STATE OF NEW MEXICO
SAN LUIS-CABEZON MUTUAL DOMESTIC WATER ASSOCIATION

FINANCIAL STATEMENTS AND REQUIRED
SUPPLEMENTARY INFORMATION
WITH ACCOMPANYING AUDITORS' REPORTS

YEAR ENDED DECEMBER 31, 2007

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INTRODUCTORY SECTION

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STATE OF NEW MEXICO
San Luis-Cabezon Mutual Domestic Water Association
Table of Contents
December 31, 2007

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STATE OF NEW MEXICO
San Luis-Cabezon Mutual Domestic Water Association
Official Roster
December 31, 2007

Board

Name	**Title**
Paul Madrid	President
Robert W. Johnson	Vice President
Dolores Montoya	Secretary
Mae Powell	Treasurer
Ralph Martinez	Member
Loraine Dominguez	Member

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FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

Hector Balderas
New Mexico State Auditor
The Office of Management and Budget and
The Board of Directors
San Luis-Cabezon Mutual Domestic Water Association
Bernalillo, New Mexico

We were engaged to audit the accompanying basic financial statements of the business-type activities of the San Luis-Cabezon Mutual Domestic Water Association (Association) as of and for the year ended December 31, 2007, which collectively comprise the Association's basic financial statements as listed in the table of contents. These financial statements are the responsibility of San Luis-Cabezon Mutual Domestic Water Association's management.

The Association did not maintain adequate accounting records relating to its cash, accounts receivable, capital assets, accounts payable, note payable, net assets, revenue and expense accounts. The Association was unable to provide bank reconciliations for its bank accounts, accounts receivable aging report to facilitate the determination of accounts receivable and the related allowance for doubtful accounts, a listing of capital assets at historical cost, depreciation schedule, and listing of accounts payable. The Association did not record its note payable and was unable to provide amortization schedules. The Association did not maintain accounting records sufficient for determining net assets. The Association had inadequate documentation to determine that: all its revenue transactions and events that should have been recorded were recorded; revenue amounts and related data were recorded appropriately; revenue transactions and events that occurred have been recorded in the correct accounting period; or revenue transactions and events have been recorded in the proper accounts; all its expenditure transactions and events that should have been recorded are recorded; expenditure amounts and related data were recorded appropriately; expenditure transactions and events occurred have been recorded in the correct accounting period; or expenditure transactions and events have been recorded in the proper accounts. The Association's records do not permit the application of other auditing procedures to its cash, accounts receivable, capital assets, accounts payable, note payable, net assets, revenues and expenses accounts. The Association did not provide a written representation letter to the auditors.

Because we were unable to obtain adequate supporting documentation for the Association's cash, accounts receivable, capital assets, accounts payable, note payable, beginning net assets, revenues and expenses accounts, and the Association not providing a written representation letter, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on the basic financial statements of the business-type activities of the Association, as of December 31, 2007, and the respective changes in financial position thereof for the year then ended.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 15, 2010 on our consideration of the Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Association has not presented Management's Discussion and Analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

We were engaged for the purpose of forming an opinion on the Association's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. The accompanying information listed as Schedule I in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Because of the significance of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express an opinion regarding whether the Schedule of Expenditures of Federal Awards and Schedule I are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Accounting & Consulting Group, L.L.P.

Accounting & Consulting Group, LLP
Albuquerque, NM
January 15, 2010

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BASIC FINANCIAL STATEMENTS

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STATE OF NEW MEXICO

Exhibit A

San Luis-Cabezon Mutual Domestic Water Association
Statement of Net Assets
Proprietary Fund
December 31, 2007

Assets		
Current assets		
Cash and cash equivalents (Note 3)	$	60,594
Grants receivable (Note 4)		595,413
Total current assets		656,007
Noncurrent assets		
Restricted assets:		
Cash and cash equivalents (Note 3)		42,739
Capital assets (Note 5)		2,638,704
Less: accumulated depreciation		-
Total noncurrent assets		2,681,443
Total assets	$	3,337,450
Liabilities and net assets		
Current liabilities		
Accounts payable	$	597,336
Interest payable		550
Current portion of notes payable (Note 6)		4,123
Total current liabilites		602,009
Noncurrent liabilities		
Notes payable (Note 6)		407,091
Total noncurrent liabilities		407,091
Total liabilities		1,009,100
Net assets		
Invested in capital assets, net of related debt		2,227,490
Restricted for:		
Utility system construction		42,739
Unrestricted		58,121
Total net assets		2,328,350
Total liabilities and net assets	$	3,337,450

The accompanying notes are an integral part of these financial statements

STATE OF NEW MEXICO Exhibit B

San Luis-Cabezon Mutual Domestic Water Association
Statement of Revenues, Expenses and Changes in Net Assets
Proprietary Fund
For the Year Ended December 31, 2007

Operating revenues		
Charges for service:		
Private lane development	$	47,137
Meter installation		23,902
Total operating revenues		71,039
Operating expenses		
Other		3,125
Travel		1,177
Telephone		1,016
Total operating expenses		5,318
Operating income (loss)		65,721
Non-operating revenues (expenses)		
Annual dues		2,598
Interest expense		(11,562)
Total non-operating revenues (expenses)		(8,964)
Income (loss) before contributions and transfers		56,757
Capital grant revenue		2,207,396
Change in net assets		2,264,153
Total net assets, beginning of year		64,197
Total net assets, end of year	$	2,328,350

The accompanying notes are an integral part of these financial statements

STATE OF NEW MEXICO Exhibit C

San Luis-Cabezon Mutual Domestic Water Association
Statement of Cash Flows
Proprietary Fund
For the Year Ending December 31, 2007

Cash flows from operating activities:		
Cash received from customers	$	71,039
Cash paid to suppliers and contractors		(5,318)
Net cash provided by operating activities		65,721
Cash flows from noncapital financing activities:		
Annual dues		2,598
Net cash provided by noncapital financing activities		2,598
Cash flows from capital financing activities		
Proceeds from capital grants		2,209,319
Proceeds from capital debt		411,550
Purchase of capital assets		(2,638,704)
Principal paid on capital debt		(336)
Interest paid on capital debt		(11,012)
Net cash (used) by capital financing activities		(29,183)
Net increase in cash and cash equivalents		39,136
Cash and cash equivalents - beginning of year		64,197
Cash and cash equivalents - end of year	$	103,333

Reconciliation of operating income to net cash provided (used) by operating activities:

Operating income	$	65,721
Adjustments to reconcile operating income to net cash provided by operating activities		-
Net cash provided by operating activities	$	65,721

The accompanying notes are an integral part of these financial statements

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity

The San Luis-Cabezon Mutual Domestic Water Association (Association) is a not-for-profit Mutual Domestic Water Association established for the purpose of constructing, maintaining, and operating a water system for members of the Association in rural Sandoval County. The Association was incorporated as a Cooperative Association under the provisions of the New Mexico Cooperative Corporation Act. The Board of Directors has organized the Association as a not-for-profit Association under the Sanitary Projects Act, NMSA 3-29-1 through 3-29-20.

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

An Attorney General's (AG) opinion (90-30, dated December 27, 1990) concludes that entities created under the Sanitary Projects Act (SPA) are subject to the New Mexico Audit Act. Additionally, Attorney General opinion (06-02) that states Mutual Domestic Water Associations (MDAs) under the SPA are public bodies whose revenues are “public money” and must abide by the Open Meeting Act.

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 from the requirement to receive an annual audit unless one or more of the following circumstances requires an audit:

a. The Association's bylaws or governing board require an annual audit.

b. A state agency (such as the NM Environment Department) that has provided the Association with a grant or pass-down federal funds requires that Association obtain an audit.

c. The Office of the State Auditor requires an audit; or

d. The Association 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 (GASB) 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 a Mutual Domestic Water Association, 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, and it continues to pay ad valorem taxes.

The Association’s financial statements include all financial information over which the Board of Directors exercises oversight responsibility. Oversight responsibility includes such aspects as appointment of governing body members, designation of management, the ability to significantly influence operations, and accountability for fiscal matters. Based upon the application of these criteria, no component units were included in the financial statements.

Attorney General Opinion 06-02 determined that Mutual Domestic Water Associations created pursuant to the Sanitary Projects Act, NMSA 1978 are public bodies of 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 Mutual Domestic Water Association’s have officially been determined to be governmental nonprofit organizations, their financial statements must follow the government format as described in GASB Statement No. 34 beginning with the fiscal year ending June 30, 2007.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

A. Financial Reporting Entity (continued)

The summary of significant accounting policies of the Association is presented to assist in the understanding of the Association's financial statements. The financial statements and notes are the representation of San Luis-Cabezon Mutual Domestic Water Association's management who is responsible for their integrity and objectivity. The financial statements of the Association conform to Generally Accepted Accounting Principles (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. The more significant of the government's accounting policies are described below.

The Board of Directors consists of seven 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.

B. Measurement Focus, Basis of Accounting and Financial Statement Presentation

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

Interest income associated with the current fiscal period is all considered to be susceptible to accrual and so has been recognized as revenue of the current fiscal period.

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

Private-sector standards of accounting and financial reporting issued on or before November 30, 1989, generally are followed in the proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

C. Operating and Non-Operating Revenues and Expenses

1. Revenues

Revenues are classified as operating or non-operating according to the following criteria:

a. Operating revenue include activities that have the characteristics of an exchange transaction, such as charges for services and fees.

b. Non-operating revenues include activities that have the characteristics of nonexchange transactions, such as i) capital grants; and ii) investment income. Grant revenue is recognized when the eligibility requirements are met.

2. Expenses

Expenses are classified as operating or non-operating according to the following criteria:

a. Operating expenses include activities that have characteristics of exchange transactions, such as i) maintenance, operations and contractual services; ii) material and supplies; iii) office expenses; iv) depreciation expenses related to Association capital assets and v) employee salaries, benefits, and related expense.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

C. Operating and Non-Operating Revenues and Expenses (continued)

2. Expenses (continued)

b. Non-operating expenses include activities that have the characteristics of nonexchange transactions, such as interest on capital asset-related debt and bond expenses that are defined as non-operating expenses by GASB Statement No. 9 - Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entries That Use Proprietary Fund Accounting, and GASB Statement No. 34.

3. Grant Revenues

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 nonoperating revenues and expenses.

D. Assets, Liabilities, and Net Assets or Equity

1. Deposits and Investments

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.

State statutes authorize the investment of the Association's funds in a wide variety of instruments including certificates of deposit and other similar obligations, state investment pool, and money market accounts and United States Government obligations. The Association is no aware of any invested funds that did not meet the State investment requirements. Investments are reported at fair value. The Association did not have any investments at December 31, 2007.

Deposits of funds may be made in interest or non-interest bearing checking accounts in one or more banks or savings and loan associations within the geographical boundaries of the Association. Deposits may be made to the extent that they are insured by an agency of the United States or collateralized as required by statue.

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

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

According to the Federal Deposit Insurance Corporation, public unit deposits are funds owned by the Association. Time deposits, savings deposits and interest bearing "Now" accounts of a public unit in an institution in the same state will be insured up to $100,000 in aggregate and separate from the $100,000 coverage for public unit demand deposits at the same institution.

On October 14, 2008, the FDIC announced its temporary Transaction Account Guarantee Program, providing depositors with unlimited coverage for noninterest-bearing transactions if their bank is a participant in the FDIC's Temporary Liquidity Guarantee Program. Noninterest bearing checking accounts include demand deposit accounts and any transaction account that has unlimited withdrawals and that cannot earn interest. Also included are low-interest NOW accounts that cannot earn more than 0.5% interest. Interest-bearing accounts include NOW accounts that can earn more than 0.5% interest, other-interest bearing checking accounts, money market deposit accounts, savings accounts, and certificates of deposit. This program is scheduled to end on December 31, 2009.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. Assets, Liabilities, and Net Assets or Equity (continued)

2. Accounts receivable

No allowance for doubtful accounts has been recorded. Receivables are recognized when services have been rendered and revenue has been earned.

3. Capital Assets

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

Assets	Years
Water utility system	40
Building and building improvements	15-40
Heavy equipment	5-20
Vehicles	5
Office equipment	5-7

The Association has not determined its ownership of any water rights, nor the value of those rights, if any. Therefore, water rights have not been capitalized.

4. Net Assets

Net assets are classified as follows:

a. Invested in capital assets, net of related debt represent the Association's total investment in capital assets, net of outstanding debt related to those capital assets.

b. Restricted net assets represent those operating funds on which external restrictions have been imposed that limit the purposes for which such funds can be used. Restricted expendable net assets are resources that the Association is legally or contractually obligated to spend in accordance with imposed restrictions by third parties. Restricted non-expendable net assets consist of endowment and similar funds in which third parties have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income.

c. Unrestricted net assets consist of those operating funds over which the governing board retains full control to use in achieving any of its authorized purposes.

5. Use of Estimates

The preparation of the 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. The Association had no significant estimates at December 31, 2007.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Income Taxes

San Luis-Cabezon Mutual Domestic Water Association is exempt from Federal income taxes under the provisions of Section 501(a) of the Internal Revenue Code as an entity described in Section 501(c)(12). Therefore, no provision for income taxes has been made.

NOTE 2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Budgetary Information

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

NOTE 3. DEPOSITS AND INVESTMENTS

Custodial Credit Risk – Deposits 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 does not have a deposit policy for custodial credit risk, other than following state statutes as set forth in the Public Money Act (Section 6-10-1 to 6-10-63, NMSA 1978). At December 31, 2007, $3,333 of the Associations deposits of $103,333 was exposed to custodial credit risk. $3,333 was uninsured and uncollateralized.

	Wells Fargo Bank, N.A.
Amount on deposits	$ 103,333
Less FDIC coverage	(100,000)
Total uninsured public funds	3,333
Collateralized by securities held by pledging institutions or by its trust department or agent in other than the Associations name	-
Total uninsured and uncollateralized	$ 3,333
Collateral requirement 50% of total uninsured public funds (Section 6-10-17, NMSA 1978)	1,667
Pledged securities (see below)	-
Over (under) collateralized	$ (1,667)

NOTE 4. GRANTS RECEIVABLE

The following is a summary of grants receivable as of December 31, 2007:

New Mexico Environment Department	$ 225,000
U.S. Department of Agriculture:	
Rural Utilities Service	187,017
Natural Resources Conservation Service	87,912
U.S. Department of Interior:	
Bureau of Land Management	95,484
Total	$ 595,413

An allowance for doubtful accounts for grants receivable was not determined by management as of December 31, 2007. Therefore, the collectability of grants receivable is unknown as of December 31, 2007.

NOTE 5. CAPITAL ASSETS

A. Summary of Changes in Capital Assets

A summary of capital asset changes occurring during the year ended December 31, 2007 follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital assets, not being depreciated:				
Land	$ -	$ -	$ -	$ -
Construction in progress	-	2,638,704	-	2,638,704
Total capital assets not being depreciated	-	2,638,704	-	2,638,704
Capital assets, being depreciated:				
Water utlity system	-	-	-	-
Buildings and building improvements	-	-	-	-
Heavy equipment	-	-	-	-
Vehicles	-	-	-	-
Office equipment	-	-	-	-
Total capital assets being depreciated	-	-	-	-
Accumulated Depreciation:				
Water utlity system	-	-	-	-
Buildings and building improvements	-	-	-	-
Heavy equipment	-	-	-	-
Vehicles	-	-	-	-
Office equipment	-	-	-	-
Total Accumulated Depreciation	-	-	-	-
Total Capital Assets, net	$ -	$ 2,638,704	$ -	$ 2,638,704

NOTE 5. CAPITAL ASSETS (continued)

A. Summary of Changes in Capital Assets (continued)

The Association was unable to provide depreciation schedules and related expense as of December 31, 2007.

B. Construction in Progress

The Association is involved in a long-term construction project as part of their master plan for implementing the water utility system operations.

Construction in progress is stated at cost, which includes the cost of construction and other direct costs attributable to the construction. No provision for depreciation is made on construction in progress until such time as the relevant assets are completed and put into use. Construction in progress at December 31, 2007, represents construction of the water utility system. As of December 31, 2007 construction in progress was estimated to be 91.71% complete. Construction is expected to be completed September 1, 2009 at an estimated cost of $238,441.

NOTE 6. LONG-TERM DEBT

A. Promissory Note – USDA – Rural Utilities Service

1. Note Payable

The Association has acquired a note to provide funds for the acquisition and construction of major capital facilities for its water utility system. The note will be paid from operating income. The detail of the loan as of December 31, 2007 is as follows:

Account Name	Original Amount	Interest Rate	Balance 12/31/2007	Due Within One Year
Promissory Note – USDA – RUS	$ 411,550	4.38%	411,214	$ 4,123

Interest paid on the note payable during the year ended December 31, 2007 was $11,562.

2. Maturity of Note Payable

Annual debt service requirements to maturity for loans payable are as follows:

Fiscal Year Ending December 31,	Principal	Interest	Total
2008	$ 4,123	$ 17,909	$ 22,032
2009	4,307	17,725	22,032
2010	4,500	17,532	22,032
2011	4,701	17,331	22,032
2012	4,910	17,122	22,032
2013-2017	28,042	82,118	110,160
2018-2022	34,885	75,275	110,160
2023-2027	43,398	66,762	110,160
2028-2032	53,989	56,171	110,160
2033-2037	67,163	42,997	110,160
2038-2042	83,553	26,607	110,160
2043-2046	77,643	6,836	84,478
	$ 411,214	$ 444,384	$ 855,598

NOTE 6. LONG-TERM DEBT (Continued)

A. *Promissory Note – USDA – Rural Utilities Service (Continued)*

3. *Changes in long-term debt*

During the year ended December 31, 2007, the following changes occurred in liabilities reported in the Statement of Net Assets:

Account Name	Beginning Balance	Additions	Retirements	Ending Balance	Due Within One Year
Promissory Note – USDA – RUS	$ -	$ 411,550	$ 336	$ 411,214	$ 4,123

NOTE 7. NET ASSETS

At December 31, 2007, $42,739 of total net assets of $2,328,350 is restricted for utility system construction and may not be used for general operating expenses.

NOTE 8. RETAINED RISKS OF LOSS

The Association is exposed to various risks of loss related to torts, theft to, damage to, and destruction of assets, error and omissions, and natural disasters. The Association does not maintain commercial insurance for its risks.

NOTE 9. SUBSEQUENT PRONOUNCEMENTS

In July 2007, the Government Accounting Standards Board (GASB) issued GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which is effective for periods beginning after June 15, 2009. For governments that were classified as phase I or phase 2 governments, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Retroactive reporting of these intangible assets by phase 3 governments is encouraged but not required. Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce these inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. The Association has not analyzed the effect that this standard will have on the financial statements.

In March 2009, the Government Accounting Standards Board (GASB) issued GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, which is effective for financial statements for periods beginning after June 15, 2010 with earlier implementation encouraged. GASB Statement No. 54 distinguishes fund balance between amounts that are considered nonspendable , such as fund balance associated with inventories, and other amounts that are classified based on the relative strength of the constraints that control the purpose for which specific amounts can be spent. This statement is intended to improve the usefulness of information provided to financial report users about fund balance by providing clearer, more structured fund balance classifications, and by clarifying the definitions of existing governmental fund types. The Association has not analyzed the effect that this standard will have on the financial statements.

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SUPPLEMENTARY INFORMATION

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STATE OF NEW MEXICO
San Luis-Cabezon Mutual Domestic Water Association
Schedule of Deposit Accounts
For the Year Ended December 31, 2007

Name of Depository	Account Name	Account Type	Bank Balance	Reconciled Balance
Wells Fargo Bank, N.A.	Operational	Checking	$ 60,594	*
Wells Fargo Bank, N.A.	Construction	Checking	42,739	*
Total on deposit			$ 103,333	*

* - The Association did not maintain bank reconciliations during the fiscal year ended December 31, 2007. As such reconciled balances are not available for disclosure. Please refer to Schedule III, Schedule of Findings and Questioned Costs.

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COMPLIANCE SECTION

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

Hector Balderas
New Mexico State Auditor
The Office of Management and Budget and
The Board of Directors
San Luis-Cabezon Mutual Domestic Water Association
Bernalillo, New Mexico

We were engaged to audit the financial statements of the business-type activities of San Luis-Cabezon Mutual Domestic Water Association (Association), as of and for the year ended December 31, 2007, which collectively comprise the Association's basic financial statements as listed in the table of contents and have issued our report thereon dated January 15, 2010. Due to the Association's inadequate accounting records relating to its cash, accounts receivable, capital assets, accounts payable, note payable, net assets, revenues and expenses accounts, and the Association not providing a representation letter, the scope of our work was not sufficient to enable us to express, and we did not express an opinion.

<u>Internal Control Over Financial Reporting</u>

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.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Association's financial statements that is more than inconsequential will not be prevented or detected by the Association's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting as item FS 2007-01, FS 2007-02, FS 2007-03, FS 2007-04, FS 2007-05, FS 2007-06, FS 2007-07, FS 2007-08, FS 2007-09, FS 2007-10, FS 2007-11, and FS 2007-12.

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

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

However, of the significant deficiencies described above, we consider items FS 2007-01, FS 2007-02, FS 2007-03, FS 2007-04, FS 2007-05, FS 2007-06, FS 2007-07, FS 2007-08, and FS 2007-09 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Association's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items FS 2007-01, FS 2007-02, FS 2007-05, FS 2007-10, FS 2007-11, and FS 2007-12.

The Association did not provide written responses to the findings in our audit as described in the accompanying schedule of findings and questioned costs.

This report is intended solely for the information and use of management, others within the Association, the New Mexico Office of the State Auditor, the New Mexico Legislature, federal and state awarding agencies, and is not intended to be and should not be used by anyone other than these parties.

Accounting & Consulting Group, L.L.P.

Accounting & Consulting Group, LLP
Albuquerque, NM
January 15, 2010

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FEDERAL FINANCIAL ASSISTANCE

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Hector Balderas
New Mexico State Auditor
The Office of Management and Budget and
The Board of Directors
San Luis-Cabezon Mutual Domestic Water Association
Bernalillo, New Mexico

Compliance

We have audited the compliance of San Luis-Cabezon Mutual Domestic Water Association (Association), with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 2007. The Association's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Association's management. Our responsibility is to express an opinion on the Association's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Association's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Association's compliance with those requirements.

As described in item FA 2007-01 and FA 2007-03 in the accompanying schedule of findings and questioned costs, the Association did not comply with requirements regarding equipment and real property management and reporting that are applicable to its Water and Waste Disposal for Rural Communities Grant, Water and Waste Disposal for Rural Communities Planning Grant and the Water and Waste Disposal for Rural Communities Loan. Compliance with such requirements is necessary, in our opinion, for the Association to comply with the requirements applicable to that program.

In our opinion, except for the effects of such noncompliance described in the preceding paragraph, the Association complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2007.

Internal Control Over Compliance

The management of the Association is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Association's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over compliance.

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

A *control deficiency* in the Association's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Association's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the San Luis-Cabezon Mutual Domestic Water Association's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items FA 2007-02 and FA 2007-04 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Association's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we considered items FA 2007-02 and FA 2007-04 to be material weaknesses.

The Association did not provide written responses to the findings in our audit as described in the accompanying schedule of findings and questioned costs.

This report is intended solely for the information and use of management, others within the Association, the New Mexico Office of the State Auditor, the New Mexico Legislature, federal and state awarding agencies, and is not intended to be and should not be used by anyone other than these parties.

Accounting & Consulting Group, L.L.P.

Accounting & Consulting Group, LLP
Albuquerque, NM
January 15, 2010

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STATE OF NEW MEXICO
San Luis-Cabezon Mutual Domestic Water Association
Schedule of Expenditures of Federal Awards
For the Year Ended December 31, 2007

		Federal CFDA Number	Disbursements/ Expenditures
U. S. Department of Agriculture			
Direct programs, Rural Utiltiy Services			
Water and Waste Disposal for Rural Communities Grant	*	10.760	$ 1,219,650
Water and Waste Disposal for Rural Communities Planning Grant	*	10.760	15,000
Water and Waste Disposal for Rural Communities Loan	*	10.760	411,550
Total Direct Programs			1,646,200
Passed Through Natural Resources Conservation Service			
Environmental Quality Incentives Program		10.912	87,912
Passed Through Department of Interior Bureau of Land Management			
Environmental Quality Incentives Program		10.912	95,484
Total Pass Through Programs			183,396
Total U. S. Department of Agriculture			1,829,596
Total Federal Financial Assistance			$ 1,829,596

* Denotes major Federal financial assistance program

Notes to Schedule of Expenditures of Federal Awards

1) Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of San Luis-Cabezon Mutual Domestic Water Association and is presented on the accrual basis of accounting, which is the same basis as was used to prepare the fund financial statements.

2) Subrecipients

San Luis-Cabezon Mutual Domestic Water Association did not provide any federal awards to subrecipients.

3) Loan Amount

San Luis-Cabezon Mutual Domestic Water Association owed $411,214 to the U.S. Department of Agriculture, Rural Utilities Services at December 31, 2007.

Reconciliation of Schedule of Expenditures of Federal Awards to Financial Statements:

Total federal awards expended per Schedule of Expenditures of Federal Awards	$ 1,829,596
Total capital asset acquisitions funded by other sources:	
New Mexico Environment Department	775,000
Association Members	34,108
Total capital asset acquisitions (Exhibit A and Note 5)	$ 2,638,704

See accompanying independent auditors' report

STATE OF NEW MEXICO
San Luis-Cabezon Mutual Domestic Water Association
Schedule of Findings and Questioned Costs
December 31, 2007

A. SUMMARY OF AUDIT RESULTS

Financial Statements:

1. Type of auditors' report issued — Disclaimer
2. Internal control over financial reporting:
   a. Material weakness identified? — Yes
   b. Significant deficiencies identified not considered to be material weaknesses? — Yes
   c. Noncompliance material to the financial statements noted? — Yes

Federal Awards:

1. Internal control over major programs:
   a. Material weaknesses identified? — Yes
   b. Significant deficiencies identified not considered to be material weaknesses? — No
2. Type of auditors' report issued on compliance for major programs — Qualified
3. Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? — Yes
4. Identification of major programs:

CFDA Number	Federal Program
10.760	Water and Waste Disposal for Rural Communities Grant
10.760	Water and Waste Disposal for Rural Communities Planning Grant
10.760	Water and Waste Disposal for Rural Communities Loan

5. Dollar threshold used to distinguish between type A and type B programs: — $300,000
6. Auditee qualified as low-risk auditee? — No

B. FINDINGS — FINANCIAL STATEMENT AUDIT

<u>FS 2007-01 — Audit Report Submitted Late</u>

Condition:
The Association's audit report for the year ended December 31, 2007 was not submitted to the State Auditor by the required due date of May 31, 2008. The audit was submitted to the State Auditor on March 3, 2010.

Criteria:
Audit reports for agencies with a fiscal year-end other than June 30 must submit the audit report to the Office of the State Auditor no later than 5 months after the fiscal year-end, according to New Mexico State Auditor regulations, Section 2.2.2.9A(1)(d)NMAC.

Effect:
The Association is in noncompliance with financial reporting requirements established by state regulation. Timely financial statements were not available for the use of management or third party stakeholders.

Cause:
The Association did not procure audit services for the fiscal year ended June 30, 2007 in a timely manner. The external auditor was not engaged to perform the audit until January 30, 2009. In addition, the condition of Association's records was also a factor in the late filing of the audit report.

Auditor's Recommendation:
We recommend that the Association procure audit services in a more timely manner and that it maintain adequate accounting records.

Agency's Response:
The Association did not respond to the finding.

<u>FS 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight and Internal Control Deviations</u>

Condition:
It was found that the Association has not implemented an effective accounting system, budgetary process or record retention system. This was demonstrated by:

- Lack of a chart of accounts.
- Lack of a general ledger.
- Lack of a trial balance.
- Lack of an accounting information system.
- Lack of journal entry preparation.
- Lack of a year end closing out process.
- Lack of a budgetary process.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight and Internal Control Deviations (continued)</u>

- Lack of maintaining supporting documentation. Supporting documentation that could be obtained was largely provided by responsible third parties; the Association's project engineer firm and one of its significant grantors, the U.S. Department of Agriculture, Rural Utilities Service.

In addition, the Association does not have comprehensive policies and procedures to communicate to management and potential employees the importance of internal controls over financial transaction cycles and account balances. Specifically:

- Lack of consistent application of significant accounting policies

- Lack of a code of conduct for employees and management

- Lack of a whistleblower process that meets regulatory compliance requirements and promotes internal control and allows for anonymity

- Lack of an Organizational Chart

- Lack of procedures for segregation of duties, particularly with respect to financial reporting, transaction processing, and information technology. With no employees on board the Association is overly dependent on its board president, and he is capable of exerting substantial influence over the Association's affairs.

- Lack of formal monitoring activities by the governing board

Furthermore, during our process of understanding the entity and its environment, we noted elements of the framework of Committee of Sponsoring Organizations (COSO) were nonexistent. The control environment or "tone at the top" did not adequately display accountability. We noted that the control environment, risk assessment, control activities, information and communication and monitoring elements are not documented or sufficiently designed.

During our review of internal controls, the following deviations in internal control were identified:

- Disbursements:
  - Tests performed on thirty (30) disbursements, out of ten (10) randomly selected disbursements totaling approximately $883 and twenty (20) judgmentally selected disbursements relating to capital asset additions and totaling approximately $2,041,368, revealed the following:
    - For thirty (30) disbursements totaling approximately $2,042,251, there is no support that the Association ever recorded the disbursements.
    - For thirty (30) disbursements totaling approximately $2,042,251, there is no support that the Association utilized purchase orders as required by governmental agencies.
    - For ten (10) totaling approximately $883, no supporting documentation, other than bank statements, were provided to:
      - Determine the accuracy of the amounts, payees and purpose of the disbursement.
      - That a disbursement does not violate the anti-donation laws.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight and Internal Control Deviations (continued)

- Receipts:
  - Tests performed on fifteen (15) receipts, out of seven (7) randomly selected receipts totaling approximately $41,760 and eight (8) judgmentally selected receipts relating to U.S. Department of Agriculture, Rural Utilities Services funded capital asset additions and totaling approximately $1,459,183, revealed the following:
    - For fifteen (15) receipts totaling approximately $1,500,943, there is no support that the Association ever recorded the receipts.
    - For six (6) receipts totaling approximately $33,560, no supporting documentation, other than bank statements were provided to determine the accuracy of the amounts and payers of the receipt or the timing of the deposit of the receipt.
    - For seven (7) receipts totaling approximately $41,760, no supporting documentation, other than bank statements were provided to determine the purpose of the receipt.

Criteria:
According to New Mexico State Auditor regulations, Section 2.2.2.8J(2)NMAC, an Association shall maintain adequate accounting records to allow for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. Furthermore, the Codification of Statements on Auditing Standards (SAS AU) paragraph 110.03 states that the financial statements are management's responsibility. Management is responsible for adopting sound accounting policies, and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.

The Committee of Sponsoring Organizations (COSO) internal control integrated framework consists of five critical elements that must be present in carrying out the achievement objectives of an organization. These elements are known as the control environment, risk assessment, control activities, information and communication and monitoring. With these elements in place, the Association can maximize its potential for achieving its performance targets and reduce the risk of loss of resources.

- Disbursements:
  - Recording
    - The Codification of Statements on Auditing Standards (SAS AU) paragraph 110.03 states that the financial statements are management's responsibility. Management is responsible for adopting sound accounting policies, and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.
  - Purchase orders
    - Association procedures require purchase orders to be fully completed and approved prior to the purchase of goods and services. Pursuant to Section 13-1-158, NMSA 1978, no payment can be issued for any purchase of services, construction or items of tangible personal property unless the using agency certifies that the services, construction or item of tangible personal property have been received and meet specifications or unless prepayment is permitted under Section 13-1-98, NMSA 1978, by exclusion of the purchase from the procurement code.
  - Supporting documentation
    - According to New Mexico State Auditor regulations, Section 2.2.2.8J(2)NMAC, an Association shall maintain adequate accounting records to allow for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight and Internal Control Deviations (continued)</u>

- ➢ New Mexico Constitution Article IX, Section 14 states that governmental agencies shall not directly or indirectly lend or pledge its credit or make any donation to or in aid of any person.

- Receipts:
  - Recording
    - ➢ The Codification of Statements on Auditing Standards (SAS AU) paragraph 110.03 states that the financial statements are management's responsibility. Management is responsible for adopting sound accounting policies, and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.
  - Supporting documentation
    - ➢ According to New Mexico State Auditor regulations, Section 2.2.2.8J(2)NMAC, an Association shall maintain adequate accounting records to allow for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America.

Effect:
Based on that fact, the Association has not implemented an effective accounting system, budgetary process or record retention system, those charged with governance are not demonstrating a sufficient level of knowledge of accounting and regulatory requirements, industry experience, and entity operations. In addition, because the internal control structure is inadequate and not documented, the Association can not be certain about what procedures and processes to follow. Adequate controls are not in place to prevent or detect intentional or unintentional misstatements of accounting information.

In addition, without all of the five elements of the COSO framework present, the Association is exposing itself to the risk of misappropriation of assets and does not have set processes in place to maximize the resources of the Association to achieve the needs of its members.

- Disbursements:
  - Internal controls over disbursements are not sufficiently monitored and maintained to prevent or detect intentional misappropriation of the Association's assets. This may result in many issues, including but not limited to:
    - ➢ Disbursements not being properly recorded.
    - ➢ Purchase of unauthorized or unnecessary items.
    - ➢ The inability to:
      - Determine the accuracy of the amounts, payees and purpose of a disbursement.
      - Determine that a disbursement does not violate the anti-donation laws.

- Receipts:
  - Internal controls over receipts are not sufficiently monitored and maintained to prevent or detect intentional misappropriation of the Association's assets. Without adequate documentation over the receipt process, this may result in many issues, including but not limited to:
    - ➢ Receipts not being properly recorded.
    - ➢ The inability to determine the accuracy of the amounts, payers and purpose of a receipt as well as the timing of the deposit of the receipt.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight and Internal Control Deviations (continued)</u>

Cause:
For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not comprehensive.

In addition, the Association was not aware the COSO internal control framework plays a key role in providing reasonable assurance regarding the achievement of effective and efficient operations, reliable financial reporting and compliance with applicable laws and regulations.

The Association failed to exercise proper oversight over the disbursement and receipt process. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not effective.

Auditor's Recommendation:
We recommend that the Association establish an effective accounting system, budgetary process and record retention system through the following:

- Maintenance of a chart of accounts.
- Maintenance of a general ledger.
- Maintenance of a trial balance.
- Implementation of an accounting information system.
- Maintenance of journal entry preparation.
- Implementation of a year end closing out process.
- Implementation of a budgetary process.
- Maintenance of supporting documentation.

We also recommend that the Association establish and document internal control policies and procedures and that it address the following:

- Consistent application of significant accounting policies.
- Code of conduct for employees and management.
- Whistleblower process that meets regulatory compliance requirements and promotes internal control and allows for anonymity.
- Organizational Chart.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight and Internal Control Deviations (continued)

- Segregation of duties, particularly with respect to financial reporting, transaction processing, and information technology.

- Monitoring activities by the governing board.

We also recommend that the Association incorporate all five elements of the COSO internal control integrated framework in their organization. In particular, there must be a documented risk assessment process in place, there should be a mechanism in place to document the monitoring of the internal controls in place and the control environment must promote the highest ethical standards and efficient and effective path towards achieving the Association's goals. We recommend that internal controls be addressed at both the entity level and activity level. We also recommend that key management personnel attend a training class on internal control.

We also recommend that the Association establish a finance committee and devise and implement a *Finance Committee Checklist* to monitor compliance with internal control polices on a monthly basis.

We make the following recommendations for the Association's internal controls:

- Disbursements:
  - The Association should ensure that all disbursements are appropriately recorded to the general ledger.
  - The Association should always follow the policy as required to ensure that purchase orders are fully completed and approved prior to the purchase of goods and services.
  - The Association should ensure that adequate supporting documentation is maintained to support that disbursements, among other things, have been appropriately initiated, authorized, recorded, processed, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.
- Receipts:
  - The Association should ensure that all receipts are appropriately recorded to the general ledger.
  - The Association should ensure that adequate supporting documentation is maintained to support that receipts, among other things, have been appropriately initiated, authorized, recorded, processed, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.

Lastly, we recommend the Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-03 — Preparation of Financial Statements and Journal Entries

Condition:
The financial statements and related footnote disclosures were not prepared by San Luis-Cabezon Mutual Domestic Water Association. In addition, certain journal entries were prepared in order to present the financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). Material journal entries were prepared in the areas of accounts receivable, accounts payable, capital assets, long term debt, revenues and expenses.

Criteria:
According to the American Institute of Certified Public Accountants' Statement on Auditing Standards No. 112, a system of internal control over financial reporting does not stop at the general ledger. It includes controls over financial statement preparation, including footnote disclosures. The recording of appropriate journal entries is a significant part of the controls over financial statement preparation. The fact that the auditor prepares the financial statements and assisted in the preparation of the journal entries may mean the financial statements are correct, but it doesn't eliminate the control deficiency.

Effect:
The Association's ability to prevent or detect a misstatement in its financial statements is limited when sufficient controls over the recording of appropriate journal entries, the preparation of financial statements and related disclosures is not designed, implemented and operating effectively.

Cause:
Association personnel have not been adequately trained in understanding the elements of financial reporting including the preparation of financial statements and related footnote disclosures. As a result, the Association is not aware of all the necessary journal entries that are required to be prepared to present their financial statements in accordance with GAAP.

Auditor's Recommendation:
We recommend Association personnel receive training on understanding the requirements of financial reporting and the journal entries required. In addition, we recommend that the Association develop and implement policies and procedures designed to prevent or detect possible misstatements in its financial statements and related footnote disclosures. The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-04 — Bank Reconciliations

Condition:
During our evaluation of the Association's cash, we noted that the Association was unable to provide reconciliations of its bank accounts during the fiscal year end December 31, 2007 or provide subsequent to year end bank statements for our consideration.

Criteria:
Good internal controls and sound business practice over cash require that the bank statements be reconciled on a timely basis to the Association's general ledger, at least monthly. Any transfers between bank accounts, that are a reflection of transfers between cash accounts in the general ledger as well, should be recorded in the general ledger on a timely basis, and the balances reflected on the reconciliation should agree to the balances reflected in the general ledger.

Effect:
Due to the failure to prepare monthly bank reconciliations and the inability to provide subsequent to year end bank statements, it is not possible to determine whether differences should exist between the cash balance per the bank and a reconciled cash balance per the general ledger for the year ended December 31, 2007. Based on these factors the external auditor must disclaim its opinion on cash.

Cause:
The Association failed to prepare monthly bank reconciliations. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not effective.

Auditor's Recommendation:
We recommend that the Association initiate policies and procedures to ensure that bank reconciliations are performed timely and on a monthly basis, and the related required adjustments are made to the general ledger on a timely basis. The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-05 — Pledged Collateral

Condition:
During our evaluation of the Association's cash, we noted that the Association's bank account balances were under pledged in the amount of $1,667 as of December 31, 2007.

Criteria:
According to the NMSA 1978 Section 6-10-16 and 6-10-17 Public Money Act, bank accounts above $100,000 are subject to a 50% collateral requirement.

Effect:
This condition could result in the loss of Association funds in the event of a bank failure.

Cause:
The Association was not aware of the requirements to maintain pledged collateral.

Auditor's Recommendation:
The Association should secure pledged collateral for its bank account balances and should periodically compare the amount of pledged collateral to ensure amounts are adequate and all deposits are secured.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-06 — Accounts Payable and Accounts Receivable

Condition:
During our evaluation of the Association's accounts receivable and accounts payable balances as of December 31, 2007, for which there are material balances, we noted several deficiencies:

- The Association does not maintain an accounts payable or an accounts receivable aging report.
- The Association was unable to provide information regarding subsequent disbursements or receipts for our consideration.
- The Association was unable to provide information regarding whether or not an allowance for doubtful accounts should be considered.

Criteria:
The Codification of Statements on Auditing Standards (SAS AU) paragraph 110.03 states that the financial statements are management's responsibility. Management is responsible for adopting sound accounting policies, and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. With respect to accounts payable and accounts receivable, this requires that records be sufficient to ensure that all disbursements and revenues are recorded on a full accrual basis. With respect to accounts receivable, this requires that records be sufficient to ensure that the balance is shown net of any allowance for doubtful accounts.

Effect:
Based on that fact, the Association has not implemented an effective accounting system those charged with governance can not be certain about what procedures and processes to follow to properly record accounts payable and accounts receivable net of any allowance for doubtful accounts, if needed. Adequate controls are not in place to prevent or detect intentional or unintentional misstatements of accounts payable and accounts receivable balances. Based on these factors the external auditor must disclaim its opinion on accounts payable and accounts receivable.

Cause:
The Association personnel have not been adequately trained in understanding the elements of the accounts payable and accounts receivable process. As a result, the Association is not aware of all the necessary journal entries that are required to properly present these balances. In addition, the Association has failed to exercise proper oversight over the receipt process. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not effective.

Auditor's Recommendation:
We recommend Association personnel receive training on understanding the procedures involved in accounts payable and accounts receivable and the journal entries required. In addition, we recommend that the Association develop and implement policies and procedures designed to prevent or detect possible misstatements of these balances. The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-07 — Capital Assets</u>

Condition:
During our evaluation of the Association's capital assets balance as of December 31, 2007, for which there is a material balance, we noted several deficiencies:

- The Association does not know what its capital assets are or how much they cost. They are not being properly recorded in its general ledger.
- The Association did not have a capitalization policy in place.
- The Association could not provide the auditors with a list of their capital assets at historical cost showing when each item was purchased.
- The Association does not have a depreciation schedule for its capital assets.
- The Association does not have a system of internal controls in place to safeguard its assets or to ensure that capital assets are not misstated in the Association's financial statements.

Criteria:
Section 12-6-10, NMSA 1978, requires the Association to conduct an annual physical inventory of movable chattels and equipment, certify the correctness of that inventory, and provide a copy of it to the Association's auditors.

Proprietary fund presentation requires that capital assets be reported at historical cost including ancillary charges directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees. Donated capital assets should be reported at their estimated fair value at the time of acquisition. Capital assets includes land, improvements to land easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems.

Section 2.20.1.8, Capital Asset Accounting System, of New Mexico Administrative Code requires that:

- A. Agencies should implement systematic and well-documented methods for accounting for their capital assets. A computerized system is recommended, with appropriate controls on access and authorization of transactions.
- B. The information to be recorded and maintained on its capital assets, must include at a minimum the following:
  - (1) Agency name or commonly used initials used to identify the agency;
  - (2) Capital asset number or capital asset number plus component number;
  - (3) A description using words meaningful for identification;
  - (4) Location, specifically a building and room number. If the asset is movable, the name and location of the capital asset coordinator should be used;
  - (5) Manufacturer name (NOT the vendor's name, unless vendor is the manufacturer);
  - (6) Model number or model name;
  - (7) Serial number, or vehicle identification number (VIN) for vehicles in agency's use and possession. If the capital asset has no serial number, e.g., a custom-built asset, absence should be acknowledged by coding this as "none";
  - (8) Estimated useful life or units expected to be produced;
  - (9) Date acquired and placed in service (month and year);

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-07 — Capital Assets (continued)

Criteria (continued):

- (10) Cost (according to the valuation methods described in Section 10 [now 2.20.1.10 NMAC];
- (11) Fund and organization that purchased the asset, or to which it was transferred.

- C. The system must be capable of generating lists of capital assets in sequences useful for managing them. It must track all transactions including acquisitions, depreciation (if needed), betterments and dispositions. It must generate all necessary accounting entries to the agency's general ledger.

Effect:
The Association's financial statements may not accurately reflect the value of the Association's capital assets due to the Association's lack of understanding regarding its capital assets. The Association's capital assets are at risk for being misappropriated because they are not properly accounted for and inventoried each year, though it is acknowledged that the nature of the capital assets reduces this risk. Based on these factors the external auditor must disclaim its opinion on capital assets.

Cause:
The Association was unaware of how to properly account for its capital assets and has not utilized the appropriate software or implemented appropriate procedures to properly capitalize and depreciate its capital assets and maintain a detailed listing of its capital assets. Information regarding the Association's capital assets had to be provided by responsible third parties; the Association's project engineer firm and one of its significant grantors, the U.S. Department of Agriculture, Rural Utilities Service.

Auditor's Recommendation:
We make the following recommendations for the Association's capital assets:

- The Association should obtain appropriate capital asset and depreciation accounting software.
- The Association should create the required capital asset records as described in the criteria section.
- The Association should implement an appropriate capitalization policy and develop a current depreciation schedule for its capital assets.
- The capital asset software should be able to generate accurate reports that provide sufficient information to reconcile capital asset additions and deletions, current year depreciation expense and accumulated depreciation to facilitate roll forward schedules each fiscal year.

The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-08 — Long-Term Debt

Condition:
During our evaluation of the Association's recording of long-term debt, for which there is a material balance, we noted several deficiencies.

- An amortization schedule for the U.S. Department of Agriculture, Rural Utilities Service note payable was not available and had to be generated by the external auditor.
- The note payable was not properly reflected in the general ledger.
- A current and non-current portion of the note payable had to be generated by the external auditor.

Criteria:
Generally Accepted Accounting Principles (GAAP) require the proper recording and presentation of long-term debt, and that it reflects a current and non-current portion. In addition, sound accounting practices require the maintenance of an amortization schedule so that the presentation can be accurately presented.

Effect:
Failure to properly present the long-term debt would result in an incorrect presentation and could negatively impact decisions made by readers of the financial statements. Information regarding the Association's long-term debt had to be provided by responsible third parties; the Association's project engineer firm and its lender, the U.S. Department of Agriculture, Rural Utilities Service. Based on these factors the external auditor must disclaim its opinion on long-term debt.

Cause:
Poor record keeping and insufficient knowledge on the part of the Association regarding oversight of long-term debt are the reasons for these deficiencies.

Auditor's Recommendation:
We recommend that the Association ensure that long term debt is properly recorded in its accounting records and that it familiarizes itself with the amortization schedule and ensure that in future years the correct allocation of current and non current portions of long-term debt is accurately reflected. The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-09 — Net Assets</u>

Condition:
During our evaluation of the Association's net assets, we noted that the Association did not have any previously issued financial statements and that they did not maintain accounting records to present beginning net assets for the year ended December 31, 2007. Beginning net assets had to be determined through examination of bank statements for the entire 2007 fiscal year, and reflects only ending cash from the prior year.

Criteria:
Generally Accepted Accounting Principles (GAAP) require the proper presentation of net assets, and that the financial statements fairly present both beginning net assets and ending net assets.

Effect:
Failure to properly present the net assets may result in a materially incorrect presentation and could negatively impact decisions made by readers of the financial statements. Review of the bank statements would not have accounted for non-cash components of net assets. Based on these factors the external auditor must disclaim its opinion on net assets.

Cause:
Poor record keeping and insufficient knowledge on the part of the Association regarding oversight of net assets are the reasons for these deficiencies.

Auditor's Recommendation:
We recommend that the Association ensure that net assets properly reflect the various potential components. These potential components, as summarized in the notes to the financial statements, are:

- Invested in capital assets, net of related debt
  - Represent the Association's total investment in capital assets, net of outstanding debt related to those capital assets.

- Restricted net assets
  - Represent those operating funds on which external restrictions have been imposed that limit the purposes for which such funds can be used. Restricted expendable net assets are resources that the Association is legally or contractually obligated to spend in accordance with imposed restrictions by third parties. Restricted non-expendable net assets consist of endowment and similar funds in which third parties have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income.

- Unrestricted net assets
  - Consist of those operating funds over which the governing board retains full control to use in achieving any of its authorized purposes.

The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-10 — Open Meetings Act

Condition:
The Association was unable to provide board minutes for board meetings that took place during the fiscal year ended December 31, 2007 and the subsequent period between the fiscal year end and the date of the audit report, January 15, 2010.

Criteria:
According to Open Meetings Act, NMSA Section 10-15 1978, the Association is required to document and retain board minutes for all board meetings that are held.

Effect:
Due to the failure of the Association to provide board minutes, there is a great potential that not all events that could impact decisions made by readers of the financial statements are appropriately disclosed in the financial statements. Furthermore, without review of the board minutes, there is no evidence that:

- A process exists by which those charged with governance are made aware of key developments that may impact financial reporting.
- Management follows ethical guidelines in dealing with external audiences, including suppliers, citizens, creditors, insurers, etc.
- Relationships with professional third parties are periodically reviewed to ensure the entity maintains association with reputable parties.
- A process exists by which those charged with governance are implementing accounting policies.

Cause:
The Association was not aware of the requirements of the Open Meetings Act.

Auditor's Recommendation:
We recommend the Association document and retain all board minutes for every board meeting that takes place. Furthermore, we recommend that the Association ensure that the board minutes are accessible to the general public and interested third parties.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

FS 2007-11 — Mileage and Per Diem

Condition:
During our review of travel and per diem expenses, we examined all seven (7) disbursements identified as travel and per diem disbursements, totaling approximately $1,177, and the following deviations in internal control were identified:

- There is no support that the Association ever recorded the disbursements.

- Due to lack of support provided, it is not possible to ascertain:
  - how many miles were driven and at what rate the reimbursement was paid.
  - whether or not any meals were a portion of the reimbursement.

- Due to lack of support provided it is not possible to ascertain that adequate documentation exists or whether or not the disbursement is reasonable and without any apparent misuse.

Criteria:
The Mileage and Per Diem Act, NMSA 1978, Sections 10-8-1 through 10-8-8, and Section 2.42.2 NMAC requires that the Association be able to support the expenditure with supporting documentation and ensure that reimbursements are at the appropriate rate, are reasonable and with out apparent abuse and are properly recorded to accounting records.

Effect:
Internal controls over travel and per diem disbursements are not sufficiently monitored and maintained to prevent or detect intentional misappropriation of the Association's assets. This may result in many issues, including but not limited to:

- Disbursements not being properly recorded.
- Reimbursements at incorrect rates or unallowable amounts.
- The inability to:
  - Determine the accuracy of the amounts, payees and purpose of a disbursement.
  - That a disbursement is reasonable and without any apparent misuse
  - That a disbursement does not violate the anti-donation laws.

Cause:
The Association failed to exercise proper oversight over the travel and per diem disbursement process. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not effective.

Auditor's Recommendation:
We make the following recommendations for the Association's internal controls:

- The Association should ensure that all travel and per diem disbursements are appropriately recorded to the general ledger.
- The Association should ensure that adequate supporting documentation is maintained to support that disbursements, among other things, have been appropriately initiated, authorized, recorded, processed, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-11 — Mileage and Per Diem (continued)</u>

Auditor's Recommendation (continued):

- We recommend the Association follow the Mileage and Per Diem Act, when paying per diem and travel reimbursements. The Association should ensure that it has access to and has reviewed the Mileage and Per Diem Act as well as the New Mexico State Auditor Rule. Furthermore, the Association should be certain that it updates these on an annual basis.

Agency's Response:
The Association did not respond to the finding.

B. FINDINGS — FINANCIAL STATEMENT AUDIT (continued)

<u>FS 2007-12 — Procurement Code – Supporting Documentation</u>

Condition:
During our review of the Association's compliance with the procurement code, we performed tests on one (1) disbursement subject to the requirement for bids, in the amount of $1,564,601. It was found that, while the documentation was made available to us, it was provided to us from the Association's project engineer firm.

Criteria:
The Association must comply with Sections 13-1-1 to 13-1-199 NMSA 1978 and 2004 State Audit Rule 2.2.2.10 H regarding the procurement code. In particular, single purchase in excess of $20,000 for tangible property or in excess of $50,000 for services, must have sealed, written bids. Additionally, sufficient documentation should be maintained to demonstrate that bids were publicly solicited, properly reviewed and awarded to the lowest bidder. Maintenance of adequate bid documentation is the responsibility of the Association, and they should not depend on third parties to provide this information.

Effect:
The Association failed to exercise proper oversight over the bidding process. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association,* they do not adequately address internal controls and are not effective.

Cause:
The Association did not have policies and procedures requiring the proper maintenance of procurement documentation.

Auditor's Recommendation:
We recommend that the Association adopt procurement policies and procedures that are in compliance with the New Mexico Procurement Code and update them as the laws are amended. We recommend that the Association ensure that their policies and procedures include, but not be limited to, the maintenance of the following:

- A listing of all goods and services the Association has gone out to bid for during a fiscal year
- A folder should be maintained for each bid
- A cover sheet should accompany each bid folder and should include, but not be limited to, the following:
  - Name of the service or good for which bids are being requested
  - The Association's best estimate of the cost of the goods or services
  - The date(s) the bid was publicly solicited and through whom
  - The date(s) and time that proposals were received from vendors
  - The date and time that sealed bids were opened and reviewed
  - The names of the bidders and the amounts of their bid
  - If a bid is selected, an indication of which bid was selected, and a brief explanatory paragraph as to why that bid was selected
  - If all bids are rejected, an indication that none were selected, and a brief explanatory paragraph as to why the bids were rejected
- The newspaper clipping(s) or any other form(s) of public solicitation for the bid
- The bid tabulation or any other method used to determine the most qualified low bidder

B. **FINDINGS — FINANCIAL STATEMENT AUDIT (continued)**

FS 2007-12 — Procurement Code – Supporting Documentation (continued)

Auditor's Recommendation (continued):

- All proposals received should be maintained in the bid folder, in their original envelope so that it is apparent the proposal was once sealed. On the envelope the Association should indicate time and date received, and it should correspond to the coversheet. It should also indicate the time and date the bid was opened and reviewed and it should correspond to the coversheet. The proposals themselves should be available inside for inspection.

- The final contract and/or invoices for the goods or services, which should correspond to the coversheet for the bid

Agency's Response:
The Association did not respond to the finding.

C. FINDINGS — FEDERAL AWARDS

FA 2007-01 — Timeliness of Submission of Audit Report to the Federal Clearing House and Noncompliance With Other Reporting Requirements

Federal program information:

Funding agency:	U.S. Department of Agriculture
Title:	Water and Waste Disposal for Rural Communities Grant
	Water and Waste Disposal for Rural Communities Planning Grant
	Water and Waste Disposal for Rural Communities Loan
CFDA number:	10.760

Condition:
The Association did not timely submit the audit report and the reporting package including the data collection form.

Also, during our tests of compliance with the Reporting provision for Federal Programs, it was revealed that the Association did not comply with the following annual reporting requirements:

- Form RD 442-2, *Statement of Budget, Income and Equity (OMB No. 0575-0015)* - This report covers financial operations relating to the borrower's water or waste disposal project.

- Form RD 442-3, *Balance Sheet (OMB No. 0575-0015)* - This report presents the financial status of the borrower's water or waste disposal project.

Criteria:
The Association is required to submit the audit report for the year ended December 31, 2007 to the Federal Audit Clearing House no later than 9 months following the Association's fiscal year end, or September 30, 2008 in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 Section.320.

Sound management practices, as well as the OMB Circular A-133 Compliance Supplement, Reporting Requirements (4-10.760-4), require that the Association comply with its financial and special reporting requirements as a recipient of a Federal Award.

Questioned Costs:
None.

Effect:
The Association is not in compliance with U.S. Office of Management and Budget (OMB) Circular A-133 for entities receiving federal awards. Non-compliance with the reporting requirement of U.S. Office of Management and Budget (OMB) Circular A-133 may affect the Association's ability to obtain federal award funding in the future. In addition, the Association does not have timely financial information for consideration in managing the Association.

Cause:
The Association did not procure audit services for the fiscal year ended June 30, 2007 in a timely manner. The external auditor was not engaged to perform the audit until January 30, 2009. The Association was not aware of the reporting requirements. In addition, the condition of Association's records was also a factor in the late filing of the audit report.

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-01 — Timeliness of Submission of Audit Report to the Federal Clearing House and Noncompliance With Other Reporting Requirements (continured)

Auditor's Recommendation:
We recommend that the Association procure audit services in a more timely manner and that it maintain adequate accounting records. We recommend that the Association implement policies and procedures to ensure that all reporting compliance requirements are met. In doing so, the Association should be exercising its proper stewardship as a recipient of federal resources.

Agency's Response:
The Association did not respond to the finding.

FA 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight Over Federal Awards and Internal Control Deviations

Federal program information:

Funding agency:	U.S. Department of Agriculture
Title:	Water and Waste Disposal for Rural Communities Grant
	Water and Waste Disposal for Rural Communities Planning Grant
	Water and Waste Disposal for Rural Communities Loan
CFDA number:	10.760

Condition:
During our process of understanding the entity and its environment with respect to federal awards, we noted elements of the framework of COSO were nonexistent. The control environment or "tone at the top" did not adequately display accountability. We noted that the control environment, risk assessment, control activities, information and communication and monitoring elements are not documented or sufficiently designed to ensure compliance with the requirements of Federal laws, regulations, and program compliance requirements.

During our review of internal controls, the following deviations in internal control were identified:

- Disbursements:
  - Tests performed on fourteen (14) judgmentally selected disbursements relating to U.S. Department of Agriculture, Rural Utilities Services funded capital asset additions, totaling approximately $1,459,183, revealed the following:
    - There is no support that the Association ever recorded the disbursements.
    - There is no support that the Association utilized purchase orders as required by governmental agencies.
- Receipts:
  - Tests performed on eight (8) judgmentally selected receipts relating to U.S. Department of Agriculture, Rural Utilities Services funded capital asset additions, totaling approximately $1,459,183, revealed that there is no support that the Association ever recorded the receipts.

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight Over Federal Awards and Internal Control Deviations (continued)

Criteria:
OMB Circular A-133 (6-2) states that the Committee of Sponsoring Organizations (COSO) internal control integrated framework consists of five critical elements that must be present to assure compliance with the requirements of Federal laws, regulations, and program compliance requirements. These elements are known as the control environment, risk assessment, control activities, information and communication and monitoring. With these elements in place, the Association can maximize its potential for achieving its performance targets and reduce the risk of loss of resources.

Disbursements:

- Recording
  - The Codification of Statements on Auditing Standards (SAS AU) paragraph 110.03 states that the financial statements are management's responsibility. Management is responsible for adopting sound accounting policies, and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.
- Purchase orders
  - The OMB Circular A-133 Compliance Supplement, Procurement Requirements (3-I-1), requires governmental agencies adhere to State policies and procedures used for procurement from non-federal funds. As such, the Association procedures require purchase orders to be fully completed and approved prior to the purchase of goods and services. Pursuant to Section 13-1-158, NMSA 1978, no payment can be issued for any purchase of services, construction or items of tangible personal property unless the using agency certifies that the services, construction or item of tangible personal property have been received and meet specifications or unless prepayment is permitted under Section 13-1-98, NMSA 1978, by exclusion of the purchase from the procurement code.

Receipts:

- Recording
  - The Codification of Statements on Auditing Standards (SAS AU) paragraph 110.03 states that the financial statements are management's responsibility. Management is responsible for adopting sound accounting policies, and for establishing and maintaining internal control that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements.

Questioned Costs:
None.

Effect:
Without all of the five elements of the COSO framework present, the Association is exposing itself to the risk of misappropriation of assets and does not have set processes in place to maximize the resources of the Association to achieve the needs of its members.

Disbursements:

- Internal controls over disbursements are not sufficiently monitored and maintained to prevent or detect intentional misappropriation of the Association's federally funded assets. This may result in many issues, including but not limited to:
  - Disbursements not being properly recorded.
  - Purchase of unauthorized or unnecessary items.

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-02 — Deficiencies in Internal Control Structure Design, Operation, and Oversight Over Federal Awards and Internal Control Deviations (continued)

Receipts:

- Internal controls over receipts are not sufficiently monitored and maintained to prevent or detect intentional misappropriation of the Association's assets. Without adequate documentation over the receipt process, this may result in many issues, including but not limited to receipts not being properly recorded.

Cause:
For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not comprehensive.

In addition, the Association was not aware the COSO internal control framework plays a key role in providing reasonable assurance regarding the achievement of effective and efficient operations, reliable financial reporting and compliance with applicable laws and regulations.

The Association failed to exercise proper oversight over the disbursement and receipt process for federal awards. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not effective.

Auditor's Recommendation:
We recommend that the Association incorporate all five elements of the COSO internal control integrated framework in their organization, in particular its federal award programs. We recommend that internal controls be addressed at both the entity level and activity level. We also recommend that key management personnel attend a training class on internal control.

We make the following recommendations for the Association's internal controls:

Disbursements:

- The Association should ensure that all disbursements are appropriately recorded to the general ledger. The Association should always follow the policy as required to ensure that purchase orders are fully completed and approved prior to the purchase of goods and services.

Receipts:

- The Association should ensure that all receipts are appropriately recorded to the general ledger.

The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives. In doing so, the Association should be exercising its proper stewardship over federal awards.

Agency's Response:
The Association did not respond to the finding.

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-03 — Capital Assets – Federal Awards

Federal program information:

Funding agency:	U.S. Department of Agriculture
Title:	Water and Waste Disposal for Rural Communities Grant
	Water and Waste Disposal for Rural Communities Planning Grant
	Water and Waste Disposal for Rural Communities Loan
CFDA number:	10.760

Condition:
During our evaluation of the Association's capital assets balance as of December 31, 2007, for which there is a material balance and has been largely funded by the U.S. Department of Agriculture, Rural Utilities Services, we noted several deficiencies:

- The Association does not know what its capital assets are, including water rights or how much they cost. They are not being properly recorded in its general ledger.
- The Association did not have a capitalization policy in place.
- The Association could not provide the auditors with a list of their capital assets at historical cost showing when each item was purchased.
- The Association does not have a depreciation schedule for its capital assets.
- The Association does not have a system of internal controls in place to safeguard its assets or to ensure that capital assets are not misstated in the Association's financial statements.

Criteria:
The OMB Circular A-133 Compliance Supplement, Procurement Requirements (3-I-1), requires governmental agencies adhere to State policies and procedures used for procurement from non-federal funds. As such, Section 12-6-10, NMSA 1978, requires the Association to conduct an annual physical inventory of movable chattels and equipment, certify the correctness of that inventory, and provide a copy of it to the Association's auditors.

Proprietary fund presentation requires that capital assets be reported at historical cost including ancillary charges directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees. Donated capital assets should be reported at their estimated fair value at the time of acquisition. Capital assets includes land, improvements to land easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems.

Section 2.20.1.8, Capital Asset Accounting System, of New Mexico Administrative Code requires that:

- A. Agencies should implement systematic and well-documented methods for accounting for their capital assets. A computerized system is recommended, with appropriate controls on access and authorization of transactions.
- B. The information to be recorded and maintained on its capital assets, must include at a minimum the following:
    - (1) Agency name or commonly used initials used to identify the agency;
    - (2) Capital asset number or capital asset number plus component number;

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-03 — Capital Assets – Federal Awards (continued)

Criteria (continued):

- (3) A description using words meaningful for identification;
- (4) Location, specifically a building and room number. If the asset is movable, the name and location of the capital asset coordinator should be used;

- (5) Manufacturer name (NOT the vendor's name, unless vendor is the manufacturer);
- (6) Model number or model name;
- (7) Serial number, or vehicle identification number (VIN) for vehicles in agency's use and possession. If the capital asset has no serial number, e.g., a custom-built asset, absence should be acknowledged by coding this as "none";
- (8) Estimated useful life or units expected to be produced;
- (9) Date acquired and placed in service (month and year);
- (10) Cost (according to the valuation methods described in Section 10 [now 2.20.1.10 NMAC];
- (11) Fund and organization that purchased the asset, or to which it was transferred.

- C. The system must be capable of generating lists of capital assets in sequences useful for managing them. It must track all transactions including acquisitions, depreciation (if needed), betterments and dispositions. It must generate all necessary accounting entries to the agency's general ledger.

Questioned Costs:
None.

Effect:
The Association's financial statements may not accurately reflect the value of the Association's capital assets, particularly those funded by federal sources, due to the Association's lack of understanding regarding its capital assets. The Association's capital assets are at risk for being misappropriated because they are not properly accounted for and inventoried each year, though it is acknowledged that the nature of the capital assets reduces this risk. Based on these factors the external auditor must disclaim its opinion on capital assets, particularly as they relate to those funded by federal sources.

Cause:
The Association was unaware of how to properly account for its capital assets and has not utilized the appropriate software or implemented appropriate procedures to properly capitalize and depreciate its capital assets and maintain a detailed listing of its capital assets. Information regarding the Association's capital assets had to be provided by responsible third parties; the Association's project engineer firm and one of its significant grantors, the U.S. Department of Agriculture, Rural Utilities Service.

Auditor's Recommendation:
We make the following recommendations for the Association's capital assets:

- The Association should obtain appropriate capital asset and depreciation accounting software.

- The Association should create the required capital asset records as described in the criteria section.

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-03 — Capital Assets – Federal Awards (continued)

Auditor's Recommendation (continued):

- The Association should implement an appropriate capitalization policy and develop a current depreciation schedule for its capital assets.
- The capital asset software should be able to generate accurate reports that provide sufficient information to reconcile capital asset additions and deletions, current year depreciation expense and accumulated depreciation to facilitate roll forward schedules each fiscal year.

The Association should contract with a consultant to obtain assistance, if necessary, to accomplish these objectives. In doing so, the Association should be exercising its proper stewardship over assets funded by federal sources.

Agency's Response:
The Association did not respond to the finding.

FA 2007-04 — Procurement Code – Supporting Documentation – Federal Awards

Federal program information:

Funding agency:	U.S. Department of Agriculture
Title:	Water and Waste Disposal for Rural Communities Grant
	Water and Waste Disposal for Rural Communities Planning Grant
	Water and Waste Disposal for Rural Communities Loan
CFDA number:	10.760

Condition:
During our review of the Association's compliance with the procurement code, we performed tests on one (1) disbursement, funded by the U.S. Department of Agriculture, Rural Utilities Service, subject to the requirement for bids, in the amount of $1,564,601. It was found that, while the documentation was made available to us, it was provided to us from the Association's project engineer firm.

Criteria:
The OMB Circular A-133 Compliance Supplement, Procurement Requirements (3-I-1), requires governmental agencies adhere to State policies and procedures used for procurement from non-federal funds. As such, the Association must comply with Sections 13-1-1 to 13-1-199 NMSA 1978 and 2004 State Audit Rule 2.2.2.10 H regarding the procurement code. In particular, single purchase in excess of $20,000 for tangible property or in excess of $50,000 for services, must have sealed, written bids. Additionally, sufficient documentation should be maintained to demonstrate that bids were publicly solicited, properly reviewed and awarded to the lowest bidder. Maintenance of adequate bid documentation is the responsibility of the Association, and they should not depend on third parties to provide this information.

Questioned Costs:
None.

Effect:
The Association failed to exercise proper oversight over the bidding process. For the fiscal year 2007 the Association did not have a documented internal control system or policy in place to follow and for the Association to monitor compliance with. While the Association does have policies and procedures that are outlined in the *Association By-Laws* and its *Rules and Regulations of San Luis-Cabezon Mutual Domestic Water Association*, they do not adequately address internal controls and are not effective.

C. FINDINGS — FEDERAL AWARDS (continued)

FA 2007-04 — Procurement Code – Supporting Documentation – Federal Awards (continued)

Cause:
The Association did not have policies and procedures requiring the proper maintenance of procurement documentation.

Auditor's Recommendation:
We recommend that the Association adopt procurement policies and procedures that are in compliance with the New Mexico Procurement Code and update them as the laws are amended. We recommend that the Association ensure that their policies and procedures include, but not be limited to, the maintenance of the following:

- A listing of all goods and services the Association has gone out to bid for during a fiscal year
- A folder should be maintained for each bid
- A cover sheet should accompany each bid folder and should include, but not be limited to, the following:
  - Name of the service or good for which bids are being requested
  - The Association's best estimate of the cost of the goods or services
  - The date(s) the bid was publicly solicited and through whom
  - The date(s) and time that proposals were received from vendors
  - The date and time that sealed bids were opened and reviewed
  - The names of the bidders and the amounts of their bid
  - If a bid is selected, an indication of which bid was selected, and a brief explanatory paragraph as to why that bid was selected
  - If all bids are rejected, an indication that none were selected, and a brief explanatory paragraph as to why the bids were rejected
- The newspaper clipping(s) or any other form(s) of public solicitation for the bid
- The bid tabulation or any other method used to determine the most qualified low bidder
- All proposals received should be maintained in the bid folder, in their original envelope so that it is apparent the proposal was once sealed. On the envelope the Association should indicate time and date received, and it should correspond to the coversheet. It should also indicate the time and date the bid was opened and reviewed and it should correspond to the coversheet. The proposals themselves should be available inside for inspection.
- The final contract and/or invoices for the goods or services, which should correspond to the coversheet for the bid

In doing so, the Association should be exercising its proper stewardship over assets funded by federal sources.

Agency's Response:
The Association did not respond to the finding.

D. Status of Prior Year Audit Findings

No prior year audit findings.

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STATE OF NEW MEXICO
San Luis-Cabezon Mutual Domestic Water Association
Other Disclosures
December 31, 2007

A. AUDITOR PREPARED FINANCIAL STATEMENTS

The financial statements and notes to the financial statements were prepared by the independent certified public accountants performing the audit. Although it would be preferred and desirable for the Association to prepare its own GAAP-basis financial statements, it is felt that the Association's personnel do not have the time to prepare them. Therefore, the external auditor prepared the GAAP-basis financial statements and footnotes for inclusion in the annual audit report. San Luis-Cabezon Mutual Domestic Water Association is responsible for ensuring the books and records adequately support the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and the records are current and in balance. Management has reviewed and approved the financial statements and notes to financial statements.

B. EXIT CONFERENCE

The contents of the report for the San Luis-Cabezon Mutual Domestic Water Association were discussed on February 3, 2010. The following individuals were in attendance.

<u>San Luis-Cabezon Mutual Domestic Water Association</u>

Paul Madrid, President

<u>Auditors</u>

Jeff McWhorter, CPA
Jo Ann Chavez, CPA
Chris Parrino