

**Financial Statements and Reports of
Independent Certified Public Accountant
Rural Water District No. 4
Mayes County, Oklahoma
August 31, 2011**

**TURNER & ASSOCIATES, PLC
Certified Public Accountants
P.O. Box 378
Vinita, OK 74301
918.256.6788**

**Rural Water District No. 4
Mayes County, Oklahoma
Water District Officials
August 31, 2011**

Board of Directors

Jack Silver	Chairman
Curtis Collins	Vice-Chairman
Jim Chronister	Secretary/Treasurer
Johnny Dodson	Member
Clyde Allred	Member
Terry Fink	Member
Wesley Abbott	Member
Charles Dryden	Member

Rural Water District No. 4
Mayes County, Oklahoma
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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Rural Water District No. 4
Mayes County, Oklahoma

We have audited the accompanying financial statements of the business-type activities of the Rural Water District No. 4, Mayes County, Oklahoma, as of and for the year ended August 31, 2011, which comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Rural Water District No. 4, Mayes County, Oklahoma as of August 31, 2011, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note III to the financial statements, the 2010-2011 financial statements have been restated to correct misstatements.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 1, 2012 on our consideration of the Rural Water District No. 4, Mayes County, Oklahoma's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The Rural Water District No. 4, Mayes County, Oklahoma 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that comprise the Rural Water District No. 4, Mayes County, Oklahoma's basic financial statements.

TURNER & Associates, PLLC

Vinita, OK
February 1, 2012



**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**

Board of Directors
Rural Water District No. 4
Mayes County, Oklahoma

We have audited the financial statements of the business-type activities of the Rural Water District No. 4, Mayes County, Oklahoma, as of and for the year ended August 31, 2011, which collectively comprise the District's basic financial statements and have issued our report thereon dated February 1, 2011. The Rural Water District No. 4 did not present the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to supplement, although not to be part of, the basic financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Rural Water District No. 4, Mayes County, Oklahoma's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Rural Water District No. 4, Mayes County, Oklahoma's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Rural Water District No. 4, Mayes County, Oklahoma's internal control over financial reporting.

Our 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. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting, describe in the accompanying schedule of findings and questioned costs that we consider to be material weaknesses in 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. We consider the deficiencies, 2011-1 and 2011-2 described in the accompanying schedule of findings and questioned costs to be material weaknesses.

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 Rural Water District No. 4, Mayes County, Oklahoma's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Rural Water District No. 4, Mayes County, Oklahoma, in a separate letter dated February 1, 2011.

The Rural Water District No. 4, Mayes County, Oklahoma's responses to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Rural Water District No. 4, Mayes County Oklahoma's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, and the Oklahoma State Auditor, is not intended to be, and should not be used by anyone other than these specified parties.

TURNER & ASSOCIATES, PLLC

Vinita, OK
February 1, 2012

**Rural Water District No. 4
Mayes County, Oklahoma
Statement of Net Assets
August 31, 2011**

ASSETS

Current Assets

Cash and Cash Equivalents	\$ 459,577.50
Investments	394,782.90
Accounts Receivable	124,793.87
Prepaid Insurance	7,697.07
Total Current Assets	986,851.34

Noncurrent Assets

Capital Assets, net	1,247,922.76
Construction in Progress	215,575.22
Total Noncurrent Assets	1,463,497.98

Total Assets	2,450,349.32
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LIABILITIES

Current Liabilities

Accounts Payable	49,589.99
Accrued Payables	3,530.01
Total Liabilities	53,120.00

NET ASSETS

Invested in Capital Assets, net of Related Debt	1,463,497.98
Restricted	-
Unrestricted	933,731.34
Total Net Assets	\$ 2,397,229.32

The accompanying Notes to the Financial Statements are an integral part of this statement.

Rural Water District No. 4
Mayes County, Oklahoma
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended August 31, 2011

Operating Revenues	
Water Revenues	\$ 867,278.41
Penalties	23,565.51
Miscellaneous Operating Revenue	9,895.00
Total Operating Revenues	<u>900,738.92</u>
Operating Expenses	
Water Purchased	396,919.99
Contract Meter Reading	9,078.10
Depreciation	87,066.13
Director's Per Diem	3,720.00
Insurance	14,783.59
Miscellaneous	5,602.40
Office Expense	18,579.87
Payroll Taxes	7,442.51
Professional Fees	6,785.87
Repairs and Maintenance	41,796.71
Salaries	121,630.70
Telephone	3,904.27
Travel and Conference	1,776.25
Utilities	38,814.25
Vehicle Maintenance	9,451.65
Total Operating Expenses	<u>767,352.29</u>
Operating Income (Loss)	<u>133,386.63</u>
Non-Operating Revenues (Expenses)	
Interest Income	6,980.10
Removal of Unused Tower Units	(213,317.42)
Total Non-Operating Revenues (Expenses)	<u>(206,337.32)</u>
Capital Contributions	
Meter Taps	<u>33,670.89</u>
Change in Net Assets	(39,279.80)
Net Assets, Beginning of Year	2,436,509.12
Net Assets, End of Year	<u>\$ 2,397,229.32</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

**Rural Water District No. 4
Mayes County, Oklahoma
Statement of Cash Flows
For the Year Ended August 31, 2011**

Cash Flows from Operating Activities

Cash Inflows:

Payments Received from Customers	\$ 895,527.92
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Cash Outflows:

Payments for Salaries and Benefits	(130,407.83)
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Payments for Goods and Services	(563,401.71)
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Total Cash Used	<u>(693,809.54)</u>
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Net Cash Provided (Used) by Operating Activities	<u>201,718.38</u>
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Cash Flows from Noncapital Financing Activities

Purchase of Capital Assets	(29,089.10)
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Construction in Progress	(173,258.73)
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Meter Taps	33,670.89
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Net Cash Provided (Used) for Capital and Related Financing Activities	<u>(168,676.94)</u>
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Cash Flows from Investing Activities

Interest Received from Investments	3,530.10
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Cashed in Certificate of Deposit	5,000.00
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Net Cash Provided by Investing Activities	<u>8,530.10</u>
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Net Cash Inflow (Outflow) from All Activities

41,571.54

Cash and Cash Equivalents at Beginning of Year

418,005.96

Cash and Cash Equivalents at End of Year

\$ 459,577.50

The accompanying Notes to the Financial Statements are an integral part of this statement.

**Rural Water District No. 4
Mayes County, Oklahoma
Statement of Cash Flows (Continued)
For the Year Ended August 31, 2011**

Reconciliation of Operating Income (Loss) to Net Cash

Provided by Operating Activities:

Operating Income (Loss)	\$ 133,386.63
Depreciation	87,066.13
(Increase) Decrease in:	
Increase in Accounts Receivable	(5,211.00)
Increase in Prepaid Insurance	1,160.45
Increase (Decrease) in:	
Increase in Accounts Payable	(13,349.21)
Increase in Payroll - Accrued Payable	1,012.54
Increase in Accrued Vacation	(2,347.16)

Net Cash Provided (Used) by Operating Activities	\$ 201,718.38
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The accompanying Notes to the Financial Statements are an integral part of this statement.

Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011

The following notes to the financial statements are an integral part of Mayes County Rural Water District No. 4's financial statements.

I. Summary of Significant Accounting Policies

Rural Water District No. 4, Mayes County, Oklahoma (the "District") was created under the provisions of Title 82, O.S. 1981, Sections 1324.1-1324.26 inclusive, for the purpose of processing and providing for the use and benefit of its members a water processing and distribution system, including physical facilities necessary for its operations and maintenance. The District was organized by the Board of County Commissioners of Mayes County, Oklahoma. District members fall within territorial boundaries within Mayes County as assigned by the Board of County Commissioners of Mayes County, Oklahoma. The membership consists of approximately 1495 users, each entitled one vote. The Board of Directors consists of 9 members serving three-year terms. The vacant Board seats are elected at the annual meeting, and following, the Board of Directors meet and elect a chairman, vice-chairman and secretary/treasurer.

The accounting policies of the District conform to generally accepted accounting principles applicable to governmental units. The District complies with generally accepted accounting principles and applies all relevant Government Accounting Standards Board (GASB) pronouncements. In addition, the District applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. The District has elected not to follow FASB pronouncements issued since that date.

The District adopted the provisions of GASB Statement No. 34 "*Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*" in fiscal year 2004. Statement 34 established standards for external financial reporting for all state and local governmental entities which includes a management's discussion and analysis section, a statement of net assets, a statement of activities and changes in net assets and a statement of cash flows. It requires the classification of net assets into three components—invested in capital assets, net of related debt; restricted; and unrestricted.

The adoption of Statement 34 had no effect on the basic financial statements except for the classification of net assets, the reflection of capital contributions as a change in net assets and the inclusion of a Management's Discussion and Analysis (MD&A) section providing an analysis of the District's overall financial position and results of operations.

A. Financial Reporting Entity

The District complies with GASB Statement No. 14, "*The Financial Reporting Entity.*" This statement establishes standards for defining and reporting on the financial reporting entity. It defines component units as legally separate organizations for which the elected officials of the primary government are financially accountable and other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

The District considered all potential component units in determining what organizations should be included in the financial statements. Based on these criteria, there are no component units to include in the District's

financial statements.

Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011

I. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation

The District's fund is an enterprise fund. Enterprise funds are proprietary funds used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

C. Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus applied.

The proprietary funds utilize an "*economic resources*" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net assets.

All proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District's enterprise fund is charges to customers for sales and services. The District also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Assets, Liabilities and Net Assets

1. Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all cash on hand, demand deposits, and highly liquid investments, with an original maturity of three months or less when purchased, to be cash and cash equivalents.

2. Investments

Investments consist of certificates of deposit maturing in the following fiscal year with interest paid monthly at varying rates.

**Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011**

I. Summary of Significant Accounting Policies (continued)

D. Assets, Liabilities and Net Assets (continued)

3. Fair Value of Financial Instruments

The District's financial statements include cash and investments. The District's estimates of the fair value of all financial instruments do not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying balance sheet. The carrying amount of these financial instruments approximates fair value because of the short maturity of these instruments.

4. Accounts Receivable

Accounts receivable consists primarily of charges for water sales. Management has not established a provision for uncollectible accounts. Such amounts are written off in the month in which management determines they are uncollectible.

5. Capital Assets

Capital assets purchased or acquired are recorded at cost. Donated capital assets are reported as estimated fair value at the date of donation. Additions and improvements that significantly extend the useful life of an asset are capitalized. Internal engineering costs are capitalized to the extent of direct support and contribution to construct and expansion projects. Costs of studies that directly result in specific construction projects are capitalized. District policy has set the capitalization threshold for reporting capital assets at \$1,000.

Maintenance and repairs, which do not significantly extend the value or life of property, plant, and equipment, are expensed as incurred.

Depreciation on capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Years</u>
Office Building	30
Office Equipment	5-10
Transportation Equipment	5
Construction Equipment	10
Pump Stations	10-20
Water Towers	10-40
Water Lines	40

**Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011**

I. Summary of Significant Accounting Policies (continued)

D. Assets, Liabilities and Net Assets (continued)

6. Equity Classifications

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

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

7. Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

II. Detailed Notes Concerning the Funds

A. Cash and Investments

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of a bank failure, the District’s deposits may not be returned to it. The District’s cash deposits, including interest-bearing certificates of deposit, are maintained in financial institutions. As of August 31, 2011, none of the District’s investments were exposed to custodial credit risk because they were either insured or collateralized.

Interest rate risk: This is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. 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.

**Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011**

II. Detailed Notes Concerning the Funds (continued)

B. Accounts Receivable

Accounts Receivable is composed of unpaid billings for services rendered as of the end of the fiscal year. The District has implemented a deferred time payment plan for customer's who can demonstrate a financial hardship. The majority of the past due balances are a result of water leaks on the customer's property who have been granted a deferred time payment plan.

Following is an aged schedule of accounts receivable as of August 31, 2011:

0-30	31-60	61-90	Total
\$ 115,411.66	\$ 2,257.92	\$ 7,124.29	\$ 124,793.87

C. Changes in Capital Assets

Capital asset activity for the year was as follows:

	Beginning of Year	Additions	Deletions	End of Year
Capital Assets				
Non-depreciable assets:				
Land	\$ 7,000.00	\$ -	\$ -	\$ 7,000.00
Depreciable assets:				
Buildings	31,146.70	-	-	31,146.70
Office Equipment	2,278.00	10,335.00	-	12,613.00
Transportation Equipment	40,880.00	-	-	40,880.00
Construction Equipment	25,724.54	-	-	25,724.54
Pump Stations	267,114.86	3,942.23	1,196.00	269,861.09
Water Towers	586,923.18	14,811.87	371,125.28	230,609.77
Water Lines	2,470,771.47	-	-	2,470,771.47
	3,424,838.75	29,089.10	372,321.28	3,081,606.57
Total	3,431,838.75	29,089.10	372,321.28	3,088,606.57
Accumulated Depreciation:	(1,912,621.54)	(87,066.13)	(159,003.86)	(1,840,683.81)
Net Capital Assets	\$ 1,519,217.21	\$ (57,977.03)	\$ 213,317.42	\$ 1,247,922.76

The board has elected to remove three (3) water tower units due to the fact that they are no longer functional and it would be cost prohibitive to bring them back on the District's lines.

**Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011**

III. Other Information

A. 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 purchases commercial insurance to cover these risks, including general and auto liability, property damage, and public officials liability. There were no significant reductions in insurance coverage from the prior year. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past four fiscal years.

B. Rates and Fees

Minimum Charge for Water Service is \$16.00 per month, which includes 1,000 gallons of water. If more than 1,000 gallons are used, the rate is \$19.50 for residential customers and \$20.00 for commercial customers.

<u>Service</u>	<u>Amount</u>
New Tap Fee	\$1,500.00
Sun Prairie Tap Fees	\$2,500.00
Road Bores	\$400.00
Cost to Move Meter	\$325.00
Reconnect Fee	\$100.00
Returned Check Fee	\$25.00

C. Correction of and Error

Beginning net assets were overstated the prior year by \$61,522.66. This was due to beginning accrued payroll taxes of \$1,872.28 were not recorded and water taps in the amount of \$67,500.00 were incorrectly recorded as assets and were being depreciated. To correct this error, the beginning net assets of \$2,498,031.78, as originally reported, has been decreased to \$2,436,509.12.

**Rural Water District No. 4
Mayes County, Oklahoma
Notes to the Financial Statements
For the Year Ended August 31, 2011**

2011-1 Material Weakness in Internal Control over Financial Reporting – Preparation of Financial Statements in Accordance with GAAP

Criteria:

The government's management is responsible for internal controls over financial reporting. This includes controls over the fair and complete presentation of the government's annual financial statements in accordance with generally accepted accounting principles (GAAP). The preparation of financial statements in accordance with GAAP requires internal controls over both (1) recording, processing, and summarizing accounting data (i.e. maintaining internal books and records, and (2) reporting government-wide and fund financial statements, including related footnotes (i.e. external financial reporting). Professional audit standards clearly indicate that the external financial statement auditor cannot perform any part of management's control activities or be a component of the internal controls over financial reporting.

Condition:

As is the case with many smaller and medium-sized entities, the government has historically relied extensively on its independent external auditors to provide the necessary expertise to assist in the preparation of the financial statements and footnotes as part of its controls over the external financial reporting process. Accordingly, the government's ability to prepare financial statements in accordance with GAAP is based, in part, on its external auditors, who cannot by definition be considered a part of the government's internal controls.

Cause:

The government lacks the necessary knowledge, expertise and education relative to preparing GAAP financial statements. As a result, management has elected to use outside assistance from the external auditors to assist in meeting its responsibilities relative to preparing its annual financial statements.

Effect or Potential Effect:

As a result of this condition, without reliance on its external auditors, the government lacks the necessary internal controls over the preparation of financial statements in accordance with GAAP. This condition also places the auditor in a questionable position regarding auditor independence as a result of potentially performing part of management's functions.

Recommendation:

The government should consider designing and implementing sufficient internal controls over financial reporting by obtaining the necessary knowledge, expertise, and continuing education to prepare financial statements in accordance with generally accepted account principles without reliance on the external financial statement auditor. This could be achieved through employment of qualified accounting staff or the outsourcing of these control activities to a qualified accounting firm other than the external auditor.

Client Response:

We concur with the recommendation for consulting with an accounting professional on significant transactions, but we feel it is cost prohibitive to have our year-end report disclosures prepared by an accounting professional and then engage an auditor to prepare the same report with his opinions.

**Rural Water District No. 4
Mayes County, Oklahoma
Schedule of Findings and Responses
For the Year Ended August 31, 2011**

2011-2 Material Adjusting Journal Entries

Criteria:

The government's management is responsible for internal controls over accounting and financial reporting. This responsibility includes the design and implantation of controls over the fair and complete presentation of the government's annual financial statements in accordance with generally accepted accounting principles (GAAP) from trial balances derived from the government's accounting records. For trial balances to be both complete and accurate, the government must have effective internal controls over recording, processing, summarizing, and adjusting accounting data. As evidence of effective internal controls over accounting and financial reporting, there should generally be few, if any, material adjustments to the trial balances required that are detected and corrected solely as a result of the financial statement audit. In other words, government management should not rely on the external auditor to detect and correct material misstatements in the books and records as part of its internal control, but rather should have its own procedures designed and in place that are independent of the external auditor to provide reasonable, although not absolute, assurance that material misstatements will be detected and corrected in its trial balances prior to audit.

Condition:

The government's trial balances for the year ended August 31, 2011, required a number of material adjusting journal entries in order for the financial statements to be prepared in accordance with GAAP. These necessary adjusting entries, identified solely as a result of the financial statement audit, included such adjustments as the following: adjusting accounts receivable/accounts payable, reclassify income/expense accounts, reclassifying petty cash activity, adjusting outstanding checks, adjusting payroll taxes and employee deductions, and recording activity for a certificate of deposit.

Cause:

The government's accounting and financial reporting staff lacks the necessary knowledge, expertise and education, relative to the complex nature of applying GAAP applicable to state and local governments, sufficient to provide reasonable assurance that the trial balances used for preparing the GAAP financial statements are complete and accurate prior to audit. As a result, management has had to rely on the external auditors to identify and correct a number of material misstatements in the trial balances.

Effect:

As a result of this condition, without reliance on its external auditors, the government lacks the necessary internal controls over the completeness and accuracy of the trial balances that are used in the preparation of its financial statements in accordance with GAAP. This condition can result in undetected and uncorrected material misstatements in the financial statements that are not detected by management and may also not be detected by the financial statement audit. In addition, if management's intentions are to continue to rely on the external auditor to detect and correct material misstatements, this condition could place the auditor in a questionable position regarding auditor independence as a result of the auditor performing part of management's functions regarding to the trial balances.

**Rural Water District No. 4
Mayes County, Oklahoma
Schedule of Findings and Responses
For the Year Ended August 31, 2011**

2011-2 Material Adjusting Journal Entries (continued)

Recommendation:

The government should consider designing and implementing sufficient internal controls over the completeness and accuracy of trial balances by obtaining the necessary knowledge, expertise, and continuing education to apply GAAP in the development of working trial balances that will be used to prepare the government's annual financial statements. This could be achieved through employment of qualified accounting staff or the outsourcing of these control activities to a qualified accounting firm other than the external auditor.

Client Response:

Rural Water District No. 4 makes every effort to comply with the development of GAAP procedures.