CENTRAL WATER SYSTEM

INDEPENDENT AUDITORS' REPORTS
FINANCIAL STATEMENTS AND
SCHEDULE OF FINDINGS

DECEMBER 31, 2010 AND 2009

CENTRAL WATER SYSTEM

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CENTRAL WATER SYSTEM

DECEMBER 31, 2010

OFFICIALS

NAME	TITLE
Jake Hinshaw	Director - Chairman
Gary Vos	Director - Secretary/Treasurer
Russ Eckard	Director
Michael Miller	Plant Superintendent

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Central Water System
Okoboji, IA 51355

We have audited the accompanying statement of net assets of Central Water System as of December 31, 2010 and 2009 and the related statements of revenue, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audits 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 basic 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Central Water System at December 31, 2010 and 2009 and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2011 on our consideration of Central Water System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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The System has not presented management's discussion and analysis which introduces the basic financial statements by presenting certain financial information as well as management's analytical insight on that information that the Government Accounting Standards Board has determined is necessary to supplement, although not required to be a part of, the basic financial statements.

Winthur, Stave + Co., LLP

September 7, 2011

BASIC FINANCIAL STATEMENTS

Exhibit A

CENTRAL WATER SYSTEM
STATEMENTS OF NET ASSETS
DECEMBER 31, 2010 AND 2009

ASSETS

	2010	2009
CURRENTS ASSETS:		
Cash	$ 312,454	$ 281,552
Accounts receivable	14,242	1,288,908
Prepaid expenses	18,356	15,787
TOTAL CURRENT ASSETS	345,052	1,586,247
NONCURRENT ASSETS:		
Capital assets	6,925,127	6,031,771
Accumulated depreciation	(1,723,652)	(1,639,842)
CAPITAL ASSETS - NET	5,201,475	4,391,929
Bond and note issuance costs - net of accumulated amortization	9,910	10,736
Restricted assets:		
Bond sinking fund	7,663	7,430
TOTAL RESTRICTED ASSETS	7,663	7,430
TOTAL NONCURRENT ASSETS	5,219,048	4,410,095
TOTAL ASSETS	$5,564,100	$5,996,342

See Accompanying Notes to Financial Statements

Exhibit A

CENTRAL WATER SYSTEM
STATEMENTS OF NET ASSETS - Continued
DECEMBER 31, 2010 AND 2009

LIABILITIES AND NET ASSETS

	2010	2009
CURRENT LIABILITIES:		
Accounts payable	$ 28,073	$1,389,391
Accrued interest	3,447	3,447
Accrued payroll taxes	4,004	3,876
Current portion long-term debt	55,000	50,000
TOTAL CURRENT LIABILITIES	90,524	1,446,714
NONCURRENT LIABILITIES:		
Revenue bonds payable	840,000	890,000
Less current portion above	(55,000)	(50,000)
Less issuance costs of refunded bonds	(20,286)	(21,977)
TOTAL NONCURRENT LIABILITIES	764,714	818,023
TOTAL LIABILITIES	855,238	2,264,737
NET ASSETS:		
Invested in capital assets - net of related debt	4,381,761	3,413,765
Restricted	7,663	7,430
Unrestricted	319,438	310,410
TOTAL NET ASSETS	4,708,862	3,731,605
TOTAL LIABILITIES AND NET ASSETS	$5,564,100	$5,996,342

See Accompanying Notes to Financial Statements

Exhibit B

CENTRAL WATER SYSTEM
STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
REVENUE:		
Operating income	$ 349,517	$ 367,330
OPERATING EXPENSES:		
Salaries - superintendent	49,785	48,570
Salaries - other	44,950	43,417
Chemicals	34,462	29,780
Repairs	5,722	16,354
Utilities	38,037	34,240
Payroll taxes and benefits	13,710	13,038
Employee insurance	23,829	23,239
General insurance	13,049	12,883
Lab supplies	7,108	7,011
Testing and lab fees	10,075	6,462
Vehicle expenses	1,932	1,398
Clothing allowance	744	749
Legal and professional	5,088	5,288
Office supplies and postage	1,492	1,287
Telephone	1,910	1,603
Board expense	1,700	1,800
Bond expense	400	400
Continuing education	180	486
Amortization	826	826
Depreciation	83,810	85,284
TOTAL OPERATING EXPENSES	338,809	334,115
OPERATING INCOME	10,708	33,215
NON-OPERATING INCOME (EXPENSE):		
Interest income	2,243	2,932
Other income	24,000	21,000
Interest expense	(40,851)	(43,051)
TOTAL NON-OPERATING INCOME (EXPENSE) - NET	(14,608)	(19,119)
INCOME BEFORE CAPITAL CONTRIBUTIONS	(3,900)	14,096
CAPITAL CONTRIBUTIONS	981,157	2,738,551
CHANGE IN NET ASSETS	977,257	2,752,647
NET ASSETS - BEGINNING OF YEAR	3,731,605	978,958
NET ASSETS - END OF YEAR	$4,708,862	$3,731,605

See Accompanying Notes to Financial Statements

Exhibit C

CENTRAL WATER SYSTEM
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	$ 355,069	$ 367,356
Cash paid to suppliers	(177,531)	(164,089)
Cash paid to employees	(94,735)	(91,987)
NET CASH PROVIDED BY OPERATING ACTIVITIES	82,803	111,280
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Anticipation note proceeds		132,032
Principal paid on bonds	(50,000)	(50,000)
Interest paid on bonds	(39,160)	(41,361)
Capital asset acquisitions	(2,239,022)	(1,304,230)
Income from antenna rental and miscellaneous	24,000	21,000
Capital contributions	2,250,271	1,175,457
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(53,911)	(67,102)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income	2,243	2,932
NET CASH PROVIDED BY INVESTING ACTIVITIES	2,243	2,932
NET CHANGE IN CASH	31,135	47,110
CASH - BEGINNING	288,982	241,872
CASH - ENDING	$ 320,117	$ 288,982
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATIONS:		
Income from operations	$ 10,708	$ 33,215
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	84,636	86,110
(Increase) decrease in:		
Accounts receivable	5,552	26
Prepaid expenses	(2,569)	(332)
Increase (decrease) in:		
Accounts payable	(15,652)	(7,236)
Accrued expenses	128	(503)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 82,803	$ 111,280

See Accompanying Notes to Financial Statements

Exhibit C

CENTRAL WATER SYSTEM
STATEMENTS OF CASH FLOWS - Continued
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCING ACTIVITIES:		
Capital asset purchases	$ 893,356	$2,671,336
(Increase) decrease in construction accounts payable	1,345,666	(1,367,106)
Cash paid to purchase capital assets	$2,239,022	$1,304,230
Capital contributions from cities	$ 981,157	$2,738,551
Capital contributions through payment of anticipation note by cities		(293,980)
(Increase) decrease in capital contributions included in accounts receivable	1,269,114	(1,269,114)
Cash received from cities for capital contributions	$2,250,271	$1,175,457

See Accompanying Notes to Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Central Water System was organized by a Joint Public Improvement Agreement between the City of Arnolds Park and the City of Okoboji dated April 11, 1977. Central Water System, organized under the Code of Iowa, Chapter 28E, was designed to operate a water system to jointly serve the two municipalities. Iowa Lakes Regional Water was later added as a customer through a water purchase contract with Central Water System dated January 11, 1989. All facilities and land acquired or constructed in connection with the System are to be owned by the two municipal parties as tenants in common with undivided ownership interest, the common facilities to be referred to as "Central Water System".

Central Water System is a component unit of the City of Arnolds Park, Iowa, as determined by criteria specified by the Governmental Accounting Standards Board. The System is operated by the parties through a joint Board of Directors consisting of one member from each city council, or such other individual as that council shall designate, and a third member appointed and approved by a majority vote of the city councils of the municipalities.

The System's financial statements are prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board.

Reporting Entity

For financial reporting purposes, Central Water System has included all funds, organizations, account groups, agencies, boards, commissions, and authorities. The System has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the System are such that exclusion would cause the System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria included appointing a voting majority of an organization's governing body, and (1) the ability of the System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the System. Central Water System has no component units which meet the Governmental Accounting Standards Board criteria.

Basis of Presentation

The accounts of Central Water System are organized as an Enterprise Fund. Enterprise Funds are used to account for operations (a) financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

The System applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

The System distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the System's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating income and expenses.

Assets and Liabilities
The following accounting policies are followed in preparing the Statement of Net Assets:

Cash - For the purposes of the statement of cash flows, the System considers as cash all currency on hand, demand deposits with banks or other financial institutions, certificates of deposit with an original maturity of three months or less, and other accounts that have the general characteristics of demand deposits in that the System may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty.

Accounts Receivable - Accounts receivable and revenue are recorded at the time that service is provided and billed. Unbilled revenue for service consumed between periodic scheduled billing dates is not considered to have a material effect on the financial statements. Accounts are reviewed annually; accounts considered uncollectible are written off at that time.

Capital Assets - Capital assets are accounted for at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. The cost of repair and maintenance is charged to expense, while the cost of renewals or substantial betterments is capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations.

Reportable capital assets are defined by the System as assets with initial, individual costs in excess of the following thresholds and estimated useful lives in excess of two years.

Asset Class	Amount
Plant and distribution system	$ 25,000
Equipment and vehicles	$ 5,000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

Asset Class	Estimated Lives (In Years)
Plant and distribution system	10 - 40
Equipment and vehicles	5 - 15

Interest costs are capitalized when incurred on debt where proceeds were used to finance the construction of assets. Interest earned on proceeds of tax-exempt borrowing arrangements restricted to the acquisition of qualifying assets is offset against interest costs in determining the amount to be capitalized. The System had no capitalized interest during 2010 and 2009.

Bond and note issuance costs - Bond and note issuance costs are amortized on a straight-line basis over the repayment term of the respective debt issue and are presented at net value. Bond issue costs of refunded bonds are deducted from the refunding debt liability.

Restricted Assets - Funds set aside for payment of revenue bonds and notes are classified as restricted.

Compensated Absences - Central Water System has established a written policy for sick leave and vacation accrual which states that no sick leave or vacation pay will accumulate one year to the next. Therefore, there are no accrued compensated absences at December 31, 2010 and 2009.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Income Taxes - Central Water System is exempt from federal and state income taxes.

Subsequent Events - Management has evaluated subsequent events through the date of the auditor's report, which is the date the financial statements were available to be issued.

2. DEPOSITS AND INVESTMENTS

The System's deposits in banks at December 31, 2010 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

2. DEPOSITS AND INVESTMENTS - Continued

The System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Directors; prime eligible bankers acceptances; certain high-rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; and certain joint investment trusts.

The System had no investments meeting the disclosure requirements of Government Accounting Standards Board Statement No. 3, as amended by Statement No. 40.

3. CAPITAL ASSETS

A summary of capital assets at December 31, 2010 is as follows:

	Balance Beginning of Year	Additions	Balance End of Year
Capital assets not being depreciated:			
Construction work in progress	$2,852,708	$892,457	$3,745,165
Capital assets being depreciated:			
Plant and distribution system	3,107,620		3,107,620
Equipment	71,443	899	72,342
Total capital assets being depreciated	3,179,063	899	3,179,962
Less accumulated depreciation for:			
Plant and distribution system	1,576,211	82,193	1,658,404
Equipment	63,631	1,617	65,248
Total accumulated depreciation	1,639,842	83,810	1,723,652
Capital assets - net	$4,391,929	$809,546	$5,201,475

A summary of capital assets at December 31, 2009 is as follows:

	Balance Beginning of Year	Additions	Balance End of Year
Capital assets not being depreciated:			
Construction work in progress	$ 204,472	$2,648,236	$2,852,708
Capital assets being depreciated:			
Plant and distribution system	3,084,520	23,100	3,107,620
Equipment	71,443		71,443
Total capital assets being depreciated	3,155,963	23,100	3,179,063
Less accumulated depreciation for:			
Plant and distribution system	1,494,865	81,346	1,576,211
Equipment	59,693	3,938	63,631
Total accumulated depreciation	1,554,558	85,284	1,639,842
Capital assets - net	$1,805,877	$2,586,052	$4,391,929

4. LONG-TERM DEBT

A summary of changes in long-term liabilities for the year ended December 31, 2010 is as follows:

	Balance Beginning of Year	Increase	Decreases	Balance End of Year	Due Within One Year
Revenue bond:					
Series 2007	$890,000		$ 50,000	$840,000	$ 55,000
	$890,000		$ 50,000	$840,000	$ 55,000

A summary of changes in long-term liabilities for the year ended December 31, 2009 is as follows:

	Balance Beginning of Year	Increase	Decreases	Balance End of Year	Due Within One Year
Revenue bonds:					
Anticipation Project Note	$ 161,948	$132,032	$293,980		
Series 2007	940,000		50,000	$890,000	$ 50,000
	$1,101,948	$132,032	$343,980	$890,000	$ 50,000

Series 2007 Notes - $990,000 Water Revenue Refunding Capital Loan Notes, Series 2007 were issued during 2007. These notes bear interest at 4.40% per annum and mature in varying annual amounts ranging from $50,000 to $90,000, with final maturity due in the year ending December 31, 2022.

The resolution providing for the issuance of the revenue notes includes the following provisions:

(a) The notes will only be redeemed from the future earnings for the enterprise activity and the note holders hold a lien on the future earnings of the system.

(b) Sufficient monthly transfers shall be made to a revenue note sinking fund account for the purpose of making the note principal and interest payments when due.

(c) User rates shall be established at a level which produces net revenues at a level not less that 110% of the amount of principal and interest on the notes falling due in the same year.

4. LONG-TERM DEBT - Continued

A summary of the annual revenue bond principal and interest requirements to maturity at December 31, 2010 is as follows:

Year	Principal	Interest	Total
2011	$ 55,000	$ 36,960	$ 91,960
2012	60,000	34,540	94,540
2013	60,000	31,900	91,900
2014	60,000	29,260	89,260
2015	65,000	26,620	91,620
2016 - 2020	370,000	88,000	458,000
2021 - 2022	170,000	11,440	181,440
Total	$ 840,000	$258,720	$1,098,720

Anticipation Project Note - In February 2008, the System entered into an "Interim Loan and Disbursement Agreement" (Agreement) with the Iowa Finance Authority pursuant to a resolution adopted by the System authorizing and providing for the issuance and securing the payment of a $1,749,000 Water Revenue Capital Loan Note Anticipation Project Note, Series 2008.

The purpose of the note was to finance the costs of acquisition, construction, extending, improving, repairing and equipping of the water system. The note was non-interest bearing. At December 31, 2009, advances under the agreement totaled $293,980, all of which was retired during the year from the proceeds of capital loan notes issued by the Cities of Arnolds Park and Okoboji.

5. PENSION AND RETIREMENT BENEFITS

The System contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 4.30% of their annual salary through June 30, 2010 and 4.50% thereafter and the System is required to contribute 6.65% of annual covered payroll through June 30, 2010 and 6.95% thereafter. Contribution requirements are established by State statute. The System's contributions to IPERS for the years ended December 31, 2010, 2009, and 2008 were $6,414, $5,954, and $5,076, respectively, equal to the required contributions for each year.

5. PENSION AND RETIREMENT BENEFITS - Continued

457 Deferred Compensation Plan

The System offers a deferred compensation plan created in accordance with Internal Revenue Code Section 457 to System employees. The plan permits the employees to defer a portion of current salary until future years. The System does not contribute to the plan. Plan funds are held in trust by a third party investor. The System provides neither administrative service to the plan nor investment advice for the plan.

6. RISK MANAGEMENT

The System is a member of the Iowa Communities Assurance Pool, as allowed by Chapter 670.7 of the Code of Iowa. The Iowa Communities Assurance Pool (Pool) is a local government risk-sharing pool whose 634 members include various governmental entities throughout the State of Iowa. The Pool was formed in August 1986 for the purpose of managing and funding third-party liability claims against its members. The Pool provides coverage and protection in the following categories: general liability, automobile liability, automobile physical damage, public officials liability, police professional liability, property, inland marine, and boiler/machinery. There have been no reductions in insurance coverage from prior years.

Each member's annual casualty contributions to the Pool fund current operations and provide capital. Annual operating contributions are those amounts necessary to fund, on a cash basis, the Pool's general and administrative expenses, claims, claims expenses, and reinsurance expenses due and payable in the current year, plus all or any portion of any deficiency in capital. Capital contributions are made during the first six years of membership and are maintained to equal 200 percent of the total current members' basis rates or to comply with the requirements of any applicable regulatory authority having jurisdiction over the Pool.

The Pool also provides property coverage. Members who elect such coverage make annual operating contributions which are necessary to fund, on a cash basis, the Pool's general and administrative expenses and reinsurance premiums, all of which are due and payable in the current year, plus all or any portion of any deficiency in capital. Any year-end operating surplus is transferred to capital. Deficiencies in operations are offset by transfers from capital and, if insufficient, by the subsequent year's member contributions.

The Commission's property and casualty contributions to the risk pool are recorded as disbursements from its operating funds at the time of payment to the risk pool. The Commission's annual contributions to the Pool for the years ended December 31, 2010 and 2009 were $10,966 and $10,857, respectively.

6. RISK MANAGEMENT - Continued

The Pool uses reinsurance and excess risk-sharing agreements to reduce its exposure to large losses. The Pool retains general, automobile, police professional, and public officials' liability risks up to $350,000 per claim. Claims exceeding $350,000 are reinsured in an amount not to exceed $2,650,000 per claim and $10,000,000 in aggregate per year. For members requiring specific coverage from $3,000,000 to $10,000,000, such excess coverage is also reinsured. Property and automobile physical damage risks are retained by the Pool up to $150,000 each occurrence, each location, with excess coverage reinsured by the Travelers Insurance Company.

The Pool's intergovernmental contract with its members provides that in the event a casualty claim or series of claims exceeds the amount of risk-sharing protection provided by the member's risk-sharing certificate, or in the event that a series of casualty claims exhausts total members' equity plus any reinsurance and any excess risk-sharing recoveries, then payment of such claims shall be the obligation of the respective individual member. As of June 30, 2010, settled claims have not exceeded the risk pool or reinsurance company coverage since the pool's inception.

Members agree to continue membership in the Pool for a period of not less than one full year. After such period, a member who has given 60 days' prior written notice may withdraw from the Pool. Upon withdrawal, payments for all claims and claims expenses become the sole responsibility of the withdrawing member, regardless of whether a claim was incurred or reported prior to the member's withdrawal. Members withdrawing within the first six years of membership may receive a partial refund of their capital contributions. If a member withdraws after the sixth year, the member is refunded 100% of its capital contributions; however, the refund is reduced by an amount equal to the annual operating contribution which the withdrawing member would have made for the one-year period following withdrawal.

The System also carries commercial insurance purchased from other insurers for coverage associated with workers' compensation. The System assumes liability for any deductibles and claims in excess of coverage limitations. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

7. MAJOR CUSTOMERS

During the years ended December 31, 2010 and 2009, the System received approximately 94% of its revenues from two entities as follows:

	2010		2009	
	Amount	Percent	Amount	Percent
City of Arnolds Park	$171,920	49%	$197,079	54%
City of Okoboji	$158,855	45%	$137,852	37%

8. LITIGATION

The System may become party to routine legal proceedings and litigation arising in the normal course of governmental operations. These legal proceedings typically are not expected to have a material adverse impact on the System's financial condition.

9. COMMITMENTS

At December 31, 2010, the System has entered into construction contracts related to a system improvement project totaling approximately $3,405,562, of which approximately $241,583 remains outstanding. The balance on the contracts will be paid as the project is completed through capital contributions by the Cities of Arnolds Park and Okoboji.

10. SUBSEQUENT EVENT

In June 2011, the System entered into a contract for phase two of the 2009 Water Treatment Plant Improvements project for approximately $8,843,800. The project is estimated to be completed by May 2013 and paid through capital contributions by the Cities of Arnolds Park and Okoboji.

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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
Central Water System
Okoboji, IA 51355

We have audited the accompanying financial statements of Central Water System as of and for the year ended December 31, 2010 and have issued our report thereon dated September 7, 2011. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Central Water System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility a material misstatement of the System's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency in internal control described in Part I of the accompanying Schedule of Findings to be a material weakness.

Member Private Companies Practice Section,
American Institute of Certified Public Accountants

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Central Water System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance 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 non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about Central Water System's operations for the year ended December 31, 2010 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of Central Water System. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

The System's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on the System's responses, we did not audit the System's responses and, accordingly, we express no opinion on them.

This report, a public record by law, is intended solely for the information and use of the officials and employees of Central Water System and other parties to whom of Central Water System may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Central Water System during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Winthrop, Stave + Co., LLP

September 7, 2011

CENTRAL WATER SYSTEM
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2010

Part I: Findings Related to the Financial Statements

Internal Control Deficiency:

I-A-10 Segregation of Duties - During our review of the internal control structure, existing procedures were evaluated in order to determine whether incompatible duties, from a control standpoint, are performed by the same employee. We noted that one individual is primarily responsible for all recordkeeping and reconciling functions for the System.

Recommendation - We realize with a limited number of office employees, segregation of duties is difficult. However, the System should review the operating procedures of the office to obtain the maximum internal control possible under the circumstances with continued administrative review by Directors.

Response - We continually review our operating procedures and strive to improve the internal control and segregation of duties whenever possible. Administrative and Board review of transactions and financial information is an important part of the controls in place, and is relied upon to strengthen controls.

Conclusion - Response accepted.

Instances of Noncompliance:

No matters were noted.

Part II: Other Findings Related to Statutory Reporting

II-A-10 Questionable Expenses - We noted no expenses that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-B-10 Travel Expense - No expenditures of money for travel expenses of spouses of System officials or employees were noted.

II-C-10 Board Minutes - No transactions were found that we believe should have been approved in the System's minutes but were not.

II-D-10 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa were noted.

II-E-10 Revenue Bonds - No instances of non-compliance with the revenue bond provisions were noted.