

Inscription Canyon Ranch Sanitary District

Financial Statements

Year Ended June 30, 2011

**Inscription Canyon Ranch Sanitary District
Financial Statements
Year Ended June 30, 2011**

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INSCRIPTION CANYON RANCH SANITARY DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Inscription Canyon Ranch Sanitary District's (District) Annual Financial Report presents an analysis of the District's financial performance during the fiscal years ended June 30, 2011 and 2010. This information is presented in conjunction with the audited basic financial statements that follow this section.

HISTORY AND BACKGROUND

The District was established December 11, 1995, as a special district under provisions of Arizona Revised Statutes Title 48. The District operates and maintains the wastewater treatment plant for the Inscription Canyon Ranch, Whispering Canyon, Preserve at the Ranch, and Talking Rock Ranch developments in Yavapai County, Arizona, under the direction of an elected three-member Board of Directors.

FINANCIAL HIGHLIGHTS FOR THE FISCAL YEARS 2011

- The District's net assets decreased by 9.7%
- Operating revenues decreased by 19.1%
- Operating expenses increased by 102.7%

The District uses fund accounting to record operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges. Therefore, its financial statements are designed to provide the reader with a broad overview of the District's finances in a manner similar to a private-sector business.

The primary source of revenue for the District is the ad valorem tax on property owners of the District. No residential user fees were billed during the fiscal year ending June 30, 2011.

During the year ended June 30, 2011, the District was in the midst of a legal dispute with developers within the District resulting from a moratorium imposed on hookups in late 2009. That dispute required the District to spend over \$400,000 for attorney fees during the year ending June 2011 seriously depleting District cash. Cash assets decreased significantly from the previous year ending June 30, 2010. The District also recorded over \$1.8 million dollars in accounts receivable from late fees and penalties charged to a developer that were not receivable due to legal authority restrictions.

In addition, the Sanitary System Operator was instructed not to maintain or repair any of the sanitary system infrastructure not previously accepted by the District. (Although the District did operate the treatment plant that had not been previously accepted.)

Adding to the turmoil, a recall election campaign in the spring of 2011 resulted in the seating of three new members of the Board of Directors in May 2011.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of the following two parts: Management's Discussion and Analysis and Basic Financial Statements.

USING THE BASIC FINANCIAL STATEMENTS

The financial statements of the District report information utilizing the full accrual basis of accounting. The financial statements conform to the accounting principles which are generally accepted in the United States of America.

The Statement of Net Assets reports the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities).

The Statement of Revenues, Expenses and Changes in Net Assets identifies the District's revenues and expenses for the fiscal year ended June 30, 2011. This statement informs the reader of the District's operations over the past year and can be used to determine whether the District has recovered all of its actual and projected costs through fees and other revenue sources.

The Statement of Net Assets and Statement of Revenues, Expense and Changes in Net Assets provides an indication of the District's financial condition and also identify if the financial condition of the District has improved during the last fiscal year. An increase in net assets over time typically indicates an improvement in financial condition.

The Statement of Cash Flows provides information on the District's cash receipts, cash payments, and changes in cash resulting from operations, investments and financing activities. The Statement of Cash Flows informs the reader of sources and uses of cash and changes in cash and cash equivalents balance for the past year.

The notes to the financial statements provide additional information that is essential to a full understanding of the information provided in the financial statements.

NET ASSETS – COMPARISON OF JUNE 30, 2011 AND 2010

A summary of the District's Statements of Net Assets is presented below in Table 1:

	June 30, 11	June 30, 10	\$ Change	% Change
Total current and other assets	270,960	882,417	(611,457)	-69.3%
Capital assets, net	1,344,883	918,727	426,156	46.4%
Total assets	1,615,843	1,801,144	(185,301)	-10.3%
Other liabilities	12,761	25,188	(12,427)	-49.3%
Total liabilities	12,761	25,188	(12,427)	-49.3%
Net assets invested in capital assets, net of related debt	1,344,883	918,727	426,156	46.4%
Unrestricted assets	258,199	857,229	(599,030)	-69.9%
Total net assets	1,603,082	1,775,956	(172,874)	-9.7%

Total assets decreased by \$185,301 or 10.3% during the fiscal year ended June 30, 2011. This is comprised of an increase in fixed assets offset by a significant decrease in cash. The change in fixed assets is attributed to an adjustment made at June 30, 2011, to reverse accumulated depreciation of the decommissioned plant in combination with an adjustment for fixed assets that were inadvertently missed from the fixed assets schedule. Cash was used to pay litigation expenses.

Total liabilities reflect an overall decrease of \$12,427 or 49.3%. This decrease is attributed to June 30, 2010, unpaid invoices that were paid in the current fiscal year.

Table 1 also indicates that total net assets decreased by \$172,874 or 9.7%.

REVENUES, EXPENSES, AND CHANGES IN NET ASSETS COMPARISON OF JUNE 30, 2011 AND 2010

A condensed statement of revenue and expenses is presented in Table 2:

Table 2
Condensed Statement of Revenues, Expenses and Changes in Net Assets
As of June 30, 2011 and 2010

	<u>June 30, 11</u>	<u>June 30, 10</u>	<u>\$ Change</u>	<u>% Change</u>
Operating revenues	433,344	535,650	(102,306)	-19.1%
Non-operating revenues	1,623	3,644	(2,021)	-55.5%
Total revenues	434,967	539,294	(104,327)	-19.3%
Depreciation expense	14,388	25,299	(10,911)	-43.1%
Other operating expenses	680,806	317,616	363,190	114.3%
Total expenses	695,194	342,915	352,279	102.7%
Changes in net assets	(260,227)	196,379	(456,606)	-232.5%
Beginning net assets	1,775,956	1,579,577	196,379	12.4%
Prior period adjustment	87,353	-	87,353	
Ending net assets	1,603,082	1,775,956	(172,874)	-9.7%

The Statement of Revenues, Expenses and Changes in Net Assets identifies the various revenue and expense items that affect the change in net assets. As the information in Table 2 indicates, total net assets at June 30, 2011, were \$1,603,082.

Total revenues decreased by \$104,327 in 2011. The decrease is due to lower operating and maintenance reimbursement revenue.

The total expense increase of \$352,279 in 2011 is attributed to higher sludge removal expenses combined with significant litigation fees.

CAPITAL ASSETS – JUNE 30, 2011

The capital assets of the District are those assets that are used in the performance of the District's functions, including infrastructure assets. As of June 30, 2011, the District's investment in capital assets totaled \$1,344,883, which is an increase of \$426,156 or 46.4% from June 30, 2010. The increase in capital assets is from an error adjustment in fixed assets combined with a reversal to accumulated depreciation to remove accrued depreciation of the decommissioned plant. The reversal of accumulated depreciation has been offset by the accumulated depreciation of the error adjustment in fixed assets.

LONG-TERM DEBT – JUNE 30, 2011

As of June 30, 2011, the District had no long-term debt.

ECONOMIC FACTORS

The budget for the fiscal year ending June 30, 2012, was created by new board members taking office in May 2011. The budget ending June 30, 2011, had been overspent due to continued litigation, leaving the District with a cash shortage. Additional legal fees are required for the fiscal year ending June 30, 2012.

With cash reserves depleted, and no prospect for significant revenue receipts until after 2011 taxes are billed by Yavapai County, the Board added a line item in the budget for user fees.

The June 30, 2012, budget had to be increased by over \$100,000. The adopted budget lowered the amount of revenue to be collected via ad valorem taxes and added \$130,000 in revenue from user fees. It is anticipated that user fees would fill the revenue gap until ad valorem taxes are collected in late 2011. It is hoped that a settlement can be reached that may result in payments for effluent previously unpaid, which would further relieve the cash position.

ADDITIONAL FINANCIAL INFORMATION

This financial report is designed to provide the District's customers, investors and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the Inscription Canyon Ranch Sanitary District PO Box 215, Chino Valley, AZ 86323; Telephone 928-237-9347.



ALYX COHAN CPA, PC

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Inscription Canyon Ranch Sanitary District
Prescott, Arizona

I have audited the Statement of Net Assets of Inscription Canyon Ranch Sanitary District as of and for the year ended June 30, 2011, and the related Statements of Revenues, Expenses, and Changes in Net Assets, and Cash Flows for the year then ended. These financial statements are the responsibility of Inscription Canyon Ranch Sanitary District's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Inscription Canyon Ranch Sanitary District as of June 30, 2011, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United State of America.

Accounting principles generally accepted in the United States of America require the Management's Discussion and Analysis on pages i through iv, 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. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consist of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquires, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

Alyx Cohan, CPA

Alyx Cohan, CPA PC
Prescott, Arizona
December 28, 2011

Inscription Canyon Ranch Sanitary District
Statement of Net Assets
June 30, 2011

Assets

Current assets

Cash and cash equivalents (Note 2 and Note 3)	\$ 174,169
Ad Valorem property tax receivables	17,294
Other receivables (Note 4)	<u>79,497</u>
Total current assets	270,960

Property, Plant and Equipment (Note 5)

Non depreciable capital assets:

Land and land rights	56,000
Decommissioned plant	877,000

Depreciable capital assets:

Property, plant and equipment, at cost, net of accumulated depreciation of \$290,523	<u>411,883</u>
Total capital assets	<u>1,344,883</u>

Total assets	<u>\$ 1,615,843</u>
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Liabilities and Fund Equity

Current liabilities

Accounts payable and accrued expenses	\$ <u>12,761</u>
Total current liabilities	<u>12,761</u>

Total liabilities	<u>12,761</u>
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Net Assets

Invested in capital assets, net of related debt	1,344,883
Unrestricted	<u>258,199</u>
Total net assets	<u>\$ 1,603,082</u>

See accompanying notes to financial statements.

**Inscription Canyon Ranch Sanitary District
Statement of Revenues, Expenses and
Changes in Net Assets
Year Ended June 30, 2011**

Revenues

Ad valorem tax revenue	\$ 367,862
Activation, commercial, user, fees and other income	17,223
Operations and maintenance reimbursement income	48,259
Total operating revenues	433,344

Operating expenses

Accounting	16,321
Consulting	3,528
Depreciation expense	14,388
District Insurance	4,058
District clerk	3,691
Election expenses	2,235
Electricity	15,124
Litigation expenses	467,382
Meetings	450
Miscellaneous	165
Office expense	315
Operator	77,645
Plant supplies and maintenance	65,561
Publications	2,508
Telephone	876
Testing	19,902
Trash	216
Water	289
Web hosting	540
Total operating expenses	695,194

Operating income	(261,850)
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Nonoperating revenues (expenses)

Interest income	1,623
Total nonoperating income and expense	1,623

Decrease in net assets	(260,227)
Net assets beginning of year	1,775,956
Prior period adjustment (Note 9)	87,353
Net assets end of year	\$ 1,603,082

See accompanying notes to financial statements.

**Inscription Canyon Ranch Sanitary District
Statement of Cash Flows
Year Ended June 30, 2011**

Cash flows from operating activities:

Cash received from property taxes	\$ 350,568
Cash received from other operating income	16,088
Cash payments for professional services	(580,994)
Cash payments for sewer system operations	(106,025)
Cash payments for administration	<u>(6,213)</u>
Net cash used by operating activities	<u>(326,576)</u>

Cash flows from investing activities:

Interest on investments	<u>1,623</u>
Net cash provided by investing activities	<u>1,623</u>

Net decrease in cash and cash equivalents	(324,953)
Cash and cash equivalents at beginning of year	<u>499,122</u>
Cash and cash equivalents at end of year	<u>\$ 174,169</u>

Reconciliation of operating income to net cash provided by operating activities:

Operating loss	\$ (261,850)
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	14,388
Change in assets and liabilities:	
(Increase) decrease in receivable	(66,687)
Increase (decrease) in accounts payable and accrued expenses	<u>(12,427)</u>
Net cash used by operating activities	<u>\$ (326,576)</u>

See accompanying notes to financial statements.

Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011

NOTE 1 – DESCRIPTION OF ENTITY

Description of Operations

Inscription Canyon Ranch Sanitary District (District) was established December 11, 1995, as a special district under the provision of Arizona Revised Statutes Title 48. The District operates and maintains the collection system and wastewater treatment plant for the Inscription Canyon Ranch, Whispering Canyon, Preserve at the Ranch, and Talking Rock Ranch developments in Yavapai County, Arizona. The District is governed by a Board of Directors elected from within the District.

Reporting Entity

In accordance with the GASB Statement No. 14, the financial reporting entity consists of a primary government and its component units. 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 and local governments. Furthermore, there are no component units combined with the District for financial statement presentation purposes, and it is not included in any other governmental reporting entity. Consequently, the District's financial statements include only the funds of those entities for which its elected governing board is financially accountable.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the District, as summarized below, are in conformity with generally accepted accounting principles applicable to governmental units as promulgated by the Governmental Accounting Standards Board (GASB).

Basis of Accounting and Measurement Focus

The accompanying financial statements have been prepared in accordance with the reporting model defined by GASB Statement No. 34, Basic Financial Statements. The reporting model requires supplementary information in the form of Management's Discussion and Analysis and makes other changes in the presentation of the financial statements.

The District is a proprietary-fund type, specifically an enterprise fund, and is accounted for on a flow of economic resources measurement focus and the accrual basis of accounting. With this measurement focus, all assets and all liabilities associated with the operation of the District are included in the Statement of Net Assets.

Net assets (total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted for debt service, and unrestricted components. Proprietary-fund type operating statements present increases (revenues) and decreases (expenses) in net total assets. Under this basis of accounting, revenues are recognized when earned and expenses are recorded when the related liability is incurred. Real estate taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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.

Generally, the state statutes allow investments in certain certificates of deposit, interest-bearing savings accounts in qualified banks and savings and loan institutions, repurchase agreements with maximum maturity of thirty days, and pooled investment funds established by the state treasurer. As required by statute, collateral is required for demand deposits, certificates of deposit, and repurchase agreements at 101% of all deposits not covered by federal depository insurance.

Part of the District's monies are under the direct supervision of the Yavapai County Treasurer's Office, which has the fiduciary responsibility to administer all monies held in the County Treasury. The treasurer invests in the Local Government Investment Pool; on a pooled cash basis. Interest earned from investments purchased with such pooled monies is allocated quarterly to each of the funds based on the average month-end cash balances. For additional information on cash and investments see the Yavapai County Financial Statements for the year ended June 30, 2011.

A. Custodial Credit Risk

Custodial credit risk for deposits is the risk that in the event of a bank failure, the District's deposits may not be recovered. The District's policy for managing custodial credit risk is to adhere to the County's governance of special districts. County regulations require the District to hold a significant portion of its deposits in pooled County funds. In addition to pooled County funds, the District may maintain several accounts in one commercial bank, which may, at times, exceed federally insured limits. To date the District has not experienced any losses in these accounts.

B. Credit Risk

Credit risk is the risk that the counterparty to an investment transaction will not fulfill its obligations. The District does not participate in investment transactions, except as noted above as required by the County, and has no formal policy for credit risk.

C. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investment will adversely affect the fair value of an investment. The District does not participate in debt investment and has no formal policy for interest rate risk.

Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and Investments (continued)

D. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The District does not participate in investment transactions and has no formal policy for concentration of credit risk.

Property, Plant, Equipment and Depreciation

Property, plant and equipment are stated at cost or estimated historical cost. Depreciation is computed for financial statement purposes on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives of depreciable assets range from five to fifty years.

Expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

Operating revenues and expenses

Operating revenues and expenses consist of those revenues that result from the ongoing principal operations of the District and consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing activities and result from nonexchange transactions or ancillary activities.

Property Taxes (Ad Valorem Tax Revenues)

Property taxes are levied each year on or before the third Monday in August based on the previous January 1 full cash value as determined by the Yavapai County Assessor. Taxes are due in two equal installments on September 1 and March 1 following the levy date and become delinquent the first business day of November and May, respectively.

Accounts Receivables

The District's receivables consist of amounts due from individual and commercial property owners within the Inscription Canyon Ranch, Whispering Canyon, Preserve at the Ranch, and Talking Rock Ranch developments in Yavapai County, Arizona. All receivables are considered due within one year and are therefore considered current. Accounts receivable balances are tied to specific properties rather than specific customers. This process ensures that all outstanding balances are paid by current property holders. No allowance for doubtful accounts has been established by District management.

Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net assets

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

Invested in capital assets, net of related debt: This component of net assets 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 assets, net of related debt. Rather, that portion of the debt is included in the same net asset component as the unspent proceeds.

Restricted: This component of net assets 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 assets: This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

When expenditures are incurred for purposes for which both restricted and unrestricted balance are available, the District considers restricted funds to have been spent first.

Budgets and Budgetary Accounting

The District follows these procedures in establishing the budgetary data reflected in the financial statements:

- A. By July 10th of each year, the District submits to the Board of Supervisors and the County Treasurer a proposed operating budget for the fiscal year commencing July 1. The operating budget includes proposed expenditures and the means of financing them.
- B. Public hearings on the budget are held each year in accordance with legal requirements in order to obtain comments from local taxpayers.
- C. Arizona statutes require that on or before the third Monday in July of each fiscal year, the District Board must adopt a tentative budget. Once this tentative budget has been adopted, the expenditures may not be increased upon final adoption; however, they may be decreased. The tentative budget must be published once per week for two consecutive weeks prior to final adoption. Final adoption must take place on or before the second Monday in August.
- D. The level of control for each legally adopted annual budget is at the total budget level.
- E. Unused appropriations for all of the above annually budgeted funds lapse as of June 30. The District does not use encumbrance accounting.
- F. The budget amounts shown in the financial statements are the final authorized amounts as amended by the District Board during the year.

Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011

NOTE 3 – CASH

Deposits

The carrying amount of the District's deposits for June 30, 2011, is \$174,169. The bank and treasurer balances at June 30, 2011, are \$186,367. The difference between the bank and county balances and the carrying balance represent outstanding checks and deposits in transit.

NOTE 4 – ACCOUNTS RECEIVABLE

The accounts receivable balance at June 30, 2011, is comprised of a related party receivable of \$79,497 of which \$24,000 (\$4,000 per month from January 1, 2011, through June 30, 2011) is contingent upon the District's approval and implementation of an Amended and Restated Development Agreement with a related party. See Note 6.

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT

The following is a summary of fixed assets at June 30, 2011:

	<u>6/30/10</u> Balance	<u>Increase</u>	<u>Decrease</u>	<u>6/30/11</u> Balance
Non-depreciable assets:				
Land and land rights	\$ 56,000	\$ -	\$ -	\$ 56,000
Decommissioned plant	<u>877,000</u>	-	-	<u>877,000</u>
Total non-depreciable assets	<u>933,000</u>	-	-	<u>933,000</u>
Depreciable assets:				
Equipment	109,548	-	-	109,548
Infrastructure Inscription Canyon	162,010	215,424	-	377,434
Infrastructure The Preserve	<u>215,424</u>	-	-	<u>215,424</u>
Total assets being depreciated	<u>486,982</u>	<u>215,424</u>	-	<u>702,406</u>
Less accumulated depreciation:				
Decommissioned plant	(169,203)	-	-	(169,203)
Equipment	(14,113)	(2,531)	-	(16,644)
Infrastructure Inscription Canyon	(84,202)	(7,549)	-	(91,751)
Infrastructure The Preserve	<u>(8,617)</u>	<u>(4,308)</u>	-	<u>(12,925)</u>
Total accumulated depreciation	<u>(276,135)</u>	<u>(14,388)</u>	-	<u>(290,523)</u>
Total property plant and equip	<u>\$ 1,143,847</u>	<u>\$ 201,036</u>	<u>\$ -</u>	<u>\$ 1,344,883</u>

In 2005 a related party (see Note 6) built a Santec plant in which wastewater is processed. When the Santec plant began operations, the District's SBR plant was decommissioned. Title to the Santec plant remains with the related party. The District continues to operate the plant under an agreement with the related party. See Note 6.

Total depreciation for the year ended June 30, 2011, is \$14,388.

**Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011**

NOTE 6 – RELATED PARTY TRANSACTIONS

At June 30, 2011, the District has a standing agreement with a related property owner/developer (related party) of the District. The District operates the sanitary plant in which the users of the District receive service but which is owned by the related party of the District.

Improvements to the plant that are incurred by the District are depreciated according to the District's capitalization and depreciation policy.

Historically, the related party reimbursed the District for a portion of operating and maintenance expenses incurred by the District for plant operations. In September of 2009 the District imposed a moratorium on the District limiting sewer services to new users within the District. At this time, the related party discontinued reimbursement of operation and maintenance costs. At June 30, 2011, as part of ongoing litigation between the related party and the District, a receivable balance of unreimbursed maintenance and operations of \$79,497 existed, of which \$24,000 is a contingent receivable. See Note 4.

As part of on-going litigation, in November of 2011 the District entered into a new development agreement with the related party. See Note 10.

In the ordinary course of business, the District provides wastewater services to Board members of the District.

NOTE 7 – 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; and natural disasters. The District carries commercial insurance for all such risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage for the fiscal year ending June 30, 2011.

NOTE 8 – CONTINGENT LIABILITIES AND GOING CONCERN

As of June 30, 2011, the District was involved in several pending litigations related to a 2009 imposed moratorium established by the District. See Note 10.

The District is party to ongoing litigation and has incurred significant attorney fees for the fiscal year ending June 30, 2011. Continued attorney fees and pending litigation could affect the District's ability as a going concern in the fiscal year ending June 30, 2012.

NOTE 9 – PRIOR PERIOD ADJUSTMENT

A prior period adjustment in the amount of \$353,192 has been made at June 30, 2011, to reverse accrued penalties and interest that were not receivable by the District due to potential legal restrictions.

At June 30, 2011, a prior period adjustment of \$215,428 has been made to add fixed assets that were inadvertently unrecorded in prior years. Additionally, an entry in the amount of \$225,121 has been made to add back accumulated depreciation of the decommissioned SBR plant from 2005 through June 30, 2010. This amount has been offset by the accumulated depreciation of the unrecorded fixed assets.

The total net prior period adjustment is \$87,353.

Inscription Canyon Ranch Sanitary District
Notes to Financial Statements
June 30, 2011

NOTE 10 – SUBSEQUENT EVENTS

During the fiscal year ending June 30, 2011, the District was involved in various litigation relating to a moratorium placed on the District in 2009. At the time of writing these financial statements, the District was in the process of finalizing a settlement agreement. Settlement costs, excluding attorney fees, are to be paid by the District's insurance and are not expected to exceed the limits of the District's policy.

As of November 2011 the District entered into a Memorandum of Understanding as part of a settlement agreement. Additionally, the District is a required party to an Amended and Restated Development Agreement.

As part of the Memorandum of Understanding the District is to receive ownership of an escrow account established by a related party (see Note 6) on behalf of the District. Additionally, the related party is to collect \$117,494 of debt on behalf of the District.

Management of the District has evaluated events and transactions subsequent to June 30, 2011, for potential recognition or disclosure in the financial statements. Subsequent events have been evaluated through the financial statements issuance date of December 28, 2011.