

AUDIT REPORT

LEFLORE COUNTY RURAL WATER DISTRICT #3

DECEMBER 31, 2010

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

LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
DECEMBER 31, 2010

TABLE OF CONTENTS

	<u>PAGE</u>
FINANCIAL SECTION:	
INDEPENDENT AUDITOR'S REPORT	3-4
BASIC FINANCIAL STATEMENTS:	
EXHIBIT A STATEMENT OF NET ASSETS - MODIFIED CASH BASIS	5
EXHIBIT B STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS - MODIFIED CASH BASIS	6
EXHIBIT C STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS	7
NOTES TO THE FINANCIAL STATEMENTS	8-15
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	16-17
SCHEDULE OF FINDINGS	18

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

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Leflore County Rural Water District #3
Leflore County, Oklahoma

I have audited the accompanying financial statements of the Leflore County Rural Water District #3, as of and for the fiscal year ended December 31, 2010, as listed in the table of contents. These financial statements are the responsibility of the Leflore 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.

As described in Note 1, these financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Leflore County Rural Water District #3, Leflore County, Oklahoma, as of December 31, 2010, and the changes in financial position thereof for the year then ended in conformity with the basis of accounting described in Note 1.

In accordance with Government Auditing Standards, I have also issued my report dated January 6, 2012, on my consideration of the Leflore 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

KERSHAW CPA & ASSOCIATES, PC

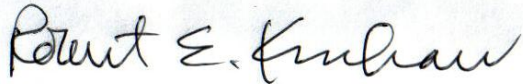
5300 WEST OKMULGEE AVENUE
MUSKOGEE, OKLAHOMA 74401
PHONE (918) 684-1040
FAX (918) 684-1041

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

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

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.

Leflore 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.



Robert E. Kershaw
Certified Public Accountant

January 6, 2012

LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS
DECEMBER 31, 2010

	<u>2010</u>	<u>Memorandum Only 2009</u>
<u>ASSETS</u>		
<u>CURRENT ASSETS:</u>		
Cash and cash equivalents	\$ 4,998	\$ 30,193
Total Current Assets	<u>4,998</u>	<u>30,193</u>
<u>NON-CURRENT ASSETS:</u>		
Certificate of Deposit	45,647	45,647
ORWA Water Assistance Certificate	1,000	1,000
Capital Assets:		
Land	1,129	500
Other Capital Assets, Net of Depreciation	<u>298,857</u>	<u>298,730</u>
Total Non-Current Assets	<u>346,634</u>	<u>345,877</u>
TOTAL ASSETS	<u>\$ 351,632</u>	<u>\$ 376,070</u>
<u>LIABILITIES & NET ASSETS</u>		
<u>LIABILITIES:</u>		
<u>CURRENT LIABILITIES:</u>		
Payroll Taxes Payable	\$ -	\$ 1,333
Current Portion of Long-Term Debt	<u>19,781</u>	<u>15,391</u>
Total Current Liabilities	<u>19,781</u>	<u>16,724</u>
TOTAL LONG-TERM LIABILITIES	<u>172,342</u>	<u>179,623</u>
TOTAL LIABILITIES	<u>192,122</u>	<u>196,347</u>
<u>NET ASSETS:</u>		
Invested in capital assets, net of related debt	107,865	104,216
Restricted for debt service	-	-
Unrestricted	<u>51,645</u>	<u>75,507</u>
TOTAL NET ASSETS	<u>159,510</u>	<u>179,723</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 351,632</u>	<u>\$ 376,070</u>

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

LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS - MODIFIED CASH BASIS
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2010

	2010	Memorandum Only 2009
<u>OPERATING REVENUES:</u>		
Water Sales	\$ 290,103	\$ 284,350
Meter Fees	870	3,000
Miscellaneous	4,752	4,866
Refunds	-	(819)
TOTAL OPERATING REVENUES	295,725	291,397
<u>OPERATING EXPENSES:</u>		
Water Purchases	117,275	102,416
Operations & Maintenance	15,496	11,771
Insurance and Bonds	9,740	8,916
Health Insurance	5,186	5,211
Utilities	17,112	14,150
Salaries & Related Payroll Expenses	93,022	80,241
Dues & Memberships	1,361	462
Professional Expense	-	6,343
Office Expense	2,687	1,532
Transportation Expense/Maintenance	14,504	5,810
Postage	2,812	2,404
Rent	-	371
Advertising	298	114
Return Checks/Fees	2,334	1,955
Contract Labor	-	357
Miscellaneous	6,429	1,667
Depreciation	20,169	17,105
Total Operating Expenses	308,425	260,825
NET OPERATING INCOME (LOSS)	(12,700)	30,572
<u>OTHER REVENUES (EXPENSES):</u>		
Interest Income	931	1,993
Interest Expense	(10,051)	(10,150)
Total Other Revenues (Expenses)	(9,120)	(8,157)
NET INCOME (LOSS)	(21,820)	22,415
TOTAL NET ASSETS, Beginning of Year	179,723	157,308
TOTAL NET ASSETS, Prior Year Adjustment	1,607	-
TOTAL NET ASSETS, End of Year	\$ 159,510	\$ 179,723

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

EXHIBIT C

LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2010

	<u>2010</u>	<u>Memorandum Only 2009</u>
<u>Net Cash Flows from Operating Activities:</u>		
Cash Receipts from Customers	\$ 295,725	\$ 291,397
Payments to Suppliers & Laborers for Goods & Services	(288,256)	(243,817)
Net Cash Provided (Used) by Operating Activities	<u>7,469</u>	<u>47,580</u>
<u>Net Cash Flows from Capital & Related Financing Activities:</u>		
Additions to Capital Assets	(18,139)	(1,250)
Gain on Conversion/Sale of Fixed Assets	-	-
Loan Proceeds	15,000	-
Principal paid on Long-Term Debt	(17,891)	(14,642)
Interest paid on Debt	(10,051)	(10,150)
Net Cash Provided (Used) by Capital & Related Financing Activities	<u>(31,081)</u>	<u>(26,042)</u>
<u>Net Cash Flows from Investing Activities:</u>		
Interest Income	931	1,993
Net Cash Provided (Used) by Investing Activities	<u>931</u>	<u>1,993</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(22,682)	23,531
Cash & Cash Equivalents, Beginning of Year	75,840	52,309
Cash & Cash Equivalents, Prior Year Adjustment	(2,513)	-
Cash & Cash Equivalents, End of Year	<u>\$ 50,645</u>	<u>\$ 75,840</u>
<u>Reconciliation of operating income (loss) to net cash provided</u>		
<u>operating activities:</u>		
Operating Income (Loss)	\$ (12,700)	\$ 30,572
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities		
Depreciation	20,169	17,105
Increase(Decrease) in Payroll Taxes Payable	-	(97)
Net Cash Provided (Used) by Operating Activities	<u>\$ 7,469</u>	<u>\$ 47,580</u>

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

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Leflore County Rural Water District #3 was created under the provisions of the laws of the State of Oklahoma. The District operates as a nonprofit corporation under Oklahoma Statutes, Title 82, Sections 1234.1 through 1234.26, as amended. The purpose of the water district is to provide for the use and benefit of its members a water treatment and distribution system, operations and maintenance.

Basis of Presentation

The Enterprise Fund is used to account for the operations of the District that are financed and operated in a manner similar to private business enterprises where the intent is that costs of providing goods or services be recovered in whole or in part through user fees or charges.

Basis of Accounting

The District utilizes the modified cash basis of accounting. Such basis is not in accordance with U.S. generally accepted accounting principles. Under the modified cash basis of accounting, revenues are recorded when received and expenditures are recorded when paid. In accordance with generally accepted accounting principles, the District would utilize the accrual method, which recognizes revenues when earned, and expenditures when incurred.

Assets, Liabilities, & Equity

Cash & Cash Equivalents

Cash is comprised of deposits in checking accounts. At December 31, 2010, it appears that all deposits were fully insured by FDIC.

Inventory

The District does not maintain inventory records of parts or supplies, but charges these purchases to maintenance or supplies as they are received.

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 40-50 years for major asset purchases. Other asset purchases are depreciated over a period of between 3 to 25 years. The District has set the capitalization amount at \$150.00 for new assets purchased.

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010

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:
 - 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.

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010

- 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.). However, the District utilizes the modified cash basis of accounting.
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 organized as a not-for-profit entity under Section 501(c)(6) of the Internal Revenue Code and is exempt from paying Federal and State Income Taxes.

Memorandum Only

The "Memorandum Only" captions above the total columns mean that totals are presented for overview information purposes only.

NOTE 2 - CASH AND INVESTMENTS

Custodial Credit Risk

At December 31, 2010, the District held deposits of approximately \$50,645 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.

LEFLORE COUNTY RURAL WATER DISTRICT #3
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2010

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.).

NOTE 3 - 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 an accumulated amount equal to the sum of the annual installment (\$24,792), 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, 2010, the District was required to have at least \$24,792.00 set aside in the reserve account; as of that date the account balance for the reserve account was \$45,647.00, which complies with the covenants of the loan agreement.

NOTE 4 - CAPITAL ASSETS

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

	Balance at Dec. 31, 2009	Additions	Deductions	Balance at Dec. 31, 2010
Land	\$ 500	\$ 629	\$ -	\$ 1,129
Building	55,000	-	-	55,000
Vehicles	26,200	15,010	-	41,210
Equipment	55,533	-	-	55,533
Capital Improvement	757,600	-	-	757,600
Water Line Improvement	93,398	2,500	-	95,898
Subtotal	988,231	18,139	-	1,006,370
Less: Accum. Depr.	(689,001)	(20,169)	2,786	(706,384)
Total Capital Assets (Net of Depreciation)	<u>\$ 299,230</u>	<u>\$ (2,030)</u>	<u>\$ 2,786</u>	<u>\$ 299,987</u>

LEFLORE COUNTY RURAL WATER DISTRICT #3
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2010

The deduction from accumulated depreciation was for a prior year adjustment to match the depreciation schedule.

NOTE 5 - LONG-TERM DEBT

The District has a note payable #91-05 with an original balance of \$137,900, to the United States Department of Agriculture Rural Development (USDA), payable in monthly installments of \$678 until maturity, including interest at 5.00%. The final payment is scheduled for December 2019. The note is secured by the water system.

The District has a note payable #91-07 with an original balance of \$41,800, to the United States Department of Agriculture Rural Development (USDA), payable in monthly installments of \$206 until maturity, including interest at 5.00%. The final payment is scheduled for December 2019. The note is secured by the water system.

The District has a note payable #91-08 with an original balance of \$220,000, to the United States Department of Agriculture Rural Development (USDA), payable in monthly installments of \$1,182 until maturity, including interest at 5.00%. The final payment is scheduled for 2021. The note is secured by the water system.

The District has a note payable with an original balance of \$15,000, to Spiro State Bank, payable in monthly installments of \$350 until maturity, including interest at 5.50%. The final payment is scheduled for 2014. The note is secured by the 2007 Chevrolet that was purchased with the loan proceeds.

Changes in Long-Term Debt

The following is a summary of changes in long-term debt for the year ended December 31, 2010:

	Balance at December 31, 2009	Additions	Deductions	Balance at December 31, 2010
Note Payable - RD #05	\$ 62,316	\$ -	\$ (5,137)	\$ 57,179
Note Payable - RD #07	18,534	-	(1,581)	16,953
Note Payable - RD #08	114,163	-	(8,673)	105,490
Note Payable - SSB	-	15,000	(2,500)	12,500
Total Long-Term Debt	<u>\$ 195,013</u>	<u>\$ 15,000</u>	<u>\$ (17,891)</u>	<u>\$ 192,122</u>

Debt Services Requirements to Maturity

The annual debt service requirements to maturity, including principal and interest, for long-term debt, as of December 31, 2010, are as follows:

LEFLORE COUNTY RURAL WATER DISTRICT #3
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2010

RD #91-05

Year Ending December 31,	Principal	Interest	Total
2011	\$ 5,400	\$ 2,736	\$ 8,136
2012	5,676	2,460	8,136
2013	5,966	2,170	8,136
2014	6,272	1,864	8,136
2015	6,592	1,544	8,136
2016-2020	21,273	2,640	23,913
Total	<u>\$ 51,179</u>	<u>\$ 13,414</u>	<u>\$ 64,593</u>

RD #91-07

Year Ending December 31,	Principal	Interest	Total
2011	\$ 1,662	\$ 810	\$ 2,472
2012	1,747	725	2,472
2013	1,837	635	2,472
2014	1,930	542	2,472
2015	2,029	443	2,472
2016-2020	7,748	696	8,443
Total	<u>\$ 16,953</u>	<u>\$ 3,850</u>	<u>\$ 20,803</u>

RD #91-08

Year Ending December 31,	Principal	Interest	Total
2011	\$ 9,116	\$ 5,068	\$ 14,184
2012	9,583	4,601	14,184
2013	10,073	4,111	14,184
2014	10,589	3,595	14,184
2015	11,130	3,054	14,184
2016-2020	54,999	6,263	61,262
Total	<u>\$ 105,490</u>	<u>\$ 26,692</u>	<u>\$ 132,182</u>

Spiro State Bank

Year Ending December 31,	Principal	Interest	Total
2011	\$ 3,602	\$ 598	\$ 4,200
2012	3,806	394	4,200
2013	4,020	180	4,200
2014	1,072	10	1,082
2015	-	-	-
2016-2020	-	-	-
Total	<u>\$ 12,500</u>	<u>\$ 1,182</u>	<u>\$ 13,682</u>

NOTE 6 - 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

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010

3. Unrestricted net assets

Restricted assets are described in Note 3 above.

NOTE 7 - EMPLOYEE RETIREMENT SYSTEM

All full-time employees are covered by and must participate in the Oklahoma Public employees Retirement Plan (OPERS). The District is not legally required to contribute to the OPERS, which is fully funded by the state and by contributions from covered employees. Under the pension plan, benefits vest after 6 years of full-time employment. An employee with 10 years of service may retire at age 55 and receive reduced retirement benefits.

Based on state statute, employees covered by the pension plan must contribute 5% of their gross earnings to the pension fund. The state is required to contribute 8 ½% of gross earnings to the plan.

The Districts total contributions for 2010, 2009 and 2008 were \$4,929, \$4,125, \$3,000, respectively.

The plan may be viewed at the Oklahoma Public Employees Retirement Plan (OPERS) office in Oklahoma City or at its website.

NOTE 8 - CONTINGENCIES

Litigation

According to management there were no known contingent liabilities at December 31, 2010, 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 - RISK MANAGEMENT

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

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010

NOTE 10 - SUBSEQUENT EVENTS

The District did not have any subsequent events through January 6, 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, 2010.

NOTE 11 - PRIOR YEAR ADJUSTMENT

Three prior year adjustments were made to Total Net Assets. One adjustment of \$2,788 was made to accumulated depreciation to match the depreciation schedule. The second adjustment of \$1,332 was made to remove prior year payroll taxes payable for the modified cash basis. The final adjustment was \$2,513 and was to adjust the beginning cash balance to actual. ($\$2,788 + 1,332 - 2,513 = \$1,607$)

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

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
Leflore County Rural Water District #3
Leflore County, Oklahoma

I have audited the financial statements of the Leflore County Rural Water District #3, which were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles, as of December 31, 2010, and have issued my report thereon dated January 6, 2012. The Leflore 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 Leflore 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 Leflore County Rural Water District #3's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Leflore 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.

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

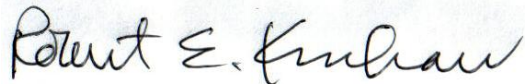
However, I identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings that I consider to be significant deficiencies in internal control over financial reporting. Those deficiencies are listed as Items 10-01 and 10-02. A significant 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 Leflore 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The District's response to the findings identified in my audit is described in the accompanying Schedule of Findings. I did not audit the District'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 Leflore County Rural Water District #3, Leflore County, Oklahoma and is not intended to be and should not be used by anyone other than these specified parties.



Robert E. Kershaw, CPA

January 6, 2012

LEFLORE COUNTY RURAL WATER DISTRICT #3
SCHEDULE OF FINDINGS
DECEMBER 31, 2010

SIGNIFICANT DEFICIENCIES OF INTERNAL CONTROL

Item 10-01: 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 10-02: Meter Deposits

Criteria: It is the responsibility of the District to properly report and account for the financial information.

Condition: The District does not maintain a ledger regarding the balance of customer meter deposits and does not maintain a separate account for customer deposits.

Cause/Effect: Customers could potentially not receive proper reimbursement on their deposit and the organization's balance sheet could be incorrect with respect to the deposit account.

Recommendation: It is recommended that the organization properly report and account for the balance of customer deposits.

Response: The District is aware of the problem.