

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
AN ENTERPRISE FUND OF  
THE NAVAJO NATION**

**FINANCIAL STATEMENTS AND REPORTS OF  
INDEPENDENT AUDITOR IN ACCORDANCE  
WITH OMB CIRCULAR A-133**

**MAY 31, 2011 AND 2010**

**MOSS ADAMS<sub>LLP</sub>**

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

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## Report of Independent Auditors

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry  
Farmington, New Mexico

We have audited the accompanying financial statements of Navajo Agricultural Products Industry (NAPI), an enterprise fund of the Navajo Nation, as of and for the year ended May 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the NAPI's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of NAPI as of and for the year ended May 31, 2010, were audited by other auditors whose report dated August 25, 2010, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NAPI's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only NAPI and do not purport to, and do not, present fairly the financial position of the Navajo Nation as of May 31, 2011 and 2010 and the changes in its financial position or its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NAPI as of May 31, 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 States of America.

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2011, on our consideration of NAPI's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

The Management's Discussion and Analysis on pages 3 through 16 is not a required part of NAPI's basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on NAPI's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Mess Adams LLP*

Albuquerque, New Mexico  
November 21, 2011

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

This discussion and analysis introduces the basic financial statements and provides an overview of Navajo Agricultural Products Industry's (NAPI) financial activities for the years ended May 31, 2011 and 2010. Please read it in conjunction with the financial statements, which immediately follow.

**PRIMARY MISSIONS**

The Navajo Agricultural Products Industry's primary missions are as follows:

- To operate a profitable commercial farm.
- To plan, develop, and promote the use of agricultural and related resources, including water in compliance with the Navajo Nation Water Code.
- Promote agribusiness development, the multiplier effect, and related businesses and industries in the Navajo Nation.

**FINANCIAL HIGHLIGHTS**

- The NAPI's overall financial position improved in fiscal year 2011. The assets of NAPI exceeded its liabilities at the close of the fiscal year by \$87,766,755. Included in this amount is \$40,126,637, which may be used to meet NAPI's ongoing mission of operating a profitable commercial farm.
- NAPI's total net assets increased by \$5,721,768.
- At May 31, 2011, total NAPI assets were \$101,897,361, compared to \$96,143,620 at May 31, 2010. NAPI's most significant current asset is crops in progress of \$17,144,802 at May 31, 2010, compared to \$17,381,180 at May 31, 2010.
- At May 31, 2011, NAPI's current assets of \$38,719,068 were sufficient to cover current liabilities of \$8,963,047 (current ratio of 4.32). At May 31, 2010, NAPI's current assets of \$29,035,825 exceeded current liabilities of \$7,743,784 (current ratio of 3.75).
- NAPI's liabilities totaled \$14,130,606 at May 31, 2011 compared to \$14,098,633 at May 31, 2010. A \$4,613,359 long-term note payable to Wells Fargo Bank represents the largest liability as of May 31, 2011.
- The Navajo Agricultural Products Industry total debt decreased by \$1,132,841 (14%) between fiscal years 2011 and 2010.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**FINANCIAL HIGHLIGHTS (CONTINUED)**

- NAPI's gross crop revenues were \$44,630,802 and \$37,180,472 for the years ended May 31, 2011 and 2010, respectively. This represented an increase in crop revenue of \$7,450,330 from the previous fiscal year. Crop revenues increased significantly as a result of favorable commodity prices.
- Funding for the Navajo Indian Irrigation Project and other related grants was \$6,699,747 and \$14,884,681 for the years ended May 31, 2011 and 2010, respectively. This represented a decrease in intergovernmental revenue of \$8,184,934 or 55% from the previous fiscal year. This decrease is a result of additional funding provided by the governmental entities to support the Navajo Indian Irrigation Project and related projects under the 638 contract in fiscal year 2010.
- Income from agricultural-related leases was \$3,769,009 and \$3,739,825 for the years ended May 31, 2011 and 2010, respectively. This represented an increase of \$29,184 or 1% from the previous fiscal year. This increase was a result of the increase potato acreage being allotted to Navajo Mesa Farms.
- Selling and administrative expenses were \$4,916,958 and \$5,347,203 for the years ended May 31, 2011 and 2010, respectively. This represented a decrease of \$430,245 or 8% from the previous fiscal year. The decrease represents a significant change with NAPI's organizational chart in June 2009 with the safety and security department being allocated to the crops.
- Interest and fiscal charges were \$527,304 and \$631,890 for the years ended May 31, 2011 and 2010, respectively. This represented a decrease of \$104,586 or 17% from the previous fiscal year due to the maturity of the notes payable with Trinity and John Deere Credit.

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The NAPI's annual financial statements are presented in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments". This format is similar to the type of financial statements typical of a business enterprise. The basic financial statements consist of the following:

The Statement of Net Assets reflects the financial position of NAPI at May 31, 2011 and 2010. It shows the various assets owned or controlled related liabilities and other obligations, and the various categories of net assets. Net assets is an accounting concept defined as total assets less total liabilities, and as such, represents equity or ownership in the total assets of NAPI. Over time, increases or decreases in net assets

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

may serve as a useful indicator of whether the financial position of NAPI is improving or deteriorating when considered with nonfinancial facts such as crop statistics (yields, acres in production, etc.) and the condition of facilities.

The Statement of Revenues, Expenses, and Changes in Net Assets reflects the results of operations and other changes for the year ended May 31, 2011 and 2010. It shows the various revenues and expenses, both operating and nonoperating, reconciling the beginning net assets amount to the ending net assets amount, which is shown on The Statement of Net Assets described above.

The Statement of Cash Flows presents the inflows and outflows of cash and cash equivalents for the years ended May 31, 2011 and 2010. It shows the various cash activities by type, reconciling the beginning cash and cash equivalents amount to the ending cash and cash equivalents amount, which is shown on the Statement of Net Assets described above. In addition, this statement reconciles cash flows from operating activities to operating income/loss on the Statement of Revenues, Expenses and Changes in Net Assets described above.

The condensed financial information below highlights the main categories of the Statement of Net Assets. Assets and liabilities are distinguished as to their current or noncurrent nature. Current liabilities are typically those obligations intended for liquidation or payment within the next fiscal year while current assets are those resources that are available for use in meeting the operating needs of NAPI, including current liabilities. Net assets are divided into two categories reflecting the equity in assets by broad characteristics.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**CONDENSED FINANCIAL INFORMATION  
CONDENSED STATEMENTS OF NET ASSETS  
As of May 31, 2011 and 2010**

	<b>May 31, 2011</b>	May 31, 2010
<b>Assets</b>		
Current assets	\$ 38,719,068	\$ 29,035,825
Noncurrent assets, other than capital	5,865,859	12,178,618
Capital assets, net	<u>57,312,434</u>	<u>54,929,177</u>
<b>Total assets</b>	<b><u>\$ 101,897,361</u></b>	<b><u>\$ 96,143,620</u></b>
<b>Liabilities</b>		
Current liabilities	\$ 8,963,047	\$ 7,743,784
Noncurrent liabilities	<u>5,167,559</u>	<u>6,354,849</u>
<b>Total liabilities</b>	<b><u>\$ 14,130,606</u></b>	<b><u>\$ 14,098,633</u></b>
<b>Net assets</b>		
Invested in capital assets, net of related debt	\$ 47,640,118	\$ 46,574,203
Unrestricted net assets	<u>40,126,637</u>	<u>35,470,784</u>
<b>Total net assets</b>	<b><u>\$ 87,766,755</u></b>	<b><u>\$ 82,044,987</u></b>

At May 31, 2011, total NAPI assets were \$101,897,361, compared to \$96,143,620 at May 31, 2010. NAPI's most significant current asset is crops in progress of \$17,144,802 at May 31, 2011, compared to \$17,381,180 at May 31, 2010.

At May 31, 2011, NAPI's current assets of \$38,719,068 were sufficient to cover current liabilities of \$8,963,047 (current ratio of 4.32). At May 31, 2010, NAPI's current assets of \$29,035,825 exceeded current liabilities of \$7,743,784 (current ratio of 3.75).

NAPI's liabilities totaled \$14,130,606 at May 31, 2011 compared to \$14,098,633 at May 31, 2010. A \$4,613,359 long-term note payable to Wells Fargo Bank represents the largest liability as of May 31, 2011.

The Navajo Agricultural Products Industry total debt decreased by \$1,132,841 (14%) between fiscal years 2011 and 2010.

As noted earlier, net assets may serve over time as a useful indicator of NAPI's financial position. In the case of the Navajo Agricultural Products Industry, assets exceeded liabilities by \$87,766,755 at the close of fiscal year 2011.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

By far the largest portion of the Navajo Agricultural Products Industry's net assets (54%) reflects its investment in capital assets (e.g. land improvements, buildings, irrigation and sprinkler equipment, automotive equipment, office and communication equipment, construction in progress, software, and farm, feedlot, shop and other equipment) less any related debt used to acquire those assets that is still outstanding. The Navajo Agricultural Products Industry uses these capital assets to operate its agricultural activities; consequently, these assets are not available for future spending. Although the Navajo Agricultural Products Industry's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The condensed financial information below highlights the main categories of the Statement of Revenues, Expenses, and Changes in Net Assets. The major sources of gross operating revenues for NAPI are agricultural products: alfalfa, barley, corn, tablestock potatoes, wheat, oats, beans, feed yard, intergovernmental revenue and agricultural-related leases. Depreciation expense is recorded in accordance with the adoption of the economic resources measurement focus. For a description of the difference between operating and nonoperating, please refer to the Summary of Significant Accounting Policies, Note 2 to the basic financial statements.

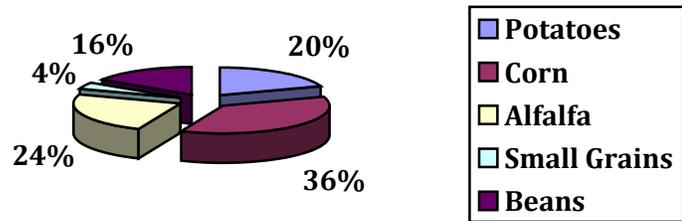
**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets  
For the Years Ended May 31, 2011 and 2010**

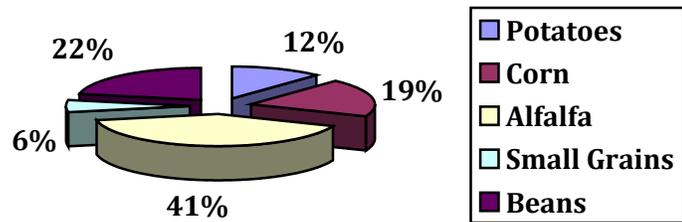
	<u>2011</u>	<u>2010</u>
<b>Revenues:</b>		
Operating:		
Crops	\$ 44,630,802	\$ 37,180,472
Agricultural-related leases	3,769,009	3,739,825
Sale of electric power rights	910,389	1,172,375
Indirect cost recovery	1,234,825	665,395
Nonoperating:		
Intergovernmental	6,699,747	14,884,681
Interest and dividends	724,304	634,241
Other	16,053	1,134,143
Gain (Loss) on sale of capital assets	190,999	(171,513)
Total revenues	<u>58,176,128</u>	<u>59,239,619</u>
<b>Expenses:</b>		
Operating:		
Cost of crops and goods sold:		
Crops	40,310,351	37,506,721
Selling and administrative	4,916,958	5,347,203
Nonoperating:		
Costs associated with the Navajo Indian Irrigation Project and other related grants	6,699,747	7,584,681
Interest and fiscal charges	527,304	631,890
Total expenses	<u>52,454,360</u>	<u>51,070,495</u>
Change in net assets	5,721,768	8,169,124
Net assets, beginning	82,044,987	73,875,863
Net assets, ending	<u>\$ 87,766,755</u>	<u>\$ 82,044,987</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**2011 Significant Crop Revenue -  
by Crop**

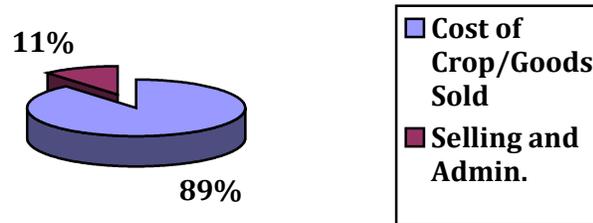


**2010 Significant Crop Revenue -  
by Crop**

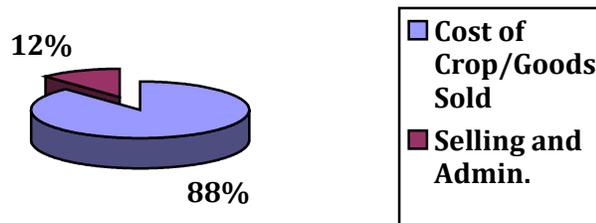


**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**2011 Operating Expenses - by Type**



**2010 Operating Expenses - by Type**



NAPI's gross crop revenues were \$44,630,802 and \$37,180,472 for the years ended May 31, 2011 and 2010, respectively. This represented an increase in crop revenue of \$7,450,330 from the previous fiscal year. Crop revenues increased significantly as a result of favorable commodity prices.

Funding for the Navajo Indian Irrigation Project (NIIP) and other related grants was \$6,699,747 and \$14,884,681 for the years ended May 31, 2011 and 2010, respectively. This represented a decrease in intergovernmental revenue of \$8,184,934 or 55% from the previous fiscal year. This decrease is a result of additional funding provided by the governmental entities to support the NIIP and related projects under the 638 contract in fiscal year 2010.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

Income from agricultural-related leases was \$3,769,009 and \$3,739,825 for the years ended May 31, 2011 and 2010, respectively. This represented an increase of \$29,184 or 1% from the previous fiscal year. This increase was a result of the increase potato acreage being allotted to Navajo Mesa Farms.

Selling and administrative expenses were \$4,916,958 and \$5,347,203 for the years ended May 31, 2011 and 2010, respectively. This represented a decrease of \$430,245 or 8% from the previous fiscal year. The decrease represents a significant change with NAPI's organizational chart in June 2009 with the safety and security department expenses being allocated to the crops.

Interest and fiscal charges were \$527,304 and \$631,890 for the years ended May 31, 2011 and 2010, respectively. This represented a decrease of \$104,586 or 17% from the previous fiscal year due to maturity of the notes payable with Trinity and John Deere Credit.

Investment income was \$724,304 and \$634,241 for the years ended May 31, 2011 and 2010, respectively. This represents an increase of \$90,063 or 14% from the previous fiscal year due to interest payments from Navajo Agricultural Marketing, Inc due on their accounts payable to NAPI. The NAMI/NAPI operating agreement outlines the details of this interest payment obligation.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

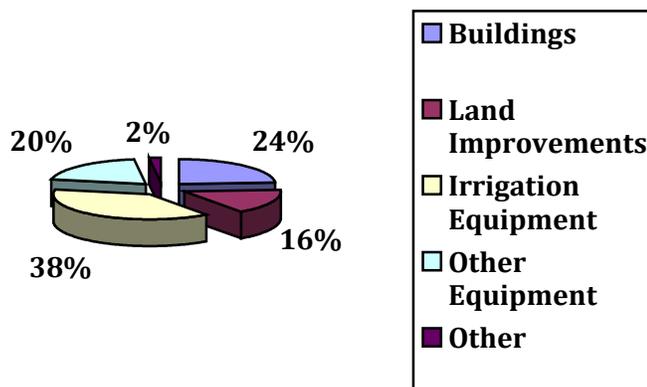
*Capital assets.* The Navajo Agricultural Products Industry's investment in capital assets (net of accumulated depreciation) as of May 31, 2011 and 2010 amounts to \$57,312,434 and \$54,929,177, respectively. This investment in capital assets includes land improvements, buildings, irrigation and sprinkler equipment, automotive equipment, office and communications equipment, construction in progress, software, and farm, feedlot, shop, and other equipment. The total increase in the Navajo Agricultural Products Industry's investment in capital assets for the current fiscal year was 4%.

Major capital asset events during the current fiscal year included the following:

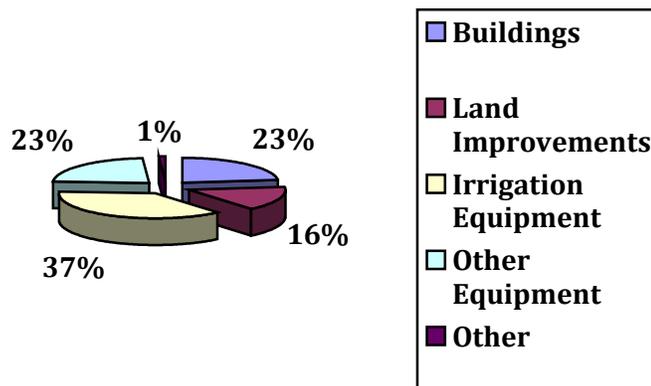
- Center Pivot Rehabilitation , \$1,168,658
- Potato Storage upgrade \$1,035,477
- Combines, \$877,746
- Farm Vehicles, \$342,873
- Pellet Mill, \$152,575
- HVAC, \$125,000

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**2011 Capital Assets - by Type**



**2010 Capital Assets - by Type**



Additional information on the Navajo Agricultural Products Industry's capital assets can be found in Note 6 to the financial statements on page 28.

*Long Term Debt.* NAPI had total long-term debt of \$7,222,133 and \$8,354,974, as of May 31, 2011 and 2010, respectively. As of May 31, 2011, this long-term debt was comprised of 3 bank notes payable and equipment lease-purchase agreements. As of May 31, 2010, this long-term debt was comprised of 2 bank notes payable and equipment lease-purchase agreements. In fiscal year 2009, to finance the purchase of pivot irrigation equipment, NAPI secured a bank note payable in the amount of \$6,458,702. During the years ended May 31, 2011 and 2010, NAPI repaid long-term debt in the amounts of \$2,097,307 and \$2,712,158, respectively.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

Navajo Agricultural Products Industry's Outstanding Debt

	<b>2011</b>	2010
Capital leases	\$ 477,375	\$ 1,095,127
Notes payable	5,858,315	7,259,847
Credit agreement	<u>886,443</u>	<u>-</u>
Total	<u>\$ 7,222,133</u>	<u>\$ 8,354,947</u>

**Navajo Indian Irrigation Project (NIIP)**

In 1962 the United States Congress authorized the construction of the Navajo Indian Irrigation Project (NIIP) for the sole purpose of providing a water delivery system from the Navajo Dam reservoir to the Navajo Nation. This project is a partial satisfaction of The Treaty of 1868 to the Navajo Nation. Revenues and expenditures from the above Public Law 93-638 Programs (Operations and Maintenance, On-Farm Development, and Soil Labs) comprised the most significant portion of NAPI's federal financial assistance. Operation and Maintenance maintains the 71-mile canal system and pipeline that transports irrigated water throughout NAPI, On-Farm Development is responsible for the installation of new irrigation systems; the Soil Labs tests the soil to ensure adequate moisture and fertilizer application.

Intergovernmental revenues from these programs totaled approximately \$6,699,747 for the year ended May 31, 2011 and \$14,884,681 for the year ended May 31, 2010. Recognized expenses of such funds were \$6,699,747 and \$7,584,681 for the year ended May 31, 2011 and for the year ended May 31, 2010, respectively. Intergovernmental revenues equaled grant expenditures for the year ended May 31, 2011.

**Economic Outlook and Agricultural Outlook**

**Economic Outlook**

- Real GDP (Gross Domestic Product) decreased by 2.8 percent in 2010 and is forecasted to increase by 2.6 percent in 2011. Economic growth is forecasted to be restrained by the aftermath of the recent financial and economic turmoil. Real GDP is not forecasted to accelerate significantly until 2012-2014 with forecasts of 2.9 percent.
- Economic growth will probably be restrained by the aftermath of the financial and economic turmoil. Experience in the United States and in other countries suggests that recovery from recessions triggered by financial crises and large declines in asset prices tends to be protracted.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**Economic Outlook and Agricultural Outlook (Continued)**

**Economic Outlook (Continued)**

- Unemployment rate was 9.0 percent through May 2011; however, with certain indicators predicting continued uncertainty of the US economy, the current estimate is for unemployment to remain near 9.1 percent the balance of 2011.
- The Eurozone and the United States are expected to see real Gross Domestic Product (GDP) decline below 2.0 percent in 2011. Canada's GDP is expected to decline 1.0 percent in 2011. The Mexican economy is expected to decrease by 2.0 percent for 2011.
- The expectation for the federal funds rate is to stay near zero. The forecast for December 2011 is a rate of 0.25%.
- The interest rate on 3-month Treasury bills is expected to remain below 1% through the 2011-2012 fiscal years.
- The interest rate on 10-year Treasury notes is projected to remain below 3% into the early part of 2012.
- Crude oil prices in 2011 are expected to remain between \$75 and \$90 with no significant price movement through the end of 2011. Gasoline and diesel prices are forecasted to follow this stable pricing at least until the end of 2011.

**Agricultural Outlook**

Exports:

- Fiscal 2011 agricultural exports are forecast at a record \$135.5, up \$9 billion from the November forecast and \$26.8 billion above final FY 2010 exports. Exports are forecast to exceed the previous record set in 2008 by \$20.6 billion. Sharply higher unit values for grains, soybeans, and cotton account for most of the forecast increase.
- Grains are forecasted at \$35.4 billion up \$3.5 billion from FY 2011. Corn and wheat are boosted significantly with most other categories changed little in aggregate.
- Corn exports are up \$1.1 billion to \$13.4 billion, largely due to higher unit values arising from tight U.S. supplies and strong domestic demand. Wheat exports are raised \$2.5 billion to \$12.3 billion on higher unit values and larger volumes.
- The forecast for agricultural exports to China is raised to a record \$20 billion as the country becomes the top U.S. market. Canada, Mexico, and the EU are all up significantly from November.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**Economic Outlook and Agricultural Outlook (Continued)**

**Agricultural Outlook (Continued)**

- The export forecast for livestock, poultry, and dairy is raised \$1.9 billion to a record \$24.9 billion, with gains across the board but most significantly for dairy and animal by-products. The export forecast for dairy products is raised \$500 million due to rising global unit values and increased export volumes to Mexico and Asia.

**Imports**

- Fiscal 2011 agricultural imports are forecast at \$88 billion, up \$2.5 billion from the previous forecast. This projection represents an 11-percent gain from 2010, of which 6 to 7 percent is attributed to higher import prices and 4 to 5 percent to greater volume. Real personal consumer spending for food and beverages rose 4.9 percent in the fourth quarter of 2010, while real spending for food services climbed 4.1 percent. The dollar's depreciation from its recent high in early 2009, however, may have a slowing effect on import demand as effective unit values increase. Commodity prices are exacerbated by higher petroleum prices.
- Grain imports are forecast at \$5.2 billion, up \$300 million from 2010. The higher wheat unit values reflect the increase of imports. An additional \$200 million worth of imported feeds and fodders over the 2010 value is also expected.
- The forecast for beef imports is lowered by \$200 million due to a weak dollar and higher unit values on tight global supplies. The pork import forecast is revised up \$64 million as unit values have climbed. The per head prices of imported cattle and swine are also up, due to high feed costs, tight supplies, and a weaker dollar.

**Other Matters with Potential Impact on Future Operations**

Agricultural products experience periodic changes due to uncontrollable market conditions and future commodity pricing that cannot be predicted. Adequate supplies of water are also a significant consideration for farming enterprises in the Southwest. NAPI's supply of water has historically been sufficient. NAPI management views this as a competitive advantage until such time that the current drought conditions improve in the region.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
May 31, 2011 and 2010**

**Other Matters with Potential Impact on Future Operations (Continued)**

Navajo Indian Irrigation Project funding has increased over previous levels for 2011 and 2010. Future funding levels cannot be determined at this time. Additional planned expansion of irrigated cropland may be slowed unless appropriations are returned to previous levels of funding.

**Request for Information**

This financial report is designed to provide a general, overview of the Navajo Agricultural Products Industry's finances for all those with an interest in NAPI's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Mr. Darryl Multine, Chief Financial Officer, PO Drawer 1318, Farmington, New Mexico, 87499.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**STATEMENTS OF NET ASSETS**  
**Years Ended May 31, 2011 and 2010**

<b>Assets</b>	<u>2011</u>	<u>2010</u>
Current assets:		
Cash and cash equivalents	\$ 7,718,907	\$ 7,088,861
Accounts receivable - trade (net of allowance for uncollectible)	1,181,023	2,726,605
Accounts receivable - Navajo Agricultural Marketing, Inc.	5,833,677	1,091,105
Inventories	20,625,583	17,900,813
Prepaid items	209,568	228,441
Note receivable - Navajo Agricultural Marketing, Inc.	3,150,310	-
<b>Total current assets</b>	<u>38,719,068</u>	<u>29,035,825</u>
Noncurrent assets:		
Accounts receivable - Navajo Agricultural Marketing, Inc.	-	4,710,552
Cash and cash equivalents - restricted	2,379,398	4,198,189
Deferred alfalfa stand costs	3,426,627	3,210,043
Other assets	59,834	59,834
Capital assets, net	57,312,434	54,929,177
<b>Total noncurrent assets</b>	<u>63,178,293</u>	<u>67,107,795</u>
<b>Total assets</b>	<u>\$ 101,897,361</u>	<u>\$ 96,143,620</u>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	\$ 4,254,042	\$ 2,144,813
Other accrued expenses	857,646	488,847
Deferred revenues	1,796,785	3,109,999
Current portion of long-term debt	2,054,574	2,000,125
<b>Total current liabilities</b>	<u>8,963,047</u>	<u>7,743,784</u>
Noncurrent liabilities:		
Noncurrent portion of long-term debt	5,167,559	6,354,849
<b>Total noncurrent liabilities</b>	<u>5,167,559</u>	<u>6,354,849</u>
<b>Total liabilities</b>	<u>14,130,606</u>	<u>14,098,633</u>
<b>Net Assets</b>		
Investment in capital assets, net of related debt	47,640,118	46,574,203
Restricted	1,065,911	-
Unrestricted	39,060,726	35,470,784
<b>Total net assets</b>	<u>87,766,755</u>	<u>82,044,987</u>
<b>Total liabilities and net assets</b>	<u>\$ 101,897,361</u>	<u>\$ 96,143,620</u>

*See Notes to Financial Statements.*

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**Years Ended May 31, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
<b>Operating revenues:</b>		
Crops	\$ 44,630,802	\$ 37,180,472
Agricultural-related leases	3,769,009	3,739,825
Sale of electric power rights	910,389	1,172,375
Indirect cost recovery	<u>1,234,825</u>	<u>665,395</u>
<b>Total operating revenues</b>	<u>50,545,025</u>	<u>42,758,067</u>
<b>Operating expenses:</b>		
Cost of crops and goods sold:		
Crops	38,598,425	36,111,289
Agricultural-related leases	1,634,513	1,347,362
Feed yard	62,097	31,937
Convenience store operation	<u>15,316</u>	<u>16,133</u>
<b>Total cost of crops and goods sold</b>	<u>40,310,351</u>	<u>37,506,721</u>
Selling and administrative	<u>4,916,958</u>	<u>5,347,203</u>
<b>Total operating expenses</b>	<u>45,227,309</u>	<u>42,853,924</u>
<b>Operating income (loss)</b>	<u>5,317,716</u>	<u>(95,857)</u>
Nonoperating revenues (expenses):		
Intergovernmental revenues	6,699,747	14,884,681
Costs associated with the Navajo Indian Irrigation Project and other related grants	<u>(6,699,747)</u>	<u>(7,584,681)</u>
Interest and dividends	724,304	634,241
Interest expense and fiscal charges	<u>(527,304)</u>	<u>(631,890)</u>
Gain (loss) on sale of capital assets	190,999	(171,513)
Other	<u>16,053</u>	<u>1,134,143</u>
<b>Total nonoperating revenues (expenses)</b>	<u>404,052</u>	<u>8,264,981</u>
<b>Change in net assets</b>	<u>5,721,768</u>	<u>8,169,124</u>
Net assets, beginning	<u>82,044,987</u>	<u>73,875,863</u>
<b>Net assets, ending</b>	<u>\$ 87,766,755</u>	<u>\$ 82,044,987</u>

*See Notes to Financial Statements.*

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**STATEMENTS OF CASH FLOWS**  
**Years Ended May 31, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
<b>Cash flows from operating activities:</b>		
Receipts from customers	\$ 50,777,393	\$ 40,083,006
Payments to suppliers	(36,976,656)	(28,561,333)
Payments to employees	(8,777,407)	(8,910,565)
<b>Net cash provided by operating activities</b>	<u>5,023,330</u>	<u>2,611,108</u>
<b>Cash flows from noncapital financing activities:</b>		
Net change in accounts receivable (Navajo Agricultural Marketing, Inc.)	-	572,922
Proceeds from note receivable (Navajo Agricultural Marketing, Inc.)	880,047	-
<b>Net cash provided by noncapital financing activities</b>	<u>880,047</u>	<u>572,922</u>
<b>Cash flows from capital and related financing activities:</b>		
Subsidy from federal grants	6,699,747	13,724,230
Disbursements of federal grants	(6,394,921)	(7,367,788)
Acquisition and construction of capital assets	(6,520,198)	(13,011,272)
Proceeds from sale of capital assets	89,193	99,830
Principal paid on notes and capital leases	(2,097,307)	(2,712,158)
Proceeds from issuance of notes	918,311	-
Interest paid on notes and capital leases	(527,304)	(631,890)
Other receipts	16,053	1,134,143
<b>Net cash used by capital and related financing activities</b>	<u>(7,816,426)</u>	<u>(8,764,905)</u>
<b>Cash flows from investing activities:</b>		
Interest and dividends	724,304	634,241
<b>Net cash provided by investing activities</b>	<u>724,304</u>	<u>634,241</u>
<b>Net decrease in cash and cash equivalents</b>	<b>(1,188,745)</b>	<b>(4,946,634)</b>
Cash and cash equivalents, beginning	<u>11,287,050</u>	<u>16,233,684</u>
<b>Cash and cash equivalents, ending</b>	<u>\$ 10,098,305</u>	<u>\$ 11,287,050</u>
<b>Reconciliation of operating income (loss) to net cash provided by operating activities:</b>		
Operating income (loss)	\$ 5,317,716	\$ (95,857)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities		
Depreciation	4,284,902	4,633,734
Change in assets and liabilities:		
Accounts receivable - trade	1,545,582	(1,598,516)
Accounts and note receivables (Navajo Agricultural Marketing, Inc.)	(4,062,377)	-
Inventories	(2,724,770)	(231,745)
Prepaid items	18,873	(63,369)
Deferred alfalfa stand costs	(216,584)	1,151,490
Deferred conservation program costs	-	40,139
Accounts payable	1,804,403	(272,997)
Other accrued expenses	368,799	124,774
Deferred revenue	(1,313,214)	(1,076,545)
<b>Net cash provided by operating activities</b>	<u>\$ 5,023,330</u>	<u>\$ 2,611,108</u>

**Noncash Investing, Capital and Financing Activities:**

The following is information about all investing, capital and financing activities of the Navajo Agricultural Products Industry for years ended May 31, 2011 and 2010 that affect recognized assets or liabilities but do not result in cash receipts or payments:

Capital assets acquired through notes and capital leases.	\$ 46,155	-
Capital assets acquired through trade in	437,798	-
Note receivable issued to NAMI for prior year accounts receivable	4,030,357	

See Notes to Financial Statements.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
NOTES TO FINANCIAL STATEMENTS  
May 31, 2011 and 2010**

**NOTE 1. NATURE OF OPERATIONS**

Navajo Agricultural Products Industry (NAPI), an enterprise fund of the Navajo Nation, was created in 1967 for the purpose of administering the development and farming of certain Navajo Nation lands in northwestern New Mexico totaling 110,630 acres. The irrigated farm represents the utilization by the Navajo Nation of a federally funded project [Navajo Indian Irrigation Project (NIIP) established under Public Law 87-483] for irrigation and diversion of water from the San Juan River. The expenditure of federal funds for planning and development of the irrigated farm NAPI commenced in July 1971.

Operation of the irrigated farm project, consisting of 11 separate blocks or tracts of land, each consisting of approximately 10,000 acres with total acreage of 110,630, commenced in 1976. Through May 31, 2011, Blocks I through VIII, covering approximately 70,000 acres, have been placed in service and are available for farming purposes. As of May 31, 2011, 714 acres of the Block IX Stage 1 development have been placed in service with the remainder of the Block IX development in progress. The future development of Blocks X and XI, in conjunction with the completion of Block IX is dependent on receipt of additional funding.

NAPI's customers are located primarily in the southwestern United States including New Mexico, Arizona, California, Nebraska, and Texas. NAPI's principal crops are alfalfa, corn, potatoes, small grains, and beans. The revenues from these crops as a percentage of total crop revenues for the years ended May 31, 2011 and 2010 are as follows:

	<b>2011</b>	2010
Alfalfa	<b>24%</b>	41%
Beans	<b>16%</b>	22%
Corn	<b>37%</b>	19%
Potatoes	<b>20%</b>	12%
Small grains	<b>4%</b>	6%

Since NAPI sells a commodity, revenues may fluctuate significantly from year to year, depending on the market prices of the crops. In addition, the quantity and quality of product NAPI has available for sale is dependent on weather conditions during the planting, growing, and harvesting cycles.

In addition to farming and related operations, portions of the farm and certain adjacent Navajo Nation lands are periodically leased to outside parties for the purpose of agricultural and other farm-related activities.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of NAPI have been prepared in conformity with U.S. Generally Accepted Accounting Principles (GAAP) as applied to Enterprises of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of NAPI's accounting policies are described below.

*Reporting Entity.* Management has concluded NAPI is not a legally separate entity as defined by governmental accounting and financial reporting principles, and accordingly, NAPI is reported as an enterprise fund of the Navajo Nation in the accompanying financial statements. The financial statements present only the financial position, changes in financial position and cash flows of NAPI and do not purport to, and do not present fairly the financial position of the Navajo Nation and the changes in its financial position and its cash flows where applicable, in conformity with accounting principles generally accepted in the United States of America.

*Basis of Presentation and Accounting.* The NAPI's activities are similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Consistent with private business enterprises, the intent of NAPI is that costs (expenses, including depreciation) of providing goods or services on a continuing basis be financed or recovered primarily through user charges.

As an enterprise fund of the Navajo Nation, NAPI is reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place.

The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. In fiscal year 2011, NAPI adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Contained in Pre-November 30, 1989 and AICPA Pronouncements*, which incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. The adoption of GASB Statement 62 had no impact on NAPI's accounting policies, as NAPI had previously elected to not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, and applicable FASB pronouncements issued on or before November 30, 1989 have now been incorporated into GASB pronouncements.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The financial statements include statements of net assets; statements of revenues, expenses, and changes in net assets; and statements of cash flows.

A statement of net assets provides information about the assets, liabilities, and net assets of NAPI at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to external restrictions or availability of assets to satisfy NAPI obligations.

A statement of revenues, expenses, and changes in fund net assets provides information about NAPI's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions. Operating revenues and expenses result from providing services and producing and delivering goods in connection with NAPI principal ongoing operations. All other revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

A statement of cash flows provides information about NAPI's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as either operating, noncapital financing, capital financing or investing.

*Cash and Cash Equivalents.* For purposes of the statements of cash flows, NAPI considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. NAPI maintains cash and cash equivalents at certain financial institutions that may exceed federally insured amounts.

*Cash and Cash Equivalents – restricted.* Cash and cash equivalents – restricted are comprised of amounts restricted under the terms of grant agreements, and such amounts are not available for expenditure for current operations of NAPI.

*Inventories.* Crops in progress inventories are stated at the lower of cost or market. Cost is based on the amounts incurred through the fiscal year end. Harvested crops available for immediate delivery and that have a readily determinable and realizable market value are stated at net realizable value. Other inventories are valued at the lower of cost or market on a first-in, first-out basis.

*Investment in Navajo Agricultural Marketing, Inc.* NAPI is the sole common stock shareholder of Navajo Agricultural Marketing, Inc. (NAMI), a State of New Mexico corporation. NAMI was incorporated in June 2005 to purchase agricultural products in local and regional markets and to trade or market such products on the Chicago Board

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

of Trade, Kansas City Board of Trade, and other commodities exchange markets.

The investment in NAMI is accounted for using the equity method of accounting. Under the equity method, NAPI records its initial investment at cost, and then adjusts the carrying amount of the investment for its share of the earnings or losses of NAMI. Any dividends would reduce the carrying amount of the investment. As disclosed in Note 16, NAPI has guaranteed any NAMI borrowings under a \$1,000,000 revolving credit line and a \$100,000 standby letter of credit available to NAMI. No amounts were drawn by NAMI as of May 31, 2011.

NAPI has not guaranteed the obligations of NAMI, and is not otherwise committed to provide further financial support to NAMI. Accordingly, NAPI discontinued adjusting the carrying amount of the investment for any further losses of NAMI at the time NAPI's investment was reduced to zero. Should NAMI report net income in future periods, NAPI will resume applying the equity method only after the reported net income of NAMI equals the losses not recognized by NAPI during the period the equity method was suspended. Further, if NAPI's investment remains at zero and NAPI commits to providing further financial support to NAMI, NAPI will record a loss for the amount of such commitment.

*Capital Assets:*

*Land.* The land occupied by present and anticipated of future farm operations of NAPI consists of certain portions of the present Navajo Nation reservation and other designated federal, state, and privately owned lands acquired by the Navajo Nation and placed in trust with the Federal Government. The title to such property remains with the Navajo Nation and, therefore, the cost or other value of the property is not reflected in the accompanying financial statements.

*Primary Irrigation Facilities and Road.* The primary irrigation canal system, roads, and related facilities were financed by the Federal Government and are maintained primarily by the Federal Government and others for the benefit of the Navajo Nation through NAPI. Ownership rights to these facilities and roads have not been transferred to NAPI and, therefore, the cost or other value of these assets has not been reflected in the accompanying financial statements.

*Other.* Purchased capital assets are reflected at cost except, as noted elsewhere, contributed capital assets are stated at fair market value at the time of receipt. NAPI capitalizes the contract construction costs, its own

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

incurred direct construction labor, certain related overhead costs of land improvements (Blocks I through VIII), and irrigation and sprinkler equipment. Such land improvement costs are generally incurred during the primary development stage of the respective blocks. Costs of leveling and other expenditures that become a permanent part of the land are capitalized as incurred and are not depreciated or amortized as they have an indefinite useful life. Depreciation or amortization of depreciable assets constructed begins when the acreage is put to use. Renewals and betterments of capital assets that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Maintenance and repairs are charged to operating costs and expenses as incurred.

*Depreciation and Amortization.* Depreciation and amortization of capital assets are provided using the straight-line method over the estimated useful lives of the respective assets, as follows:

	<u>Useful lives</u> <u>(years)</u>
Buildings	10 to 20
Irrigation and sprinkler equipment	3 to 20
Farm, feedlot, shop, and other equipment	3 to 20
Pre production cost	3 to 20
Automotive equipment	3 to 5
Office and communication equipment	5 to 10
Software	5

*Capital Asset Capitalization Threshold.* Capital assets are defined by NAPI as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of one year.

*Alfalfa-Stand Costs.* Deferred alfalfa stand costs, net of amortization, represent the direct and indirect costs of preparing alfalfa stands for cultivation. Such deferred costs are amortized to operations over the lives of the alfalfa stands, which are estimated to be five years.

*Land Development Cost.* Land and development cost include both permanent and limited-life costs. Permanent land costs, such as initial land clearing, leveling and develop are not subject to depreciation. Limited-life development costs, such as water

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

delivery systems, are depreciated over the estimated life of the improvement. When crop production on developed land is at commercial quantities, depreciation of limited life capitalized costs begins. Crop revenues prior to production of commercial quantities reduce expenses in the year recognized.

*Net Assets.* Net assets of NAPI are classified in three components. Invested in capital assets, net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are non-capital net assets that are externally restricted for a particular purpose, in this case, for allowable grant expenditures as specified in grant agreements. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

*Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of.* NAPI reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

*Contributed Water and Related Cost.* In the course of conducting farm operations, NAPI utilizes irrigation water provided by the Federal Government, as discussed previously under primary irrigation facilities and roads. Neither the cost nor the contribution of the water is reflected in the accompanying financial statements.

*Nonexchange Transactions.* NAPI receives grants from certain Federal Government agencies, primarily the BIA and the Bureau of Reclamation, which meet the definition of nonexchange transactions under generally accepted accounting principles. Also, as an enterprise fund of the Navajo Nation, any capital contributions received from the Navajo Nation meet the definition of nonexchange transactions pursuant to generally accepted accounting principles.

NAPI recognizes revenue for the Federal Government grants and the capital contributions when all eligibility requirements have been met. Monies received before the eligibility requirements have been fulfilled by NAPI are reported as deferred revenue.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Crop Revenues and Cost Recognition.* Crop revenues and associated costs are recognized on a "crop year" basis. The crop year ends when the crop is harvested or when substantially all associated costs are incurred. Costs associated with crops are matched with the corresponding revenue for the crop year. Crop costs incurred subsequent to the crop year are recorded as crops in progress in the fiscal year incurred, and are matched with the corresponding revenues of the following crop year's harvest.

*Accounts Receivable.* Receivables are recorded net of allowance for doubtful accounts to report the receivables at their net realizable values.

*Federal Income Taxes.* The Navajo Nation is a recognized Indian Nation and is exempt from Federal and State income taxes. Accordingly, no provision for Federal and State income taxes has been made in the financial statements.

*Estimates.* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

*Concentrations of Credit Risk.* NAPI's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. NAPI places its cash with high credit worthy institutions. At times such cash may be in excess of the FDIC insurance limit. As of May 31, 2011 and 2010, all of NAPI's cash held with financial institutions was fully insured under the Dodd-Frank Deposit Insurance Provision as all NAPI's cash balances are non-interest bearing. This program expires on December 31, 2012.

*Comparative Data.* Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 3. CASH AND INVESTMENTS**

At May 31, 2011 and 2010, cash and cash equivalents consisted of the following:

	2011	2010
Cash on hand	\$ 2,150	\$ 1,850
Cash in bank and repurchase agreements	5,781,897	4,955,098
Cash equivalents – money market	<u>4,314,258</u>	<u>6,330,102</u>
Total	<u>\$ 10,098,305</u>	<u>\$ 11,287,050</u>

*Custodial Credit Risk.* Custodial credit risk is the risk that in the event of a bank failure, NAPI's deposits may not be returned. NAPI does not have a deposit policy for custodial credit risk. NAPI's cash and cash equivalents were not subject to custodial risk as all cash was fully insured, the repurchase agreement was fully collateralized, and money market accounts are not subject to custodial credit risk.

**NOTE 4. ACCOUNTS RECEIVABLE - TRADE**

At May 31, 2011 and 2010, accounts receivable - trade were as follows:

	2011	2010
Receivables:		
Crops	\$ 1,163,495	\$ 2,212,349
Other	<u>129,168</u>	<u>702,103</u>
Gross receivables	1,292,663	2,914,452
Less allowance for uncollectible	<u>(111,640)</u>	<u>(187,847)</u>
Net total receivables	<u>\$ 1,181,023</u>	<u>\$ 2,726,605</u>

**NOTE 5. ACCOUNTS AND NOTE RECEIVABLE – NAMI**

The May 31, 2011 and 2010 NAPI reported accounts receivables from NAMI of \$5,833,677 and \$5,801,657 respectively. The accounts receivable consisted of items such as:

- Short term cash loans to NAMI
- Corn and wheat inventory sold to NAMI
- Fees associated with granary facility storage
- Other miscellaneous charges paid by NAPI on behalf of NAMI for items such as consultants, travel, and utilities

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 5. ACCOUNTS AND NOTE RECEIVABLE – NAMI (CONTINUED)**

In January 2011, NAPI entered into a note receivable with NAMI for \$4,030,357. The note receivable requires monthly principal payments of \$229,264 through April 2012, with a final principal payment of \$687,793 due in May 2012. The note bears interest at prime plus 1%, or 4.5% as of May 31, 2011.

In February 2011, NAPI and NAMI rescinded their current marketing agreement that, among other items, had limited NAMI to a \$.35 per bushel profit margin on harvested crops. Management believes the elimination of this cap will allow NAMI to fully repay amounts owed to NAPI during fiscal year 2012. As management believes the account and note receivables are fully collectible, no provision for uncollectible receivables has been established on these amounts as of May 31, 2011. A future deterioration of commodity prices, while not deemed likely, may occur and cause such receivable balances to not be fully collected.

**NOTE 6. INVENTORIES**

At May 31, 2011 and 2010, inventories were as follows:

	<b>2011</b>	2010
Crops in progress	<b>\$ 17,144,802</b>	\$ 17,381,180
Repair parts and supplies	<u><b>3,480,781</b></u>	<u>519,633</u>
	<u><b>\$ 20,625,583</b></u>	<u>\$ 17,900,813</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 7. CAPITAL ASSETS**

Capital asset activity for the year ended May 31, 2011 was as follows:

	Beginning Balance	Increases	Decreases	Reclass	Ending Balance
Capital assets, not being depreciated:					
Construction in progress	\$ 1,138,623	\$ 5,611,382	\$ -	\$ (4,240,965)	\$ 2,509,040
Total capital assets, not being depreciated	<u>1,138,623</u>	<u>5,611,382</u>	<u>-</u>	<u>(4,240,965)</u>	<u>2,509,040</u>
Capital assets, being depreciated:					
Land improvements	18,975,594	-	-	-	18,975,594
Buildings	27,456,905	143,476	(6,100)	1,160,839	28,755,120
Irrigation and sprinkler equipment Farm, feedlot, shop and other equipment	43,723,044	14,205	-	1,681,658	45,418,907
Automotive equipment	20,599,025	1,225,480	(1,669,828)	1,055,594	21,210,271
Software, office and communications equipment	3,309,810	2,425	(413,312)	342,874	3,241,797
	2,643,238	7,183	-	-	2,650,421
Total capital assets, being depreciated	<u>116,707,616</u>	<u>1,392,769</u>	<u>(2,089,240)</u>	<u>4,240,965</u>	<u>120,252,110</u>
Less accumulated depreciation for:					
Land improvements	(2,858,822)	(3,837)	-	-	(2,862,659)
Buildings	(20,118,033)	(823,911)	6,100	-	(20,935,844)
Irrigation and sprinkler equipment Farm, feedlot, shop and other equipment	(22,983,143)	(897,978)	-	-	(23,881,121)
Automotive equipment	(13,089,408)	(1,827,101)	1,351,851	-	(13,564,658)
Software, office and communications equipment	(2,102,488)	(522,051)	395,297	-	(2,229,242)
	(1,765,168)	(210,024)	-	-	(1,975,192)
Total accumulated depreciation	<u>(62,917,062)</u>	<u>(4,284,902)</u>	<u>1,753,248</u>	<u>-</u>	<u>(65,448,716)</u>
Total capital assets, being depreciated, net	<u>53,790,554</u>	<u>(2,892,133)</u>	<u>(335,992)</u>	<u>4,240,965</u>	<u>54,803,394</u>
Total capital assets, net	<u>\$ 54,929,177</u>	<u>\$ 2,719,249</u>	<u>\$ (335,992)</u>	<u>\$ -</u>	<u>\$ 57,312,434</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 7. CAPITAL ASSETS (CONTINUED)**

Capital asset activity for the year ended May 31, 2010 was as follows:

	Beginning Balance	Increases	Decreases	Reclass	Ending Balance
Capital assets, not being depreciated:					
Construction in progress	\$ 2,668,736	\$ 2,097,048	\$ -	\$ (3,627,161)	\$ 1,138,623
Total capital assets, not being depreciated	<u>2,668,736</u>	<u>2,097,048</u>	<u>-</u>	<u>(3,627,161)</u>	<u>1,138,623</u>
Capital assets, being depreciated:					
Land improvements	18,975,594	-	-	-	18,975,594
Buildings	24,721,369	-	(60,015)	2,795,551	27,456,905
Irrigation and sprinkler equipment	35,352,025	7,539,409	-	831,610	43,723,044
Farm, feedlot, shop and other equipment	18,744,008	2,519,364	(664,347)	-	20,599,025
Automotive equipment	2,509,382	836,377	(35,949)	-	3,309,810
Software, office and communications equipment	2,624,164	19,074	-	-	2,643,238
Total capital assets, being depreciated	<u>102,926,542</u>	<u>10,914,224</u>	<u>(760,311)</u>	<u>3,627,161</u>	<u>116,707,616</u>
Less accumulated depreciation for:					
Land improvements	(2,854,985)	(3,837)	-	-	(2,858,822)
Buildings	(19,327,221)	(850,827)	60,015	-	(20,118,033)
Irrigation and sprinkler equipment	(21,719,986)	(1,263,157)	-	-	(22,983,143)
Farm, feedlot, shop and other equipment	(11,606,988)	(1,895,968)	413,548	-	(13,089,408)
Automotive equipment	(1,738,293)	(379,600)	15,405	-	(2,102,488)
Software, office and communications equipment	(1,524,823)	(240,345)	-	-	(1,765,168)
Total accumulated depreciation	<u>(58,772,296)</u>	<u>(4,633,734)</u>	<u>488,968</u>	<u>-</u>	<u>(62,917,062)</u>
Total capital assets, being depreciated, net	<u>44,154,246</u>	<u>6,280,490</u>	<u>(271,343)</u>	<u>3,627,161</u>	<u>53,790,554</u>
Total capital assets, net	<u>\$ 46,822,982</u>	<u>\$ 8,377,538</u>	<u>\$ (271,343)</u>	<u>\$ -</u>	<u>\$ 54,929,177</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 8. SHORT-TERM DEBT – REVOLVING LINE OF CREDIT**

During fiscal year 2010, NAPI entered into a revolving line of credit with Well Fargo Bank. This revolving line of credit is to provide for short term working capital to be used for purchasing trading and/or marketing of agricultural products. The responsible parties under this revolving line of credit are NAPI and NAMI. This revolving line of credit is authorized up to \$10,000,000, carries an interest rate of 1.75% above LIBOR and has maturity date of June 30, 2013. Interest accrued on this revolving line of credit shall be payable on the 15<sup>th</sup> day of each month, commencing December 15, 2008. During the fiscal year 2011 and 2010, NAPI/NAMI did not utilize this revolving line of credit and it had a balance of \$0 at May 31, 2011 and 2010.

This obligation is secured by crops, inventory and accounts receivable of both responsible parties, in addition to the commodity bank account of NAMI.

**NOTE 9. LONG-TERM DEBT**

*Capital Leases.* NAPI was entered into various lease agreements as the lessee for financing the acquisition of agricultural equipment. These lease agreements qualify as capital leases for accounting purposes and, therefore, have been recorded at the present value of their future minimum lease payments as of the inception date.

At May 31, assets acquired through capital leases are as follows:

	<b>2011</b>	2010
Asset:		
Farm, feedlot, shop, and other equipment	\$ 3,246,297	\$ 3,200,142
Less accumulated depreciation	<u>(2,289,254)</u>	<u>(1,933,861)</u>
Total	<u>\$ 957,043</u>	<u>\$ 1,266,281</u>

The future minimum lease obligations and the net present value of these minimum lease payments as of May 31, 2011

Year ending May 31,	
2012	\$ 317,159
2013	<u>185,008</u>
Total minimum lease payments	502,167
Less amount representing interest	<u>(24,792)</u>
Present value of minimum lease payments	<u>\$ 477,375</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 9. LONG-TERM DEBT (CONTINUED)**

*Note Payable.* At May 31, 2011 and 2010, NAPI's note payable consisted of the following:

	2011	2010
Wells Fargo bank note payable, secured by equipment, principal payments of \$922,672 plus accrued interest due on April 1 annually, interest accrues at 6.81%, due April 2016	\$ 4,613,359	\$ 5,536,030
Key Equipment Finance note payable, secured by equipment, payable in monthly installments of \$48,017, including interest of 6.46%, due September 2013	1,244,956	1,723,817
Key Bank note payable, secured by crops and accounts receivables, payable in installments of \$112,000 on December 1, February 28, and September 1, annually; interest at 3.25% due December 2013.	<u>886,443</u>	<u>-</u>
Total notes payable	6,744,758	7,259,847
Less current portion of the notes payable	<u>(1,758,480)</u>	<u>(1,401,533)</u>
Noncurrent portion of the notes payable	<u>\$ 4,986,278</u>	<u>\$ 5,858,314</u>

As of May 31, 2011 annual debt service requirements to maturity for the note payable are as follows:

Year ending May 31,	Principal	Interest	Total
2012	\$ 1,758,480	\$ 390,568	\$ 2,149,048
2013	1,792,468	293,746	2,086,214
2014	1,348,466	198,789	1,547,255
2015	922,672	125,668	1,048,340
2016	<u>922,672</u>	<u>62,834</u>	<u>985,506</u>
Total	<u>\$ 6,744,758</u>	<u>\$ 1,071,605</u>	<u>\$ 7,816,363</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 9. LONG-TERM DEBT (CONTINUED)**

*Changes in long-term liabilities.* Long term liability activity for the year ended May 31, 2011 was as follows:

	June 1, 2010	Additions	Reductions	May 31, 2011	Due Within One Year
Notes payable	\$ 7,259,847	\$ 918,311	\$ 1,433,400	\$ 6,744,758	\$ 1,758,480
Capital leases	1,095,127	46,155	663,907	477,375	296,094
Total	<u>\$ 8,354,974</u>	<u>\$ 964,466</u>	<u>\$ 2,097,307</u>	<u>\$ 7,222,133</u>	<u>\$ 2,054,574</u>

Long-term liability activity for the year ended May 31, 2010 was as follows:

	June 1, 2009	Additions	Reductions	May 31, 2010	Due Within One Year
Notes payable	\$ 9,093,494	\$ -	\$ 1,833,647	\$ 7,259,847	\$ 1,401,533
Capital leases	1,682,038	-	586,911	1,095,127	598,592
Credit agreement	291,600	-	291,600	-	-
Total	<u>\$ 11,067,132</u>	<u>\$ -</u>	<u>\$ 2,712,158</u>	<u>\$ 8,354,974</u>	<u>\$ 2,000,125</u>

**NOTE 10. DEFERRED REVENUE**

At May 31, 2011 deferred revenue consisted of the following:

Agricultural operations related:

Prepaid leases and crop payments	\$ 913,193
Other	<u>33,626</u>
Total deferred revenue related to agricultural operations	\$ 946,819

Navajo Indian Irrigation Project (NIIP) related:

Portion of U.S. Department of Interior grant reimbursements in excess of expenditures	<u>849,966</u>
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Total deferred revenue \$ 1,796,785

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
NOTES TO FINANCIAL STATEMENTS  
May 31, 2011 and 2010**

**NOTE 10. DEFERRED REVENUE (CONTINUED)**

At May 31, 2010 deferred revenue consisted of the following:

Agricultural operation related:		
Prepaid leases and crop payments	\$	683,737
Other		<u>41,784</u>
Total deferred revenue related to agricultural operations		725,521
Navajo Indian Irrigation Project (NIIP) related:		
Portion of U.S. Department of Interior grant reimbursements in excess of expenditures		<u>2,384,478</u>
Total deferred revenue		<u>\$ 3,109,999</u>

**NOTE 11. RISK MANAGEMENT**

NAPI is exposed to various risks of loss related to torts and civil rights; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and non-employees; and natural disasters. NAPI participates in the Navajo Nation Risk Management Program (Risk Management), which was established to manage, control, and minimize this risk. Under this program, the Risk Management pool provides coverage for up to a maximum of \$500,000 for each incident. Risk Management purchases commercial insurance for claims in excess of coverage provided by the Risk Management pool.

**NOTE 12. OPERATING AGREEMENTS**

At May 31, 2011 and 2010 NAPI had various operating agreements as follows:

- (a) Pumpkin Patch Fundraisers, Inc.

On February 2, 1998, NAPI entered into an operating agreement with Pumpkin Patch Fundraisers, Inc. (Pumpkin Patch) to plant, grow, harvest, market, sell, and ship pumpkins grown on NAPI land. The parties entered into a revised operating agreement on May 23, 2002. Under this agreement, NAPI provides land, water, maintenance of the NAPI water delivery system, and limited equipment, materials, and labor costs. NAPI receives reimbursement of specified costs, a base lease payment for office space. During the years

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 12. OPERATING AGREEMENTS (CONTINUED)**

ended May 31, 2011 and 2010, NAPI recorded revenues of \$248,138 and \$253,619, respectively, under this agreement. Such revenue is included in agricultural-related joint ventures revenue in the accompanying financial statements. This agreement expires on December 31, 2014.

(b) Upland Desert Popcorn, Ltd.

On September 12, 2003, NAPI entered into an Industrial Park Lease and Facilities Agreement with Upland Desert Popcorn, Ltd. (UDP) to use only the construction, repair and maintenance of storage bins for popcorn. As part of the consideration of Upland Desert Popcorn for the nominal lease payments to be made to NAPI, UDP shall construct and install utilities, roadways and other infrastructure and keep facilities free of liens or any other encumbrances. Under this agreement, UDP has the option to farm corn in rotation with pumpkins. If UDP does so exercise such option, UDP shall pay NAPI \$140 per acre per year. During the years ended May 31, 2011 and 2010, NAPI recorded revenues of \$923,468 and \$534,616 respectively, under this agreement. Such revenue is included in agricultural-related joint ventures revenue in the accompanying financial statements. This agreement expires on December 31, 2014.

(c) Navajo Mesa Farms, LLC

On February 1, 2003, NAPI entered into an operating and lease agreement with Navajo Mesa Farms, LLC (Navajo Mesa) to plant, grow, harvest, and store potatoes grown on approximately 1,595 acres of NAPI land. Under this agreement, NAPI provides land and water, maintenance on the NAPI water delivery system, storage facilities, a disposal area for waste potatoes and wastewater, and reasonable services from NAPI's soils lab. Navajo Mesa provides seed, seed freight, cultivation, center plot irrigation labor, chemigation, pesticide applications, harvest, hauling, storage, shipping, and any costs associated with these operations. This agreement was amended in 2009 to increase the total acres to approximately 4,000 with additional storage as well. NAPI receives rental payments for irrigated croplands and potato storage facilities in the amount of \$400 per acre per annum or \$1,600,000 per year. In addition, in any year Navajo Mesa exceeds \$2,600 per Acre of gross sales, Navajo Mesa shall pay NAPI 10% of gross sales in excess of \$2,600 per acre as participation rent. Further, NAPI also receives payments for the use of the potato storage facility and scales. During the years ended May 31, 2011 and 2010, NAPI recorded revenues of \$2,052,686 and \$3,470,315 respectively, under this agreement. Such revenue

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 12. OPERATING AGREEMENTS (CONTINUED)**

is included in agricultural-related joint ventures revenue in the accompanying financial statements. The agreement expires on October 31, 2018.

(d) Wilbur-Ellis Company

On November 02, 2003 NAPI entered into a facilities and equipment lease, and product sales and application agreement with Wilbur-Ellis Company. Under this agreement, Wilbur-Ellis shall maintain adequate inventories or products at the Facilities to meet NAPI's expected demand for the products. Wilbur-Ellis shall apply aerial application of products on a timely basis as requested by NAPI. NAPI shall lease to Wilbur-Ellis certain facilities for the storage and distribution of the products on NAPI land. During the years ended May 31, 2011 and 2010, revenue of \$62,850 and \$63,000 respectively, was recognized under this agreement. The agreement expires on October 31, 2013.

(e) Five Star Oil and Gas

On April 19, 2006, NAPI entered into a facilities agreement with Five Star Oil and Gas: for Lessees' rent of Farm-N-Go Convenience Store located near Highway 37.1 and N3003. Under this agreement, the Contractor shall use the premises only for the repair, maintenance and operation of a service station and related facilities. Contractor also has the option to add on a laundromat, food mart and feed store at later dates. In lieu of monetary rental payments, Contractor shall provide fuel to NAPI for NAPI's on-farm needs at the Contractor's posted retail prices minus three cents per gallon for a period of one year from the effective date of the agreement. On April 18, 2010, this lease was amended and in lieu of providing fuel to NAPI for NAPI's on-farm needs, the Contractor will pay NAPI \$850 per month for use of the facilities. This agreement is month to month.

(f) J & M Baling, Inc.

On October 31, 2008, NAPI entered into an Operations and Rental Agreement with J&M Baling, Inc. Under this agreement, Contractor will custom swath, bale and field stack up to 225,000 bales of three-twine or big bales wheat straw. NAPI will provide up to six combines and two stripper headers, and Contractor will provide four strip headers in good working condition. This agreement expired on October 31, 2009. On November 13, 2009, NAPI entered into an Operations and Rental Agreement with J&M Baling, Inc. Under this agreement, Contractor will custom rake, bale, and field stack 18,011.8 acres of alfalfa hay into two-twine, three-twine or big bales for NAPI. The contractor shall supply all

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
NOTES TO FINANCIAL STATEMENTS  
May 31, 2011 and 2010**

**NOTE 12. OPERATING AGREEMENTS (CONTINUED)**

necessary equipment, machinery and qualified personnel need to ensure the needs and interest of NAPI. This agreement expires on December 31, 2012.

(g) JBS Five Rivers Cattle Feeding, LLC

On September 1, 2009 NAPI entered into a feedlot agreement with JBS Rivers. Under this agreement, JBS Five Rivers shall perform and manage all its activities on NAPI lands in accordance to the highest standards of agricultural practices in maintaining the NAPI feedlot in accordance of US EPA NNEPA and CAFO regulations. In consideration for the use of NAPI's feedlot, JBS Five Rivers will pay \$50,000 base rent, not exceeding \$100,000 per year plus an additional amount per year equal to 20% of NAPI's cost to maintain the facility. JBS also agreed to pay NAPI \$300 per month for telecommunication service. This agreement is not a joint venture with NAPI so no revenue on the cost reimbursement is recognized from the agreement. The agreement expired on August 31, 2011.

**NOTE 13. FACILITIES AND EQUIPMENT LEASE AND PRODUCT SALES AND APPLICATION AGREEMENT**

In an effort to reduce costs and improve crop yields, NAPI entered into a Facilities and Equipment Lease, and Product Sales and Application Agreement with the Wilbur-Ellis Company (Wilbur-Ellis). According to the terms of the agreement Wilbur-Ellis will sell and apply various agricultural chemicals, fertilizers, seeds, and micronutrients to NAPI fields. During the years ended May 31, 2011 and 2010, NAPI paid \$12,067,611 and \$9,523,380 respectively to Wilbur-Ellis for their services. In conjunction with this, NAPI leases from Wilbur-Ellis certain facilities and equipment for storage and distribution of the chemicals and fertilizer utilized to treat NAPI's fields. During the years ended May 31, 2011 and 2010, NAPI received approximately \$84,000 and \$71,900, respectively, in base rental revenue for the facilities and equipment, under the terms of this agreement. The agreement has been extended through October 31, 2013.

**NOTE 14. CONTINGENCIES**

All federal and state program expenditures are subject to audit by the various grantors, which may result in disallowed program expenditures. Generally, such audits must commence within three years of the program's termination date. No provision for

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 14. CONTINGENCIES (CONTINUED)**

disallowed costs has been made in the accompanying financial statements, as the disallowed costs, if any, will be recorded in the period they are determined.

NAPI is party to various legal proceedings in the normal course of business. In management's opinion, after consultation with outside legal counsel, the disposition of these matters will not materially affect the financial position of the farm.

**NOTE 15. WHOLLY OWNED RELATED PARTY TRANSACTIONS**

In addition to the guarantee of debt described in Note 16, the equity method investment described in Note 17, and the sales commitments described in Note 18, NAPI transacted the following business transactions with NAMI during fiscal years 2011 and 2010:

Fiscal year 2011

1. NAPI sold corn and wheat inventory to NAMI "on account" in the amount of \$13,132,742.
2. NAMI repaid \$9,042,916 to NAPI for corn and wheat inventory purchases, granary charges, and other miscellaneous items incurred during both fiscal years 2011 and 2010.
3. NAMI utilized NAPI's granary facilities to store its purchased corn and wheat inventory. NAPI charged NAMI \$817,012 for this storage service.
4. At May 31, 2011, NAPI has recognized a current account receivable due from NAMI in the amount of \$5,833,677 (See Note 5).
5. At May 31, 2011, NAPI has recognized a current note receivable due from NAMI in the amount of \$3,150,310 (See Note 5).

Fiscal year 2010

1. NAPI sold corn and wheat inventory to NAMI "on account" in the amount of \$6,999,177.
2. NAMI repaid \$7,585,651 to NAPI for corn and wheat inventory purchases, granary charges, and other miscellaneous items incurred during both fiscal years 2009 and 2010.
3. NAMI utilized NAPI's granary facilities to store its purchased corn and wheat inventory. NAPI charged NAMI \$692,355 for this storage service.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 15. WHOLLY OWNED RELATED PARTY TRANSACTIONS (CONTINUED)**

4. At May 31, 2010, NAPI has recognized accounts receivable due from NAMI in the amount of \$5,801,657, of which \$1,091,105 was classified as current, and \$4,710,552 was long-term (See Note 5).

**NOTE 16. GUARANTEE OF DEBT - WHOLLY OWNED RELATED PARTY**

NAMI's share of the debt disclosed in Note 8 includes a \$1,000,000 revolving credit line and a \$100,000 standby letter of credit with Wells Fargo Bank, N.A. The following is a recap of significant terms of the two credit lines:

- *Revolving credit line.* Principal associated with this credit line is due and payable fourteen months from the effective date of the loan. The interest rate shall equal 1.75% above LIBOR. Interest payments are due on a monthly basis. As of May 31, 2011, the revolving credit line balance was \$0. The maturity date for this credit line is June 30, 2013.
- *Standby letter of credit.* Principal associated with the letter of credit is due and payable as one payment, no later than July 2011. The interest rate shall equal the Wells Fargo Bank Prime Rate minus .88% (floating). Interest payments are due on a monthly basis. As of May 31, 2011 and 2010, the standby letter of credit balance was \$0.

This obligation is secured by crops, inventory and accounts receivable of both responsible parties, in addition to the commodity bank account of NAMI.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY**  
**NOTES TO FINANCIAL STATEMENTS**  
**May 31, 2011 and 2010**

**NOTE 17. EQUITY METHOD INVESTMENT – WHOLLY OWNED RELATED PARTY**

Summary financial statements of NAMI, reported by NAPI under the equity method of accounting (see Note 2), are as follows at May 31, 2011 and 2010:

**SUMMARIZED BALANCE SHEETS**

	<b>Unaudited</b>	
	<b>2011</b>	<b>2010</b>
Current assets:		
Cash	\$ 616,381	587,906
Accounts receivable	1,768,882	452,438
Inventories	3,288,281	1,661,703
Other	73,998	316,518
Total assets	<u>5,747,542</u>	<u>3,018,565</u>
Current liabilities:		
Accounts payable - NAPI	5,833,677	1,091,005
Notes payable - NAPI	3,150,310	-
Other	383,994	41,845
	<u>9,367,981</u>	<u>1,132,850</u>
Long-term liabilities:		
Accounts payable - NAPI	<u>-</u>	<u>4,710,552</u>
Total liabilities	<u>9,367,981</u>	<u>5,843,402</u>
Stockholder's equity		
Common stock	1,000,000	1,000,000
Retained deficit	(4,590,601)	(4,023,337)
Accumulated other comprehensive (loss) income	(29,838)	198,500
Total stockholder's equity	<u>(3,620,439)</u>	<u>(2,824,837)</u>
Total liabilities and stockholder's equity	<u>\$ 5,747,542</u>	<u>3,018,565</u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
NOTES TO FINANCIAL STATEMENTS  
May 31, 2011 and 2010**

**NOTE 17. EQUITY METHOD INVESTMENT – WHOLLY OWNED RELATED PARTY  
(CONTINUED)**

**SUMMARIZED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**

	<b>Unaudited 2011</b>	<b>2010</b>
Sales	\$ 12,996,293	5,669,752
Cost of goods sold	12,533,780	4,909,076
Selling and administrative expenses	271,117	213,045
Interest and other expenses	714,590	614,293
Income tax (benefit) expense	44,070	(98,121)
Net income (loss)	(567,264)	31,459
Unrealized gain for changes in value on cash flow hedges	547,509	197,856
Net gains (losses) reclassified on matured cash flow hedges	(775,847)	285,919
Comprehensive income (loss)	<u>\$ (795,602)</u>	<u>515,234</u>

**NOTE 18. CORN/WHEAT SALES COMMITMENTS – WHOLLY OWNED RELATED PARTY**

NAPI has entered into various corn/wheat sales contracts with NAMI. The provisions of these contracts stipulate that NAPI is required to deliver to NAMI a specific number of bushels at a contracted price.

The following schedule provides a brief recap by fiscal year of these outstanding forward purchase contracts at May 31, 2011:

<u>Crop</u>	<u>Fiscal Year</u>	<u>Bushels</u>	<u>Average Price per Bushel</u>	<u>Extended Amount</u>
Corn	2012	150,000	\$ 4.7500	\$ 712,500
Wheat	2012	525,000	5.0000	\$ 2,625,000

**SUPPLEMENTAL INFORMATION**

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**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
For the Year Ended May 31, 2011**

<b>Federal Grantor/Program Title</b>	<b>CFDA Number</b>	<b>Expenditures</b>
<b>U.S. Department of Interior</b>		
Bureau of Indian Affairs		
Maintenance and Replacement; On-Farm Development; and Agricultural Testing, Research and Laboratory Programs	15.036	<u>\$ 5,726,646</u>
Bureau of Reclamation		
O&M of Facilities in Construction Status	15.04-NA-40-2095	972,701
Cooperative Agreement for Minor Construction	15.05-NA-40-2290	397
E-40	15.9-07-40-R0860	<u>3</u>
Total Bureau of Reclamation		<u>973,101</u>
Total Expenditures of Federal Awards		<u><u>\$ 6,699,747</u></u>

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
For the Year Ended May 31, 2011**

**NOTE 1. BASIS OF ACCOUNTING**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Navajo Agricultural Products Industry (NAPI) and is presented on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Because the schedule presents only a selected portion of the operations of NAPI, it is not intended to and does not present the financial position, changes in net assets or cash flows of NAPI.

**NOTE 2. CATALOG OF FEDERAL DOMESTIC ASSISTANCE (CFDA) NUMBERS**

The program titles and CFDA numbers were obtained from the federal or pass-through grantor or the Catalog of Federal Domestic Assistance. When no CFDA number had been assigned to a program, the two-digit federal agency identifier, a period, and the federal contract number was used.

**NOTE 3. SUBRECIPIENTS**

The Navajo Agricultural Products Industry did not provide federal awards to subrecipients during the year ended May 31, 2011.

## **Report of Independent Auditors 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***

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry  
Farmington, New Mexico

We have audited the financial statements of Navajo Agricultural Products Industry (NAPI), an enterprise fund of the Navajo Nation, as of and for the year ended May 31, 2011, and have issued our report thereon dated November 21, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

Management of NAPI is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered NAPI'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 an opinion on the effectiveness of NAPI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of NAPI'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 that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry

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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 10-01 and 11-01 to be material weaknesses.

#### Compliance and Other Matters

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

NAPI's responses to the findings identified in the audit are described in the accompanying schedule of findings and questioned costs. We did not audit NAPI's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Board of Directors and management of NAPI, the Navajo Nation, and federal awarding agencies and it is not intended to be and should not be used by anyone other than these specified parties.

*Mess Adams LLP*

Albuquerque, New Mexico  
November 21, 2011

## **Report of Independent Auditors on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133**

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry  
Farmington, New Mexico

### Compliance

We have audited the compliance of Navajo Agricultural Products Industry (NAPI), an enterprise fund of the Navajo Nation, with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of NAPI's major federal programs for the year ended May 31, 2011. NAPI's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of NAPI's management. Our responsibility is to express an opinion on Navajo Agricultural Products Industry's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about NAPI's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of NAPI's compliance with those requirements.

As described in item 11-04 in the accompanying schedule of findings and questioned costs, NAPI did not comply with requirements regarding Davis Bacon Act that are applicable to its Maintenance and Replacement, On-Farm Development, and Agricultural Testing, Research and Laboratory Programs. Compliance with such

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry

requirements is necessary, in our opinion, for NAPI to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, NAPI complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended May 31, 2011.

#### Internal Control Over Compliance

Management of NAPI is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered NAPI's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of NAPI's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance 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 discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses, and other deficiencies that we consider to be significant deficiencies.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected,

Honorable Chairman and Members of the Board of Directors  
Navajo Agricultural Products Industry

on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 10-05, 11-02, and 11-04 to be material weaknesses.

*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 11-03 to be a significant deficiency.

NAPI's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit NAPI's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Board of Directors and management of NAPI, the Navajo Nation, and federal awarding agencies, and is not intended to be and should not be used by anyone other than these specified parties.

*Mess Adams LLP*

Albuquerque, New Mexico  
November 21, 2011

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section I — Summary of Auditor's Results**

***Financial Statements***

Type of auditor's report issued:	<b>Unqualified</b>	
	<b>YES</b>	<b>NO</b>
Material weakness(es) identified?	<u>  X  </u>	<u>      </u>
Significant deficiency(ies) identified?	<u>      </u>	<u>  X  </u>
Noncompliance material to the financial statements noted?	<u>      </u>	<u>  X  </u>

***Federal Awards***

Material weakness(es) identified?	<u>  X  </u>	<u>      </u>
Significant deficiency(ies) identified?	<u>  X  </u>	<u>      </u>

Type of auditor's report issued on compliance for major programs: **Qualified for CFDA 15.036**  
**Unqualified for 15.04-NA-40-2095**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	<u>  X  </u>	<u>      </u>
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Identification of major programs:

<u>CFDA / Contract Number</u>	<u>Name of Federal Program or Cluster</u>
CFDA 15.036	Maintenance and Replacement; On-Farm Development; and Agricultural Testing, Research and Laboratory Programs
CFDA 15.04-NA-40-2095	O&M of Facilities in Construction Status

Dollar threshold used to distinguish between Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee?	<u>      </u>	<u>  X  </u>
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**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section II – Financial Statement Findings**

**10-01 – Financial Reporting (Material Weakness)**

CONDITION

In testing financial statement balances, we noted material adjustments were required and reconciliation of several statement of net asset accounts had not been properly performed or documented. Specifically, we noted the following:

- The federal grant activity was not properly reconciled and various material entries were required to properly state the balances (see finding 10-05).
- The opening general ledger balances did not agree to prior year's audited balances, and further the differences were not identified or reconciled by NAPI.
- Fixed assets were not properly reconciled and a roll-forward of fixed assets that agreed to prior audited balances, current year general ledger balances, and to the fixed asset system's balances could not be provided. We assisted management in the research of the cause of the variances and management posted an adjustment for the needed corrections.

CRITERIA

A properly designed system of internal controls includes the complete and accurate reconciliation of all accounts. To properly reconcile accounts, NAPI must first reconcile and adjust the general ledger to agree to audited opening balances. At year-end, reconciliations between subsidiary records and the general ledger should be prepared, such as a fixed asset roll-forward that properly reconciles the recorded balances to subsidiary records.

CAUSE

Current reconciliation processes are not adequately designed to ensure that all accounts are subject to complete and proper reconciliation. Also, the reconciliations should be reviewed by the Controller and exceptions should be identified and corrected.

EFFECT

The financial information distributed to management, the board, and to external parties during the year was materially inaccurate, and there is an increased risk that errors, fraud, or irregularities can go undetected and corrected.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section II – Financial Statement Findings (Continued)**

**10-01 – Financial Reporting (Material Weakness) (Continued)**

RECOMMENDATION

We recommend NAPI implement a formal process for reconciling the activity of account on a monthly basis. The year-end reconciliations should follow the same process as used in the monthly reconciliations, as adjusted to include the full year of activity. As a pre-requisite to complete and accurate reconciliations, NAPI must reconcile and adjust opening balances to the prior audited balances.

MANAGEMENT'S RESPONSE

As a result of the 2009-2010 audit recommendation made by Miller Allen, NAPI hired a qualified candidate to occupy the Program Analyst position in October 2010. The Program Analyst was hired to take on the responsibilities of the 638 accounting activities to ensure that all program funding requirements and reconciliations are submitted in a timely manner.

In response to the second item noted under 10-01 Financial Reporting (Material Weakness) NAPI has revised the NAPI Accounting Policies and Procedures Manual (effective September 23, 2011) to reflect that all reconciliations will be performed or conducted on a monthly basis by the Controller or other authorized Accounting personnel.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section II – Financial Statement Findings (Continued)**

**11-01 – Procurement (Material Weakness)**

CONDITION

In testing for proper procurement under NAPI's policies and procedures, we noted an instance where a contract was not subject to proper procurement procedures. The total payments made to the contractor approximated \$562,000 during fiscal year 2011.

CRITERIA

NAPI's procurement policy requires that NAPI obtain 3 bids for every contract in excess of \$1,000. Further, any contract in excess of \$50,000 requires CFO approval, and any contract in excess of \$500,000 requires board approval.

CAUSE

While NAPI has a procurement policy, it is not being adhered to in all cases. Further, NAPI has not implemented a formal process to ensure all procurements follow proper procurement policy. For example, there is no checklist to ensure all required documentation is present prior to awarding the contract. Such documentation should include: the Request For Proposals (RFP), copies of advertisements placed with media, copies of all bids received, justification for sole source or emergency procurements, documentation supporting the selection of the winning bidder, and documentation supporting proper approvals (approvals by management and the Board).

Lastly the policy may be circumvented as individual payments to contractors may be less than the threshold for procurement, yet significantly exceed the threshold over the course of the year.

EFFECT

NAPI did not comply with applicable procurement procedures. Further, procurements may have been awarded to less qualified bidders. Also, weak procurement controls pose the risk of fraud to the Organization.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section II – Financial Statement Findings (Continued)**

**11-01 – Procurement (Material Weakness) (Continued)**

RECOMMENDATION

We recommend NAPI create a checklist to ensure all documentation supporting procurements is obtained and maintained, prior to awarding the contract. Such documentation should include, to the extent applicable:

- the RFP
- copies of advertisements placed with media
- copies of all bids received
- written justification for sole source or emergency procurements
- written documentation supporting the selection of the winning bidder

While certain of these attributes were made available in some cases, the documentation should be required as part of every contract and included in a single file for validation purposes.

Lastly, NAPI should ensure the procurement policy appropriately addresses individual payments that can be made to a single contractor that are less than the required procurement threshold, yet significantly higher over the course of the year when considered in total.

We also recommend that management summarize the payments made to all contractors during the year and report this information for the Board's review and approval.

MANAGEMENT'S RESPONSE

NAPI has updated its Accounting Policies and Procedures to include language, generally requiring three bids conforming to the Navajo Business Opportunity Act for projects over \$50,000. As an agricultural entity, there are unforeseen situations or events that arise that would require NAPI to respond immediately to initiate a rapid emergency response to initiate corrective actions. Therefore, NAPI must be able to call upon the services of vendors that possess the necessary equipment and experience to perform project requirements at any given time.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs**

**10-05 – Financial Reporting over Federal Grants (Material Weakness)**

**U.S. Department of Interior, Bureau of Indian Affairs**

**CFDA# 15.036 (previously 15.049), Maintenance and Replacement; On-Farm Development; and Agricultural Testing, Research and Laboratory Programs**

**Contract Numbers:**

**CTN00X10215 (Grant Period January 1, 2011 through December 31, 2011)**

**CTN00X10213 (Grant Period January 1, 2010 through December 31, 2010)**

**U.S. Department of Interior, Bureau of Reclamation**

**Contract Number 15.04-NA-40-2095, O&M of Facilities in Construction Status, Navajo Indian Irrigation Project**

**CONDITION**

In testing federal grant activity during the year ended May 31, 2011, we noted material adjustments were required and reconciliation of the year's federal grant activity had not been properly performed or documented. Specifically, we noted the following:

- NAPI was unable to provide total federal expenditures for the year and reconcile this balance to the general ledger.
- A reconciliation of the current year activity for each grant had not been prepared and could not be provided.
- The federal grant general ledger balances could not be rolled from the prior year's audited balances as NAPI's records were not adjusted to prior year audited balances.
- The due to/due from on the federal grant general ledger was not properly reconciled to NAPI's general ledger.
- Various material audit entries were necessary to properly record the federal grant activity for the year.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**10-05 – Financial Reporting over Federal Grants (Material Weakness)  
(Continued)**

CRITERIA

OMB Circular A-133 Subpart C includes the following requirements for auditees, among other items:

- Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.
- Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.
- Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §\_\_.310.
- Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with §\_\_.315(b) and §\_\_.315(c), respectively.

CAUSE

The current federal grant accountant began with NAPI approximately mid-way through the year and was unable to implement needed corrections as of May 31, 2011.

EFFECT

The lack of proper and complete reconciliations poses several significant risks to NAPI, including:

- Reports submitted may not be accurate.
- Internal financial reporting may not be accurate.
- NAPI may not be receiving proper or timely reimbursement for funds disbursed under the federal grant programs.
- Costs may be incorrectly charged to federal grants.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**10-05 – Financial Reporting over Federal Grants (Material Weakness)  
(Continued)**

QUESTIONED COSTS

None.

RECOMMENDATION

We recommend NAPI implement a formal process for reconciling the complete activity of each grant on an annual basis. The reconciliation should begin with the prior year's receivable or deferred balance, plus expenditures, and less receipts, to derive the end of year balance. Further, federal grant revenues should be reconciled to federal grant expenses, and any differences should be identified at a detail level and documented. An example of a reconciling difference between revenues and expenses is the purchase of a capital asset with federal funds.

MANAGEMENT'S RESPONSE

NAPI 638 program is aware of the lack of proper and complete reconciliations during this audit but has since implemented a process for reconciling the activities for each grant. Reports are now submitted to the awarding agency on a quarterly basis to ensure accuracy and compliance.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-02 – Procurement (Material Weakness)**

**U.S. Department of Interior, Bureau of Indian Affairs**

**CFDA# 15.036 (previously 15.049), Maintenance and Replacement; On-Farm Development; and Agricultural Testing, Research and Laboratory Programs**

**Contract Numbers:**

**CTN00X10215 (Grant Period January 1, 2011 through December 31, 2011)**

**CTN00X10213 (Grant Period January 1, 2010 through December 31, 2010)**

**CONDITION**

In testing for proper procurement under NAPI's policies and procedures, we noted for 3 out of 5 procurements tested under this Federal Program during fiscal year 2011, the procurements did not follow proper procedures or evidence that the procurements were made in accordance with NAPI policy was not maintained. Further, we noted NAPI did not check the suspended or debarred list prior to entering into the 7 contracts (none of the 7 contractors appears on the suspended or debarred listing per our testing).

**CRITERIA**

NAPI's procurement policy is referenced and made part of the Annual Funding Agreement (AFA) over contract number CTN00X10215, between the Bureau of Indian Affairs and NAPI. NAPI's procurement policy requires that NAPI obtain 3 bids for every contract under the AFA for amounts in excess of \$100. Further, NAPI is required to ensure contractors are not on the suspended and debarred listing.

OMB Circular A-133 Subpart C includes the following requirements for auditees, among other items:

- Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

**CAUSE**

NAPI has not implemented a formal process to ensure all procurements under the AFA follow appropriate NAPI procurement policy. For example, there is no checklist

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-02 – Procurement (Material Weakness), Continued**

to ensure all required documentation is present prior to awarding the contract. Such documentation should include: the Request For Proposals (RFP), copies of advertisements placed with media, copies of all bids received, justification for sole source or emergency procurements, documentation supporting the selection of the winning bidder, and documentation supporting proper approvals (approvals by management and the Board).

**EFFECT**

NAPI did not comply with applicable procurement policy and could jeopardize the Organization's ability to obtain future funding. Further, procurements may have been awarded to less qualified bidders. Also, weak procurement controls pose the risk of error or fraud to the Organization. Lastly, NAPI could have contracted with suspended or debarred parties.

**QUESTIONED COSTS**

Unknown

**RECOMMENDATION**

We recommend NAPI create a checklist to ensure all documentation supporting procurements made under the AFA is obtained and maintained, prior to awarding the contract. Such documentation should include, to the extent applicable:

- the RFP
- copies of advertisements placed with media
- copies of all bids received
- written justification for sole source or emergency procurements
- written documentation supporting the selection of the winning bidder
- verification that the contractor is not on the suspended or debarred listing

While certain of these attributes were made available in some cases, the documentation should be required as part of every contract and included in a single file for validation purposes. Maintaining such complete documentation will also help protect NAPI from any claims that awards were improper.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-02 – Procurement (Material Weakness), Continued**

MANAGEMENT'S RESPONSE

The procurement policy used during the audit has been updated in NAPI's accounting policies and procedures dated September 23, 2011, so that required number of bids will be needed for the amounts in excess of \$1,000, section 110 Purchasing and receiving, Bids and Quotes. The process has been developed and explained to personnel involved in the procurement process to document emergency procurement, sole source vendors, and verifying if a contractor is on the suspended and debarred listing.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-03 – Allowable Costs and Activities (Significant Deficiency)**

**U.S. Department of Interior, Bureau of Indian Affairs**

**CFDA# 15.036 (previously 15.049), Maintenance and Replacement; On-Farm Development; and Agricultural Testing, Research and Laboratory Programs**

**Contract Numbers:**

**CTN00X10215 (Grant Period January 1, 2011 through December 31, 2011)**

**CTN00X10213 (Grant Period January 1, 2010 through December 31, 2010)**

**U.S. Department of Interior, Bureau of Reclamation**

**Contract Number 15.04-NA-40-2095, O&M of Facilities in Construction Status, Navajo Indian Irrigation Project**

**CONDITION**

In testing internal controls over purchases within the Bureau of Indian Affairs contract, we noted the following:

- Required authorization was not obtained on a purchase over \$50,000.
- Purchases in the amount of \$1,440 were added to a purchase order subsequent to the approval of a purchase order.
- NAPI overpaid a vendor \$1,527 (payment exceeded invoice by this amount).

In testing internal controls over purchases within the Bureau of Reclamation contract, we noted the following:

- Required authorization was not obtained on a purchase over \$10,000.

**CRITERIA**

NAPI has established policies and procedures over purchasing. Those procedures require CEO approval on purchases over \$50,000, and require an approved purchase order on purchases for goods, supplies and materials; capital; leases and rentals; and service contracts. NAPI policy also requires amended purchase orders for changes greater than \$500.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-03 – Allowable Costs and Activities (Significant Deficiency)**

OMB Circular A-133 Subpart C includes the following requirements for auditees, among other items:

- Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

**CAUSE**

NAPI is not enforcing established policies and procedures, or documenting approved exceptions to those policies and procedures at the time of the transaction.

**EFFECT**

NAPI may pay for unauthorized expenditures, or expenditures that do not fall within the acceptable guidelines of the grant agreement.

**QUESTIONED COSTS**

\$1,527

**RECOMMENDATION**

We recommend NAPI implement additional management review controls to ensure NAPI's policies and procedures are adhered to. NAPI may further consider establishing a minimum threshold for requiring purchase orders.

**MANAGEMENT'S RESPONSE**

NAPI has updated the accounting policies and Procedures manual and the departments that oversees the procurement has reviewed the policies to ensure compliance. The program analyst reviews and makes recommendations as needed.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-04 – Davis Bacon Act (Material Noncompliance and Material Weakness)**

**U.S. Department of Interior, Bureau of Indian Affairs**

**CFDA# 15.036 (previously 15.049), Maintenance and Replacement; On-Farm Development; and Agricultural Testing, Research and Laboratory Programs**

**Contract Numbers:**

**CTN00X10215 (Grant Period January 1, 2011 through December 31, 2011)**

**CTN00X10213 (Grant Period January 1, 2010 through December 31, 2010)**

**CONDITION**

We noted certified payrolls as required by the Davis Bacon Act were not obtained or reviewed on 3 construction contractors.

**CRITERIA**

The Davis Bacon Act requires the payment of prevailing wage rates to all labors and mechanics on Federal or Federally assisted construction contracts.

**CAUSE**

NAPI was not requesting or receiving and monitoring certified payrolls on construction contractors.

**EFFECT**

NAPI did not comply with the requirements for requiring and monitoring prevailing wage rates, and as a result, it is not known whether construction contractors paid prevailing wages on those contracts.

**QUESTIONED COSTS**

Unknown.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended May 31, 2011**

**Section III – Federal Award Findings and Questioned Costs (Continued)**

**11-04 – Davis Bacon Act (Material Noncompliance and Material Weakness)**

RECOMMENDATION

We recommend NAPI implement procedures to ensure certified payrolls on construction contracts are remitted to NAPI and monitored for compliance with prevailing wage rates.

MANAGEMENT'S RESPONSE

A procedure has been developed to request certified payrolls from contractors prior to payment being made. This will ensure compliance with federal contracts.

**NAVAJO AGRICULTURAL PRODUCTS INDUSTRY  
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS  
Year Ended May 31, 2011**

**The following summarizes the status of prior year audit findings:**

**Section II – Financial Statement Findings**

**Finding 10-01.** Financial Reporting (Material Weakness)

Current Status: Revised and Repeated

**Finding 10-02.** Credit Cards

Current Status: Corrected

**Finding 10-03.** Evidence of physical inventory over capital assets

Current Status: Corrected

**Finding 10-04.** Entering and Updating Employee Information in Payroll System

Current Status: Corrected

**Section III – Federal Award Findings and Questioned Costs**

**Finding 10-05.** Review of the entity's trial balance and general ledger on monthly basis and reconciliation of subsidiary ledgers and/or accounting records to the general ledger

Current Status: Revised and Repeated

**Finding 10-06.** Support of physical inventory

Current Status: Corrected