is as follows:

	Balance 2008	Additions	Deletions	Balance 2009
Nondepreciable				
Wetlands land	\$ -	-	-	-
Depreciable				
Treatment plant	3,188,013	5,575	-	3,193,588
Wastewater collection system	2,642,632	-	-	2,642,632
Wetlands treatment facilities	590,746	-	-	590,746
	<hr/>			<hr/>
Total	6,421,391	5,575	-	6,426,966
	<hr/>			<hr/>
Accumulated depreciation				
Treatment plant	(165,945)	(155,723)	-	321,668
Collection system	(782,392)	(87,601)	-	869,993
Wetlands	(590,746)	-	-	590,746
	<hr/>			<hr/>
Total	(1,539,083)	(243,324)	-	1,782,407
	<hr/>			<hr/>
Net capital assets	\$ 4,882,308	(237,749)	-	4,644,559

Depreciation expense for years ended December 31, 2009 and 2008 was \$243,324 and \$234,739, respectively.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 4. COMMITMENTS

Agreements

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.

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.

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.

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.

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 4. COMMITMENTS (CONTINUED)

Discharge Permit

The Association's discharge permit was renewed in 2007. The State of New Mexico Environment Department has the authority to fine the Association for the expiration of the discharge permit.

NOTE 5. DEBT

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

Debt Description	December 31, 2008	Payments	December 31, 2009	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, uncollateralized	\$ 485,508	(19,330)	466,178	19,910
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, uncollateralized	484,217	(19,279)	464,939	19,858
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, uncollateralized	<u>513,262</u>	<u>(19,101)</u>	<u>494,161</u>	<u>19,674</u>
Total	<u>\$ 1,482,987</u>	<u>(57,709)</u>	<u>1,425,278</u>	<u>59,442</u>

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 5. DEBT (CONTINUED)

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, 2009 and 2008, accrued interest on loan amounts is:

Loan Number	2009	2008
Loan #RIP 2004-11	\$ 10,233	4,275
Loan #RIP 2005-04	6,152	2,934
Loan #RIP 2006-01	<u>7,473</u>	<u>17,618</u>
Total accrued interest	<u>\$ 23,858</u>	<u>24,827</u>

As of December 31, 2009, 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
2010	\$ 59,442	42,758	102,200
2011	61,225	40,975	102,200
2012	63,061	39,139	102,200
2013	64,953	37,247	102,200
2014	66,902	35,298	102,200
2015-2019	365,846	145,154	511,000
2020-2024	424,115	86,885	511,000
2025-2028	<u>319,734</u>	<u>21,363</u>	<u>341,097</u>
	<u>\$ 1,425,278</u>	<u>448,819</u>	<u>1,874,097</u>

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 scheduled payments required for the debt service agreements.

The wetlands sewage treatment system was 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:

**PAA-KO COMMUNITIES SEWER ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2009 and 2008**

NOTE 5. DEBT (CONTINUED)

- 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, 2009**

	Original Budget	Final Budget	Actual	Positive (Negative) Variance
Revenues				
Members' assessments	\$ 308,025	308,025	308,800	775
Sewer hookup fees	15,000	15,000	19,500	4,500
Sewer transfer fees	2,000	2,000	1,400	(600)
Loan proceeds	-	-	-	-
Interest income	11,000	11,000	6,012	(4,988)
Transfer from savings	23,375	58,340	59,625	1,285
Total revenues	359,400	394,365	395,337	972
Budgeted cash balance	3,000	13,098	9,998	(3,100)
Total revenues and budgeted cash balance	\$ 362,400	407,463	405,335	(2,128)
Expenses				
Debt service principal and interest	102,200	102,200	101,230	970
Accounting and auditing fees	18,700	18,700	17,656	1,044
36-month treatment plan monitoring contract	13,000	13,000	12,816	184
Monthly operations and maintenance contract	117,000	117,000	112,821	4,179
Administration fees	6,000	6,000	1,770	4,230
Testing and analysis	8,000	8,000	6,056	1,944
Repairs and maintenance	20,000	20,000	11,068	8,932
Septic pumping	44,000	44,000	28,687	15,313
Insurance	10,000	10,000	5,698	4,302
Property taxes	3,500	3,500	-	3,500
Professional fees	4,500	4,500	50	4,450
Utilities	9,800	18,200	14,469	3,731
License and permits	400	400	356	44
Postage and delivery	1,800	1,800	289	1,511
Office and miscellaneous	500	500	706	(206)
Completion of treatment plant	-	5,575	5,575	-
Costs to close wetlands	-	20,990	14,918	6,072
Total expenses	359,400	394,365	334,165	60,199
	\$ 3,000	13,098	71,170	58,071
Revenues, budgetary basis			\$ 405,335	
Cash balance			(9,998)	
Transfer from savings			(59,625)	
Total revenues, GAAP basis			\$ 335,712	
Expenses, budgetary basis			\$ 334,165	
Bad debts write off			4,176	
Closure costs			(14,918)	
Capital outlay - treatment plant			(5,575)	
Debt service principal			(57,709)	
Depreciation			243,324	
Total expenses, GAAP basis			\$ 503,463	

OTHER SUPPLEMENTARY INFORMATION

**PAA-KO COMMUNITIES SEWER ASSOCIATION
SCHEDULE OF INDIVIDUAL DEPOSIT ACCOUNTS AND PLEDGED COLLATERAL
December 31, 2009**

	Bank Balance	Book Balance
Account		
Compass Bank		
General checking account	\$ 2,143	\$ 4,389
Association savings account	5,609	5,609
	<hr/>	<hr/>
Total Compass Bank	7,752	9,998
First Community Bank		
Certificate of deposit	90,000	90,000
NM Bank & Trust		
Certificate of deposit	75,000	75,000
Main Bank		
Certificate of deposit	191,006	191,006
	<hr/>	<hr/>
Total	363,758	<u>\$ 366,004</u>
FDIC coverage	<hr/>	<hr/>
	363,758	
	<hr/>	<hr/>
Total uninsured public funds	\$ -	
Collateral requirements - 50% (Section 6-10-17)	\$ -	
Amounts of pledged collateral -	<hr/>	<hr/>
pledged inventory	175,983	
Compass Bank		
Maturity		
Date	1/25/2034	
CUSIP	31393VGC3	
Description	FNMA	
	<hr/>	<hr/>
Total over uncollateralized	\$ 175,983	

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, 2009, the bank balances were not exposed to custodial credit risk. Credit quality risk, securities custodial risk, and interest rate rise disclosures do not apply.

OTHER REPORT

**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
Sandia Park, New Mexico

We have audited the financial statements of the business-type activities and related budgetary comparison presented as supplemental information of the Paa-Ko Communities Sewer Association (Paa-Ko or the Association) as of and for the year ended December 31, 2009, and have issued our report thereon dated May 14, 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.

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, 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

STATE COMPLIANCE SECTION

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

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

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

Ricci & Company LLC

Albuquerque, New Mexico
May 14, 2010

**PAA-KO COMMUNITIES SEWER ASSOCIATION
SUMMARY SCHEDULE OF PRIOR AUDIT FINDING
For the Years Ended December 31, 2009 and 2008**

PRIOR YEAR – FINANCIAL STATEMENT FINDING

2007-01 Full Government GAAP Financial Statement
Preparation Capability

RESOLVED

CURRENT YEAR – FINANCIAL STATEMENT FINDING

NONE

**PAA-KO COMMUNITIES SEWER ASSOCIATION
EXIT CONFERENCE
For the Year Ended December 31, 2009**

An exit conference was held on May 20, 2010 to discuss the annual financial report. Attending were the following:

Representing the PAA-Ko Community Sewer Association:

Ken Lundy
W. Bruce Franks

President
Secretary/Treasurer

Representing the Independent Auditor:

Herman Chavez, CPA
Shawn Mortensen, CPA

Note: Management is responsible for the context of the report, even though the financial statements were prepared substantially by the independent auditor.