



Pine-Strawberry Water Improvement District
Financial Statements and
Report on Internal Control and on Compliance
Year Ended June 30, 2016

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
JUNE 30, 2016**

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REPORT ON AUDIT OF FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Pine Strawberry Water Improvement District

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of Pine Strawberry Water Improvement District (District), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on conducting an audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Pine Strawberry Water Improvement District did not maintain sufficient internal controls and/or adequate records for cash, disbursements, and journal entries. Accordingly, we were unable to perform procedures sufficient to achieve the audit objectives for these account balances and transaction classes.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements referred to in the first paragraph.

Change in Accounting Principle

As described in Note 1, the District implemented the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 72, Fair Value Measurement and Application, for the year ended June 30, 2016, which represents a change in accounting principle.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis as listed in the table of contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because of the lack of sufficient internal controls and/or adequate records. We do not express an opinion or provide any assurance on the information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2017, on our consideration of Pine Strawberry Water Improvement District'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 engagement to perform an audit in accordance with *Government Auditing Standards* in considering Pine Strawberry Water Improvement District's internal control over financial reporting and compliance.

Heinfeld, Meech & Co., P.C.
Flagstaff, Arizona
March 28, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
(Required Supplementary Information)

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2016**

As management of the Pine-Strawberry Water Improvement District (District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2016.

FINANCIAL HIGHLIGHTS

- The District's total net position increased \$131,674, which represents a 14 percent increase from the prior fiscal year as a result of the District refinancing the note payable.
- Operating revenues accounted for \$2.5 million in revenue, an increase of two percent from the prior year.
- The District had approximately \$1.9 million in operating expenses, a decrease of two percent from the prior fiscal year.
- The District had approximately \$479,054 in non-operating expenses, an increase of \$146,970 due to increased interest payments on refinanced note payable.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise two components: 1) proprietary financial statements, and 2) notes to the financial statements.

The statement of net position presents information on all the District's assets, liabilities, and deferred inflows/outflows of resources with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The statement of revenues, expenses, and changes in net position presents information showing how the District's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The statement of cash flows outlines the cash inflows and outflows related to the operation of the District for the year ended June 30, 2016.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2016**

OVERVIEW OF FINANCIAL STATEMENTS

As discussed more thoroughly in Note 1 to the financial statements, the operations of the District are accounted for in a single proprietary fund. As a result, only the financial statements required for a proprietary fund are presented.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found immediately following the basic financial statements.

FINANCIAL ANALYSIS

Net position may serve over time as a useful indicator of a government's financial position. In the case of the District, liabilities exceeded assets and deferred outflows by \$800,871 at the current fiscal year end. At the fiscal year end the District reported negative total net position. In addition, portions of the District's net position are restricted for debt service repayment and capital projects.

The following table presents a summary of the District's net position for the fiscal years ended June 30, 2016 and June 30, 2015.

| | As of June 30, 2016 | As of June 30, 2015 |
|----------------------------------|------------------------|------------------------|
| Current and other assets | \$ 1,263,281 | \$ 1,535,502 |
| Capital assets, net | 3,414,791 | 4,167,727 |
| Total assets | <u>4,678,072</u> | <u>5,703,229</u> |
| Deferred outflows of resources | <u>1,037,479</u> | <u>1,068,918</u> |
| Current and other liabilities | 230,044 | 228,583 |
| Long-term liabilities | <u>6,286,378</u> | <u>6,762,000</u> |
| Total liabilities | <u>6,516,422</u> | <u>6,990,583</u> |
| Net position: | | |
| Net investment in capital assets | (2,871,587) | (2,594,273) |
| Restricted | 264,057 | 625,477 |
| Unrestricted | <u>1,806,659</u> | <u>1,750,360</u> |
| Total net position | <u>\$ (800,871)</u> | <u>\$ (218,436)</u> |

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2016**

FINANCIAL ANALYSIS

The District's financial position is the product of several financial transactions including the net result of activities, the acquisition of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets. The following is a significant current year transaction that had an impact on the Statement of Net Position.

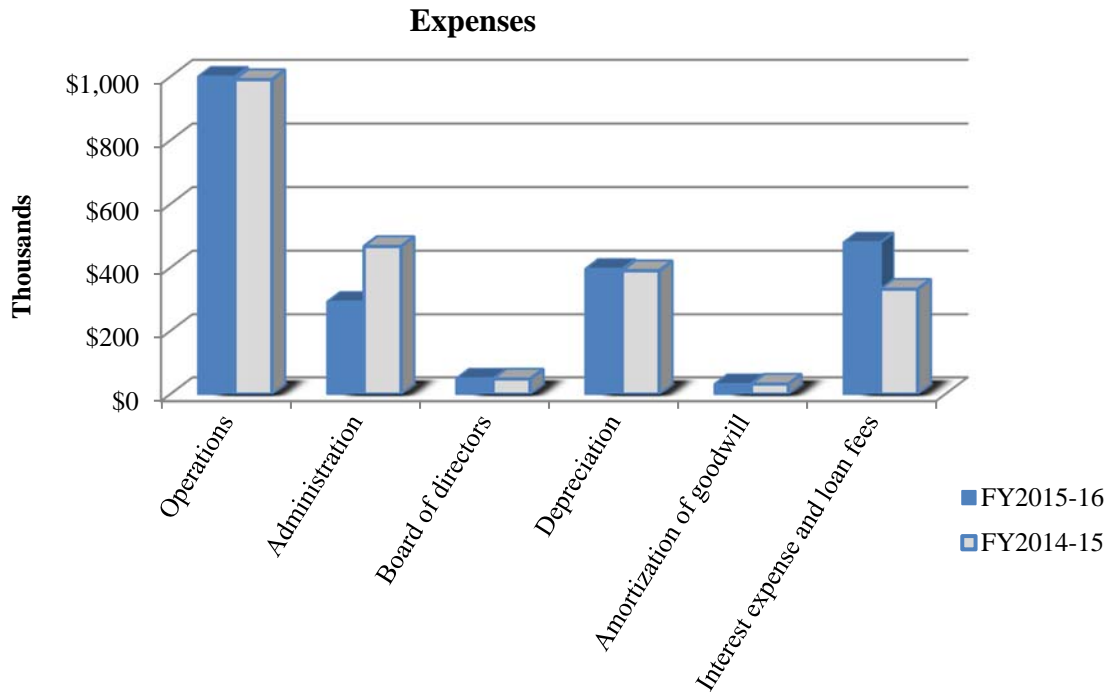
- The decrease of \$475,622 in long-term liabilities due to refinancing the note payable.

Changes in net position. The District's total revenues for the current fiscal year were \$2.5 million. The total expenses were \$2.4 million. The following table presents a summary of the changes in net position for the fiscal years ended June 30, 2016 and June 30, 2015.

| | <u>Fiscal Year Ended June 30, 2016</u> | <u>Fiscal Year Ended June 30, 2015</u> |
|-----------------------------------------------|--------------------------------------------|--------------------------------------------|
| Revenues: | | |
| Operating revenues: | | |
| Other local | \$ 29,187 | \$ 25,542 |
| Property taxes | 472,383 | 500,011 |
| Water fees | 1,998,485 | 1,928,517 |
| Nonoperating revenues: | | |
| Investment income | 7,422 | 1,976 |
| Total revenues | <u>2,507,477</u> | <u>2,456,046</u> |
| Expenses: | | |
| Operating expenses: | | |
| Operations | 1,127,814 | 990,425 |
| Administration | 292,246 | 466,195 |
| Board of directors | 49,242 | 47,634 |
| Depreciation | 396,008 | 389,977 |
| Amortization – goodwill | 31,439 | 31,439 |
| Nonoperating expenses: | | |
| Interest expense and loan fees | 479,054 | 332,084 |
| Total expenses | <u>2,375,803</u> | <u>2,257,754</u> |
| Change in net position | 131,674 | 198,292 |
| Net position, beginning | (218,436) | (416,728) |
| Net effect of prior period adjustments | (714,109) | |
| Net position, beginning restated | (932,545) | |
| Net position, ending | <u>\$ (800,871)</u> | <u>\$ (218,436)</u> |

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2016**

FINANCIAL ANALYSIS



The following are significant current year transactions that had an impact on the change in net position.

- The increase of \$137,389 in operations expense due to no allocation of service provider costs to administrative costs due to the District hiring the administrative employees as of June 1, 2015.
- The decrease of \$173,949 in administration expense due to no allocation of costs from operations contract and administrative employees now employed by the District.
- The increase of \$146,970 in interest expense and loan fees due to refinancing of note payable.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets. At year end, the District had invested \$5.4 million in capital assets, including wells, distribution piping, fire hydrants, vehicles, computers, and other equipment. This amount represents a net increase prior to depreciation of \$155,080 from the prior fiscal year, primarily due to completion of tank replacement projects. Total depreciation expense for the current fiscal year was \$396,008.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2016**

CAPITAL ASSETS AND DEBT ADMINISTRATION

The following schedule presents a summary of capital asset balances for the fiscal years ended June 30, 2016 and June 30, 2015.

| | As of June 30, 2016 | As of June 30, 2015 |
|-----------------------------------|------------------------|------------------------|
| Capital assets – non-depreciable | \$ 352,173 | \$ 237,166 |
| Capital assets – depreciable, net | 3,062,618 | 3,930,561 |
| Total | <u>\$ 3,414,791</u> | <u>\$ 4,167,727</u> |

The estimated cost to complete current construction projects is \$128,045.

Additional information on the District's capital assets can be found in Note 6.

Debt Administration. At year end, the District had \$6.3 million in long-term debt outstanding. This represents a net decrease of \$475,622 due primarily to refinancing the note payable.

Additional information on the District's long-term debt can be found in Notes 8 and 9.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

Many factors were considered by the District's administration during the process of developing the fiscal year 2016-15 budget. Among them:

- Fiscal year 2015-16 budget balance carry forward (estimated \$307,000).
- Capital projects (estimated \$405,000).

Also considered in the development of the budget is the local economy and inflation of the surrounding area.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the resources it receives. If you have questions about this report or need additional information, contact the Business and Finance Department, Pine-Strawberry Water Improvement District, P.O. Box 134, Pine, AZ 85544-0134.

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
STATEMENT OF NET POSITION
JUNE 30, 2016

ASSETS

Current assets:

| | |
|---------------------------------|------------|
| Cash and investments | \$ 388,811 |
| Restricted cash and investments | 264,057 |
| Property taxes receivable | 12,581 |
| Accounts receivable, net | 348,853 |
| Customer deposits | 166,662 |
| Prepaid items | 36,832 |
| Inventory, at cost | 45,485 |
| Total current assets | 1,263,281 |

Non-Current assets:

| | |
|-----------------------------------|------------------|
| Capital assets, non-depreciable | 352,173 |
| Capital assets, depreciable (net) | 3,062,618 |
| Total non-current assets | 3,414,791 |
| Total assets | 4,678,072 |

DEFERRED OUTFLOWS OF RESOURCES

| | |
|--------------------------------|-----------|
| Goodwill - net of amortization | 1,037,479 |
|--------------------------------|-----------|

LIABILITIES

Current liabilities:

| | |
|------------------------------------------|---------|
| Accounts payable | 19,835 |
| Payroll liabilities | 3,709 |
| Deposits held for others | 166,662 |
| Interest payable | 39,838 |
| Current portion of long-term obligations | 209,411 |
| Total current liabilities | 439,455 |

Non-current liabilities:

| | |
|----------------------------------------------|------------------|
| Non-current portion of long-term obligations | 6,076,967 |
| Total non-current liabilities | 6,076,967 |
| Total liabilities | 6,516,422 |

NET POSITION

| | |
|----------------------------------|---------------------|
| Net investment in capital assets | (2,871,587) |
| Restricted for: | |
| Debt service | 250,000 |
| Capital outlay | 14,057 |
| Unrestricted net position | 1,806,659 |
| Total net position | \$ (800,871) |

The notes to the financial statements are an integral part of this statement.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2016**

| | |
|-----------------------------------------------------------|---------------------|
| Operating revenues: | |
| Other local | \$ 29,187 |
| Property taxes | 472,383 |
| Water fees | <u>1,998,485</u> |
| Total operating revenues: | <u>2,500,055</u> |
| Operating expenses: | |
| Operations | 1,127,814 |
| Administration | 292,246 |
| Board of directors | 49,242 |
| Depreciation | 396,008 |
| Amortization - goodwill | <u>31,439</u> |
| Total operating expenses | <u>1,896,749</u> |
| Operating income | <u>603,306</u> |
| Nonoperating revenues (expenses) | |
| Investment income | 7,422 |
| Interest expense and loan fees | <u>(479,054)</u> |
| Total nonoperating revenues (expenses) | <u>(471,632)</u> |
| Changes in net position | <u>131,674</u> |
| Total net position, beginning of year, as restated | <u>(932,545)</u> |
| Total net position, end of year | <u>\$ (800,871)</u> |

The notes to the financial statements are an integral part of this statement.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2016**

Decrease in Cash and Cash Equivalents

| | |
|---------------------------------------------------------------------|------------------------|
| Cash flows from operating activities: | |
| Cash received from customers, service fees, capacity fees and other | \$ 1,907,629 |
| Cash received from property taxes | 494,017 |
| Cash paid to suppliers | (1,357,867) |
| Cash paid to employees | (127,712) |
| | <hr/> |
| Net cash provided by operating activities | 916,067 |
| Cash flows from capital and related financing activities: | |
| Interest paid | (490,495) |
| Purchase of capital assets | (376,247) |
| Disposal of capital assets | 19,066 |
| | <hr/> |
| Net cash used for capital and related financing activities | (847,676) |
| Cash flows from noncapital financing activities: | |
| Proceeds from notes payable | 6,444,398 |
| Payments on notes payable | (6,920,020) |
| | <hr/> |
| Net cash used for noncapital financing activities | (475,622) |
| Cash flows from investing activities: | |
| Interest on investments | 7,422 |
| | <hr/> |
| Net cash provided by investing activities | 7,422 |
| Net decrease in cash and cash equivalents | <hr/> (399,809) |
| Cash and cash equivalents, beginning of year | <hr/> 1,219,339 |
| Cash and cash equivalents, end of year | <hr/> <hr/> \$ 819,530 |

Reconciliation of Operating Income to Net Cash Provided by Operating Activities

| | |
|-----------------------------------------------------------------------------------------|------------------------|
| Operating income | \$ 603,306 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | |
| Depreciation | 396,008 |
| Amortization | 31,439 |
| Change in assets and liabilities: | |
| Decrease in property taxes receivable | 21,634 |
| Increase in accounts receivable | (138,132) |
| Increase in prepaid items | (8,764) |
| Increase in inventory | (2,326) |
| Decrease in accounts payable | (3,638) |
| Decrease in payroll liabilities | (1,549) |
| Increase in deposits held for others | 18,089 |
| | <hr/> |
| Total adjustments | 312,761 |
| Net cash provided by operating activities | <hr/> <hr/> \$ 916,067 |

The notes to the financial statements are an integral part of this statement.

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Pine-Strawberry Water District (District) have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to government units. The operations of the District are presented in the accompanying financial statements as a single proprietary fund. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

During the year ended June 30, 2016, the District implemented the provisions of GASB Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements and establishes a hierarchy of inputs to valuation techniques used to measure fair value. This Statement also enhances accountability and transparency through revised note disclosures.

The more significant of the District's accounting policies are described below.

A. Reporting Entity

Management of the District is independent of other state or local governments. The County Treasurer collects taxes for the District, but exercises no control over its expenditures/expenses.

The Board of Directors consists of seven members elected by the public. Under existing statutes, the Board of Directors' duties and powers include, but are not limited to, the acquisition, maintenance and disposition of District property, charges for water and related services.

The Board also has broad financial responsibilities, including the approval of the annual budget, and the establishment of a system of accounting and budgetary controls.

The financial reporting entity consists of a primary government. A component unit is a legally separate entity that must be included in the reporting entity in conformity with generally accepted accounting principles. The District is a primary government because it is a special-purpose government that has a separately elected governing body, is legally separate, and is fiscally independent of other state or local governments. Furthermore, there are no component units combined with the District for financial statement presentation purposes, and the District is not included in any other governmental reporting entity. Consequently, the District's financial statements include only the funds of those organizational entities for which its elected Board of Directors is financially accountable. The District's major operations include construction and maintenance of District facilities, and charges for water and related services.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The District's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied.

Operating revenues and expenses are distinguished from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District are water fees and property taxes. Operating expenses include the cost of goods and services and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

C. Cash and Investments

For purposes of the Statement of Cash Flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents at year end were cash in bank, and cash and investments held by the County Treasurer.

Arizona statute requires a pooled collateral program for public deposits and a Statewide Collateral Pool Administrator (Administrator) in the State Treasurer's Office. The purpose of the pooled collateral program is to ensure that governmental entities' public deposits placed in participating depositories are secured with collateral of 102 percent of the public deposits, less any applicable deposit insurance. An eligible depository may not retain or accept any public deposit unless it has deposited the required collateral with a qualified escrow agent or the Administrator. The Administrator manages the pooled collateral program, including reporting on each depository's compliance with the program.

D. Investment Income

Investment income is composed of interest, dividends, and net changes in the fair value of applicable investments. Investment income is included in nonoperating revenues in the proprietary financial statements.

E. Receivables and Payables

All receivables, including property taxes receivable, are shown net of an allowance for uncollectibles.

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

F. Property Tax Calendar

The County Treasurer is responsible for collecting property taxes for all governmental entities within the county. The county levies real and personal property taxes on or before the third Monday in August that become due and payable in two equal installments. The first installment is due on the first day of October and becomes delinquent after the first business day of November. The second installment is due on the first day of March of the next year and becomes delinquent after the first business day of May.

Pursuant to A.R.S., a lien against assessed real and personal property attaches on the first day of January preceding assessment and levy; however according to case law, an enforceable legal claim to the asset does not arise.

G. Inventory

All inventories are valued at cost using the first-in/first-out (FIFO) method. Inventories consist of expendable supplies held for consumption. Inventories are recorded as expenses when consumed.

H. Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in the proprietary financial statements.

I. Capital Assets

Capital assets, which include infrastructure; land and improvements; buildings and improvements; vehicles, furniture, and equipment; and construction in progress, are reported in the proprietary financial statements.

On September 30, 2009 the District acquired a water utility company. The District valued the assets using the Reconstructed Cost New Less Depreciation (RCNLD) method.

Capital assets are defined by the District as assets with an initial, individual cost in excess of \$5,000 and an estimated useful life of more than two years. Such assets are recorded at historical cost, or estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at the estimated fair market value at the date of donation.

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the life of the asset are not capitalized.

Capital assets are depreciated using the straight-line method over the following estimated useful lives:

| | |
|-----------------------------------|--------------|
| Infrastructure | 5 – 50 years |
| Leasehold improvements | 3 – 5 years |
| Buildings and improvements | 10 years |
| Vehicles, furniture and equipment | 5 – 10 years |

J. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position may report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then.

K. Long-term Obligations

Long-term debt and other long-term obligations are reported as liabilities on the statement of net position. Note premiums and discounts, are amortized over the life of the notes using the straight-line method. Deferred amounts on refunding result from the difference between the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

L. Net Position

Net position comprise the various net earnings from operating income, nonoperating revenues and expenses, and capital contributions. Net position are classified in the following three components.

Net investment in capital assets: This component of the net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested net position, net of related debt. Rather, that portion of the debt is included in the same net asset component of the unspent proceeds.

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Restricted: This component of net position consists of constraints imposed by creditors (such as through debt covenants), grantors, contributors, laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted net position: This component of net position consists of net position that does not meet the definition of “restricted” or “net investment in capital assets.”

M. Net Position Flow Assumption

The District applies restricted resources first when outlays are incurred for purposes for which either restricted or unrestricted amounts are available.

N. 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 amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

NOTE 2 – STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Net Position – At year end, the District reported a net position deficit of \$800,871. The deficit arose primarily due to unfunded depreciation expense and amortization expense. Continued attempts to reduce costs and increase revenues in future fiscal years are expected to eliminate the deficit.

NOTE 3 – CASH AND INVESTMENTS

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of bank failure the District’s deposits may not be returned to the District. The District does not have a deposit policy for custodial credit risk. At year end, the carrying amount of the District’s deposits was \$743,629 and the bank balance was \$771,937. At year end, \$271,937 of the District’s deposits were covered by collateral held by the pledging financial institution’s trust department or agent but not in the District’s name. Additionally, the District had \$600 cash on hand at year end.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 3 – CASH AND INVESTMENTS

Fair Value Measurements. The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset.

- Level 1 inputs are quoted prices in active markets for identical assets
- Level 2 inputs are significant other observable inputs
- Level 3 inputs are significant unobservable inputs

The County Treasurer’s pool is an external investment pool with no regulatory oversight. The pool is not required to register (and is not registered) with the Securities and Exchange Commission. The fair value of each participant’s position in the County Treasurer investment pool approximates the value of the participant’s shares in the pool and the participants’ shares are not identified with specific investments. Participants in the pool are not required to categorize the value of shares in accordance with the fair value hierarchy.

At year end, the District’s investments consisted of the following:

| | <u>Average Maturities</u> | <u>Fair Value</u> |
|------------------------------------|---------------------------|-------------------|
| County Treasurer’s investment pool | 0.71 years | \$ 75,301 |
| Total | | <u>\$ 75,301</u> |

Interest Rate Risk. The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk. The District has no investment policy that would further limit its investment choices. As of year end, the District’s investment in the County Treasurer’s investment pool did not receive a credit quality rating from a national rating agency.

Custodial Credit Risk - Investments. The District’s investment in the County Treasurer’s investment pool represents a proportionate interest in the pool’s portfolio; however, the District’s portion is not identified with specific investments and is not subject to custodial credit risk.

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

NOTE 4 – RECEIVABLES

Accounts receivables are net of an allowance for doubtful accounts of \$12,255 leaving a net accounts receivable balance of \$348,853 at June 30, 2016. The District’s receivables primarily consist of amounts due from individuals and businesses in the Town of Pine, Arizona and the Town of Strawberry, Arizona areas and are not subject to liens unless accounts are delinquent.

NOTE 5 – GOODWILL

Goodwill arose during the year as a result of the acquisition of a water utility company on September 30, 2009. The District has elected to amortize the goodwill over a 40 year period.

NOTE 6 – CAPITAL ASSETS

A summary of capital asset activity for the current fiscal year follows:

| | Beginning Balance (as restated) | Increase | Decrease | Ending Balance |
|----------------------------------------------|---------------------------------------|-------------------|-------------------|---------------------|
| Capital assets, not being depreciated: | | | | |
| Land | \$ 201,967 | \$ | \$ | \$ 201,967 |
| Construction in progress | 35,199 | 297,231 | 182,224 | 150,206 |
| Total capital assets, not being depreciated | <u>237,166</u> | <u>297,231</u> | <u>182,224</u> | <u>352,173</u> |
| Capital assets, being depreciated: | | | | |
| Infrastructure | 4,680,610 | 259,889 | 221,167 | 4,719,332 |
| Buildings and improvements | 66,686 | 1,351 | | 68,037 |
| Leasehold improvements | 19,310 | | | 19,310 |
| Vehicles, furniture and equipment | 217,266 | | | 217,266 |
| Total capital assets being depreciated | <u>4,983,872</u> | <u>261,240</u> | <u>221,167</u> | <u>5,023,945</u> |
| Less: Accumulated depreciation for: | | | | |
| Infrastructure | (1,549,089) | (358,369) | (202,101) | (1,705,357) |
| Buildings and improvements | (55,455) | (10,004) | | (65,459) |
| Leasehold improvements | (19,310) | | | (19,310) |
| Vehicles, furniture and equipment | (143,566) | (27,635) | | (171,201) |
| Total accumulated depreciation | <u>(1,767,420)</u> | <u>(396,008)</u> | <u>(202,101)</u> | <u>(1,961,327)</u> |
| Total capital assets, being depreciated, net | <u>3,216,452</u> | <u>(134,768)</u> | <u>19,066</u> | <u>3,062,618</u> |
| Capital assets, net | <u>\$ 3,453,618</u> | <u>\$ 162,463</u> | <u>\$ 201,290</u> | <u>\$ 3,414,791</u> |

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 6 – CAPITAL ASSETS

Depreciation expense was charged to expense functions as follows:

| | | | |
|----------------------------|--|----|------------|
| Administration | | \$ | 6,790 |
| Operations | | | 389,218 |
| Total depreciation expense | | | \$ 396,008 |

Construction Commitments – At year end, the District had contractual commitments related to various capital projects for the construction of upgrades to tanks, pumps, motors and other infrastructure. At year end, the District had spent \$150,206 on the projects and had estimated remaining contractual commitments of \$128,045. These projects are being funded with water fees.

NOTE 7 – OPERATING LEASES

The District has a noncancelable operating lease for the use of office facilities. The lease generally contains a renewal option and requires the District to pay certain executory costs such as taxes, maintenance, and insurance. Rental expense for the lease consisted of \$14,400 for the year ended June 30, 2016.

The District leases a copier under the provisions of long-term lease agreements classified as operating leases for accounting purposes. Rental expenses under the terms of the operating lease totaled \$1,279 for the year ended June 30, 2016.

| | | | |
|---------------------------------|------|----|----------|
| Year Ending June 30: | | | |
| | 2017 | \$ | 1,279 |
| Total minimum payments required | | | \$ 1,279 |

NOTE 8 – NOTES PAYABLE

The District entered into a secured loan agreement in the aggregate sum of \$6,444,398 to refinance the existing note payable. This is a 10-year refinance with an average interest rate of 3.85 percent due in quarterly amortized payments through June 30, 2026.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016**

NOTE 8 – NOTES PAYABLE

Annual debt service requirements to maturity on notes payable at year end are summarized as follows:

| Year Ending June 30: | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|----------------------|---------------------|---------------------|---------------------|
| 2017 | \$ 209,411 | \$ 239,026 | \$ 448,437 |
| 2018 | 217,590 | 230,847 | 448,437 |
| 2019 | 226,089 | 222,348 | 448,437 |
| 2020 | 234,921 | 213,517 | 448,438 |
| 2021 | 244,096 | 204,341 | 448,437 |
| 2022-2026 | 5,154,271 | 757,483 | 5,911,754 |
| Total | <u>\$ 6,286,378</u> | <u>\$ 1,867,562</u> | <u>\$ 8,153,940</u> |

NOTE 9 – CHANGES IN LONG-TERM LIABILITIES

Long-term liability activity for the current fiscal year was as follows:

| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending Balance</u> | <u>Due Within One Year</u> |
|---------------------------------------------|------------------------------|---------------------|---------------------|---------------------------|--------------------------------|
| Notes payable | \$ 6,762,000 | \$ 6,444,398 | \$ 6,920,020 | \$ 6,286,378 | \$ 209,411 |
| Governmental activity long-term liabilities | <u>\$ 6,762,000</u> | <u>\$ 6,444,398</u> | <u>\$ 6,920,020</u> | <u>\$ 6,286,378</u> | <u>\$ 209,411</u> |

NOTE 10 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance for all risks of loss, including property and liability, workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE 11 – PRIOR PERIOD ADJUSTMENT

The July 1, 2015, net position does not agree to the prior year financial statements due to a correction of an error. In prior years, the District had multiple items that did not meet the capitalization threshold or other requirements.

| | <u>Statement of Activities</u> |
|-----------------------------------------------------|------------------------------------|
| Net position, June 30, 2015, as previously reported | \$ (218,436) |
| Capital asset items included an error | (714,109) |
| Net position, July 1, 2015, as restated | <u>\$ (932,545)</u> |

**REPORT ON INTERNAL CONTROL
AND ON COMPLIANCE**

**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***

Independent Auditor's Report

Board of Directors
Pine-Strawberry Water Improvement District

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Pine-Strawberry Water Improvement District, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise Pine-Strawberry Water Improvement District's financial statements, and have issued our report thereon dated March 28, 2017, which included a disclaimer of opinion because of a lack of internal controls and/or adequate records. Our report included an emphasis of matter paragraph as to comparability because of the implementation of Governmental Accounting Standards Board Statement No. 72.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements of Pine-Strawberry Water Improvement District, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Pine-Strawberry Water Improvement District's internal control. Accordingly, we do not express an opinion on the effectiveness of Pine-Strawberry Water Improvement District's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as item FS-2016-001 that we consider to be a material weakness.

Compliance and Other Matters

In connection with our engagement to audit Pine-Strawberry Water Improvement District's financial statements, 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 engagement, 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 responses as item FS-2016-001. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Pine-Strawberry Water Improvement District's Response to Findings

Pine-Strawberry Water Improvement District's response to the finding identified in our engagement is described in the accompanying schedule of findings and responses. Pine-Strawberry Water Improvement District's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Heinfeld, Meech & Co., P.C.
Flagstaff, Arizona
March 28, 2017

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2016**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Finding Number: FS-2016-001

Repeat Finding: No

Type of Finding: Material Weakness

Description: Internal Controls Over Financial Reporting and Accounting Records, Cash, Capital Assets, and Disbursements

CRITERIA

The District is responsible for establishing and maintaining internal controls that include controls for the generally accepted accounting principles (GAAP) basis financial statements issued by the District. The District's system of internal controls must extend beyond the general ledger and the supporting schedules prepared by the District; rather, it must also include controls over the GAAP basis financial statements including:

- The District must reconcile all bank accounts to the District's financial records on a timely basis and resolve all reconciling differences to ensure the bank statements reflect the District's records. This should be done by an employee not directly involved in the check writing process.
- The District management is also responsible for establishing and maintaining internal controls that include the preparation of complete and accurate capital asset schedules for inclusion in the financial statements.
- The District must have internal controls over its disbursements to ensure that all disbursements were properly processed and controlled.
- The District should ensure that access to the accounting system is adequately safeguarded, and that access to individual modules is limited to authorized personnel.
- The District should ensure that journal entries are reviewed and approved by someone outside the process to ensure all items are properly processed and controlled.

CONDITION

The District lacked adequate internal controls over several processes of the District's cash, capital assets, disbursements, and accounting records.

CAUSE

The District did not adequately segregate duties over cash and reconciliations. Assets were not adequately safeguarded to prevent misappropriation. Additionally, the District's internal controls over accounting records and financial reporting at the financial statement and general ledger level were not adequate to ensure that a misstatement would be prevented and/or detected.

EFFECT

The District left itself susceptible to errors and fraudulent activity. In addition, the lack of controls over capital asset items resulted in a net position restatement.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2016**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Finding Number: FS-2016-001

CONTEXT

During review of various disbursements and other items the following were noted:

- It was noted during review of multiple bank statements, several unauthorized payments appear to have been made to a business owned and operated by a District consultant/employee, resulting in a total of at least \$89,601 in unauthorized disbursements. In addition, the employee created various unapproved journal entries to hide these disbursements. The Office of the Arizona Auditor General is investigating this matter.
- The District did not have appropriate internal controls in place to review cash receipts to a detail level, and as such, it appears that cash was allegedly stolen from multiple cash receipts throughout the fiscal year by a District employee.
- The District did not have adequate controls over capital assets. The listing initially included many items that did not meet the capitalization thresholds or requirements. In addition, the District did not provide a comprehensive additions listing and had multiple differences in the beginning balance, resulting in a restatement.
- The District lacked internal controls over the processing of disbursements, the cash reconciliation process, and the final recording of the general ledger. The District lacked adequate segregation of duties as well.
- The District did not pay credit cards timely, which resulted in \$39 in late fees and \$4 in finance charges.
- For one of five credit card transactions reviewed, no documentation to support the purchase was maintained by the District. Therefore, it could not be determined if the transaction was authorized. Additionally, for one of five credit card transactions reviewed, no receipt could be located. The District did provide other documentation to demonstrate that the item was approved and received.
- The District did not maintain a written formal credit card policy or require a signed credit card user agreement.
- The District paid the July 1, 2016 operating lease payment on June 16, 2016, but was not recorded as a prepaid item.
- For three of 25 disbursements reviewed, a purchase order was not prepared for the disbursement, as required by the District's policies.
- For three of 25 disbursements reviewed, the District did not retain the receipts or vendor invoices supporting the purchases; therefore, there was no documentation available to determine whether disbursements were for authorized purposes.
- For one of 25 disbursements reviewed, the purchase order was not signed and dated.
- For one of 25 disbursements reviewed, the purchase order was approved after the items were ordered and received.
- For one of 25 disbursements reviewed, the purchase was for gift certificates for employees and members of the outside service provider. In addition, these were coded as Supplies/Printing - Adm. Finally, there was no documentation of tracking to indicate gift certificates were given to the employees as indicated.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2016**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Finding Number: FS-2016-001

CONTEXT

- For one of 25 disbursements reviewed, the rent payment for the building was not supported by a monthly invoice or receipt of payment from the landlord.
- For the one procurement reviewed between \$10,001 and \$25,000, the District obtained only one quote. The District policy requires at least two quotes.
- For one of three procurements reviewed between \$1,000 and \$10,000, the District did not acquire two quotes as required by policy. In addition, for one of three disbursements reviewed between \$1,000 and \$10,000, the District maintained documentation for only one of the quotes obtained.
- For three of five journal entries reviewed, there was no evidence of approval. In addition, there was no review of journal entries performed from April through to the end of the fiscal year.
- Bank reconciliations were performed by the same employee who deposited funds and wrote checks and were not always fully reviewed in a timely manner.
- One employee of the District had access to multiple areas of the cash, revenue, expense, and other processes, including full access to all areas of the accounting software resulting in inappropriate and/or unauthorized disbursements and journal entries.

RECOMMENDATION

The District should institute segregation of duties regarding cash receipts, bank reconciliations and disbursements, including having bank reconciliations prepared and/or reviewed by persons not directly involved in the check writing or receipting process. Additionally, the District should implement stronger review controls over the capital asset process to ensure the listing contains only those items that meet the Board adopted policies. The District should also include stronger controls over journal entries including requiring a review by someone other than the person creating the journal entry. Finally, the District should ensure disbursements are supported by appropriate documentation, approved prior to purchase and all procurement policies are followed.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2016**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Finding Number: FS-2016-001

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS

In the month of April 2016, the District's employed accountant resigned without prior notice or the opportunity for a smooth transition. At that time, the District entered into a contract for accounting services with the firm of Accounting for You in Payson, Arizona. Under this contract, Accounting for You provides an on-site part-time accountant to the offices of the District for the purpose of the recording of all the required accounting processes for the District. This includes, but is not limited to, the recording of all revenue, expenses and journal entries for the District on the District's network through the QuickBooks accounting system.

1. The District does have segregation of duties regarding cash receipts and billings. Deposits are prepared by the customer service representatives and the office manager. A daily report is prepared and submitted to the District's on-site part-time accountant for recording in the accounting system. Billings are prepared weekly and reports are submitted to the accountant for posting to our system. Payroll is entered by the office manager and reviewed and entered into ADP by the part-time on-site accountant. Payroll is processed by ADP for the District.
2. The District has done a thorough review of the capital asset process and prior year adjustments have been made to the assets of the District to meet the Board adopted policies as noted on Page 10 total net position, beginning of year, as restated. Going forward, the District's Treasurer will periodically review all capital asset transactions for compliance with the Board approved capital asset policy.
3. Prior to any payment of invoices received, the invoices are approved by the person that ordered the materials, etc. If the invoice is for just a service provided to the District, that invoice will be approved for payment by the board Treasurer. If the invoice is for a capital project expenditure, the invoice will be approved by the District Manager and by the Treasurer for payment processing. When the checks for services and/or projects are written, they will be reviewed and signed by two of the three authorized signors on the bank account. At the time of processing, the accountant will prepare a check listing that will also be reviewed by the signors and initialed. In addition, this listing will contain any automatic withdrawals from the operations account for such items as utilities, payroll and payroll taxes. A supporting document for these withdrawals will be attached for review as well.

**PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2016**

**FINDINGS RELATED TO FINANCIAL STATEMENTS REPORTED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Finding Number: FS-2016-001

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS

4. When the bank statements arrive for the prior month, the accountant will prepare the bank reconciliations with all the supporting documentation for review by the Treasurer. A thorough review is done by the Treasurer and the Treasurer will sign off on the reconciliations. The only person having access to the QuickBooks accounting system is the onsite part-time accountant. Although there is no way for segregation of the bank reconciliation task with only one accountant, the District believes that the Board Treasurer's review provides adequate oversight.
5. There are many journal entries required to enter the billings, receipts, payroll and other items such as prepaid items and depreciation. The accountant will prepare the monthly journal entries and record them to the system. All of the journal entries with supporting documents are put in a folder for that month. The Treasurer will review all of the journal entries and sign indicating the review.
6. The District recently retained an audit firm to review its disbursement policies and practices. The audit firm provided a number of recommendations on how to strengthen the District's compliance including a sample check off list for solicitation and credit card policy. As a result of the auditor's recommendations, the District revised its Rules and Regulations to address any recommendations that needed to be addressed in that document. The District is currently incorporating the remainder of the recommendations through policy and procedure changes. The District does have a credit card policy in place. There is only one credit card issued in the name of District Manager and it is only used for online payments for very few items when a check is not possible for payment for that service. The credit card is maintained in the office by the accountant and can only be used with prior authorization by the District Manager or the board members authorized including Chairman, Treasurer and Secretary. All supporting documents are maintained in the file with the card and payments are made online to avoid any finance charges in the future.