

AUDIT REPORT

RURAL WATER DISTRICT #9 MCCURTAIN COUNTY, OKLAHOMA

DECEMBER 31, 2011



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RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
DECEMBER 31, 2011

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Rural Water District #9
McCurtain County, Oklahoma

We have audited the accompanying modified cash basis financial statements of the Rural Water District #9, as of and for the fiscal year ended December 31, 2011, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting described in Note 1. This includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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, and in accordance with Oklahoma Statutes. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

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Basis for Adverse Opinion

The District's use of the modified cash basis of accounting provides that revenues are recorded when received in a cash transaction rather than when billed to the customer. However, these customer billings (accounts receivable) are expected to result in cash transactions. The District uses water billing software to track its accounts receivable and customer billings. However, the financial statements, including the ledgers, are derived from bank statement (cash) transactions. For the year ending December 31, 2011, adjustments, which could not be verified as to having been approved by the board or management, were made to reduce accounts receivable by a total of \$27,644.60. Additional unexplained differences occurred from month-to-month that reduced accounts receivable by a cumulative amount of \$17,724.42. These reductions could be the result of cash receipts that are posted in the billing software but never deposited into the bank. However, because of the lack of documentation and approval of these activities, these items are considered unexplained.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the financial statements referred to above do not present fairly, in conformity with the basis of accounting described in Note 1, the modified cash basis financial position of the Rural Water District #9, McCurtain County, Oklahoma, as of December 31, 2011, and the changes in modified cash basis financial position thereof for the year then ended.

In accordance with Government Auditing Standards, we have also issued our report dated May 6, 2013, on our consideration of the Rural Water District #9'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 compliance with Government Auditing Standards and should be considered in assessing the results of our audit.

Basis of Accounting

We draw attention to Note 1 of the financial statements that describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Kershaw CPA & Associates, P.C.

Kershaw CPA & Associates, PC

May 6, 2013

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
STATEMENT OF NET POSITION - MODIFIED CASH BASIS
DECEMBER 31, 2011

	2011	Memo Only 2010
<u>ASSETS</u>		
<u>Current Assets:</u>		
Petty Cash	\$ 500	\$ 500
Cash in Checking	74,023	59,755
Cash in Savings	45,145	7,868
Certificates of Deposit	19,743	19,516
Total Current Assets	139,410	87,639
<u>Capital Assets:</u>		
Land	10,737	10,737
Other Capital Assets	3,620,542	3,474,744
Less: Accumulated Depreciation	(793,785)	(693,318)
Total Capital Assets	2,837,494	2,792,163
TOTAL ASSETS	\$ 2,976,905	\$ 2,879,802
<u>LIABILITIES & NET POSITION</u>		
<u>Current Liabilities:</u>		
Payroll Taxes Payable	\$ -	\$ 925
Current Portion of Long-Term Debt	21,803	20,793
Total Current Liabilities	21,803	21,718
<u>Long-term Liabilities:</u>		
Notes Payable - USDA Rural Development	1,350,789	1,371,699
Less: Current Portion of Long-Term Debt	(21,803)	(20,793)
Total Long-term Liabilities	1,328,986	1,350,906
TOTAL LIABILITIES	1,350,789	1,372,624
<u>Net Assets:</u>		
Invested in capital assets, net of related debt	1,486,705	1,420,464
Restricted for debt service	64,887	27,384
Unrestricted	74,524	59,330
TOTAL NET POSITION	1,626,116	1,507,178
TOTAL LIABILITIES & NET POSITION	\$ 2,976,905	\$ 2,879,802

See Accountant's Audit Report & Notes Which Accompany These Financial Statements

**RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION - MODIFIED CASH BASIS
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2011**

	<u>2011</u>	<u>Memo Only 2010</u>
<u>Operating Revenue:</u>		
Water Sales	\$ 315,815	\$ 305,306
Miscellaneous Income	-	5,507
Total Operating Revenue	<u>315,815</u>	<u>310,813</u>
<u>Operating Expenses:</u>		
Water Purchases	77,894	70,341
Salaries & payroll taxes	21,656	20,661
Contracted services	28,016	33,165
Office Expense	7,045	5,399
Utilities and telephone	7,265	7,081
Insurance	6,453	7,776
Postage	1,824	1,812
Repairs & Maintenance	30,590	19,692
Memberships & dues	608	5,542
Depreciation Expense	100,467	95,271
Total Operating Expenses	<u>281,818</u>	<u>266,740</u>
Operating Income (Loss)	<u>33,997</u>	<u>44,073</u>
Other Revenues and (Expenses):		
Interest Income	304	308
Interest Expense	<u>(64,590)</u>	<u>(63,848)</u>
Total Other Revenues and (Expenses)	<u>(64,286)</u>	<u>(63,540)</u>
Net Income (Loss) Before Contributions	(30,289)	(19,467)
Capital Contributions	<u>148,302</u>	<u>167,149</u>
Change in Net Position	118,013	147,682
Total Net Position, Beginning of Year	1,507,178	1,359,495
Total Net Position, Prior Year Adjustment	925	-
Total Net Position, End of Year	<u><u>\$ 1,626,116</u></u>	<u><u>\$ 1,507,178</u></u>

See Accountant's Audit Report & Notes Which Accompany These Financial Statements

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2011

	<u>2011</u>	<u>Memo Only 2010</u>
<u>Cash Flows from Operating Activities:</u>		
Cash Receipts from Customers	\$ 315,815	\$ 310,813
Payments to Suppliers and Laborers for Goods & Services	<u>(181,351)</u>	<u>(171,426)</u>
Net Cash Provided (Used) by Operating Activities	<u>134,464</u>	<u>139,387</u>
<u>Cash Flows from Capital & Related Financing Activities:</u>		
Additions to Capital Assets	(145,798)	(164,249)
Capital Grants	144,902	162,449
Capital Contributions - Membership Fees	3,400	4,700
Loan Proceeds	-	-
Principal paid on Debt	(20,910)	(21,652)
Interest paid on Debt	<u>(64,590)</u>	<u>(63,848)</u>
Net Cash Provided (Used) by Capital & Related Financing Activities	<u>(82,996)</u>	<u>(82,600)</u>
<u>Cash Flows from Investing Activities:</u>		
Interest Income	<u>304</u>	<u>308</u>
Net Cash Provided (Used) by Investing Activities	<u>304</u>	<u>308</u>
Net Increase (Decrease) in Cash and Cash Equivalents	51,772	57,095
Cash & Cash Equivalents, Beginning of Year	87,639	30,544
Cash & Cash Equivalents, Prior Year Adjustment	-	-
Cash & Cash Equivalents, End of Year	<u>\$ 139,410</u>	<u>\$ 87,639</u>
<u>Reconciliation of operating income (loss) to net cash provided operating activities:</u>		
Operating Income (Loss)	\$ 33,997	\$ 44,073
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities		
Depreciation	100,467	95,271
Increase(Decrease) in Payroll Taxes Payable	<u>-</u>	<u>43</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ 134,464</u>	<u>\$ 139,387</u>

See Accountant's Audit Report & Notes Which Accompany These Financial Statements

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES & OPERATIONS

As discussed further in Note 1.C, these financial statements are presented on a modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America (GAAP) established by the Governmental Accounting Standards Board (GASB). These modified cash-basis financial statements generally meet the presentation and disclosure requirements applicable to GAAP, in substance, but are limited to the elements presented in the financial statements and the constraints of the measurement and recognition criteria of the modified cash basis of accounting.

A. Organization & Reporting Entity

The District was organized October 27, 1997 under the "Rural Water Districts Act" of the State of Oklahoma to provide a waterworks distribution system to its members.

B. Basis of Presentation

The accounts of the District are organized on the basis of proprietary fund type, specifically an enterprise fund. The activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the District's assets, liabilities, net assets, revenues and expenses. Enterprise Funds account for activities (1) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or (2) that are required by laws or regulations that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or (3) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

C. Measurement Focus and Basis of Accounting

Measurement Focus

The District utilizes an economic resources measurement focus within the limitations of the modified cash basis of accounting. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), net financial position, and cash flows. All assets, deferred outflows, liabilities, and deferred inflows (whether current or noncurrent or financial or nonfinancial) associated with their activities are generally reported within the limitations of the modified cash basis of accounting.

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

Basis of Accounting

The financial statements are presented on a modified cash basis of accounting, which is a basis of accounting other than GAAP as established by GASB. This basis of accounting involves modifications to the cash basis of accounting to report in the statements of net position cash transactions or events that provide a benefit or result in an obligation that covers a period greater than the period in which the cash transaction or event occurred. Such reported balances include investments, capital assets and related depreciation, and short-term and long-term liabilities arising from cash transactions or events.

This modified cash basis of accounting differs from GAAP primarily because certain assets and their related revenues (such as accounts receivable and revenue billed or provided services not yet collected and other accrued revenue and receivables) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid and other accrued expenses and liabilities) are not recorded in these financial statements. In addition, other economic assets, deferred outflows, liabilities, and deferred inflows that do not arise from a cash transaction or event are not reported, and the measurement of reported assets and liabilities does not involve adjustment to fair value.

If the District utilized the basis of accounting recognized as generally accepted in the United States, the fund financial statements for proprietary fund types would use the accrual basis of accounting.

D. Financial Position

Cash and Cash Equivalents

For the purpose of financial reporting, cash and cash equivalents includes all demand and savings accounts and certificates of deposit or short-term investments with an original maturity of three months or less.

Capital Assets (Property, Plant & Equipment)

Property, plant and equipment, including infrastructure assets, are recorded at cost. Office furniture and equipment placed in service is depreciated using the straight-line method over a five to seven year life and the building and waterworks system assets including infrastructure, are depreciated over a twenty to forty year life.

Purchases of capital items in excess of \$1,500.00 that increase the capacity or operation efficiency or extend the useful life of any asset are capitalized. Repairs and maintenance are expensed as incurred.

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

Long-Term Debt

Long-term debt is reported at face value, net of applicable discounts and deferred loss on refunding. Costs related to the issuance of debt are deferred and amortized over the lives of various debt issues.

Equity Classification

Equity is classified as net assets and displayed in three components:

1. Invested in capital assets, net of related debt—Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvements of those assets.
2. Restricted net assets—Consists of net assets with constraints placed on the use either by (a) external groups such as creditors, grantors, contributors, or laws and regulations of other governments; or (b) law through constitutional provisions or enabling legislation.
3. Unrestricted net assets—All other net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Revenues, expenditures & expenses

Operating revenues and expenses for proprietary funds result from providing services and producing and delivering goods and/or services. They also include all revenues and expenses not related to capital and related financing, noncapital financing, or investing activities.

Use of Estimates

The preparation of financial statements in conformity with the modified cash basis of accounting used by the District requires management to make estimates and assumptions that affect certain reported amounts and disclosures; accordingly, actual results could differ from those estimates.

Memorandum Only

The “Memo Only” captions above the total columns mean that totals are presented for overview information purposes only.

NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

As a local government unit, the District is subject to various federal, state, and local laws and contractual regulations. In accordance with Government Auditing Standards, the auditor has issued a report on his consideration of the District’s

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

internal control over financial reporting and tested its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in compliance with Government Auditing Standards and should be read in conjunction with this report in considering the results of the audit.

Deficit Fund Balance or Retained Earnings

As indicated in the financial statements, there are no fund balance or retained earnings deficits for the District for this fiscal year.

NOTE 3 - CASH AND INVESTMENTS

Custodial Credit Risk

At December 31, 2011, the District held deposits of approximately \$139,410 at financial institutions. The District's cash deposits, including interest-bearing certificates of deposit are covered by Federal Depository Insurance (FDIC) or direct obligation of the U.S. Government insured or collateralized with securities held by the District or by its agent in the District's name.

Investment Interest Rate Risk

The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Investment Credit Risk

The District has no policy that limits its investment choices other than the limitation of state law as follows:

- a. Direct obligations of the U.S. Government, its agencies and instrumentalities to which the full faith and credit of the U.S. Government is pledged, or obligations to the payment of which the full faith and credit of the State is pledged.
- b. Certificates of deposits or savings accounts that are either insured or secured with acceptable collateral with in-state financial institutions, and fully insured certificates of deposit or savings accounts in out-of-state financial institutions.
- c. With certain limitation, negotiable certificates of deposit, prime bankers' acceptances, prime commercial paper and repurchase agreements with certain limitations.
- d. County, municipal or school district tax supported debt obligations, bond or revenue anticipation notes, money judgments, or bond or revenue anticipation notes of public trusts whose beneficiary is a county, municipality or school district.

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

- e. Notes or bonds secured by mortgage or trust deed insured by the Federal Housing Administrator and debentures issued by the Federal Housing Administrator, and in obligations of the National Mortgage Association.
- f. Money market funds regulated by the SEC and in which investments consist of the investments mentioned in the previous paragraphs (a.-d.).

NOTE 4 - RESTRICTED ASSETS

The loan agreement with the United States Department of Agriculture Rural Development (USDA) requires the District to set aside into a Reserve Account the sum of 10% of the monthly installment or \$712.50 each month until there is an accumulated amount equal to the sum of the annual installment (\$85,500), after which deposits may be suspended, except to replace withdrawals. The District cannot withdraw funds from the reserve account without USDA approval. As of December 31, 2011, the District was required to have at least \$81,225.00 set aside in the reserve account; as of that date the account balance for the reserve account was \$64,887.27 (savings account & two certificates of deposit), which does not comply with the covenants of the loan agreement.

NOTE 5 - CAPITAL ASSETS

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

	Balance at Dec. 31, 2010	Additions	Deductions	Balance at Dec. 31, 2011
Non-depreciable assets:				
Land	\$ 10,737	\$ -	\$ -	\$ 10,737
Construction in Progress	-	-	-	-
Total non-depreciable assets	\$ 10,737	\$ -	\$ -	\$ 10,737
Depreciable assets:				
Buildings	88,374	-	-	88,374
Distribution System	3,352,141	145,798	-	3,497,939
Equipment	21,272	-	-	21,272
Office Furnishings	12,957	-	-	12,957
Total depreciable assets	3,474,744	145,798	-	3,620,542
Less: Accum. Depreciation				
Buildings	(17,967)	(2,678)	-	(20,645)
Distribution System	(645,373)	(95,920)	-	(741,293)
Equipment	(18,658)	(1,308)	-	(19,965)
Office Furnishings	(11,320)	(562)	-	(11,882)
Total Accum. Depreciation	(693,318)	(100,467)	-	(793,785)
Total depreciable assets, net	2,781,426	45,331	-	2,826,757
Total Capital Assets, Net	\$ 2,792,163	\$ 45,331	\$ -	\$ 2,837,494

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

NOTE 6 - LONG TERM DEBT

The District has a note, dated May 1, 2001, due to USDA Rural Development in the original amount of \$1,500,000 with a fixed interest rate of 4.75% with 480 monthly payments of principal and interest of \$7,125.00. The note is secured by the system's assets and revenues.

Changes in Long-Term Debt

The following is a summary of changes in long-term debt for the year ended December 31, 2011:

	Balance at December 31, 2010	Additions	Deductions	Balance at December 31, 2011
Notes Payable - USDA RD	\$ 1,371,699	\$ -	\$ 20,910	\$ 1,350,789
Total Long-Term Debt	<u>\$ 1,371,699</u>	<u>\$ -</u>	<u>\$ 20,910</u>	<u>\$ 1,350,789</u>

Debt Services Requirements to Maturity

Note Payable - USDA RD
Year Ending Dec.

31,	Principal	Interest	Total
2012	\$ 21,803	\$ 63,697	\$ 85,500
2013	22,861	62,639	85,500
2014	23,971	61,529	85,500
2015	25,135	60,365	85,500
2016	26,355	59,145	85,500
2017-2021	152,255	275,245	427,500
2022-2026	192,980	234,520	427,500
2027-2031	244,599	182,901	427,500
2032-2036	310,024	117,476	427,500
2037-2041	330,806	35,597	366,404
Total	<u>\$ 1,350,789</u>	<u>\$ 1,153,115</u>	<u>\$ 2,503,904</u>

NOTE 7 - FUND EQUITY

As described in Note 1 above, equity is classified as net assets and displayed in three components:

1. Invested in capital assets, net of related debt
2. Restricted net assets
3. Unrestricted net assets

The restricted net assets include assets related to Note 4 above.

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
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NOTE 8 - CONTINGENCIES

Litigation

According to management there were no known contingent liabilities at December 31, 2011, which would have a material effect on the financial statements.

Grant Program Involvement

In the normal course of operations, the District participates in various Federal or State grant or loan programs from year to year. The grant/loan programs are often subject to additional audits by agents of the granting or loaning agency, the purpose of which is to ensure compliance with the specific conditions of the grant or loan. Any liability of reimbursement that may arise as a result of these audits cannot be reasonably determined at this time, although it is believed the amount, if any, would not be material.

NOTE 9 - RISK MANAGEMENT

The District is exposed to normal risk involving their employees' life and health, property and liability, workers compensation, unemployment and disability. The District participates in the Oklahoma Rural Water Association Assurance Group which provides for the pooling of self-insured reserves, claims or losses among the participants. Insurance requirements are reviewed annually to determine adequate coverage exists.

NOTE 10 - SUBSEQUENT EVENTS

The District did not have any subsequent events through May 6, 2013, which is the date the financial statements were issued, for events requiring recording or disclosure in the financial statements for the year ending December 31, 2011.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Rural Water District #9
McCurtain County, Oklahoma

We have audited, in accordance with the 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, and in accordance with Oklahoma Statutes, the modified cash basis financial statements of the Rural Water District #9, as of and for the year ended December 31, 2011, and the related notes to the financial statements, which were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles, and have issued our report thereon dated May 6, 2013, which was an adverse opinion because of the unexplained differences in customer billings.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Rural Water District #9's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Rural Water District #9's internal control. Accordingly, we do not express an opinion on the effectiveness of Rural Water District #9's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or

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significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control described in the accompanying Schedule of Findings that we consider to be significant deficiencies. Those deficiencies are listed as Item 11-01, 11-02 and 11-03.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Rural Water District #9's financial statements are free of material misstatement, we performed tests of 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 instances of noncompliance that are required to be reported under Government Auditing Standards, which are included in the Schedule of Findings as Items 11-04 and 11-05. The results of our tests disclosed no instances of other matters that are required to be reported under Government Auditing Standards.

Rural Water District #9's Response to Findings

Rural Water District #9's response to the findings identified in our audit is described in the accompanying Schedule of Findings. Rural Water District #9's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

This report is intended solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Kershaw CPA & Associates, P.C.

Kershaw CPA & Associates, PC

May 6, 2013

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
SCHEDULE OF FINDINGS
DECEMBER 31, 2011

INTERNAL CONTROL FINDINGS:

Item 11-01: Segregation of Duties

Criteria: A good system of internal control requires a proper segregation of duties to prevent one person from being in a position to authorize, execute, and record the same transaction.

Condition: Due to the size of the District's major areas of internal control, that would be prevalent in a larger District, such segregation of duties is not available for this size operation. Duties are concentrated in the hands of a few individuals, who are responsible for all phases of the accounting functions. Because of this lack of division of responsibility, internal control is determined to be weak, and in some instances, non-existent.

Cause/Effect: Due to the limited number of personnel, a breach of internal controls could occur and not be detected in the normal course of operations.

Recommendation: The Board should continue to be actively involved in the operations of the District.

Response: The Board continues to be actively involved in the operations of the District.

Item 11-02: Safeguarding assets

Criteria: Internal control refers to the methods and procedures used to provide reasonable assurance regarding the achievement of objectives in the following categories: Safeguarding assets, Ensuring validity of financial records and reports, Promoting adherence to policies, procedures, regulations and laws, and Promoting effectiveness and efficiency of operations. Internal control also refers to how an entity processes, summarizes and records the financial transactions. In general terms, internal controls are simply good business practices.

Condition: The District did not have strong internal controls in place for safeguarding its assets (i.e. cash).

Cause/Effect: Due to the weak internal control system, a breach of internal controls could occur. Cash payments could be received but never deposited.

Recommendation: The person responsible for receiving cash should be a different individual than the person responsible for making deposits.

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
SCHEDULE OF FINDINGS
DECEMBER 31, 2011

Response: The Board continues to be actively involved in the operations of the District. However, it is not economically feasible to have more than one person reviewing transactions.

Item 11-03: Payroll and Time Sheets

Criteria: Same as 11-02 above.

Condition: The District did not have strong internal controls in place for ensuring validity of financial records and reports (i.e. time sheets).

Cause/Effect: The same individual responsible for preparing the time sheets was the same individual preparing the payroll reports and writing the paychecks. There was no system in place for verifying the hours reported as being worked by the individual. It has been suggested that someone else was actually working in place of the employee and being paid directly by that employee.

Recommendation: The Board or other management should have oversight in the day-to-day activities of the District.

Response: The Board continues to be actively involved in the operations of the District.

COMPLIANCE FINDINGS:

Item 11-04: Payroll Reporting and Compliance

Criteria: The District is required to withhold one half social security tax and applicable federal and state income tax from gross wages and timely remit such funds to the United States Treasury, the Oklahoma Tax Commission and the OESC. Reporting payroll activity on IRS forms 941, Oklahoma forms OW-8, OES-3 is required at various periods during the year, monthly, quarterly or annually.

Condition: Payroll taxes for the past and current year were not paid in a timely manner. The related forms were not filed in a timely manner.

Cause/Effect: The past due taxes have left the District subject to additional tax liability, penalties, and interest charges by the taxing agencies.

Recommendation: The District needs to get in compliance with the federal and state payroll tax requirements.

RURAL WATER DISTRICT #9
MCCURTAIN COUNTY, OKLAHOMA
SCHEDULE OF FINDINGS
DECEMBER 31, 2011

Item 11-05: Reserve Requirements

Criteria: The loan agreement with the United States Department of Agriculture Rural Development (USDA) requires the District to set aside into a Reserve Account the sum of 10% of the monthly installment or \$712.50 each month until there is an accumulated amount equal to the sum of the annual installment (\$85,500), after which deposits may be suspended, except to replace withdrawals. The District cannot withdraw funds from the reserve account without USDA approval.

Condition: The Authority has a loan reserve account with a balance of \$64,887.27 and is only depositing \$600.00 a month into the savings account.

Cause/Effect: This leaves the Authority out of compliance with the Rural Development loan agreement. According to the Rural Development, during a past year, the Authority withdrew money from the account without approval from the USDA. This unauthorized withdrawal left an insufficient balance in the account.

Recommendation: The Authority should make a deposit to bring the account into compliance.

Response: At December 31, 2011, the money was not available to bring the account into compliance. However, during 2011, the District made an additional deposit of \$30,000 to the savings account, in an effort to bring the balance up to the required amount.