

AUDIT REPORT
RURAL WATER DISTRICT NUMBER 2
COUNTY OF OKMULGEE, OKLAHOMA
PRESTON, OKLAHOMA
NOVEMBER 30, 2011

RALPH OSBORN
CERTIFIED PUBLIC ACCOUNTANT
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P.O. BOX 1015
BRISTOW, OKLAHOMA 74010-1015

INDEPENDENT AUDITORS' REPORT

The Honorable Members of the Board of Directors
Rural Water District Number 2, County of Okmulgee, Oklahoma
Preston, Oklahoma

I have audited the accompanying financial statements of the business-type activities of Rural Water District Number 2, County of Okmulgee, Oklahoma as of and for the year ended November 30, 2011, which collectively comprise Rural Water District Number 2, County of Okmulgee, Oklahoma's basic financial statements. These financial statements are the responsibility of Rural Water District Number 2, County of Okmulgee, Oklahoma'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. 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 respective financial position of the business-type activities of Rural Water District Number 2, County of Okmulgee, Oklahoma as of November 30, 2011, and the respective changes in financial position and cash flows, where applicable, thereof in conformity with accounting principles generally accepted in the United States of America.

Rural Water District Number 2, County of Okmulgee, Oklahoma has not presented Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, I have also issued my report dated July 27, 2012, on my consideration of Rural Water District Number 2, County of Okmulgee, Oklahoma'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 my 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 and other matters. 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 my audit.

Ralph Osborn

Ralph Osborn
Certified Public Accountant
Bristow, Oklahoma
July 27, 2012

RURAL WATER DISTRICT NUMBER 2
COUNTY OF OKMULGEE, OKLAHOMA
PRESTON, OKLAHOMA
STATEMENT OF NET ASSETS
November 30, 2011

ASSETS

Current assets:

Cash and cash equivalents	\$ 152,023
Investments	135,507
Accounts receivable	57,332
Due from Okmulgee County	12,003
Accrued interest receivable	316
Prepaid expense	11,993
Inventory	<u>29,742</u>
Total current assets	<u>398,916</u>

Non-current assets

Capital assets:

Land	1,000
Other capital assets, net of accumulated depreciation	<u>2,212,468</u>
Total non-current assets	<u>2,213,468</u>

Total assets	<u>2,612,384</u>
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LIABILITIES

Current liabilities:

Due to City of Beggs (see Note H)	36,551
Accounts payable	14,992
Accrued interest	779
Accrued vacation and sick leave	3,741
Notes payable, current	<u>23,680</u>
Total current liabilities	<u>79,743</u>

Non-current liabilities:

Notes payable, non-current	<u>786,254</u>
Total non-current liabilities	<u>786,254</u>

Total liabilities	<u>865,997</u>
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NET ASSETS

Nonspendable	1,403,534
Restricted for debt service	53,124
Unrestricted	<u>289,729</u>

Net assets of business-type activities	<u>\$ 1,746,387</u>
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See accompanying notes to financial statements.

RURAL WATER DISTRICT NUMBER 2
COUNTY OF OKMULGEE, OKLAHOMA
PRESTON, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED November 30, 2011

OPERATING REVENUES

Charges for services:	
Water sales	\$ 601,861
Water taps	8,195
Penalty	12,506
Other	2,925

Total operating revenues	625,487
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OPERATING EXPENSES

Water purchased	159,891
Salaries and wages	136,883
Payroll taxes	11,177
Health insurance	25,339
Insurance	16,014
Office	29,026
Administrative expense	15,575
Operating expense	24,674
Repairs and maintenance	48,499
Utilities	27,036
Depreciation	80,852

Total operating expenses	574,966
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Operating income (loss)	50,521
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NON-OPERATING REVENUE (EXPENSES)

CDBG grant passed through Okmulgee County	149,348
Gain on sale of asset	10,000
Settlement to City of Beggs	(93,750)
Interest earnings	288
Interest on notes payable and fees	(36,500)

Total non-operating revenue (expenses)	29,386
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Change in net assets	79,907
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Total net assets, beginning	1,666,480
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Total net assets, ending	\$ 1,746,387
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See accompanying notes to financial statements.

RURAL WATER DISTRICT NUMBER 2
COUNTY OF OKMULGEE, OKLAHOMA
PRESTON, OKLAHOMA
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED November 30, 2011

Cash flows from operating activities	
Cash received from customers	\$ 623,298
Cash payments for employees and benefits	(170,755)
Cash payments to suppliers for goods and services	<u>(315,906)</u>
Net cash provided (used) by operating activities	<u>136,637</u>
Cash flows from capital and related financing activities	
Settlement paid to City of Beggs	(57,199)
CDBG grant passed through Okmulgee County	149,348
Sale of asset	10,000
Acquisition of fixed assets	(201,869)
Interest paid on notes payable	(36,522)
Principal paid on notes payable	<u>(22,602)</u>
Net cash used for capital and related financing activities	<u>(158,844)</u>
Cash flows from investing activities	
Interest earnings	288
Transfer to investments	<u>(261)</u>
Net cash used by investing activities	<u>27</u>
Net increase in cash and cash equivalents	(22,180)
Cash and cash equivalents, beginning	<u>174,203</u>
Cash and cash equivalents, ending	<u>\$ 152,023</u>
Reconciliation of operating income (loss)	
to net cash provided by (used) by operating activities	
Operating income (loss)	\$ 50,521
Adjustments to reconcile operating income to	
net cash used by operating activities:	
Depreciation	80,852
Changes in assets and liabilities:	
Decrease in accrued receivables	15,286
Increase in prepaid expenses	(7,228)
Decrease in accounts payable	(5,438)
Increase in accrued vacation and sick leave	<u>2,644</u>
Net cash provided by operating activities	<u>\$ 136,637</u>

See accompanying notes to financial statements.

RURAL WATER DISTRICT NUMBER 2
COUNTY OF OKMULGEE, OKLAHOMA
PRESTON, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
November 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rural Water District Number 2 (the "District") was created by the County of Okmulgee, Oklahoma Board of County Commissioners under the provisions of Title 82 Oklahoma statutes 1961, Sections 1301 to 1321 on August 30, 1965. The District is managed by a seven member Board of Directors elected by the members of the District. Terms of the Directors are staggered to expire in different years. Directors are elected at the annual meeting of the membership of the District. Membership in the District is acquired by paying a membership fee and receiving services from the District. The District is exempt from federal and state taxation.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The District's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

The financial statements report using the economic resources measurement focus and the accrual basis of accounting. Reimbursements are reported as reductions to expenses. Revenues are recorded when earned and expenses recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating income reported in financial statements include revenues and expenses related to the primary, continuing operations of the District. Principal operating revenues are charges to customers for sales or services. Principal operating expenses are the cost of providing goods or services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

Investments

The District follows Governmental Accounting Standards Board (GASB) Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," which requires marketable securities to be carried at fair value. The District considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The investments reported in the financial statements consist of Certificates of Deposits.

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NOTES TO FINANCIAL STATEMENTS
November 30, 2011

Inventories and Prepaids

Inventories consist of expendable supplies held for consumption stated on a first-in, first-out basis. They are reported at cost which is recorded as an expenditure at the time individual inventory items are used.

Prepaids record payments to vendors that benefit future reporting periods and are also reported on the consumption basis.

Capital Assets, Depreciation, and Amortization

The District's property, plant, and equipment, with useful lives of more than one year are stated at historical cost and comprehensively reported in the financial statements. Capital assets costing \$1,000 or more are capitalized and depreciated. Donated assets are stated at fair value on the date donated. The cost of normal maintenance and repairs that do not add to the assets value or materially extend useful lives are not capitalized. Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are moved from the respective accounts, and the resulting gain or loss is recorded in operations.

Estimated useful lives, in years, for depreciable assets are as follow:

Buildings	5-60
Improvements, other than buildings	2-50
Mobile equipment	3-40
Furniture, machinery, and equipment	3-30
Utility system	5-50

Reserves and Designations

Reserves represent those portions of net assets not available for expenditure or legally segregated for a specific future use. Designated net assets represent tentative plans for future use of financial resources.

Use of 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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

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November 30, 2011

Compensated Absences

Full-time, permanent employees are granted personal leave in varying amounts to specified maximums depending on tenure with the District. The estimated liabilities include required salary-related payments. Compensated absences are reported as accrued in the financial statements.

FUND TYPES AND MAJOR FUNDS

The District reports as a single fund special purpose entity.

NOTE B - DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS

Custodial Credit Risk

Custodial credit risk is the risk that in the event of failure of counterparty, the District will not be able to recover the value of its deposits or investments. Deposits are exposed to custodial credit risk if they are uninsured and uncollateralized. Investment securities are exposed to custodial credit risk if they are uninsured, are not registered in the name of the District, and are held by counterparty or the counterparty's trust department but not in the name of the District. The District's policy requires that all deposits and investments in excess of amounts covered by federal deposit insurance be fully collateralized by the entity holding the deposits or investments. As of November 30, 2011, all of the District's deposits and investments were either covered by federal deposit insurance or were fully collateralized.

Deposits

The District had deposits at financial institutions with a carrying amount of approximately \$287,530 at November 30, 2011. The bank balance of the deposits at November 30, 2011 was approximately \$296,889.

Credit Risk

Fixed-income securities are subject to credit risk. However, the District did not have fixed income securities at November 30, 2011.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Board of Directors monitor's the investment performance on an ongoing basis to limit the District's interest rate risk. As of November 30, 2011, the District's deposits consisted of demand deposits and certificates of deposit with a maturity of 12 months or less.

NOTE C - ACCOUNTS RECEIVABLE

The District records the total due on accounts owed for services unpaid at November 30. Any uncollectible amounts are written-off as they become uncollectible.

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NOTES TO FINANCIAL STATEMENTS
November 30, 2011

NOTE D - CAPITAL ASSETS

Changes in capital assets.

The following table provides a summary of changes in capital assets:

	<u>CAPITAL ASSETS, DEPRECIATED</u>			
	<u>Buildings</u>	<u>Improvements Other Than Buildings</u>	<u>Furniture, Machinery, And Equipment</u>	<u>Totals</u>
Balance, Nov. 30, 2010	\$ 72,630	\$ 2,831,977	\$ 193,207	\$ 3,097,814
Increases	-	189,869	12,000	201,869
Decreases	-	-	(27,704)	(27,704)
Balance, Nov. 30, 2011	<u>72,630</u>	<u>3,021,846</u>	<u>177,503</u>	<u>3,271,979</u>
Accumulated Depreciation				
Balance, Nov. 30, 2010	34,422	815,670	156,271	1,006,363
Increase	2,893	65,267	12,692	80,852
Decreases	-	-	(27,704)	(27,704)
Balance, Nov. 30, 2011	<u>37,315</u>	<u>880,937</u>	<u>141,259</u>	<u>1,059,511</u>
Other Capital Assets, Net	<u>\$ 35,315</u>	<u>\$ 2,140,909</u>	<u>\$ 36,244</u>	<u>\$ 2,212,468</u>
		<u>Capital Assets Not Depreciated Land</u>		
Business-type activities				
Balance, Nov. 30, 2010	\$ 1,000			
Increases	-			
Decreases	-			
Balance, Nov. 30, 2011	<u>1,000</u>			
Business-type Activities				
Capital Assets, Net	<u>\$ 1,000</u>			

RURAL WATER DISTRICT NUMBER 2
COUNTY OF OKMULGEE, OKLAHOMA
PRESTON, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
November 30, 2011

NOTE E - NOTES PAYABLE

The District has incurred indebtedness for the expansion of system facilities and acquisition of equipment. The following is a summary of note payable transactions for the year ended November 30, 2011.

	<u>Payable at</u> <u>Nov. 30, 2010</u>	<u>Retired/</u> <u>Added</u>	<u>Balance at</u> <u>Nov. 30, 2011</u>
Rural Development	\$ 616,271	\$ (7,802)	\$ 608,469
Rural Development	35,483	(4,865)	30,618
Rural Development	165,849	(4,568)	161,281
Citizens Security Bank	<u>14,933</u>	<u>(5,367)</u>	<u>9,566</u>
	<u>\$ 832,536</u>	<u>\$ (22,602)</u>	<u>\$ 809,934</u>

The notes payable are summarized as follows:

<u>Outstanding</u>	<u>Amount</u>
\$643,800 Note No. 91-08, issued by Rural Development with monthly payments of \$2,820, interest of 4.25%	\$ 608,469
\$110,700 Note No. 91-03, issued by Rural Development with monthly payments of \$544, interest of 5%	30,618
\$220,000 Note No. 91-06, issued by Rural Development with monthly payments of \$1,063, interest of 5%	161,281
\$21,669 Note, issued by Citizens Security Bank, with monthly payments of \$500, interest of 5.0%, final payment due July 16, 2013	<u>9,566</u>
Total	<u>\$ 809,934</u>

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November 30, 2011

The Rural Development note agreements require a loan reserve equal to 12 months payments. The required loan reserve is \$53,124. The reserve at November 30, 2011 was in the amount of \$53,124.

Debt service requirements, including principal and interest, are as follows:

<u>Year Ended Nov. 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 23,680	\$ 35,444	\$ 59,124
2012	22,832	34,292	57,124
2013	19,802	33,322	53,124
2014	20,746	32,378	53,124
2015	21,735	31,389	53,124
2016-2020	90,982	144,174	235,156
2021-2025	111,377	121,603	232,980
2026-2030	140,794	92,186	232,980
2031-2035	103,488	65,712	169,200
2036-2040	127,943	41,257	169,200
2041-2045	<u>126,555</u>	<u>8,805</u>	<u>135,360</u>
	<u>\$ 809,934</u>	<u>\$ 640,562</u>	<u>\$ 1,450,496</u>

NOTE F - EMPLOYEE RETIREMENT PLAN

The District allows employees to participate in a SIMPLE IRA retirement plan. The employee may have up to 3% of salary withheld for the plan. The District matches up to 3%. Benefits from the plan will depend on the amount paid in plus earnings.

NOTE G - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance, including workers compensation, for risk of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE H - LITIGATION

The District was involved in litigation concerning boundary disputes and water purchase contracts. The outcome of the litigation concerning a water purchase contract was an amount due to City of Beggs in the aggregated total amount of \$93,750, of which the district paid \$57,199 in October of 2011 and the remainder has been accrued for payment in fiscal year 2012. Due to the litigation, the District incurred significant legal fees during the audit period.

NOTE I - WATER PURCHASE

The District purchases water for resale from City of Okmulgee, Oklahoma and from City of Beggs, Oklahoma. The District would not be able to replace the lost water if the City of Okmulgee, Oklahoma supply was interrupted.

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 Number 2
Okmulgee County
Preston, Oklahoma

I have audited the financial statements of the business - type activities of Rural Water District Number 2, Okmulgee County, Preston, Oklahoma as of and for the year ended November 30, 2011, and have issued my report thereon dated July 27, 2012 which did not include Management's Discussion and Analysis. 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.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered Rural Water District Number 2, Okmulgee County, Preston, Oklahoma's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Rural Water District Number 2, Okmulgee County, Preston, Oklahoma's internal control over financial reporting. Accordingly, I do not express an opinion of the effectiveness of Rural Water District Number 2, Okmulgee County, Preston, Oklahoma'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 a 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 weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Rural Water District Number 2, Okmulgee County, Preston, Oklahoma's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Sincerely,

Ralph Osborn

Ralph Osborn
Certified Public Accountant
Bristow, Oklahoma
July 27, 2012