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March 6, 2012

To the Board of Trustees  
Sallal Water Association, Inc.

We have audited the financial statements of Sallal Water Association, Inc. for the year ended 2011, and have issued our report thereon dated March 6, 2012. Professional standards require that we provide you with the following information related to our audit.

## Our Responsibilities under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered Sallal Water Association, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether Sallal Water Association, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Sallal Water Association, Inc.'s compliance with those requirements.

## Other Information in Documents Containing Audited Financial Statements

Included with the financial statements is additional information referred to as supplemental information. The supplemental information on page 13 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subject to the procedures applied in the audit of the 2011 basic financial statements and, in our opinion, is fairly stated in all material aspects in relation to the basic financial statements taken as a whole.

## Significant Audit Findings

*Qualitative Aspects of Accounting Practices*

- Management's estimate of the allowance for uncollectible accounts is based on historical sales, historical loss levels, and the collectability of individual accounts. We evaluated the key factors and assumptions used to develop the allowance for uncollectible accounts in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the recovery periods for the cost of capitalized assets is based on the Association's internal policies. We evaluated the key factors and assumptions used to develop the recovery periods in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- Property and equipment
- Construction work in progress
- Long-term debt
- Commitments
- Retirement plans

#### *Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing and completing our audit.

#### *Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

#### *Audit Adjustments*

For purposes of this report, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may or may not indicate matters that could have a significant effect on the Association's financial reporting process (that cause future financial statements to be materially misstated).

Audit adjustments for the year ended December 31, 2011 posted during the audit process consisted of the following:

- adjusted RDA loan #9 and related interest to statement
- reclassified refund of escrow account for permit fee
- adjusted accounts receivable and other receivables to year end billing statements
- adjusted estimated unbilled water revenue
- adjusted accounts payable and accrued taxes to year-end listing
- reclassified property and equipment capitalized and adjusted accumulated depreciation to depreciation schedule
- reclassified payroll expenses to payroll tax reports
- reclassified current portion of long-debt
- recorded various immaterial adjustments and reclassifications

#### *Disagreements with Management*

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### *Management Representations*

We have requested certain representations from management that are included in the management representation letter dated March 6, 2012.

*Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the Association’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

*Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Association’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

In addition to the required communications above, we have noted the following matters for your consideration.

- The Association currently records transactions to the Quickbooks accounting system on a cash basis. The accounts are adjusted to accrual basis at the end of the year. In order to make the financial reports generated by the accounting system as meaningful as possible, the Association should record adjusting entries for accounts receivable, and other significant accrued assets and liabilities on a monthly basis. Vendor bills should be recorded timely in Quickbooks to properly record accounts payable. In addition, the Association should consider paying bills and other disbursements within Quickbooks accounts payable module to improve accuracy and efficiency.
- The Association should prepare a computerized report, such as an Excel spreadsheet, to document more clearly the current and new memberships received during the year.
- The Association should adopt and abide by a document retention policy. While not explicitly required, the Internal Revenue Service generally views the establishment of such a policy as a means to establish transparency and ensure compliance.

This information is intended solely for the use of the trustees and management of Sallal Water Association, Inc. and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

*Blodgett, Mickelsen & Naef, P.S.*