

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND
SEWAGE WORKS ASSOCIATION



AUDITED FINANCIAL STATEMENTS
AND
SUPPLEMENTAL INFORMATION

YEARS ENDED JUNE 30, 2010 and 2009

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
Years Ended June 30, 2010 and 2009

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INTRODUCTORY SECTION

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION

OFFICIAL ROSTER
JUNE 30, 2010

| <u>Name</u> | <u>Title</u> |
|-------------------------------------|---------------------------|
| <i><u>Board of Directors</u></i> | |
| Jim Wilcox | President |
| Danny Bass | Vice-President |
| Larry Coalson | Secretary/Treasurer |
| Jim Fry | Director |
| Shawn Mitchell | Director |
| <i><u>Association Officials</u></i> | |
| Gerald Fugate | General Manager |
| Cutter Rogers | Assistant General Manager |
| Lori Rogers | Office Manager |

FINANCIAL SECTION

JW Anderson & Associates, PC

Certified Public Accountants

Coppertree Office Park
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PO Box 6785
Lubbock, Texas 79493-6785
Office (806) 771-4000
Fax (806) 771-4005

INDEPENDENT AUDITORS' REPORT

Hector Balderas
New Mexico State Auditor, and
The Chairman and Board of Directors
Otis Mutual Domestic Water Consumers and
Sewage Works Association
Otis, New Mexico

We have audited the accompanying basic financial statements of the Otis Mutual Domestic Water Consumers and Sewage Works Association as of ended June 30, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

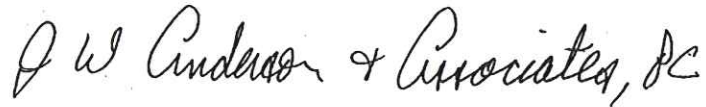
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan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

In our opinion, the financial statements referred to above present fairly, in all materials respects, the respective financial position of the Association as of June 30, 2010 and 2009 and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated July 16, 2010 on our consideration of Otis Mutual Domestic Water Consumers and Sewage Works Association's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Otis Mutual Domestic Water Consumers and Sewage Works Association has not presented the Management's Discussion and Analysis that the *Governmental Accounting Standards Board* has determined is necessary to supplement, although not required to be a part of the basic financial statements.

Our audit was performed for the purposes of forming an opinion on the financial statements as a whole. The accompanying schedules, listed as supplemental information in the table of contents, are presented for purposes of additional analysis and are 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.

A handwritten signature in cursive script that reads "JW Anderson & Associates, PC".

JW Anderson & Associates, PC
Certified Public Accountants
Lubbock, Texas
July 16, 2010

BASIC FINANCIAL STATEMENTS

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
STATEMENTS OF NET ASSETS
June 30, 2010 and 2009

| | 2010 | 2009 |
|--|---------------------|---------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and Cash Equivalents | 592,378 | 565,439 |
| Accounts Receivable | 81,678 | 67,626 |
| Grant Receivable | - | 12,533 |
| Inventory | 209,121 | 182,411 |
| Total Current Assets | <u>883,177</u> | <u>828,009</u> |
| NONCURRENT ASSETS | | |
| Capital Assets, Net | <u>2,173,693</u> | <u>2,136,219</u> |
| Total Assets | <u>\$ 3,056,870</u> | <u>\$ 2,964,228</u> |
| LIABILITIES AND MEMBERSHIP CAPITAL | | |
| CURRENT LIABILITIES | | |
| Accounts Payable | 91 | 20,746 |
| Accrued Salaries | 10,557 | 6,718 |
| Accrued Payroll Taxes | 4,168 | 286 |
| Sales Tax Payable | 4,673 | 5,035 |
| Compensated Absences | 11,916 | 10,542 |
| Customer Deposits | 77,201 | 74,150 |
| Total Current Liabilities | 108,606 | 117,477 |
| MEMBERSHIP CAPITAL | | |
| Memberships | 187,380 | 166,100 |
| Capital Improvement and Water Rights Assessments | 668,841 | 668,841 |
| Federal Grants and Contributions | 192,000 | 192,000 |
| Unrestricted Net Assets | 1,900,043 | 1,819,810 |
| Total Membership Capital | <u>2,948,264</u> | <u>2,846,751</u> |
| Total Liabilities and Membership Capital | <u>\$ 3,056,870</u> | <u>\$ 2,964,228</u> |

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
STATEMENTS OF ACTIVITIES
Years Ended June 30, 2010 and 2009

| | 2010 | 2009 |
|---|------------------|------------------|
| OPERATING REVENUES | | |
| Water Sales | 798,692 | 789,974 |
| Service and Late Fees | 53,807 | 31,990 |
| Lease and Rental Income | 692 | 8,567 |
| Miscellaneous | 621 | 1,030 |
| | <u>853,812</u> | <u>831,561</u> |
| Total Operating Revenue | | |
| OPERATING EXPENSES | | |
| Salaries | 259,726 | 225,271 |
| Employee Benefits and Expenses | 100,804 | 82,916 |
| Water Purchases | 33,566 | 37,635 |
| Utilities | 53,069 | 66,169 |
| Repairs and Maintenance | 35,907 | 52,720 |
| Equipment Rental and Supplies | 90,666 | 53,242 |
| Insurance | 20,550 | 23,513 |
| Property and Other Taxes | 33,478 | 31,818 |
| Freight and Postage | 7,206 | 8,632 |
| Legal, Accounting and Other Contract Services | 23,054 | 12,393 |
| Auto Expense | 32,948 | 32,740 |
| Travel | 3,712 | 9,455 |
| Dues, Fees, Permits and Continuing Education | 1,592 | 1,946 |
| Office and Administrative Expense | 12,468 | 12,139 |
| Advertising | 1,475 | 2,340 |
| Other Expenses | 700 | 624 |
| Depreciation | 107,767 | 98,683 |
| | <u>818,688</u> | <u>752,236</u> |
| Total Operating Expenses | | |
| | 35,124 | 79,325 |
| Operating Income | | |
| NON-OPERATING REVENUES | | |
| Interest Income | 1,812 | 1,677 |
| Capital Grants and Contributions | 43,297 | 12,533 |
| | <u>45,109</u> | <u>14,210</u> |
| Total Non-Operating Revenues | | |
| | <u>\$ 80,233</u> | <u>\$ 93,535</u> |
| Increase in Net Assets | | |

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
STATEMENTS OF CHANGES IN MEMBERSHIP CAPITAL
Years Ended June 30, 2010 and 2009

| | <u>Memberships</u> | <u>Capital Improvement and Water Rights Assessments</u> | <u>Federal Grants and Contributions</u> | <u>Unrestricted Net Assets</u> | <u>Total</u> |
|---------------------------------------|--------------------|---|---|------------------------------------|---------------------|
| Balance June 30, 2008 (1,651 members) | \$ 165,100 | \$ 617,600 | \$ 192,000 | \$ 1,726,275 | \$ 2,700,975 |
| Repurchased Membership Rights | (100) | (4,859) | - | - | (4,959) |
| Resale of Membership Rights | 1,100 | 56,100 | - | - | 57,200 |
| Increase in Net Assets | <u>-</u> | <u>-</u> | <u>-</u> | <u>93,535</u> | <u>93,535</u> |
| Balance June 30, 2009 (1,661 members) | 166,100 | 668,841 | 192,000 | 1,819,810 | 2,846,751 |
| Repurchased Membership Rights | (4,720.00) | | | | (4,720) |
| Resale of Membership Rights | 26,000.00 | | | | 26,000 |
| Increase in Net Assets | <u>-</u> | <u>-</u> | <u>-</u> | <u>80,233</u> | <u>80,233</u> |
| Balance June 30, 2010 (1,665 members) | <u>187,380</u> | <u>\$ 668,841</u> | <u>\$ 192,000</u> | <u>\$ 1,900,043</u> | <u>\$ 2,948,264</u> |

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2010 and 2009

| | 2010 | 2009 |
|---|--------------------------|--------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from Customers | 884,598 | 889,829 |
| Payments To and On Behalf of Employees | (385,704) | (332,217) |
| Payments to Suppliers and Contractors | (397,004) | (343,898) |
| Other Receipts and Payments, Net | <u>(8,632)</u> | <u>(14,046)</u> |
| Net Cash Provided By Operating Activities | 93,258 | 199,668 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of Capital Assets | (145,241) | (60,664) |
| Interest Income | <u>1,812</u> | <u>1,677</u> |
| Net Cash Used By Investing Activities | (143,429) | (58,987) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from Sale of Membership Rights | 26,000 | 57,200 |
| Purchase of Membership Rights | (4,720) | (4,959) |
| Capital Grants and Contributions | <u>55,830</u> | <u>-</u> |
| Net Cash Provided By Financing Activities | <u>77,110</u> | <u>52,241</u> |
| Net Increase in Cash and Cash Equivalents | 26,939 | 192,922 |
| Cash and Cash Equivalents at Beginning of Year | <u>565,439</u> | <u>372,517</u> |
| Cash and Cash Equivalents at End of Year | <u><u>\$ 592,378</u></u> | <u><u>\$ 565,439</u></u> |
| Reconciliation of Operating Income to Net Cash Provided by Operating Activities | | |
| Increase in Operating Income | \$ 35,124 | \$ 79,325 |
| Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities | | |
| Depreciation | 107,767 | 98,683 |
| Changes in | | |
| Accounts Receivable | (14,052) | 19,138 |
| Inventory | (26,710) | - |
| Accounts Payable | (20,655) | (7) |
| Accrued Salaries | 3,839 | 1,918 |
| Compensated Absences | 1,374 | 1,821 |
| Accrued Payroll Taxes | 3,882 | (3,794) |
| Sales Tax Payable | (362) | 1,384 |
| Customer Deposits | <u>3,051</u> | <u>1,200</u> |
| Net Cash Provided By Operating Activities | <u><u>\$ 93,258</u></u> | <u><u>\$ 199,668</u></u> |

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2010 and 2009

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Otis Mutual Domestic Water Consumers and Sewage Works Association (Association) is a not-for-profit Mutual Domestic Association established for the purpose of constructing, maintaining and operating a water and wastewater system for the members of the Association in the Otis community in southern Eddy County of New Mexico. The Association was initially incorporated as a Cooperative Association, but the Board of Directors changed the form of organization from a not-for-profit cooperative to a not-for-profit association under the Sanitary Projects Act (SPA), NMSA 3-29-1 through 3-29-20, effective July 1, 2005.

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

An Attorney General's (AG) opinion (90-30, dated December 27, 1990) concluded that entities created under the SPA are subject to the New Mexico Audit Act. Additionally, another AG opinion (68-38) states Mutual Domestic Associations (MDA) under the SPA are created for "one purpose only, and that is to establish and maintain a water system." Further it concluded MDAs are not municipal corporations. HB 297, enacted during the 2009 legislative session, exempts MDAs from being subject to ad valorem taxes.

Associations created pursuant to the Sanitary Projects Act (3-29-1 NMSA 1978) are subject to audit under the Audit Act 12-6-2, NMSA 1978 and State Audit Rule 2.2.2 NMAC. However, the policy of the Office of the State Auditor has been to exempt Mutual Domestic Water Associations (MDWA's) from the requirement to receive an annual audit unless one of the following circumstances requires an audit: the MDWA's bylaws or governing board require an annual audit; a state agency (such as the NM Environment Department) that has provided the MDWA with a grant or pass-down federal funds requires that MDWA obtain an audit; the Office of the State Auditor requires an audit; or the MDWA expends \$500,000 or more of federal funds during a fiscal year, requiring a Single Audit.

The Association is considered to be a special-purpose governmental entity in accordance with Governmental Accounting Standards Board Statement No. 14. The Association is not a component unit of a governmental entity nor does it have any component units. This conclusion was reached because the Association was converted from a cooperative to an MDWA, pursuant to NMSA 3-29-20, by a vote of the Board of Directors rather than through legislative action or action by the entire membership; it does not have the ability to levy taxes but it does have the ability to set and change rates for service, it continues to file not-for-profit tax returns, it is not a subdivision of any governmental entity.

Attorney General Opinion 06-02 determined that MDWAs created pursuant to the Sanitary Projects Act, NMSA 1978 are public bodies/political subdivisions, whose revenues are "public money" and they have statutory responsibilities to abide by: the Open Meetings Act, the Inspection of Public Records Act, the Procurement Code, and the Per Diem and Mileage Act. Due to the fact that MDWA's have officially been determined to be governmental nonprofit organizations, their financial statements must follow the government format as described in GASB 34 beginning with the fiscal year ending June 30, 2007.

The Board of Directors consists of five members elected by the membership. The Board shall appoint qualified personnel to guide and direct the operations of the Association, and to approve all major contracts, capital outlay, etc involving the Association.

Change in Bylaws – In June, 2009, the Board of Directors and the general membership approved a change in the bylaws which reclassifies how the Association records the \$5,200 in initial membership purchase amount.

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

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
Year Ended June 30, 2010 and 2009

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Basis of Presentation - The Association is required to report information regarding its financial position and activities according to three classes of membership equity: unrestricted membership equity, temporarily restricted membership equity, and permanently restricted membership equity. The Association only has unrestricted membership equity. Unrestricted membership equity is defined as net assets not subject to donor-imposed stipulations.

The business-type financial statements are accounted for on a flow of economic resources measurement focus and utilize the accrual basis of accounting. This basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable and expenses in the accounting period in which they are incurred and become measurable. Revenue from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied. Grant funds are considered to be earned to the extent of expenditures made under the provisions of the grant. Accordingly, when such funds are received, they are recorded as deferred revenues until related and authorized expenditures have been made. Miscellaneous revenues are recorded as revenue when received because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

All activities of the Association are accounted for within a proprietary (enterprise) fund. Proprietary funds are used to account for operations that (a) are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. The Association is classified as a special purpose government and is required to meet the requirements for being reported under criteria prescribed by GASB 34.

GASB Statement Number 20 requires that governments' proprietary activities apply all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins. Governments are given the option whether or not to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. The Association has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

Deposits and Investments - For purposes of the statement of cash flows, the Association's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

Receivables - Substantially all of the Association's outstanding receivables are due from its customers for water sales. Collateral is generally not required on receivables, but a deposit is required to activate new service. It is the opinion of management that no allowance for doubtful accounts was necessary as of June 30, 2010 or 2009.

Concentration of Credit Risk - The Association grants credit without collateral to its customers for its services, but the customers are subject to service termination if the receivables are not settled within a specified time frame.

Inventory - Inventory includes water pipe and supplies for future water system installation and repairs. Inventory is valued at the lower of cost or market on a first-in, first-out basis.

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
Year Ended June 30, 2010 and 2009

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Property and Equipment - The Association's policy is to capitalize all expenditures for furniture, equipment and software in excess of \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Items with a cost of less than \$5,000 are expensed in the year of acquisition, except for costs associated with the installation of new water lines, pumps and tanks, which are capitalized. Expenditures related to the maintenance of the existing water system are expensed in the current period. Assets acquired under capital leases are amortized over the life of the respective leases or the service lives of the assets using the straight-line method and the amortization is included with depreciation expense.

Grants and Contributions - The Association receives grants as well as contributions in the course of operations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

Operating and Nonoperating Revenues - Operating revenue includes activities which have the characteristics of exchange transactions, such as patient services and contracts and grants. Nonoperating revenues include activities which have the characteristics of non-exchange transactions, such as investment income and ad valorem taxes. These revenue streams are recognized under GASB Statement No. 33 - *Accounting and Financial Reporting for Nonexchange Transactions*.

Income Taxes - The Association operates as a not-for-profit association and has received exempt status under Code Section 501(c) (12) of the Internal Revenue Code. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

Budgetary Data - As a governmental non-profit organization, the Association's annual budget is not subject to having to be presented to the New Mexico Department of Finance and Administration for review, adjustment or approval. Accordingly, no formal budget has been adopted or presented as supplemental information.

Use of Restricted Cash - When the Association incurs an expense for which it may use either restricted or unrestricted assets, it uses the restricted assets first whenever they will have to be returned if they are not used.

Compensated Absences - It is the Associations policy to permit some employees to accumulate earned but unused vacation and sick pay benefits. All sick pay and vacation pay is accrued when incurred.

Advertising - Advertising costs are expensed as incurred. Advertising costs for the year ended June 30, 2010 and 2009 was approximately \$2,340 and \$2,340, respectively.

Risk Management - The Association is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any preceding years.

Subsequent Events – Newly adopted accounting standard FASB ASC 855-10-50-1 requires reporting entities to disclose the date through which subsequent events have been evaluated and whether that date is the date the financial statements were issued or were available to be issued. Management has evaluated subsequent events through July 16, 2010, the date the financial statements were issued.

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
Year Ended June 30, 2010 and 2009

NOTE B – EMINENT DOMAIN CONTINGENCY RISK

The Association is not servicing any debt, thereby exposing the Association to a potential risk of being absorbed by the local municipality through eminent domain proceedings. Management feels the risk of the eminent domain proceedings is minimal.

NOTE C – CASH AND CASH EQUIVALENTS

Custodial Credit Risk - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Association does not have a formal deposit policy for custodial credit risk other than following the state statutes as put forth in the Public Money Act (Sec. 6-10-1 to 6-10-63, NMSA 1978).

Time deposits, savings deposits and interest bearing NOW accounts in an institution are insured up to \$250,000 in aggregate and separate from the \$250,000 coverage for demand deposits at the same institution by the FDIC. FDIC changed its policy of coverage in October, 2008 and will maintain the additional coverage until December, 2013, where it will revert back to the original \$100,000 coverage. Deposits above the FDIC limitations may be secured by the financial institution through pledging securities held by institution as collateral against the Association's deposits above the FDIC limitations. Section 6-10-17 NMSA 1978 require a minimum of 50% of the deposited funds with each institution be collateralized by the institution.

The types of collateral an institution is permitted to use as pledged securities are limited to direct obligations of the United States Government and all bonds issued by any agency or political subdivision of the State of New Mexico. The Association was exposed to custodial credit risk of \$106,040 and \$17,172 for the fiscal years ending June 30, 2010 and 2009. The amounts of the Association's secured and unsecured cash deposits are as follows.

| | 2010 Western Commerce Bank | 2009 Western Commerce Bank |
|--|--------------------------------------|-------------------------------------|
| Cash and Cash Equivalents | \$ 592,378 | \$ 565,439 |
| Cash on Hand | (300) | (300) |
| Net Reconciling Items | <u>6,047</u> | <u>3,410</u> |
| Total on Deposit | 598,125 | 568,549 |
| Less FDIC | <u>(250,000)</u> | <u>(250,000)</u> |
| Amount to be Collateralized | 348,125 | 318,549 |
| 50% Collateral Requirement | \$ 174,062 | \$ 159,274 |
| Securities Pledged by the Financial Institution Held by the Trust Department | <u>(242,085)</u> <u>(242,085)</u> | <u>(301,377)</u> <u>(301,377)</u> |
| Under (Over) Collateralized | <u>\$ 106,040</u> <u>\$ (68,023)</u> | <u>\$ 17,172</u> <u>\$(142,106)</u> |

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
Year Ended June 30, 2010 and 2009

NOTE D – CAPITAL ASSETS

The majority of the assets of the Association are located on land not owned by the Association, but are constructed on private easements for the specific and registered use of the Association or within the public utility right-of-way associated with public roads granted by plats from the county. Leasehold improvements and equipment capital asset activity for each year is detailed below.

| | Balance 06/30/08 | Increases | Decreases | Balance 06/30/09 | Increases | Decreases | Balance 06/30/10 |
|---------------------------------------|---------------------|--------------------|-------------|---------------------|------------------|-----------------|---------------------|
| <i>Nondepreciable Assets</i> | | | | | | | |
| Land and Water Rights | \$ 977,560 | \$ - | \$ - | \$ 977,560 | \$ 23,451 | \$ - | \$ 1,001,011 |
| <i>Depreciable Assets</i> | | | | | | | |
| Building and Well House | 140,738 | - | - | 140,738 | - | - | 140,738 |
| System Water Lines | 1,595,332 | 21,741 | - | 1,617,073 | 16,128 | - | 1,633,201 |
| Wells and Tanks | 1,083,817 | - | - | 1,083,817 | 49,104 | - | 1,132,921 |
| Tools and Equipment | <u>436,110</u> | <u>38,923</u> | <u>-</u> | <u>475,033</u> | <u>56,558</u> | <u>(22,168)</u> | <u>509,423</u> |
| Total Depreciable Assets | 4,233,557 | 60,664 | - | 4,294,221 | 145,241 | (22,168) | 4,417,294 |
| <i>Less Accumulated Depreciation:</i> | | | | | | | |
| Building and Well House | (85,092) | (6,020) | - | (91,112) | (6,020) | - | (97,132) |
| System Water Lines | (1,082,962) | (39,883) | - | (1,122,845) | (40,466) | - | (1,163,311) |
| Wells and Tanks | (519,977) | (33,851) | - | (553,828) | (35,175) | - | (589,003) |
| Tools and Equipment | <u>(371,288)</u> | <u>(18,929)</u> | <u>-</u> | <u>(390,217)</u> | <u>(26,106)</u> | <u>22,168</u> | <u>(394,155)</u> |
| Total Accumulated Depreciation | <u>(2,059,319)</u> | <u>(98,683)</u> | <u>-</u> | <u>(2,158,002)</u> | <u>(107,767)</u> | <u>22,168</u> | <u>(2,243,601)</u> |
| Net Capital Assets | <u>\$ 2,174,238</u> | <u>\$ (38,019)</u> | <u>\$ -</u> | <u>\$ 2,136,219</u> | <u>\$ 37,474</u> | <u>\$ -</u> | <u>\$ 2,173,693</u> |

Depreciation expense was \$107,767 and \$98,683 for the years ended June 30, 2010 and 2009, respectively, and is computed principally by the straight-line method over the following estimated useful lives:

| Assets | Years |
|----------------------------------|-------|
| Leasehold improvements | 40 |
| Water lines, pumps and tanks | 20-40 |
| Office and maintenance equipment | 5 – 7 |
| Vehicles | 5 |

OTIS MUTUAL DOMESTIC WATER CONSUMERS
 AND SEWAGE WORKS ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS - CONTINUED
 Year Ended June 30, 2010 and 2009

NOTE E – COMPENSATED ABSENCES

Vacation and sick leave is earned by employees during the year based on time worked, is non-cumulative and considered to be payable within one year. Vacation leave due, if any, is paid upon an employee’s termination. Compensation for sick leave is limited to time-off and is not monetarily compensated. The activity of the vacation leave due to employees as of June 30, 2010 and 2009 is detailed below.

| | Balance | | | Balance | | | Balance |
|----------------------|----------|-----------|------------|-----------|-----------|-------------|-----------|
| | 06/30/08 | Increases | Decreases | 06/30/09 | Increases | Decreases | 06/30/10 |
| Compensated Absences | \$ 8,721 | \$ 10,182 | \$ (8,361) | \$ 10,542 | \$ 13,059 | \$ (11,685) | \$ 11,916 |

NOTE F – RELATED PARTY TRANSACTIONS

A current board member owns and operates an auto repair business close to the Association’s office. As a convenience, the Association sometimes has vehicles repaired at the board member’s business. Rates charged to the Association are comparable to other auto repair businesses in the immediate area. Total amount paid to the board member for auto repair services for the year ended June 30, 2010 and 2009 is approximately \$5,445 and \$9,085, respectively.

NOTE G – DEFINED CONTRIBUTION PENSION PLAN

Plan Description – The Association’s full-time employees have elected participate in a public employee retirement system authorized under the Public Employees’ Retirement Act (PERA) (Chapter 10, Article 11, NMSA 1978) PERA is the administrator of the plan, which is a multiple-employer defined benefit retirement plan. The plan provides for retirement, disability benefits and cost-of-living adjustments to plan members and beneficiaries. PERA issues a separate, publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to PERA, PO Box 2123, Santa Fe, NM 87501-2123.

Funding Policy – Plan members will be required to contribute 9.15% of their gross salary, excluding any overtime. The Association will be required to contribute a matching 9.15% for all employees. The contribution requirements of plan members and the Association are established in Chapter 10, Article 7C, NMSA 1978. These requirements may be amended by acts of the legislature. Contributions for the years ended June 30, 2010, 2009 and 2008 were \$17,917, \$16,453 and \$11,531, respectively. No contributions were made to the plan by the Association for the year ended June 30, 2007 as the plan was not effective at the fiscal year end.

The Association does not provide any other type of deferred compensation or retirement benefits, nor does it participate in the Retiree Health Care Act (10-7C-1 to 10-7C-16, NMSA 1978).

SUPPLEMENTAL INFORMATION

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
SCHEDULE OF DEPOSITS AND TEMPORARY INVESTMENTS
Years Ended June 30, 2010 and 2009

| Name of Depository | Account Type | Bank Balance June 30, 2010 | Net Reconciling Items | Reconciled Balance June 30, 2010 |
|-----------------------|-------------------|----------------------------------|-----------------------------|--|
| Western Commerce Bank | Interest Checking | \$ 449,521 | \$ (6,047) | 443,474 |
| Western Commerce Bank | Money Market | 148,604 | - | 148,604 |
| | | <u>\$ 598,125</u> | <u>\$ (6,047)</u> | <u>\$ 592,078</u> |

Reconciliation to Basic Financial Statements

Total Association Cash

Cash Deposits

Petty Cash

\$ 592,078

300

Total Cash

\$ 592,378

| Name of Depository | Account Type | Bank Balance June 30, 2009 | Net Reconciling Items | Reconciled Balance June 30, 2009 |
|-----------------------|-------------------|----------------------------------|-----------------------------|--|
| Western Commerce Bank | Interest Checking | \$ 420,168 | \$ (3,410) | \$ 416,758 |
| Western Commerce Bank | Money Market | 148,381 | - | 148,381 |
| | | <u>\$ 568,549</u> | <u>\$ (3,410)</u> | <u>\$ 565,139</u> |

Reconciliation to Basic Financial Statements

Total Association Cash

Cash Deposits

Petty Cash

\$ 565,139

300

Total Cash

\$ 565,439

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
SCHEDULE OF COLLATERAL PLEDGED BY DEPOSITORY
FOR PUBLIC FUNDS
June 30, 2010

| Name of Depository | Pledged Collateral | CUSIP | Name and Location of Custodian | Fair Market Value June 30, 2010 |
|-----------------------|-----------------------------------|-----------|--------------------------------------|------------------------------------|
| Western Commerce Bank | FHLMC #420166 Matures 1/1/2020 | 31346AFF7 | Federal Home Loan Bank Dallas, TX | \$ 62,189 |
| Western Commerce Bank | GNMA #8263 Matures 9/20/2017 | 36202KFC4 | Federal Home Loan Bank Dallas, TX | 55,028 |
| Western Commerce Bank | GNMA #8453 Matures 1/20/2019 | 36202KMA0 | Federal Home Loan Bank Dallas, TX | 59,676 |
| Western Commerce Bank | GNMA #80185 Matures 04/20/2028 | 36225CF35 | Federal Home Loan Bank Dallas, TX | <u>65,192</u> |
| | | | | <u>\$ 242,085</u> |

COMPLIANCE

JW Anderson & Associates, PC

Certified Public Accountants

Coppertree Office Park
4412 74th Street, Suite F-101
PO Box 6785
Lubbock, Texas 79493-6785
Office (806) 771-4000
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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Hector Balderas
New Mexico State Auditor, and
The Chairman and Board of Directors
Otis Mutual Domestic Water Consumers
and Sewage Works Association
Otis, New Mexico

We have audited the accompanying basic financial statements of Otis Mutual Domestic Water Consumers and Sewage Works Association as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated July 16, 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the 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.

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 a 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 the 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

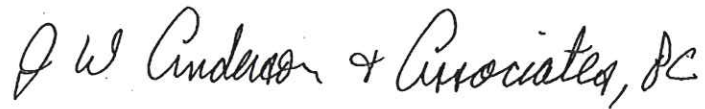
Compliance and Other Matters

As part of obtaining reasonable assurance about whether Otis Mutual Domestic Water Consumers and Sewage Works 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*.

However, we noted certain matters that are required to be reported under *Government Auditing Standards January 2007 Revision* paragraphs 5.14 and 5.16 and Section 12-6-5 NMSA 1978 which are described in the accompanying Schedule of Audit Findings and Responses as 2010-1.

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

This report is intended solely for the information and use of the Association's management and Board of Directors, New Mexico Office of the State Auditor, the New Mexico Legislature, New Mexico Department of Finance and Administration and applicable state and federal awarding agencies and pass-through agencies, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "JW Anderson & Associates, PC".

JW Anderson & Associates, PC
Certified Public Accountants
Lubbock, Texas
July 16, 2010

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
For the Years Ended June 30, 2010 and 2009

Prior Year - 2009-1 Anti-Donation Clause Violation - Resolved

Current Year -

2010-1 Segregation of Duties

CONDITION - The Association has a lack of segregation of duties due to personnel constraints.

CRITERIA – Segregation of certain specific accounting and administrative functions is needed to minimize concentration of internal control and reduce the possibility of overriding of controls.

CAUSE – Personnel and funding limitations have relegated the Association to consolidate some incompatible accounting and administrative functions.

EFFECT - The lack of proper segregation of duties is common in smaller and medium Associations that are forced to control personnel costs at the expense of improved control.

RECOMMENDATION – Although the Association has compensating controls in place to reduce the effect of the lack of segregation of duties, we recommend management periodically evaluate whether its level of control is appropriate for the current situation.

RESPONSE – The Association will continually monitor the internal control environment and adjust policies and procedures when conflicts in internal control arise.

OTIS MUTUAL DOMESTIC WATER CONSUMERS
AND SEWAGE WORKS ASSOCIATION
EXIT CONFERENCE
For the Year Ended June 30, 2010 and 2009

The contents of this report were discussed with the Otis Mutual Domestic Water Consumers and Sewage Works Association representatives on July 16, 2010. The following individuals were available for the conference:

Otis MDWC & SWA

Lori Rogers, Office Manager
Jim Wilcox, Board Member
Danny Bass, Board Member
Cutter Rogers, Ass't General Manager

J.W. Anderson & Associates, PC

Scott Northam, Audit Manager

The financial statements of Otis Mutual Domestic Water Consumers and Sewage Works Association were prepared from original books and records provided by and with assistance from the management of the Association and J.W. Anderson & Associates, PC.

Although Statement of Auditing Standards No. 112 - *Communicating Internal Control Related Matters Identified in an Audit* strongly emphasizes that the Otis Mutual Domestic Water Consumers and Sewage Works Association prepare its own financial statements, the consensus between the Association management and the auditors was that it would be more time and cost efficient for the auditors to prepare the financial statements and the related notes. Accordingly, the Association has designated a competent management-level individual to oversee the auditors' services and have made all management decisions and performed all management functions. The Association has reviewed, approved, and accepted responsibility for the accompanying financial statements and related notes, and for ensuring that the underlying accounting records adequately support the preparation of the financial statements in accordance with generally accepted accounting principles and that the records are current and in balance.

JW Anderson & Associates, PC

Certified Public Accountants

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COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Hector Balderas
New Mexico State Auditor, and
The Chairman and Board of Directors
Otis Mutual Domestic Water Consumers and
Sewage Works Association
Otis, New Mexico

We have audited the accompanying basic financial statements of Otis Mutual Domestic Water Consumers and Sewage Works Association as of and for the years ended June 30, 2010 and 2009, and have issued our report thereon dated July 16, 2010. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards and *Government Auditing Standards*

As communicated in our engagement letter dated May 13, 2010, our responsibility, as described by professional standards, is to form and express opinions about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audits of the financial statements do not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements 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 entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of Otis Mutual Domestic Water Consumers & Sewage Works Association solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

We have provided our findings regarding significant control deficiencies over financial reporting and material noncompliance, and other matters noted during our audit in a separate letter to you dated July 16, 2010.

Other Information in Documents Containing Audited Financial Statements

Pursuant to professional standards, our responsibility as auditors for other information in documents containing Otis Mutual Domestic Water Consumers & Sewage Works Association's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. However, in accordance with such standards, we have read the information and considered whether such information, or the manner of its presentation, was materially inconsistent with its presentation in the financial statements.

Our responsibility also includes communicating to you any information which we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

Qualitative Aspects of the Entity's Significant Accounting Practices

Significant Accounting Policies - Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by Otis Mutual Domestic Water Consumers & Sewage Works Association is included in Note A to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during June 30, 2010. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates - Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements is depreciation of capital assets..

Management's estimate of the depreciation expense is based on the historical basis and useful lives of the capital assets. We evaluated the key factors and assumptions used to develop the depreciation expense and determined that it is reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

Financial Statement Disclosures - Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting Otis Mutual Domestic Water Consumers & Sewage Works Association's financial statements relate to custodial credit risk and unsecured and uncollateralized cash and cash equivalents.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected financial statement misstatements whose effects, as determined by management, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole and each applicable opinion unit.⁸

In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. There were no material misstatements that we identified as a result of our audit procedures to be brought to the attention of, and corrected by, management.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to Otis Mutual Domestic Water Consumers & Sewage Works Association's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Representations Requested from Management

We have requested certain written representations from management, which are included in the attached letter dated July 16, 2010

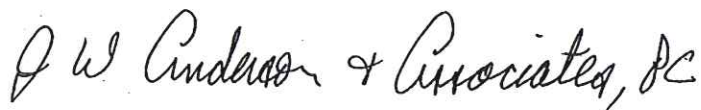
Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Findings or Issues

In the normal course of our professional association with Otis Mutual Domestic Water Consumers & Sewage Works Association, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as Otis Mutual Domestic Water Consumers & Sewage Works Association's auditors.

This report is intended solely for the information and use of the Association's management and Board of Directors, New Mexico Office of the State Auditor, the New Mexico Legislature, New Mexico Department of Finance and Administration and applicable state and federal awarding agencies and pass-through agencies, and is not intended to be and should not be used by anyone other than these specified parties.



JW Anderson & Associates, PC
Certified Public Accountants
Lubbock, Texas
July 16, 2010