

AUDIT REPORT

MUSKOGEE COUNTY RURAL WATER DISTRICT #3 COUNCIL HILL, OKLAHOMA

DECEMBER 31, 2011



KERSHAW CPA & ASSOCIATES, PC

5300 WEST OKMULGEE AVENUE
MUSKOGEE, OKLAHOMA 74401
PHONE (918) 684-1040
FAX (918) 684-1041

WEB: KERSHAWCPA.COM
E-MAIL: REK@KERSHAWCPA.COM

607 NORTH 1ST STREET
PONCA CITY, OKLAHOMA 74601
PHONE (580) 762-1040
FAX (580) 762-1047

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
DECEMBER 31, 2011

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MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
DECEMBER 31, 2011

BOARD OF DIRECTORS

<u>NAME</u>	<u>POSITION</u>
JOHN DOCK	CHAIRMAN
JEFF ELLER	VICE - CHAIRMAN
BARBARA BOSS	SECRETARY/TREASURER
ART CHRISTIAN	MEMBER
VACANT POSITION	MEMBER

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Muskogee County Rural Water District #3
Council Hill, Oklahoma

I have audited the accompanying financial statements of the Muskogee County Rural Water District #3, as of and for the fiscal year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the Muskogee County Rural Water District #3's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my 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 I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Muskogee County Rural Water District #3, Council Hill, Oklahoma, as of December 31, 2011, and the changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, I have also issued my report dated April 2, 2012, on my consideration of the Muskogee County Rural Water District #3's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is 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 my audit.

Muskogee County Rural Water District #3 has implemented the general provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34. However the District has not presented the Management's Discussion and Analysis required by the Governmental Accounting Standards Board (GASB) that the GASB has determined is necessary to supplement, although not required to be part of, the basic financial statements.

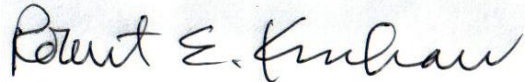
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The introductory and the other supplementary information sections listed in the accompanying table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements of the District. Such additional information has not been subjected to the auditing procedures applied in my audit of the basic financial statements, and accordingly, I do not express an opinion thereon.



Robert E. Kershaw
Certified Public Accountant

April 2, 2012

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
STATEMENT OF NET ASSETS
DECEMBER 31, 2011

	2011	Memo Only 2010
<u>ASSETS</u>		
<u>CURRENT ASSETS:</u>		
Cash and Cash Equivalents	\$ (9,164)	\$ (15,753)
Accounts Receivable	43,156	36,101
Prepaid Insurance	5,754	5,128
Total Current Assets	39,746	25,476
<u>RESTRICTED ASSETS:</u>		
Cash and Cash Equivalents:		
Renters Deposits	1,386	1,381
Cash in Trust Fund:		
Construction Account	390,054	967,801
Sinking Fund	11,635	11,734
Reserve Fund	140,553	140,553
Total Restricted Assets	543,628	1,121,469
<u>PROPERTY, PLANT & EQUIPMENT:</u>		
Land	1,000	1,000
Construction in Progress	780,416	102,609
Water System & Lines	1,373,804	1,354,380
Maintenance Equipment	29,806	29,806
Automatic Meter Reading System	72,600	72,600
Office Furniture & Equipment	13,572	13,572
Less: Accumulated Depreciation	(679,241)	(636,087)
Net Property, Plant & Equipment	1,591,958	937,882
<u>OTHER ASSETS:</u>		
Loan Costs	91,490	91,490
Less: Accumulated Amortization	(18,806)	(12,707)
Total Other Assets	72,684	78,783
TOTAL ASSETS	\$ 2,248,015	\$ 2,163,609
<u>LIABILITIES & NET ASSETS</u>		
<u>CURRENT LIABILITIES:</u>		
Interest Payable	\$ 9,191	\$ 9,300
Renter Deposits	1,200	1,300
Accounts Payable	-	30
Current Maturities of Long-Term Debt	25,000	25,000
Total Current Liabilities	35,391	35,630
<u>LONG-TERM LIABILITIES:</u>		
Notes Payable - USDA Rural Development	-	-
Revenue Bonds Payable	1,715,000	1,740,000
Less: Unamortized Discount on Bonds Payable	(48,181)	(49,971)
Less: Current Maturities of Long-Term Debt	(25,000)	(25,000)
Total Long-Term Liabilities	1,641,819	1,665,029
TOTAL LIABILITIES	1,677,210	1,700,659
<u>NET ASSETS:</u>		
Invested in capital assets, net of related debt	(123,042)	(802,118)
Restricted for debt service	543,628	1,121,469
Unrestricted	150,219	143,600
TOTAL NET ASSETS	570,805	462,950
TOTAL LIABILITIES AND NET ASSETS	\$ 2,248,015	\$ 2,163,609

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

**MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2011**

	<u>2011</u>	<u>Memo Only 2010</u>
<u>OPERATING REVENUES:</u>		
Water Revenue	\$ 288,235	\$ 271,216
Penalties Collected	11,331	8,466
Benefit Unit Sales	4,950	6,000
Reconnects/Transfer Fees	2,450	658
Other Income	4,282	2,676
TOTAL OPERATING REVENUES	<u>311,249</u>	<u>289,015</u>
<u>OPERATING EXPENSES:</u>		
Accounting & Legal	2,350	880
Plant Operations & Maintenance	62,339	96,652
Insurance	10,327	10,558
Easement	375	420
Miscellaneous	2,765	5,220
Office Supplies & Postage	3,706	2,596
Salaries	69,225	69,970
Taxes, Payroll	5,272	6,362
Travel	10,976	7,738
Telephone	2,076	2,148
Utilities	29,087	31,269
Trustee Fees	1,500	1,500
Bad Debt Expense	-	5,176
Amortization	6,099	6,099
Depreciation	43,154	42,766
TOTAL OPERATING EXPENSES	<u>249,252</u>	<u>289,354</u>
NET OPERATING INCOME (LOSS)	61,997	(338)
<u>OTHER REVENUES (EXPENSES):</u>		
Interest Income	131	160
Interest Expense	(113,281)	(114,593)
McIntosh RWD #4 Debt Service Income	58,000	58,000
Grant Income	99,999	-
NET INCOME (LOSS)	106,846	(56,771)
TOTAL NET ASSETS, Beginning of Year	462,950	520,307
TOTAL NET ASSETS, Prior Year Adjustment	1,009	(585)
TOTAL NET ASSETS, End of Year	\$ 570,805	\$ 462,950

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

**MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2011**

	<u>2011</u>	<u>Memo Only 2010</u>
<u>Net Cash Flows from Operating Activities:</u>		
Cash Receipts from Customers	\$ 304,194	\$ 297,631
Payments to Suppliers for Goods & Services	(131,429)	(170,183)
Payments to Employees & Laborers	(69,225)	(69,970)
Receipts of Customer Utility Deposits, Net of Refunds	(100)	200
Net Cash Provided (Used) by Operating Activities	<u>103,440</u>	<u>57,679</u>
<u>Net Cash Flows from Capital & Related Financing Activities:</u>		
Additions to Capital Assets	(697,231)	(69,992)
Proceeds from lease purchase	-	-
Proceeds from long-term debt	-	-
Loan Fees	-	-
Debt Service Income from McIntosh RWD #4	58,000	58,000
Grant Income Received	99,999	-
Principal paid on long-term debt	(25,000)	(25,000)
Interest paid on Debt	(111,600)	(112,913)
Net Cash Provided (Used) by Capital & Related Financing Activities	<u>(675,832)</u>	<u>(149,904)</u>
<u>Net Cash Flows from Investing Activities:</u>		
(Increase)Decrease in Restricted Assets	577,841	61,927
Interest Income	131	160
Net Cash Provided (Used) by Investing Activities	<u>577,972</u>	<u>62,087</u>
Net Increase (Decrease) in Cash and Cash Equivalents	5,580	(30,138)
Cash & Cash Equivalents, Beginning of Year	(15,753)	14,970
Cash & Cash Equivalents, Prior Year Adjustment	1,009	(585)
Cash & Cash Equivalents, End of Year	<u>\$ (9,164)</u>	<u>\$ (15,753)</u>
<u>Reconciliation of operating income (loss) to net cash provided</u>		
<u>operating activities:</u>		
Operating Income (Loss)	\$ 61,997	\$ (338)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities		
Depreciation	43,154	42,766
Amortization	6,099	6,099
(Increase)Decrease in Accounts Receivable	(7,054)	8,616
(Increase)Decrease in Prepaid Insurance	(626)	306
Increase(Decrease) in Accounts Payable	(30)	30
Increase(Decrease) in Renters Deposits	(100)	200
Net Cash Provided (Used) by Operating Activities	<u>\$ 103,440</u>	<u>\$ 57,679</u>

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

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

NOTE 1 -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

Muskogee County Rural Water District No. 3 (the "District") was incorporated under the laws of the State of Oklahoma in accordance with Title Eight-Two of the Oklahoma Statutes, as a subdivision of the State of Oklahoma. The District operates and maintains a water treatment and distribution system within Muskogee County, Oklahoma, and provides potable water services to members of the District.

FUND ACCOUNTING

The District is accounted for within the framework of enterprise fund accounting. Enterprise funds are used to account for operations that are operated in a manner similar to private business enterprises wherein the intent of the District's Board of Directors is to recover the cost of providing goods and services through user charges.

BASIS OF ACCOUNTING

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. The District utilizes the accrual basis of accounting, which is in accordance with U.S. generally accepted accounting principles. Revenues are recognized when earned and expenses when incurred.

BUDGETARY DATA

The District is required by its Rural Development loan agreements to prepare annually an estimated budget.

ASSETS, LIABILITIES & EQUITY

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents consist of unrestricted cash in the checking accounts.

Capital Assets

Asset acquisitions are recorded and depreciated at historical cost. Depreciation on capital assets is calculated using the straight-line method of depreciation with useful lives as follows:

	<u>Life (in years)</u>
Water System & Lines	20-50
Office Furniture and Equipment	3-5
Maintenance Equipment	5

The dollar threshold for capitalization has been set at \$250.00.

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

Accounts Receivable

Accounts receivable represent customer billings for water sales, which were due and owing at the balance sheet date.

Allowance for Doubtful Accounts

The District does not have an allowance for doubtful accounts because it believes the ultimate amount received will be materially similar to the amount accrued.

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.

Governmental Accounting Standards Board Statement No. 34

In June 1999, the Governmental Accounting Standards Board (GASB) unanimously approved Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments. Certain of the significant changes in the Statement include the following:

1. For the first time the financial statement should include:

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
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- a. A Management Discussion and Analysis (MD&A) section providing analysis of the District's overall financial position and results of operations. However, the District has chosen not to present the required MD&A for the current year.
 - b. Financial statements prepared using full accrual accounting for all of the District's activities, except for including the General capital assets or infrastructure (lines, pump stations, etc.).
2. A change in the fund financial statements to focus on major funds.

These and other changes are reflected in the accompanying financial statements (including the notes to the financial statements). The District has elected to implement the general provisions of the Statement and report infrastructure acquired after December 31, 2003 as provided by GASB standards.

Income Taxes

The District is exempt from income taxes under Section 501(c)(12) of the Internal Revenue Code.

Compensated Absences

The organization does not accrue a liability for compensated absences. This is not in accordance with generally accepted accounting principles. However, because of the limited number of people employed by the organization, any liability for compensated absences at December 31, 2011 would not be material to the financial statements taken as a whole.

Estimates

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

Memorandum Totals

The "Memorandum 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 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.

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

Finance-related Legal & Contractual Provisions

The terms of the loan agreements require Reserve Accounts as shown in Note 4. All of the requirements have been met.

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 EQUIVALENTS

Custodial Credit Risk

At December 31, 2011, the District held deposits of approximately -\$9,164 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.
- 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.).

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
 COUNCIL HILL, OKLAHOMA
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2011

NOTE 4 - RESTRICTED ASSETS

Cash in Trust Fund

The Cash in Trust Fund account is an account that is an offset to the Revenue Bonds Payable (See Note 6). This fund is made up of four individual accounts all held by the Trustee Bank (BancFirst). The four accounts are the main account, the debt service reserve fund, the sinking fund, and the construction fund.

NOTE 5 - CAPITAL ASSETS

The following is a summary of the property, plant and equipment of the District as at December 31, 2011:

	12/31/10	Additions	Deletions	12/31/11
Land	\$ 1,000	\$ -	\$ -	\$ 1,000
Water System & Lines	1,354,381	19,423	-	1,373,804
Office Furniture & Equip. Automatic Meter Reading System	13,572 72,600	- -	- -	13,572 72,600
Maintenance Equipment	29,806	-	-	29,806
Construction in Progress	102,609	677,807	-	780,416
	<u>\$1,573,968</u>	<u>\$697,230</u>	<u>\$ -</u>	<u>\$2,271,198</u>
Accumulated Depreciation	<u>\$ 636,087</u>	<u>\$ 43,154</u>	<u>\$ -</u>	<u>\$ 679,241</u>

The capital asset additions included distribution system additions and the plant upgrade project.

NOTE 6 - LONG-TERM DEBT

Revenue Bonds Payable

On November 3, 2008, the District issued \$1,790,000.00 Revenue Bonds Series 2008, to provide funds to refund certain outstanding indebtedness of the District and to provide improvements to the water system as approved by the District. The District sold the Revenue Bonds at a purchase price of Ninety-seven per centum (97%) of the principal, plus accrued interest from the date thereof to the date of delivery, said Bonds to bear interest at the average annual rate of not to exceed Six and three-fourths per centum (6.75%).

The Series 2008 Revenue Bonds are secured by the "Pledged Revenues" (as defined in the Bond Indenture) and amounts held by the bond trustee bank. Under the terms of the Bond Indenture Agreement, the District is required to maintain certain deposits with a trustee bank. Such deposits are included as restricted assets in the Statement of Net Assets.

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
 COUNCIL HILL, OKLAHOMA
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2011

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
Revenue Bonds Payable	\$ 1,740,000	\$ -	\$ (25,000)	\$ 1,715,000
Total Long-Term Debt	<u>\$ 1,740,000</u>	<u>\$ -</u>	<u>\$ (25,000)</u>	<u>\$ 1,715,000</u>
Less: Unamortized Discount on Bonds Payable	\$ (49,971)	<u>\$ -</u>	<u>\$ 1,790</u>	\$ (48,181)
Less: Current Maturities of Long-Term Debt	<u>\$ (25,000)</u>			<u>\$ (25,000)</u>
Net Long-Term Debt	<u><u>\$ 1,665,029</u></u>			<u><u>\$ 1,641,819</u></u>

The annual debt service requirements to maturity, including principal and interest, for long-term debt, as of December 31, 2011, are as follows:

Revenue Bonds Payable Year Ended December 31,	Principal	Interest	Annual Payment
2012	\$ 25,000	\$ 110,288	\$ 135,288
2013	30,000	108,975	138,975
2014	30,000	107,400	137,400
2015	30,000	105,825	135,825
2016	35,000	104,250	139,250
2017-2021	195,000	492,000	687,000
2022-2026	265,000	426,075	691,075
2027-2031	355,000	331,398	686,398
2032-2036	500,000	193,170	693,170
2037-2038	250,000	26,030	276,030
Total	<u><u>\$ 1,715,000</u></u>	<u><u>\$ 2,005,410</u></u>	<u><u>\$ 3,720,410</u></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 are described in Note 4 above.

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

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.

Federally Assisted Programs

In the normal course of operations, the District participates in various federal or state/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 - INSURANCE COVERAGE

The District has the following insurance coverage:

- Property Coverage (Buildings and Personal Property)
- Comprehensive General Liability
- Errors or Omissions
- Employment Related Practices Liability
- Employee Dishonesty and Crime Coverage
- Worker's Compensation

NOTE 10 - WATER CONTRACT

As of October 17, 2008, the District entered into a contract with the McIntosh County Rural Water District #4 (the Purchaser) for the sale of water. The Purchaser agrees to pay the District the following amounts, on or before the tenth (10th) day of each month, for water delivered to the Purchaser (going through the Master Meter) in accordance with the agreement:

- \$4,833.33 per month which shall serve as the Purchaser's share of the monthly debt service payment
- \$3.00 Per 1,000 Gallons of Water for all gallons of water passing through the Purchaser's Master Meter

The payment of \$4,833.33 per month (\$57,999.96 annually) for debt service has been included on the Statements of Revenues, Expenses and Changes in Net Assets in the Other Revenues (Expenses) Section.

Also, per the water contract, the improvements and extensions of the water supply distribution system by the District has been financed by the Revenue Bonds, Series 2008 of the District. In addition it is mutually agreed that proceeds from the aforesaid Bonds in the amount of \$125,000.00 will be transferred to the Purchaser to provide improvements to its water supply system. This transfer is shown on the Statement of Revenues, Expense and Changes in Net Assets in the Other Revenues (Expenses) Section.

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011

NOTE 11 - PRIOR YEAR ADJUSTMENT

A check in the amount of \$1,009 that was recorded as outstanding at December 31, 2010 was removed from the books in 2011.

NOTE 12 - SUBSEQUENT EVENTS

The District did not have any subsequent events through April 2, 2012, 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.

KERSHAW CPA & ASSOCIATES, PC

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MUSKOGEE, OKLAHOMA 74401
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WEB: KERSHAWCPA.COM
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PONCA CITY, OKLAHOMA 74601
PHONE (580) 762-1040
FAX (580) 762-1047

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
Muskogee County Rural Water District #3
Council Hill, Oklahoma

I have audited the financial statements of the Muskogee County Rural Water District #3, as of December 31, 2011 and have issued my report thereon dated April 2, 2012. The Muskogee County Rural Water District #3 has implemented the general provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, except that the District did not present the required MD&A. I conducted my audit in accordance with U.S. generally accepted auditing standards, 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.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Muskogee County Rural Water District #3 internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Muskogee County Rural Water District #3's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Muskogee County Rural Water District #3's internal control over financial reporting.

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.

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weakness, as defined above. However, I identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings that I consider to be significant deficiencies in internal control over

KERSHAW CPA & ASSOCIATES, PC

5300 WEST OKMULGEE AVENUE
MUSKOGEE, OKLAHOMA 74401
PHONE (918) 684-1040
FAX (918) 684-1041

WEB: KERSHAWCPA.COM
E-MAIL: REK@KERSHAWCPA.COM

607 NORTH 1ST STREET
PONCA CITY, OKLAHOMA 74601
PHONE (580) 762-1040
FAX (580) 762-1047

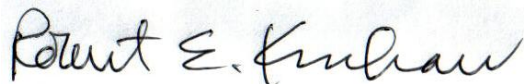
financial reporting. Those deficiencies are listed as Item 11-01. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Muskogee County Rural Water District #3's financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Muskogee Co. RWD #3's response to the findings identified in my audit is described in the accompanying Schedule of Findings. I did not audit Muskogee Co. RWD #3's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the Board of Directors and management of the Muskogee County Rural Water District #3 and is not intended to be and should not be used by anyone other than these specified parties.



Robert E. Kershaw
Certified Public Accountant

April 2, 2012

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
SCHEDULE OF FINDINGS
DECEMBER 31, 2011

Item 11-01: Overdrawn Bank Account

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 consistently maintained a negative bank balance for its operating and maintenance account.

Cause/Effect: The District suffered a decrease in water income and a major water leak during 2010 and was still not able to get the bank balance into the positive during 2011.

Recommendation: The District needs to continue reducing expenses as much as possible to keep the bank account from showing a negative balance.

Response: The water leak was found and repaired during 2011. The new automatic meter reading water meters have been determined to be faulty which lead to the decrease in water income for 2010. The District is considering replacing the new meters to correct the problem.

MUSKOGEE COUNTY RURAL WATER DISTRICT #3
COUNCIL HILL, OKLAHOMA
SCHEDULE OF WATER RATES AND CUSTOMERS
DECEMBER 31, 2011

Water Rates

0 - 1,000 gallons	=	\$35.00 Minimum Bill
Next 5,000 gallons	=	\$ 5.00 per 1,000 gallons
Next 4,000 gallons	=	\$ 5.50 per 1,000 gallons
Next 15,000 gallons	=	\$ 6.00 per 1,000 gallons
Remainder	=	\$ 7.00 per 1,000 gallons

Total Gallons Pumped	50,641,100*
Total Gallons Sold	41,704,500
Total Gallons Fire/Flush	1,423,500
Percentage of Loss	17.65%*

*These figures may not be accurate because the December Water Pumped Amount was much smaller than the December Water Sold Amount.

Customers

The Muskogee Co. Rural Water District #3 had 331 customer meters at the close of this fiscal year.

Current membership fee is \$900 per meter sign-up.