

Pinetop-Lakeside Sanitary District

Lakeside, Arizona



FINANCIAL STATEMENTS

For the fiscal years ended June 30, 2017 and 2016

Pinetop-Lakeside Sanitary District
FINANCIAL STATEMENTS
Years Ended June 30, 2017 and 2016

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Independent Auditors' Report

To the Board of Directors of
Pinetop-Lakeside Sanitary District
Lakeside, Arizona

Report on the Financial Statements

We have audited the accompanying statements of net position of Pinetop-Lakeside Sanitary District (the District) as of June 30, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the District's basic 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District, as of June 30, 2017 and 2016, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3–6, Schedule of the District's Proportionate Share of the Net Pension Liability – Cost-Sharing Pension Plan on page 28, and Schedule of the District Pension Contributions on page 29 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 9, 2017, on our consideration of the 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Fester & Chapman, PLLC

October 9, 2017

Pinetop-Lakeside Sanitary District
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017 and 2016

This document is the District's Management Discussion and Analysis (MD&A) of financial activities and performance for the fiscal year ending June 30, 2017.

Information contained in this MD&A has been prepared by the District's management and should be considered in conjunction with the financial statements and the accompanying notes to the financial statements which follow this section.

Overview of the Financial Statements

The financial section of this annual report consists of three parts: MD&A, the basic financial statements, and the notes to the financial statements. The basic financial statements include: the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position, and the Statements of Cash Flows.

Analysis of the Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position illustrate whether the District's financial position has improved as a result of the year's activity. The Statements of Net Position presents information on all the District's assets and liabilities, with the difference being reported as net position. Over time the increases and decreases in net position may serve as an indicator of whether the financial position of the District is improving or deteriorating. The Statements of Revenues, Expenses and Changes in Net Position reflect how the operating and non-operating activities of the District affected changes in the net position of the District. These activities are recorded under the accrual basis of accounting reflecting the timing of the underlying event regardless of the timing of related cash flows.

Although the financial statements provide useful information in assessing the financial health of the District, consideration of other factors not shown on the financial reports should be evaluated to assess the District's true financial condition. Factors such as changes to the District operations and the local economy should also be considered when assessing the financial health of the District.

Governmental entities typically account for activities by utilizing "fund" accounting. A fund is a grouping of related accounts that is used to maintain control or restrict the use of resources that have been segregated for a specific activity or objective. The District uses only one fund, an enterprise fund, which reports all business type activities of the District.

Financial Highlights

Key financial highlights for fiscal year 2016 – 2017 are as follows:

- The assets of the Pinetop-Lakeside Sanitary District exceeded its liabilities at the close of the most recent fiscal year by \$30,769,528. Of this amount, \$5,086,441 (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.
- The District's net position *decreased by* \$197,016.
- Operating revenues for 2017 totaled \$2,362,308, an increase of \$20,036 over 2016.

Pinetop-Lakeside Sanitary District
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017 and 2016

- Operating expenses totaled \$1,885,062, a decrease of \$155,544 from 2016 due primarily to a continuing decrease in cost of chemical utilized for disinfection, and electrical usage. An additional reason for the decrease was a reduction in the number of staff.

Condensed Statements of Net Position

	2017	2016
Assets:		
Current and other assets:	\$ 7,099,506	\$ 6,583,457
Capital assets (net of depreciation)	25,663,087	26,667,704
Total assets	32,762,593	33,251,161
 Deferred Outflows of Resources	 314,680	 163,398
Liabilities:		
Current liabilities	286,631	486,322
Other non-current liabilities	1,754,527	1,755,192
Total liabilities	2,041,158	2,241,514
 Deferred Inflows of Resources	 286,586	 206,501
Net Position:		
Invested in capital assets	25,683,087	26,667,704
Unrestricted net position	5,085,441	4,298,840
Total net position	\$ 30,768,528	\$ 30,966,544

Operating Financial Activity

The Statement of Revenues, Expenses, and Changes in Net Position show how the District's net assets changed during the fiscal year as result of operations. These changes are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, some revenues and expenses reported in this statement will only affect future fiscal period cash flows.

The following summary represents the 2017 operating results compared to budget.

Revenues: Total operating revenues exceeded budget by \$60,707 with the largest variances in inspection fees \$7,000, septic receiving \$13,000, collection fees \$9,000, and salvage sales \$13,000.

Expenses: Operating expenses, before depreciation, were \$296,385 below budget, attributed to a decrease in payroll costs, chemicals, and electricity.

Pinetop-Lakeside Sanitary District
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017 and 2016

Non-Operating revenue – expenses: Interest income received exceed budget by \$244,424 with the annexation and connection of homes adjacent to the Crimson Oak SLE completed in October 2016.

Condensed
Statements of Revenues, Expenses and Change in Net Position

		2017		2016
Operating revenues	\$	2,362,308	\$	2,342,272
Operating expenses		(1,885,062)		(2,040,606)
Operating income before depreciation		477,246		301,666
Depreciation		(1,463,329)		(1,428,048)
Loss from operations		(986,083)		(1,126,382)
Total other income		812,933		644,653
Total other expense		23,866		22,994
		789,067		621,659
Change in net position		(197,016)		(504,723)
Net position at beginning of year		30,966,544		31,471,267
Net position at year end	\$	30,769,528	\$	30,966,544

Capital Assets and Debt Administration:

Capital Assets:

Capital assets are reported at actual cost. These amounts do not represent the replacement cost, which could be significantly higher.

Changes to the capital assets during fiscal year ending June 30, 2017:

- General Equipment – The District purchased a maintenance truck with a crane for in field service of the lift stations and ordered a replacement vacuum truck.
- Line Extension Sewers – The District completed and accepted the Crimson Oak SLE into the wastewater collection system.
- Treatment Plant – The first major upgrade of the treatment plant since it was first constructed was completed. The upgrade has improved the effectiveness of the treatment process and noticeably decreased electrical and chemical costs.

Pinetop-Lakeside Sanitary District
MANAGEMENT'S DISCUSSION AND ANALYSIS
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Debt Administration:

The District's net pension liabilities for the unfunded portion of the retirement plan were \$1,754,527 and \$1,755,192 for the years ending June 30, 2017 and 2016, respectively.

Economic and Other Factors

The rate at which new connections were added to the systems remained relatively the same for the fiscal year, with less than 1.0% increase in connections to the systems. This trend is forecasted to continue at least through fiscal year 2017 – 2018, perhaps longer.

The goal of the District is to be proactive in meeting both the immediate and future needs of the connected users. The District will continue to introduce sewer infrastructure in areas currently not served; as long as capital funds are available. Additionally, repairs, replacement, or upgrades to existing infrastructure are being planned and completed as needs warrant.

The Board of Directors has reviewed all connection fees and procedures and approved a modification to the flat rate for all new connections established last fiscal year. The flat fee is based on the total number of potential customers (as the systems are currently designed) and the total cost of the systems to date. This program goes a long way to insuring that each connection is responsible for not only service to their property, but also their portion of the infrastructure's cost. This also is in line with the Board's policy that new growth should not be financed by existing customers, or become a financial burden.

Financial Contact

The District's financial statements are designed to present users with a general overview of financial information and to demonstrate accountability. If you have any questions about the report, or need additional financial information, please contact Mark Heberer, Finance Manager.



Pinetop-Lakeside Sanitary District
 STATEMENTS OF NET POSITION
 June 30, 2017 and 2016

	2017	2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,797,155	\$ 3,581,728
Accounts receivable	141,697	141,400
Assessments receivable	4,120	12,645
Covenants receivable	21,180	9,573
Levied taxes receivable	12,452	15,746
Interest receivable	193	222
Prepaid expenses	32,136	30,213
Total current assets	4,008,933	3,791,527
Non-current assets:		
Restricted cash	2,841,548	2,706,622
Accounts receivable, net of current	17,647	17,646
Assessments receivable, net of current		2,704
Covenants receivable, net of current	209,445	43,025
Other receivables	21,933	21,933
Capital assets, not being depreciated	309,349	1,714,356
Capital assets, net of accumulated depreciation	25,373,738	24,953,348
Total non-current assets	28,773,660	29,459,634
Total assets	32,782,593	33,251,161
DEFERRED OUTFLOWS OF RESOURCES		
Deferred outflows related to pensions	\$ 314,680	\$ 163,398

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

Pinetop-Lakeside Sanitary District
 STATEMENTS OF NET POSITION
 June 30, 2017 and 2016
 (Continued)

	2017	2016
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 28,172	\$ 217,817
Accrued wages	33,403	34,256
Accrued payroll taxes	21,445	28,223
Unearned revenue - prepaid accounts	43,584	39,720
Other accrued liabilities	1,178	1,178
Accrued compensated absences	158,850	165,128
Total current liabilities	286,632	486,322
Other non-current liabilities:		
Net pension liability	1,754,527	1,755,192
Total liabilities	2,041,159	2,241,514
DEFERRED INFLOWS OF RESOURCES		
Deferred inflows related to pensions	\$ 286,586	\$ 206,501
NET POSITION		
Net investment in capital assets	25,683,087	26,667,704
Unrestricted	5,086,441	4,298,840
Total net position	\$ 30,769,528	\$ 30,966,544

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

Pinetop-Lakeside Sanitary District
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
 Years ended June 30, 2017 and 2016

	2017	2016
OPERATING REVENUES:		
User and inspection fees	\$ 2,267,103	\$ 2,257,699
Lateral fees	7,775	4,725
Miscellaneous	87,430	79,848
Total operating revenue	2,362,308	2,342,272
OPERATING EXPENSES:		
Salaries and wages		
General and administrative	354,914	387,767
Line construction/maintenance	268,232	258,680
Inspections	54,888	52,402
Treatment	105,042	101,751
Lab	7,339	2,370
Digester operations	63,809	70,249
Engineering and survey	63,086	59,129
Repairs and maintenance	23,809	18,208
Small jobs and miscellaneous	100,771	100,544
Total salaries and wages	1,041,890	1,051,100
Materials and supplies		
Line construction/maintenance	5,795	
Treatment	5,364	3,668
Lab	14,606	15,191
Digester operation	12,769	7,942
Chemicals	27,441	59,081
Engineering and survey	1,381	7,451
Small jobs and miscellaneous	9,104	8,204
Total material and supplies	76,460	101,537

(continuing)

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

Pinetop-Lakeside Sanitary District
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
Years ended June 30, 2017 and 2016
(Continued)

	2017	2016
Other operating expenses		
Auto - gas	14,210	14,170
Directors' fees	9,000	9,000
Dues and subscriptions	1,979	1,979
Education and training	1,872	5,078
Employee benefits	300,740	321,535
Insurance - auto, liability, casualty	30,263	28,501
Legal and professional	41,186	33,046
Licenses and permits	9,953	9,239
Office supplies	23,371	22,970
Outside services	1,846	9,618
Postage	11,155	16,192
Publishing and printing	1,599	612
R & M - grounds and building	8,697	4,364
R & M - equipment	21,086	30,071
R & M - digester	9,626	4,228
R & M - office	12,542	15,481
R & M - plant	18,476	20,682
Pension expense	42,024	70,329
Telephone	17,321	16,820
Utilities	166,124	231,660
Miscellaneous	23,642	22,394
Total other operating expenses	<u>766,712</u>	<u>887,969</u>
Total operating expenses	<u>1,885,062</u>	<u>2,040,606</u>
Net operating income before depreciation	477,246	301,666
Depreciation expense	1,463,329	1,428,048
Net operating loss	<u>(986,083)</u>	<u>(1,126,382)</u>
NON-OPERATING REVENUES (EXPENSES)		
Ad valorem tax	397,587	401,401
Connection fees	242,604	62,100
Capacity charge fees	97,673	104,091
Interest earnings	39,942	41,531
Tax collection expense	(23,866)	(22,994)
Developer contributions		35,530
Annexation	35,127	
Total non-operating revenue	<u>789,067</u>	<u>621,659</u>
Change in net position	(197,016)	(504,723)
Total net position - beginning	<u>30,966,544</u>	<u>31,471,267</u>
Total net position - ending	<u>\$ 30,769,528</u>	<u>\$ 30,966,544</u>

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

Pinetop-Lakeside Sanitary District
 STATEMENTS OF CASH FLOWS
 Years ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Cash received from customers and users	\$ 2,187,848	\$ 2,338,533
Cash paid for operating expenses	(734,001)	(525,790)
Cash paid for salaries and wages	(1,428,401)	(1,411,509)
Net cash flows from operating activities	25,446	401,234
Cash flows from noncapital financing activities		
Cash received from ad valorem tax	400,881	399,204
Cash received from connection fees	242,604	62,100
Cash received from annexation	35,127	
Net cash flow from noncapital financing activities	678,612	461,304
Cash flows from capital and related financing activities		
Assessments received	11,229	11,556
Capacity charges received	97,673	104,091
Acquisition of capital assets	(478,712)	(1,745,033)
Tax collection expense	(23,866)	(22,817)
Interest received	39,971	41,618
Net cash flows from capital and related financing activities	(353,705)	(1,610,585)
 Net change in cash and cash equivalents	350,353	(748,047)
Cash and equivalents, beginning of year	6,288,350	7,036,397
Cash and equivalents, end of year	\$ 6,638,703	\$ 6,288,350

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

Pinetop-Lakeside Sanitary District
 STATEMENTS OF CASH FLOWS
 Years ended June 30, 2017 and 2016
 (Continued)

Reconciliation of operating loss to net cash flows from operating activities	2017	2016
Net operating loss	\$ (986,083)	\$ (1,126,382)
Depreciation	1,463,329	1,428,048
Changes in assets, deferred outflows of resources, liabilities, and deferred inflows of resources:		
Increase/(decrease) in net pension liability	(665)	28,374
(Increase)/decrease in deferred outflows of resources related to pensions	(151,282)	43,438
Increase/(decrease) in deferred inflows of resources related to pensions	80,085	(116,986)
(Increase)/decrease in accounts receivable	(297)	(13,163)
(Increase)/decrease in covenants receivable	(178,028)	6,587
(Increase)/decrease in prepaid expense	(1,923)	(1,712)
Increase/(decrease) in accounts payable	(189,646)	143,893
Increase/(decrease) in accrued wages	(853)	5,928
Increase/(decrease) in accrued payroll taxes	(6,778)	(86)
Increase/(decrease) in unearned revenue-prepaid accounts	3,865	2,837
Increase/(decrease) in accrued compensated absences	(6,278)	458
	<u>\$ 25,446</u>	<u>\$ 401,234</u>
Net cash flows from operating activities	\$ 25,446	\$ 401,234
 Summary of cash and cash equivalents		
Unrestricted cash and cash equivalents	\$ 3,797,155	\$ 3,581,728
Restricted cash and cash equivalents	<u>2,841,548</u>	<u>2,706,622</u>
	<u>\$ 6,638,703</u>	<u>\$ 6,288,350</u>
Total	\$ 6,638,703	\$ 6,288,350
 Supplementary schedule of non-cash investing and financing activities		
Non-cash contributions of line extensions	\$	\$ 35,530

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

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Pinetop-Lakeside Sanitary District, (the District) conform with accounting principles generally accepted in the United States (GAAP) as applicable to government units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The District's significant accounting policies are described below.

Reporting Entity

Pinetop-Lakeside Sanitary District was formed April 1, 1963 as a municipal corporation, and as such, is a political subdivision of the State of Arizona. All income earned by the District in its normal course of operations is exempt from federal income taxation under Section 115 of the Internal Revenue Code of 1986. The District provides a wastewater collection, treatment and disposal system on a fee basis to the citizens within the geographical boundaries of the District in the Pinetop-Lakeside area. The District is governed by an elected five member board.

As required by GAAP, management has considered all potential component units in defining the reporting entity. Various special assessment districts (SIDs) have been formed within the boundaries of the District and are considered blended component units. These SIDs were formed to finance the construction of infrastructure within the SID's boundaries. The District administers the construction and financing activities. When construction and payment of the debt is complete, the individual SID is closed, and all assets and responsibility for the maintenance and operation of these assets is transferred to the District. These SIDs, although separate legal entities, are in substance, part of the District's operations.

The following is the one special assessment district still open as of June 30, 2017 that has been blended into the District's financial statements:

- Forest View – Piney Slope Sewer Improvement District

The activities of the blended component unit are combined with the District's activities in these financial statements. Condensed financial information of the component unit has not been included as part of the notes to the financial statements as its financial activities are immaterial.

Basis of Presentation and Reporting

The activities of the District are accounted for in a single enterprise fund. Enterprise funds are for operations that are financed and operated in a manner similar to private business enterprises where the costs (expenses, including depreciation) of providing service are financed through user charges.

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Measurement Focus and Basis of Accounting

Enterprise funds are accounted for on a cost of service or economic resources measurement focus utilizing full accrual accounting. Under this method, assets and revenues are recorded when earned, liabilities and expenses when incurred. Property taxes are recognized as revenues in the year for which they are levied.

The District distinguishes operating revenues and expenses from non-operating revenues and expenses. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues are generated from sewer services provided to residents and businesses within the boundaries of the District and are billed quarterly. Operating expenses include the cost of providing services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Cash and Cash Equivalents

Cash equivalents include amounts in demand deposit accounts as well as short term investments that are readily convertible to known amounts of cash with insignificant risks of changes in value because of changes in interest rates. The District considers all cash and monies deposited with the Navajo County Treasurer, including amounts reported as restricted assets, to be cash and cash equivalents. Certain resources set aside for the capital improvements are classified as restricted cash.

Accounts Receivable

Due to the nature of the accounts receivable for this type of entity, management does not consider an allowance for uncollectible accounts receivable necessary or material. Therefore, no allowance for uncollectible accounts receivable is presented.

Inventory

Supplies inventory is deemed immaterial and not recorded.

Prepaid Expenses

Certain payments to vendors which reflect costs applicable to future accounting periods are recorded as prepaid items.

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Compensated Absences

Vested or accumulated vacation leave is reported as an expense and a fund liability as the benefits accrue to the employees. In addition, 50% of the vested or accumulated sick leave is recorded as an expense and a liability as the benefits accrue to employees with five or more years of service with the District.

Capital Assets

Capital assets are recorded at cost. Depreciation is computed using the straight-line method over the following estimated useful lives:

Sewer system and improvements	40-50 years
Building and improvements	15-30 years
Plant equipment	5-15 years
Vehicles and equipment	3-10 years
Office furniture and equipment	2- 3 years

When assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts. Any resulting gain or loss is reflected in the change in net position for the period. The cost of maintenance and repairs is charged to expense as incurred; significant renewals and betterments are capitalized. Material construction period interest expense is capitalized net of interest earnings on the temporary investment of tax-exempt funds in accordance with GAAP.

Net Position Classifications

Net position is reported as restricted when constraints placed on the use of resources are either: a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or b) imposed by law through constitutional provisions or enabling legislation. A portion of the District's unrestricted net position, \$2,841,580 and \$2,706,662, as of June 30, 2017 and 2016, respectively, is reserved to provide funding to pay for expansion and improvements of the wastewater collection, treatment and disposal systems by the District's board resolutions.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred Outflows and Inflows of Resources

The statement of net position includes separate sections for deferred outflows of resources and deferred inflows of resources. Deferred outflows of resources represent a consumption of net position that applies to future periods that will be recognized as an expense or expenditure in future periods. Deferred inflows of resources represent an acquisition of net position that applies to future periods and will be recognized as revenue in future periods.

Pensions

For purposes of measuring the net position (asset and) liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the pension plan's fiduciary net position and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by the plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Subsequent Events

Subsequent events have been evaluated through October 9, 2017, which was the date the District's financial statements were issued.

NOTE 2 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Encumbrances

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriations, is not employed by the District.

Budget Policy and Procedures

The District adopts an annual budget. The budget is prepared on the cash basis. The District is not legally required to adopt or submit the budget to any state or other oversight agency before it has been adopted by the Board. Budgetary information has not been amended during the year. Budget appropriations lapse at year-end.

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 2 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY (continued)

Taxes

Arizona Revised Statutes require that property taxes be levied on or before the third Monday of August. Taxes are levied and collected by the Navajo County Treasurer. Real property taxes become a lien 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 in October and becomes delinquent after the first business day in November. The second installment is due on the first day in March of the next year and becomes delinquent after the first business day in May. Interest and penalties are assessed if a tax payer fails to pay the tax within a period specified by state law.

NOTE 3 – CASH AND INVESTMENTS

Arizona Revised Statutes authorize the District to invest monies in the State or County Treasurer's investment pools; interest bearing savings accounts, certificates of deposit, and repurchase agreements in eligible depositories; bonds of other obligations of the United States government; and bonds of the State of Arizona counties, cities, towns, school districts, or special districts as specified by statute. As required by statute, collateral is required for demand deposits, certificates of deposit, and repurchase agreements at 102 percent of all deposits not covered by Federal Depository Insurance Corporation (FDIC).

Deposits

Custodial Credit Risk

For deposits, this is a risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a formal policy for custodial credit risk. At June 30, 2017 and 2016, the carrying amount of the District's deposits was \$6,638,702 and \$6,288,350, respectively, and the bank balance was \$381,744 and \$189,388, respectively. Bank balances are covered by federal depository insurance up to \$250,000. Amounts in excess of the FDIC limit are collateralized through the Arizona State Treasurer's Office Pooled Collateral Program. Total of \$6,305,758 and \$6,169,405 as of June 30, 2017 and 2016 were held by the Navajo County Treasurer. Navajo County combines all entity cash balances for investment purposes. As a result, they do not have pledged securities specific to Pinetop-Lakeside Sanitary District; however, all deposits held by Navajo County are collateralized.

Pinetop-Lakeside Sanitary District
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2017 and 2016

NOTE 3 – CASH AND INVESTMENTS (continued)

Investments

The District held no instruments accounted for as investments as of June 30, 2017 or 2016. As discussed in Note 1, amounts deposited with the Navajo County Treasurer Local Government Investment Pool are considered cash and cash equivalents.

Interest rate risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The District's policy for managing its exposure to fair value loss arising from increasing interest rates is to comply with the provisions of State Law (A.R.S. 35-323) which requires that the District's investment portfolio maturities do not exceed five years from the time of purchase.

NOTE 4 – COVENANTS RECEIVABLE

Covenants are agreements made with individual property owners who cannot afford to pay the connection fee at the time the permit for connection is made. Covenants are collateralized by a Deed of Trust on the individual's property.

As of June 30, covenants receivable consist of the following:

	2017	2016
Covenants due from various users for connection fees, payable over a 10-year period with interest at 6.0% per annum	\$ 230,625	\$ 52,598
Less: current portion	21,180	9,573
	\$ 209,445	\$ 43,025

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 5 – CAPITAL ASSETS

The following table summarizes the changes to capital assets for the year ended June 30, 2017:

	June 30, 2016		June 30, 2017	
	Balance	Additions	Deletions	Balance
Capital asset not being depreciated				
Land & Easements	\$ 165,454	\$		\$ 165,454
Construction work in progress	1,548,902	405,348	(1,810,355)	143,895
Total capital assets not being depreciated	<u>1,714,356</u>	<u>405,348</u>	<u>(1,810,355)</u>	<u>309,349</u>
Capital assets being depreciated				
Buildings	1,091,703		(3,650)	1,088,053
Treatment	7,061,056	996,411		8,057,467
Collector sewers				
Improvement districts	18,288,321			18,288,321
Line extensions	14,735,562	369,211		15,104,773
Interceptor sewers	5,370,741			5,370,741
Sewer chimneys and laterals	700,791			700,791
Digester and scales	1,784,316			1,784,316
Wetland marsh	2,106,023			2,106,023
Well	60,937	9,449		70,386
General equipment	1,122,827	63,915	(27,935)	1,158,807
Plant equipment	967,046	444,735	(86,724)	1,325,057
SCADA	338,415			338,415
Tools and shop equipment	111,225			111,225
Computers	72,784			72,784
Furniture and fixtures	39,055			39,055
Total capital assets being depreciated	<u>53,850,802</u>	<u>1,883,720</u>	<u>(118,309)</u>	<u>55,616,214</u>
Less accumulated depreciation for:				
Buildings	(421,736)	(41,583)	3,650	(459,669)
Treatment	(5,176,257)	(189,499)		(5,365,756)
Collector sewers				
Improvement districts	(10,088,618)	(401,507)		(10,490,125)
Line extensions	(4,649,058)	(356,853)		(5,005,911)
Interceptor sewers	(3,675,350)	(110,402)		(3,785,752)
Sewer chimneys and laterals	(451,819)	(13,886)		(465,705)
Digester and scales	(1,435,959)	(115,703)		(1,551,662)
Wetland marsh	(995,666)	(46,393)		(1,042,059)
Well	(56,841)	(1,664)		(58,505)
General equipment	(884,487)	(61,854)	27,935	(918,406)
Plant equipment	(626,762)	(95,684)	86,724	(635,722)
SCADA	(261,102)	(23,298)		(284,400)
Tools and shop equipment	(65,602)	(2,291)		(67,893)
Computers	(72,784)			(72,784)
Furniture and fixtures	(35,413)	(2,712)		(38,125)
Total accumulated depreciation	<u>(28,897,454)</u>	<u>(1,463,329)</u>	<u>118,309</u>	<u>(30,242,474)</u>
Total capital assets being depreciated, net	<u>24,953,348</u>	<u>420,391</u>	<u>0</u>	<u>25,373,740</u>
Total Capital Assets - net	<u>\$ 26,667,704</u>	<u>\$ 825,739</u>	<u>\$ (1,810,355)</u>	<u>\$ 25,683,089</u>

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 5 – CAPITAL ASSETS (continued)

The following table summarizes the changes to capital assets for the year ended June 30, 2016:

	June 30, 2015		Additions		Deletions		June 30, 2016
	Balance						Balance
Capital asset not being depreciated:							
Land & Easements	\$ 165,454						\$ 165,454
Construction work in progress	256,518	\$	1,619,981	\$	(327,597)		1,548,902
Total capital assets not being depreciated	<u>421,972</u>		<u>1,619,981</u>		<u>(327,597)</u>		<u>1,714,356</u>
Capital assets being depreciated							
Buildings	1,091,703						1,091,703
Treatment	6,798,012		276,227		(13,183)		7,061,056
Collector sewers:							
Improvement districts	18,288,321						18,288,321
Line extensions	14,648,508		87,054				14,735,562
Interceptor sewers	5,370,741						5,370,741
Sewer chimneys and laterals	700,791						700,791
Digester and scales	1,784,316						1,784,316
Wetland marsh	2,106,023						2,106,023
Well	60,937						60,937
General equipment	1,139,950		131,219		(148,342)		1,122,827
Plant equipment	967,421				(375)		967,046
SCADA	338,415						338,415
Tools and shop equipment	123,281				(12,056)		111,225
Computers	73,878				(1,094)		72,784
Furniture and fixtures	39,694				(639)		39,055
Total capital assets being depreciated	<u>53,531,991</u>		<u>494,500</u>		<u>(175,689)</u>		<u>53,850,802</u>
Less accumulated depreciation for:							
Buildings	(378,708)		(43,028)				(421,736)
Treatment	(5,019,302)		(170,138)		13,183		(5,176,257)
Collector sewers:							
Improvement districts	(9,687,110)		(401,508)				(10,088,618)
Line extensions	(4,298,131)		(350,927)				(4,649,058)
Interceptor sewers	(3,564,949)		(110,401)				(3,675,351)
Sewer chimneys and laterals	(437,934)		(13,885)				(451,819)
Digester and scales	(1,320,257)		(115,702)				(1,435,959)
Wetland marsh	(949,273)		(46,393)				(995,666)
Well	(54,727)		(2,114)				(56,841)
General equipment	(976,635)		(56,194)		148,342		(884,487)
Plant equipment	(544,940)		(82,197)		375		(626,762)
SCADA	(232,558)		(28,544)				(261,102)
Tools and shop equipment	(74,100)		(3,558)		12,056		(65,602)
Computers	(73,878)				1,094		(72,784)
Furniture and fixtures	(32,592)		(3,460)		639		(35,413)
Total accumulated depreciation	<u>(27,645,094)</u>		<u>(1,428,049)</u>		<u>175,689</u>		<u>(28,897,454)</u>
Total capital assets being depreciated, net	<u>25,886,897</u>		<u>(933,549)</u>				<u>24,953,348</u>
Business-type activities capital assets, net	\$ <u>26,308,869</u>	\$	<u>686,432</u>	\$	<u>(327,597)</u>	\$	<u>26,667,704</u>

Pinetop-Lakeside Sanitary District
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2017 and 2016

NOTE 5 – CAPITAL ASSETS (continued)

Construction in progress consists of the following projects as of June 30:

	2017	2016
Crimson Oak Line Extension	\$	156,766
WWTP Upgrade		1,309,638
SCADA Upgrade	\$ 135,660	74,263
Mogollon Line Extension	8,235	8,235
Total construction in progress	\$ 143,895	\$ 1,548,902

NOTE 6 – PENSION AND OTHER POSTEMPLOYMENT BENEFITS

Arizona State Retirement System

Plan Description – The District employees participate in the Arizona State Retirement System (ASRS). The ASRS administers a cost-sharing multiple-employer defined benefit pension plan, a cost-sharing multiple-employer defined benefit health insurance benefit (OPEB) plan, and a cost-sharing multiple-employer defined long-term disability (OPEB) plan. The Arizona State Retirement System Board governs the ASRS according to the provisions of A.R.S. Title 38, Chapter 5, Articles 2 and 2.1. The ASRS issues a publicly available financial report that included its financial statements and required supplementary information. The report is available on its website at www.azasrs.gov.

Benefits provided – The ASRS provides retirement, health insurance premium supplement, long-term disability, and survivor benefits. State statute establishes benefit terms. Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit as follows:

	Retirement Initial membership date:	
	Before July 1, 2011	On or after July 1, 2011
Years of services and age required to receive benefit	Sum of years and age equals 80 10 years, age 62 5 years, age 50* any years, age 65	30 years, age 55 25 years, age 60 10 years, age 62 5 years, age 50* Any years, age 65
Final average salary is based on	Highest 36 consecutive months of last 120 months	Highest 60 consecutive months of last 120 months
Benefit percent per year of service	2.1% to 2.3%	2.1% to 2.3%
*With actuarially reduced benefits		

Pinetop-Lakeside Sanitary District
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2017 and 2016

NOTE 6 – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (continued)

Retirement benefits for members who joined the ASRS prior to September 13, 2013 are subject to automatic cost-of-living adjustments based on excess investment earnings. Members with a membership date on or after September 13, 2013, are not eligible for cost-of-living adjustments. Survivor benefits are payable upon a member's death. For retired members, the survivor benefit option chosen determines the survivor benefit. For all other members, the beneficiary is entitled to the member's account balance that includes the member's contributions and employer's contribution, plus interest earned.

Contributions – In accordance with state statute, annual actuarial valuations determine active member and employer contribution requirements. The combined active member and employer contribution rates are expected to finance the cost of benefits employees earn during the year, with an additional amount to finance any unfunded accrued liability. For the year ended June 30, 2017, statute required active ASRS members to contribute the actuarially determined rate of 11.48 percent (11.34 percent for retirement and 0.14 percent for long term disability) of the members annual covered payroll, and statute required the District to contribute at the same actuarially determined rate of 11.48 percent (10.78 percent for retirement, 0.56 percent for health insurance premium, and 0.14 percent for long-term disability) of the active member's annual covered payroll. For the year ended June 30, 2016, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.47 percent (11.35 percent for retirement and 0.12 percent for long-term disability) of the members' annual covered payroll, and the District was required by statute to contribute at the same actuarially determined rate of 11.47 percent (10.85 percent for retirement, 0.50 percent for health insurance premium benefit, and 0.12 percent for long-term disability) of the active members' annual covered payroll.

The District's contributions to the pension plan for the year ended June 30, 2017 and June 30, 2016 were \$113,886 and \$115,503 respectively.

The District's OPEB contributions for the current and 2 preceding years for OPEB, all of which were equal to the required contributions, were as follows:

Years ended June 30,	Health Benefit Supplement Fund	Long-Term Disability Fund
	<u> </u>	<u> </u>
2017	\$5,624	\$1,406
2016	\$4,864	\$1,167
2015	\$5,808	\$1,181

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 6 – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (continued)

Pension Liability – At June 30, 2017, the District reported a liability of \$1,754,527 for its proportionate share of the ASRS’s net pension liability. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined using update procedures to roll forward the total pension liability from an actuarial valuation as of June 30, 2015, to the measurement date of June 30, 2016. The District’s proportion of the net pension liability was based on the District’s actual contributions to the plan relative to the total of all participating employers’ contributions for the year ended June 30, 2016. The District’s proportion measured as of June 30, 2016, was 0.01087 percent which was a decrease of 0.00040 from its proportion measured as of June 30, 2015.

At June 30, 2016, the District reported a liability of \$1,755,192 for its proportionate share of the ASRS’ net pension liability. The net pension liability was measured as of June 30, 2015. The total pension liability used to calculate the net pension liability was determined using update procedures to roll forward the total pension liability from an actuarial valuation as of June 30, 2014 to the measurement date of June 30, 2015.

The District’s proportion of the net pension liability was based on the District’s actual contributions to the plan relative to the total of all participating employers’ contributions for the year ended June 30, 2015. The District’s proportion measured as of June 30, 2015, was 0.011270 percent, which was a decrease of 0.00040 from its proportion measured as of June 30, 2014.

Pension Expense and Deferred Outflows/Inflows of Resources – For the years ended June 30, 2017 and 2016, the District recognized pension expense for ASRS of \$36,936 and \$70,239, respectively. The District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	June 30, 2017	
	Deferred Outflow of Resources Resources	Deferred Inflow of Resources Resources
Differences between expected and actual experience	\$ 10,662	\$ 120,699
Changes in assumptions		92,829
Net difference between projected and actual earnings on pension plan investments	190,132	
Changes in proportion and differences between district contributions and proportionate share of contributions		73,058
District contributions subsequent to the measurement date	113,886	
Total	\$ 314,680	\$ 286,586

Pinetop-Lakeside Sanitary District
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2017 and 2016

NOTE 6 – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (continued)

	June 30, 2016	
	Deferred Outflow of Resources Resources	Deferred Inflow of Resources Resources
Differences between expected and actual experience	\$ 47,895	\$ 91,974
Net difference between projected and actual earnings on pension plan investments		56,250
Changes in proportion and differences between district contributions and proportionate share of contributions		58,277
District contributions subsequent to the measurement date	115,503	
Total	\$ 163,398	\$ 206,501

The \$113,886 and \$115,503 reported as deferred outflows of resources related to ASRS pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017 and 2016, respectively. Other amounts reported as deferred outflows of resources and deferred inflow of resources related to ASRS pensions will be recognized in pension expense as follows:

Year ending June 30,	
2017	\$(126,826)
2018	(85,650)
2019	73,373
2020	53,311

Actuarial Assumptions – The significant actuarial assumptions used to measure the total pension liability are as follows:

ASRS	
Actuarial valuation date	June 30, 2015
Actuarial roll forward date	June 30, 2016
Actuarial cost method	Entry age normal
Asset valuation	Fair value
Investment rate of return	8%
Projected salary increases	3 – 6.75%
Inflation	3%
Permanent benefit increase	Included
Mortality rates	1994 GAM Scale BB

Pinetop-Lakeside Sanitary District
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2017 and 2016

NOTE 6 – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (continued)

Actuarial assumptions used in the June 30, 2015, valuation were based on the results of an actuarial experience study for the 5-year period ended June 30, 2012.

The long-term expected rate of return on ASRS pension plan investments was determined to be 8.75 percent using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Arithmetic Real Rate of Return</u>
Equity	58%	6.73%
Fixed income	25%	3.70%
Real estate	10%	4.25%
Multi-asset	5%	3.41%
Commodities	<u>2%</u>	3.84%
Total	<u>100%</u>	

Discount Rate - The discount rate used to measure the ASRS total pension liability was 8 percent, which is less than the long-term expected rate of return of 8.75 percent. The projection of cash flow used to determine the discount rate assumed that contributions from participating employers will be made based on the actuarially determined rates based on the ASRS Board's funding policy, which establishes the contractually required rate under Arizona statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the District's Proportionate Share of the ASRS Net Pension Liability to Changes in the Discount Rate - The following table presents the District's proportionate share of the net pension liability calculated using the discount rate of 8 percent, as well as the District's proportionate share of the net pension liability would be if it were calculated using the discount rate that is 1 percentage point lower (7 percent) or 1 percentage point higher (9 percent) than the current rate.

	<u>1% Decrease (7%)</u>	<u>Current Discount Rate (8%)</u>	<u>1% Increase (9%)</u>
District's proportionate share of the net pension liability	\$2,237,155	\$1,754,527	\$1,367,565

Pinetop-Lakeside Sanitary District
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE 6 – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (continued)

Pension Plan Fiduciary Net Position – Detailed information about the pension plan’s fiduciary net position is available in the separately issued ASRS financial Report.

NOTE 7 – CONSTRUCTION AND OTHER COMMITMENTS

The District has major contractual commitments related to equipment purchases at June 30, 2017, to maintain the District’s collection systems. The contractual commitments with vendors at June 30, 2017 total \$527,000. These purchases were financed by the District’s cash resources.

NOTE 8 – 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 maintains insurance for general liability, auto liability, employee dishonesty and worker’s compensation. Settled claims resulting from these risks have not exceeded insurance coverage in any of the past five fiscal years. Insurance expense for the year ended June 30, 2017 and 2016 totaled \$30,263 and \$28,501.

Pinetop-Lakeside Sanitary District
 REQUIRED SUPPLEMENTARY INFORMATION
 SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
 COST-SHARING PENSION PLAN
 June 30, 2017

Arizona State Retirement System

	Reporting Fiscal Year (Measurement Date)			
	2017 (2016)	2016 (2015)	2015 (2014)	2014 through 2006
District's proportion of the net pension liability	0.010870%	0.011270%	0.011670%	
District's proportionate share of the net pension liability \$	1,754,527	\$ 1,755,192	1,726,818	Information
District's covered payroll	1,004,286	1,017,648	1,037,228	not available
District's proportionate share of the net pension liability as a percentage of its covered payroll	174.70%	172.48%	166.48%	
Plan fiduciary net position as a percentage of the total pension liability	67.06%	68.35%	69.49%	

Pinetop-Lakeside Sanitary District
 REQUIRED SUPPLEMENTARY INFORMATION
 SCHEDULE OF THE DISTRICT PENSION CONTRIBUTIONS
 June 30, 2017

Arizona State Retirement System	Reporting Fiscal Year				2013 through 2006
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	
Statutorily required contribution	\$ 113,886	\$ 115,503	\$ 119,074	\$ 112,564	Information not available
District's contributions in relation to the statutorily required contribution	<u>113,886</u>	<u>115,503</u>	<u>119,074</u>	<u>112,564</u>	
District's contribution excess	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	
District's covered payroll	<u>\$ 1,004,286</u>	<u>\$ 1,017,648</u>	<u>\$ 1,037,228</u>	<u>\$ 1,052,001</u>	
District's contributions as a percentage of covered payroll	11.34%	11.35%	11.48%	10.70%	



Independent Auditors' Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

To the Board of Directors of
Pinetop-Lakeside Sanitary District
Lakeside, Arizona

We have audited, in accordance with the 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 accompanying statement of net position of Pinetop-Lakeside Sanitary District (the District), as of June 30, 2017, and the related statement of revenues, expenses and changes in net position, and statement of cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated October 9, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Fester & Chapman, PLLC

October 9, 2017