

AUDIT REPORT

LEFLORE COUNTY RURAL WATER DISTRICT #3

DECEMBER 31, 2012

KERSHAW CPA & ASSOCIATES, PC

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LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
DECEMBER 31, 2012

TABLE OF CONTENTS

	<u>PAGE</u>
FINANCIAL SECTION:	
INDEPENDENT AUDITOR'S REPORT	3-5
BASIC FINANCIAL STATEMENTS:	
EXHIBIT A STATEMENT OF NET POSITION - MODIFIED CASH BASIS	6
EXHIBIT B STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION - MODIFIED CASH BASIS	7
EXHIBIT C STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS	8
NOTES TO THE FINANCIAL STATEMENTS	9-18
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>	19-21
SCHEDULE OF FINDINGS	22

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We were engaged to audit the accompanying modified cash basis financial statements of the Leflore County Rural Water District #3 as of and for the fiscal year ended December 31, 2012, as listed in the table of contents and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and in accordance with Oklahoma Statutes. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an opinion.

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Basis for Disclaimer of Opinion

Oversight by the District's Board of Directors was lacking and sometimes non-existent. Irregularities in utility billing collections and deposits resulted in a possible embezzlement of funds. Unauthorized payroll compensation and questionable reimbursements were disbursed. Management did not designate qualified individuals with the expertise to be responsible and accountable for maintaining adequate, effective internal controls for the preparation, substantial accuracy and completeness of the financial statements, including reviewing proposed entries and understanding the nature and impact of proposed entries to the financial statements. Records were poorly maintained, inaccurate, and in some cases missing. As a result, we were unable to determine whether any adjustments to the amounts reported were necessary.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matters

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2016, on our consideration of the Leflore County Rural Water District #3's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in compliance with *Government Auditing Standards* in considering

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Leflore County Rural Water District #3's internal control over financial reporting and compliance.

Basis of Accounting

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

Kershaw CPA & Associates, P.C.
Kershaw CPA & Associates, PC

March 4, 2016

EXHIBIT A

LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
STATEMENT OF NET POSITION - MODIFIED CASH BASIS
DECEMBER 31, 2012

	2012	Memorandum Only 2011
<u>ASSETS</u>		
<u>CURRENT ASSETS:</u>		
Cash and cash equivalents	\$ 44,295	\$ 17,025
Total Current Assets	44,295	17,025
<u>NON-CURRENT ASSETS:</u>		
Certificate of Deposit	27,467	27,467
ORWA Water Assistance Certificate	1,000	1,000
Capital Assets:		
Land	1,129	1,129
Other Capital Assets, Net of Depreciation	273,876	278,938
Total Non-Current Assets	303,473	308,535
TOTAL ASSETS	\$ 347,768	\$ 325,560
<u>LIABILITIES & NET POSITION</u>		
<u>LIABILITIES:</u>		
<u>CURRENT LIABILITIES:</u>		
Payroll Taxes Payable	\$ -	\$ -
Current Portion of Long-Term Debt	21,896	20,812
Total Current Liabilities	21,896	20,812
TOTAL LONG-TERM LIABILITIES	129,784	151,618
TOTAL LIABILITIES	151,680	172,430
<u>NET POSITION:</u>		
Net investment in capital assets	123,325	107,637
Restricted for debt service	-	-
Unrestricted	72,762	45,492
TOTAL NET POSITION	196,088	153,129
TOTAL LIABILITIES AND NET POSITION	\$ 347,768	\$ 325,560

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

EXHIBIT B

LEFLORE COUNTY RURAL WATER DISTRICT #3
LEFLORE COUNTY, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION - MODIFIED CASH BASIS
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2012

	2012	Memorandum Only 2011
<u>OPERATING REVENUES:</u>		
Water Sales	\$ 355,451	\$ 299,537
Meter Fees	1,400	2,250
Miscellaneous	16,646	3,040
Refunds	-	-
TOTAL OPERATING REVENUES	373,497	304,828
<u>OPERATING EXPENSES:</u>		
Water Purchases	85,822	99,825
Operations & Maintenance	53,913	24,122
Insurance and Bonds	8,393	8,477
Health Insurance	5,861	6,345
Utilities	12,032	13,270
Salaries & Related Payroll Expenses	95,352	93,283
Dues & Memberships	3,550	1,182
Professional Expense	8,312	1,498
Office Expense	6,300	3,633
Transportation Expense/Maintenance	16,343	17,726
Postage	2,910	3,094
Rent	-	-
Advertising	-	681
Return Checks/Fees	1,680	973
Contract Labor	-	-
Miscellaneous	3,519	8,727
Depreciation	21,062	19,919
Total Operating Expenses	325,051	302,757
NET OPERATING INCOME (LOSS)	48,446	2,071
<u>OTHER REVENUES (EXPENSES):</u>		
Interest Income	892	792
Interest Expense	(8,242)	(9,300)
Total Other Revenues (Expenses)	(7,350)	(8,508)
CHANGE IN NET POSITION	41,096	(6,437)
TOTAL NET POSITION, Beginning of Year	153,129	159,510
TOTAL NET POSITION, Prior Year Adjustment	1,862	57
TOTAL NET POSITION, End of Year	\$ 196,088	\$ 153,129

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, 2012

	2012	Memorandum Only 2011
<u>Cash Flows from Operating Activities:</u>		
Cash Receipts from Customers	\$ 373,497	\$ 304,828
Payments to Suppliers & Laborers for Goods & Services	(303,989)	(282,838)
Net Cash Provided (Used) by Operating Activities	<u>69,508</u>	<u>21,990</u>
<u>Cash Flows from Capital & Related Financing Activities:</u>		
Additions to Capital Assets	(16,000)	-
Gain on Conversion/Sale of Fixed Assets	-	-
Loan Proceeds	-	-
Principal paid on Long-Term Debt	(20,750)	(19,692)
Interest paid on Debt	(8,242)	(9,300)
Net Cash Provided (Used) by Capital & Related Financing Activities	<u>(44,992)</u>	<u>(28,992)</u>
<u>Cash Flows from Investing Activities:</u>		
Interest Income	892	792
Net Cash Provided (Used) by Investing Activities	<u>892</u>	<u>792</u>
Net Increase (Decrease) in Cash and Cash Equivalents	25,408	(6,210)
Cash & Cash Equivalents, Beginning of Year	44,492	50,645
Cash & Cash Equivalents, Prior Year Adjustment	1,862	57
Cash & Cash Equivalents, End of Year	<u>\$ 71,762</u>	<u>\$ 44,492</u>
<u>Reconciliation of operating income (loss) to net cash provided</u>		
<u>operating activities:</u>		
Operating Income (Loss)	\$ 48,446	\$ 2,071
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities		
Depreciation	21,062	19,919
Increase(Decrease) in Payroll Taxes Payable	-	-
Net Cash Provided (Used) by Operating Activities	<u>\$ 69,508</u>	<u>\$ 21,990</u>

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

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES & OPERATIONS

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

A. 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.

B. Basis of Presentation

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

C. Measurement Focus and Basis of Accounting

Measurement Focus

The District utilizes an economic resources measurement focus within the limitations of the modified cash basis of

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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

Basis of Accounting

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

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

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

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

D. Financial Position

Cash & Cash Equivalents

Cash is comprised of deposits in checking accounts. At December 31, 2012, 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.

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.

Net Position Classifications

Net Position is classified and displayed in three components:

1. *Net investment in capital assets.* 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 and adjusted for any deferred inflows and outflows of resources attributable to capital assets and related debt.
2. *Restricted.* Consists of restricted assets reduced by liabilities and deferred inflows or resources related to those assets, with restriction constraints placed on

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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 amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

It is the District's policy to first use restricted net resources prior to the use of unrestricted net resources when an expense is incurred for purposes for which both restricted and unrestricted net resources are available.

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.

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, 2012, the District held deposits of approximately \$71,762 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.

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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.).

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, 2012, 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 \$24,967.00, which complies with the covenants of the loan agreement.

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 4 - CAPITAL ASSETS

Capital asset activity, for the fiscal year ended December 31, 2012, was as follows:

	Balance at Dec. 31, 2011	Additions	Deductions	Balance at Dec. 31, 2012
Land	\$ 1,129	\$ -	\$ -	\$ 1,129
Building	55,000	-	-	55,000
Vehicles	41,210	-	-	41,210
Equipment	55,533	16,000	-	71,533
Capital Improvement	757,600	-	-	757,600
Water Line Improvement	95,898	-	-	95,898
Subtotal	1,006,371	16,000	-	1,022,371
Less: Accum. Depr.	(726,303)	(21,062)	-	(747,365)
Total Capital Assets (Net of Depreciation)	<u>\$ 280,068</u>	<u>\$ (5,062)</u>	<u>\$ -</u>	<u>\$ 275,006</u>

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 2020. 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.

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

Changes in Long-Term Debt

The following is a summary of changes in long-term debt for the year ended December 31, 2012:

	Balance at December 31, 2011	Additions	Deductions	Balance at December 31, 2012
Note Payable - RD #05	\$ 51,779	\$ -	\$ (5,676)	\$ 46,103
Note Payable - RD #07	15,291	-	(1,747)	13,544
Note Payable - RD #08	96,373	-	(9,583)	86,790
Note Payable - SSB	8,988	-	(3,743)	5,244
Total Long-Term Debt	<u>\$ 172,430</u>	<u>\$ -</u>	<u>\$ (20,750)</u>	<u>\$ 151,680</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, 2012, are as follows:

RD #91-05

Year Ending December 31,	Principal	Interest	Total
2013	\$ 5,966	\$ 2,170	\$ 8,136
2014	6,272	1,864	8,136
2015	6,592	1,544	8,136
2016	6,930	1,206	8,136
2017	7,284	852	8,136
2018-2019	13,059	582	13,641
Total	<u>\$ 46,103</u>	<u>\$ 8,218</u>	<u>\$ 54,321</u>

RD #91-07

Year Ending December 31,	Principal	Interest	Total
2013	\$ 1,837	\$ 635	\$ 2,472
2014	1,930	542	2,472
2015	2,029	443	2,472
2016	2,133	339	2,472
2017	2,242	230	2,472
2018-2019	3,372	127	3,499
Total	<u>\$ 13,544</u>	<u>\$ 2,315</u>	<u>\$ 15,859</u>

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

RD #91-08

Year Ending December 31,	Principal	Interest	Total
2013	\$ 10,073	\$ 4,111	\$ 14,184
2014	10,589	3,595	14,184
2015	11,130	3,054	14,184
2016	11,700	2,484	14,184
2017	12,298	1,886	14,184
2018-2020	31,000	1,893	32,893
Total	<u>\$ 86,790</u>	<u>\$ 17,023</u>	<u>\$ 103,813</u>

Spiro State Bank

Year Ending December 31,	Principal	Interest	Total
2013	\$ 4,020	\$ 180	\$ 4,200
2014	1,224	15	1,239
2015	-	-	-
2016	-	-	-
2017	-	-	-
2018-2022	-	-	-
Total	<u>\$ 5,244</u>	<u>\$ 195</u>	<u>\$ 5,439</u>

NOTE 6 - NET POSITION

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

1. Net investment in capital assets
2. Restricted
3. Unrestricted

Restricted amounts 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

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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 2012, 2011 and 2010 were \$4,500, \$4,500, \$4,929, 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, 2012, 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.

NOTE 10 - SUBSEQUENT EVENTS

The District did not have any subsequent events through March 3, 2016, which is the date the financial statements were issued, for

LEFLORE COUNTY RURAL WATER DISTRICT #3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

events requiring recording or disclosure in the financial statements for the year ending December 31, 2012.

NOTE 11 - PRIOR YEAR ADJUSTMENT

Prior year adjustments of \$1,862.22 were made to void old outstanding checks.

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

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

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and in accordance with Oklahoma Statutes, the modified cash basis financial statements of Leflore County Rural Water District #3 as of and for the year ended December 31, 2012, and the related notes to the financial statements, which were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles, and have issued our report thereon dated March 4, 2016, which was a disclaimer of opinion because inadequate accounting records precluded us from performing sufficient audit procedures on the financial statements.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Leflore County Rural Water District #3's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Leflore County Rural Water District #3's internal control. Accordingly, we do not express an opinion on the effectiveness of Leflore County Rural Water District #3's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements

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will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control described in the accompanying Schedule of Findings that we consider to be significant deficiencies. Those deficiencies are listed as Items 12-01 and 12-02.

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

Leflore County Rural Water District #3's Response to Findings

Leflore County Rural Water District #3's response to the findings identified in our audit is described in the accompanying Schedule of Findings. Leflore County Rural Water District #3's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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Purpose of this Report

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

Kershaw CPA & Associates, P.C.
Kershaw CPA & Associates, PC

March 4, 2016

LEFLORE COUNTY RURAL WATER DISTRICT #3
SCHEDULE OF FINDINGS
DECEMBER 31, 2012

SIGNIFICANT DEFICIENCIES OF INTERNAL CONTROL

Item 12-01: 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 be actively involved in the operations of the District.

Response: The District is aware of the problem.

Item 12-02: 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.