

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2023
WITH INDEPENDENT AUDITOR'S REPORT

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Independent Auditor's Report

To the Board of Directors
Hill County Emergency Services District #2

Report on the Audit of the Financial Statements

Opinion

I have audited the accompanying financial statements of the governmental activities of the Hill County Emergency Services District #2 (the ESD) as of and for the year ended September 30, 2023, and the related notes to the financial statements, which collectively comprise the ESD's basic financial statements as listed in the table of contents.

In my opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the ESD as of September 30, 2023, and the changes in financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

I conducted my audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards*). My responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I am required to be independent of the ESD and to meet my other ethical responsibilities, in accordance with the relevant ethical requirements relating to my audit. I believe that the audit evidence I have obtained is sufficient and appropriate for my audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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 to error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the ESD's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than one resulting from error, as fraud may involve collusion, forgery, intentional omission, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*,

- exercise professional judgment and maintain professional skepticism throughout the audit.
- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- obtain an understanding of internal control relevant to the audit 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 ESD's internal control. Accordingly, no opinion is expressed.
- evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- conclude whether, in my judgement, there are conditions or events, considered in the aggregate, that raise substantial doubt about the ESD's ability to continue as a going concern for a reasonable period of time.

I am required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal-control related matters that I identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4-7 be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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 GAAS, which consisted of inquiries of management about the methods

of preparing the information and comparing the information for consistency with management's responses to my inquiries, 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued my report dated June 20, 2024 on my consideration of the ESD's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the effectiveness of the ESD's 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 ESD's internal control over financial reporting and compliance.

Bill Sanders

West, Texas
June 20, 2024

**HILL COUNTY EMERGENCY SERVICES DISTRICT #2
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2023**

Within this section of Hill County Emergency Services District #2's (the ESD) financial report, the ESD's management provides narrative discussion and analysis of the financial activities of the ESD for the year ended September 30, 2023. The ESD's financial performance is discussed and analyzed within the context of the accompanying financial statements and following this section.

Financial Highlights:

The ESD's assets exceeded its liabilities by \$14,923,914 (net position) for the fiscal year reported. The ESD's net position improved dramatically during the fiscal year by \$3,767,287, primarily due to an increase in sales taxes, which were approved by the voters in 2015, and and fully implemented in the fiscal year ended September 30, 2018, as well as a significant decrease in capital expenditures, as our needs have declined after completing construction of our stations.

Total net position is comprised of the following:

- (1) Capital assets of \$3,329,159 include land, buildings, and equipment, net of accumulated depreciation.
- (2) Unrestricted net position of \$11,594,755 represents the portion available to maintain the ESD's continuing obligations to citizens and creditors.

The ESD's governmental fund reported an ending fund balance of \$11,594,755 this year. This compares favorably to the prior year ending fund balance of \$7,846,471, showing an increase of \$3,748,284, again, largely due to an increase in revenues and a decrease in expenditures. Overall, the ESD is proud to have four stations in operation now (Hubbard, Itasca, Whitney, and Hillsboro), with no future debt payments to burden the taxpayers.

Overview of the Financial Statements

Management's Discussion and Analysis introduces the ESD's basic financial statements. The basic financial statements include: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to financial statements.

Government-wide Financial Statements

The ESD's annual report includes two government-wide financial statements. These statements provide both long-term and short-term information about the ESD's overall status. Financial reporting at this level uses a perspective similar to that found in the private sector with its basis in full accrual accounting.

The first of these government-wide statements is the *Statement of Net Position*. This is the ESD-wide statement of financial position presenting information that includes all of the ESD's assets and liabilities, with the difference reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the ESD as a whole is improving or deteriorating. Evaluation of the overall economic health of the ESD would extend to other nonfinancial factors such as the condition of the ESD infrastructure in addition to the financial information provided in this report.

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2023
(Continued)

The ESD's financial reporting entity includes only the funds of the ESD, since there are no component units for which the ESD is accountable.

Fund Financial Statements

A fund is an accountability unit used to maintain control over resources segregated for specific activities or objectives. The ESD uses funds to ensure and demonstrate compliance with finance-related laws and regulations. Within the basic financial statements, fund financial statements focus on the ESD's most significant funds rather than the ESD as a whole.

The ESD has one kind of fund:

Governmental funds are reported in the fund financial statements and encompass essentially the same functions reported as governmental activities reported in the government-wide financial statements. These statements report short-term fiscal accountability focusing on the use of spendable resources during the year and balances of spendable resources available at the end of the year. They are useful in evaluating annual financing requirements of governmental programs and the commitment of spendable resources for the near-term.

A budgetary comparison statement is included in the basic financial statements for the general fund. This statement demonstrates compliance with the ESD's budget.

Because the ESD qualifies as a *special-purpose government engaged in a single program*, its fund financial statements have been combined with its government-wide financial statements in a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column.

Notes to the financial statements

The accompanying notes to the financial statements provide information essential to a full understanding of the government-wide and fund financial statements. The notes to the financial statements begin immediately following the basic financial statements.

Financial Analysis of the ESD

As year-to-year financial information is accumulated on a consistent basis, changes in net position may be observed and used to discuss the changing financial position of the ESD.

The ESD's net position at fiscal year-end is \$14,923,914. This is a \$3,767,287 increase over last year's net position of \$11,156,627. The following table provides a summary of the ESD's net position at September 30:

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2023
(Continued)

Summary of Net Assets

	Governmental Activity		Change
	2023	2022	
Current assets	\$ 11,712,642	\$ 7,955,452	\$ 3,757,190
Capital assets	3,329,159	3,310,156	19,003
Total assets	15,041,801	11,265,608	3,776,193
Total liabilities	22,300	17,025	5,275
Deferred Inflow of Resources	95,587	91,956	3,631
Net position:			
Invested in capital assets	3,329,159	3,310,156	19,003
Unrestricted	11,594,755	7,846,471	3,748,284
Total net position	<u>\$ 14,923,914</u>	<u>\$ 11,156,627</u>	<u>\$ 3,767,287</u>

The following data provides a summary of the ESD's changes in net position for the years ended September 30, 2023 and 2022.

Summary of Changes in Net Assets

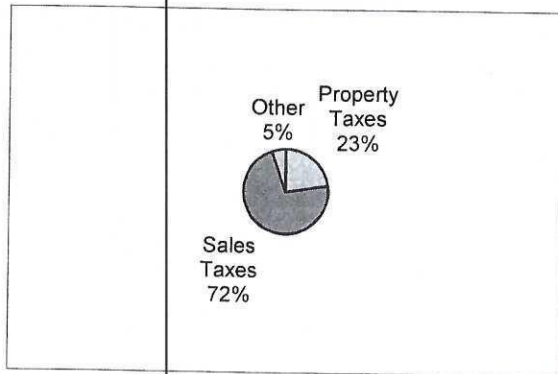
	2023	2022
Revenues:		
Property Taxes	\$ 1,107,035	\$ 1,035,850
Sales Taxes	3,542,185	2,775,575
Taxpayer Penalties	22,719	27,681
Rent	26,450	19,800
Interest	212,455	26,574
Total Revenues	\$ 4,910,844	\$ 3,885,480
Expenses:		
EMS Providers	757,236	714,375
Membership Fees	127,500	127,500
Collection Fees	22,795	21,503
Appraisal Fees	35,451	32,419
Legal & Professional	13,617	15,975
First Responder Fees	52,750	38,500
Conference Expenses	6,842	7,448
Insurance	13,068	17,628
Depreciation	66,587	52,373
Office & Other	47,711	25,867
Total Expenses	<u>1,143,557</u>	<u>1,053,588</u>
Change in Net Position	\$ 3,767,287	\$ 2,831,892
Beginning Net Position	<u>11,156,627</u>	<u>8,324,735</u>
Ending Net Position	<u>\$ 14,923,914</u>	<u>\$ 11,156,627</u>

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2023
(Continued)

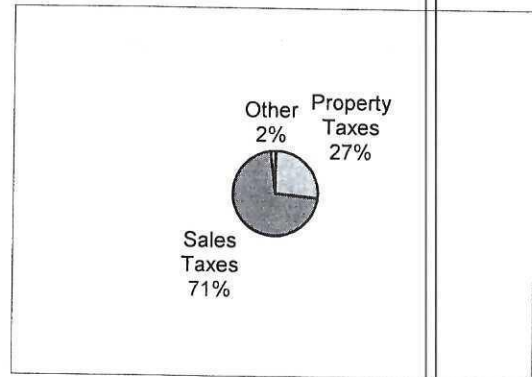
Graphic presentations of selected data from the summary of changes in net position follow to assist in the analysis of the ESD's activities for fiscal years 2023 and 2022:

Revenues

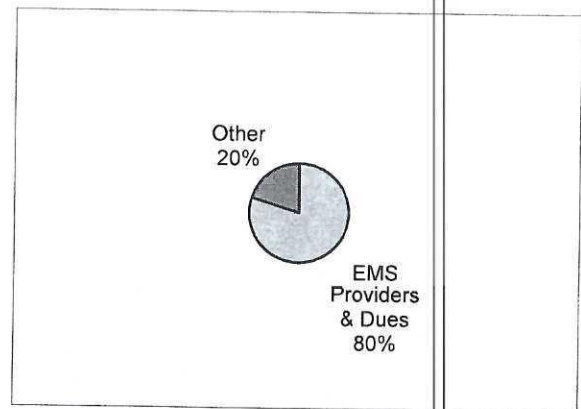
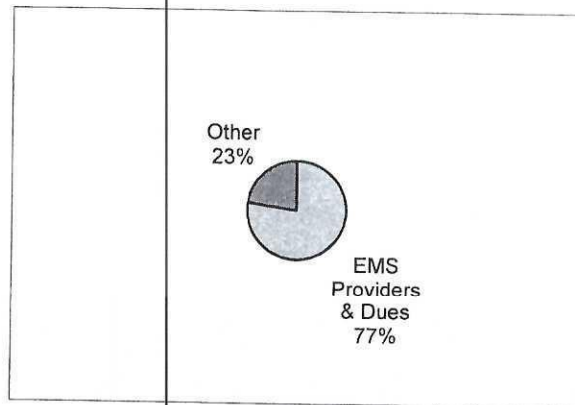
2023



2022



Expenses



These graphs show that virtually all of the ESD's revenues are comprised of property and sales taxes and about 80% of our expenses are payments to our Emergency Medical Service Providers and required dues to related organizations.

Contacting the District's Financial Management

This financial report is designed to provide an overview of the ESD's finances, comply with finance-related laws and regulations, and demonstrate the ESD's commitment to public accountability. If you have questions about this report or would like to request additional information, contact the ESD at 201 S. Outlet Dr., Hillsboro, Texas 76645.

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
STATEMENT OF NET POSITION AND GOVERNMENTAL FUND BALANCE SHEET
SEPTEMBER 30, 2023

ASSETS	General Fund	Adjustments (Note 1)	Statement of Net Position
Cash in Banks	\$ 10,883,583	\$ -	\$ 10,883,583
Sales Taxes Receivable	724,831		724,831
Property Taxes Receivable, Net	103,628		103,628
Prepaid Expenses	600		600
Capital Assets (net of accumulated depreciation)		3,329,159	3,329,159
Total Assets	<u>\$ 11,712,642</u>	<u>\$ 3,329,159</u>	<u>\$ 15,041,801</u>
LIABILITIES			
Accounts Payable	\$ 22,300	\$ -	\$ 22,300
Total Liabilities	22,300	-	22,300
DEFERRED INFLOWS OF RESOURCES			
Deferred Property Taxes	<u>95,587</u>	<u>-</u>	<u>95,587</u>
FUND BALANCE / NET POSITION:			
Fund Balance:			
Nonspendable	600	(600)	
Unassigned	<u>11,594,155</u>	<u>(11,594,155)</u>	
Total Fund Balance	<u>11,594,755</u>	<u>(11,594,755)</u>	
Total Liabilities and Fund Balance	<u>\$ 11,712,642</u>		
Net Position:			
Invested in Capital Assets		3,329,159	3,329,159
Unrestricted		<u>11,594,755</u>	<u>11,594,755</u>
Net Position		<u>\$ 14,923,914</u>	<u>\$ 14,923,914</u>

The accompanying notes are an integral part of this financial statement.

**HILL COUNTY EMERGENCY SERVICES DISTRICT #2
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND
REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED SEPTEMBER 30, 2023**

	General Fund	Adjustments	Statement of Activities
Expenditures / Expenses:			
EMS Provider	\$ 757,236		\$ 757,236
Membership Fees	127,500		127,500
Collection Fees	22,795		22,795
Appraisal Fees	35,451		35,451
Legal & Professional	13,617		13,617
First Responder Fees	52,750		52,750
Conference Expenses	6,842		6,842
Insurance	13,068		13,068
Office & Other	47,711		47,711
Depreciation	-	66,587	66,587
Capital Outlay	85,590	(85,590)	-
Total Expenditures / Expenses	1,162,560	(19,003)	1,143,557
Revenues:			
General Revenues:			
Property Taxes	\$ 1,107,035	\$ -	\$ 1,107,035
Sales Taxes	3,542,185		3,542,185
Rents	26,450		26,450
Taxpayer Penalties	22,719		22,719
Interest	212,455		212,455
Total Revenues	4,910,844	-	4,910,844
Excess (Deficit) of Revenues Over (Under) Expenditures	3,748,284	19,003	3,767,287
Change in Net Position:			
Net Position / Fund Balance Beginning of Year	7,846,471	3,310,156	11,156,627
End of Year	<u>\$11,594,755</u>	<u>\$3,329,159</u>	<u>\$14,923,914</u>

The accompanying notes are an integral part of this financial statement.

**HILL COUNTY EMERGENCY SERVICES DISTRICT #2
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2023**

	<u>Budget</u>	<u>Actual</u>	Variance Favorable (Unfavorable)
Expenditures / Expenses:			
EMS Providers	\$ 757,226	\$ 757,236	\$ (10)
Membership Dues	127,500	127,500	-
Collection Fees	-	22,795	(22,795)
Appraisal Fees	36,289	35,451	838
Legal & Professional	17,500	13,617	3,883
First Responder Fees	42,000	52,750	(10,750)
Conference Expenses	10,000	6,842	3,158
Insurance	13,000	13,068	(68)
Office & Other	43,475	47,711	(4,236)
Capital Expenditures	100,000	85,590	14,410
Total Expenditures / Expenses	1,146,990	1,162,560	(15,570)
Revenues:			
General Revenues:			
Property Taxes	\$ 1,113,151	\$ 1,107,035	\$ (6,116)
Sales Taxes	2,405,000	3,542,185	1,137,185
Rents	30,800	26,450	(4,350)
Taxpayer Penalties	-	22,719	22,719
Interest	65,000	212,455	147,455
Total Revenues	\$ 3,613,951	\$ 4,910,844	\$ 1,296,893
Excess of Revenues Over Expenditures	2,466,961	3,748,284	1,281,323
Fund Balance, Beginning of Year	7,846,471	7,846,471	-
Fund Balance, End of Year	<u>\$10,313,432</u>	<u>\$11,594,755</u>	<u>\$ 1,281,323</u>

The accompanying notes are an integral part of this financial statement.

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2023

1. Summary of Significant Accounting Policies

Reporting Entity

Hill County Emergency Services District #2 (the ESD) was created in 2005 as a political subdivision of the State of Texas, to provide emergency medical services within its boundaries. The ESD can acquire and sell real and personal property, enter into contracts, impose taxes, borrow money, and lease its facilities to others to accomplish its mission.

The ESD is governed by a separate five-member Board of Commissioners who are appointed by the Hill County Commissioners Court and serve two-year terms.

The ESD contracts with CareFlite for air ambulance services, and various cities and volunteer fire departments for first responder services.

The financial statements of the ESD are prepared in accordance with generally accepted accounting principles and all relevant Government Accounting Standards Board (GASB) pronouncements. The ESD is not included in any other reporting entity as defined in GASB pronouncements, nor is any component unit included in the ESD's financial statements.

Government-Wide and Fund Financial Statements

The government-wide financial statements include the Statement of Net Assets and the Statement of Activities. These statements report financial information for the ESD as a whole and focus on the sustainability of the ESD as an entity and the change in financial position resulting in the activities of the fiscal year.

As a special-purpose government engaged in a single governmental program, the ESD has opted to combine its government-wide and fund financial statements in a columnar format, with one column reconciling the differences between the two formats.

The General Fund is the ESD's only operating fund, and accounts for all of the operations and financial resources of the ESD.. The principal source of revenue is property taxes. Fund financial statements are provided for governmental funds.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The financial statements of the ESD are prepared in accordance with generally accepted accounting principles (GAAP).

The government-wide statements report using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year in which they are levied.

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2023
(Continued)

The fund financial statements report using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The ESD considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are recorded when the related fund liability is incurred.

Property taxes receivable at the end of the fiscal year are treated as deferred revenues, because they are not considered available to pay liabilities of the current year.

Budget

The ESD adopts annual an budget for the General Fund, which is prepared on the accrual basis of accounting.

Cash Deposits

The ESD's cash and cash equivalents are demand deposits and certificates of deposit with original maturities of one year or less. These funds are valued at cost.

The ESD has adopted a written investment policy, as required by the Public Funds Investment Act, Chapter 2256, and Texas Government Code. The investments of the District are in compliance with their investment policies.

State statutes require that all funds invested in depository institutions be covered by federal depository insurance and/or pledged collateral. The types of collateral to be pledged to secure ESD demand deposits and certificates of deposit are stated in the ESD's Investment Policy. Balances in demand accounts and certificates of deposit were entirely covered by federal depository insurance or pledged collateral held by The Independent Bankers Bank in the ESD's name.

The ESD maintained deposits at one financial institution in Central Texas during the fiscal year. At year-end, these balances totaled \$10,883,583, and were covered by FDIC insurance of \$250,000, and collateral interests in 25 municipal bonds with combined face values and par values of \$14,675,000, and combined market values of \$11,257,950, held by an independent financial institution.

Property Taxes

Property taxes receivable are shown net of an allowance for estimated uncollectible taxes. The estimated uncollectible amount is equal to ten percent of delinquent outstanding property taxes. At September 30, 2023, the ESD's taxes receivable consisted of \$115,142, less a ten percent allowance of \$11,514.

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2023
(Continued)

Property taxes attach as enforceable liens on property as of January 1. Taxes are levied on October 1 and are due and payable on or before January 31 of the following year. All unpaid taxes become delinquent on February 1 of the following year. The ESD's taxes are billed and collected by the Hill County Tax Office. ESD property tax revenues are recognized when levied.

Capital Assets and Depreciation

The ESD's capital assets consist of real and personal property with useful lives of five to ten years for equipment, forty years for station buildings, and fifty years for helipads, and is stated at historical cost and comprehensively reported in the government-wide financial statements. The costs of normal repairs and maintenance that do not add to the asset value or materially extend useful lives are not capitalized. Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded in operations.

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.

2. Changes in Capital Assets

The following is a summary of the changes in capital assets for the fiscal year:

	Beginning Balance	Additions	(Deletions)	Ending Balance
Equipment	\$ 163,633	\$ 21,573	\$ -	\$ 185,206
Station Buildings	2,294,649	64,017		2,358,666
Helipads	63,757			63,757
Land (not depreciated)	999,336			999,336
Accumulated Deprec.	(211,219)	(66,587)		(277,806)
	<u>\$ 3,310,156</u>	<u>\$ 19,003</u>	<u>\$ -</u>	<u>\$ 3,329,159</u>

Depreciation recognized in the fiscal year was \$66,587.

3. Economic Dependence / Commitments and Contingencies

During the year ended September 30, 2023, the ESD used one contractor to provide all of its emergency air ambulance services to Hill County. This contract is established annually.

HILL COUNTY EMERGENCY SERVICES DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2023
(Continued)

4. Risk Management

The ESD is exposed to various risks of loss related to torts: theft of, damage to, and destruction of assets; errors and omissions; personal injuries; and natural disasters. The risk of loss is covered by commercial insurance. There were no instances where settlements exceeded insurance coverage in any of the three previous years.

WILLIAM B. SANDERS
Certified Public Accountant

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**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 Directors
Hill County Emergency Services District #2

I have audited the financial statements of the governmental activities of the Hill County Emergency Services District #2 (the ESD), as of and for the year ended September 30, 2023, which comprise the ESD's basic financial statements and have issued my report thereon dated June 20, 2024. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the ESD is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered the ESD's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the ESD's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the ESD's internal control over financial reporting.

My 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 that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described below, I identified a deficiency in internal control over financial reporting that I 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 that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. I consider the deficiency described below to be a material weakness.

Recently-issued auditing standards have clarified that the components of internal controls are the same for all entities. There is no exemption or special relief given to a smaller entity because of its size or the challenges present when achieving effective internal control. Certain internal controls that have often been overlooked by small businesses relate to the financial reporting process. Annual financial reporting control objectives address the preparation of accurate annual financial statements and related note disclosures in accordance with generally accepted accounting principles. That is to say, the system of internal control over financial reporting does not stop at the entity's general ledger. It includes controls over the actual financial statement preparation, including note disclosures.

I have drafted the annual financial statements and related note disclosures of the ESD at the ESD's request. This was done because, due to its limited resources, the ESD's internal personnel did not possess all the skills and competencies necessary to prepare its own financial statements in accordance with the highly technical pronouncements and requirements of generally accepted accounting principles. However, I can not be considered part of the ESD's internal controls. Consequently, the inability of the ESD to internally prepare its own financial statements and related notes is considered a control deficiency. The fact that I prepare the financial statements may give users more confidence that the financial statements are correct; however, it does not eliminate the control deficiency.

To remedy the control deficiency related to the preparation of the annual financial statements, the ESD needs to ensure that appropriate personnel are in place and that they have the appropriate knowledge and tools (i.e., current accounting literature, current disclosure checklist, etc.) to be an effective element of the internal control process. Another remedy in this area may be for the ESD to engage another firm or person to outsource the financial statement preparation portion of the process. Alternatively, management may make a conscious decision to accept the degree of risk in this control deficiency because of cost or other considerations. That decision would not affect my continued drafting of the ESD's financial statements and notes in the future. However, my responsibility under professional standards includes communicating deficiencies, regardless of management's decisions, as long as the deficiency exists.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the ESD's financial statements are free of material misstatements, I 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 my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the use of management and the Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

Bill Sanders

West, Texas
June 20, 2024