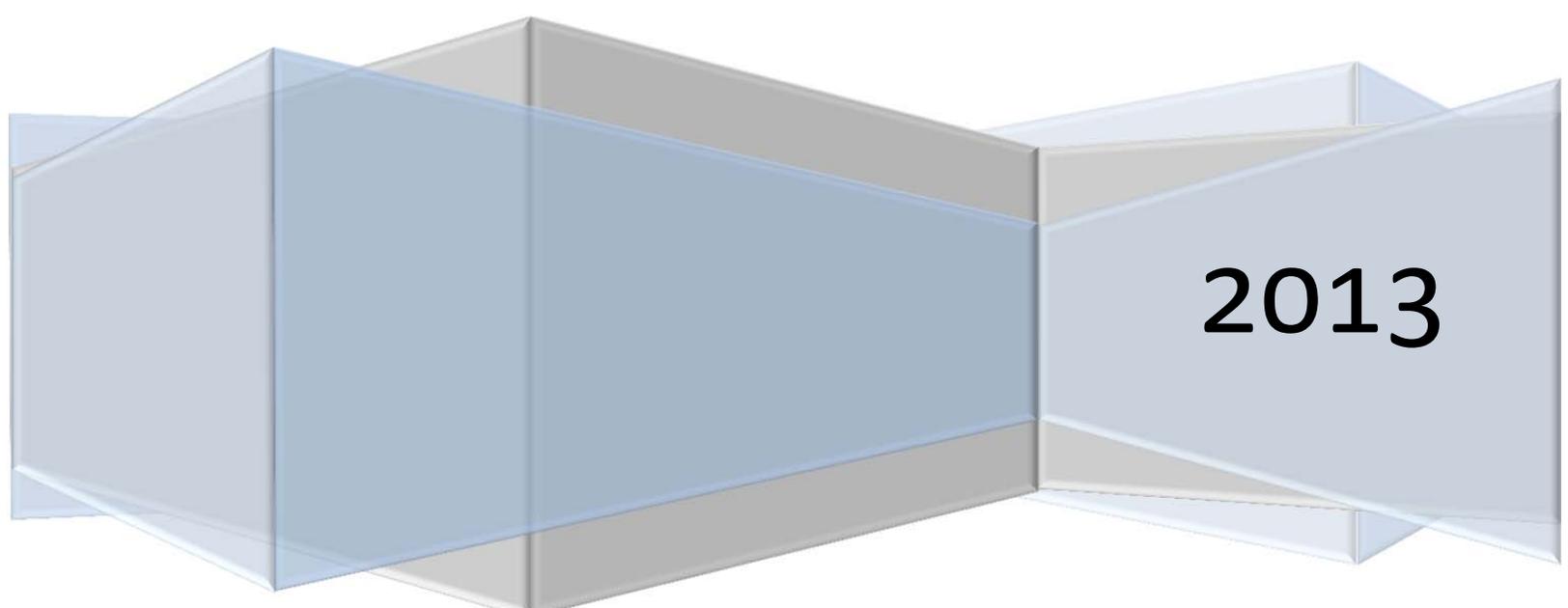


# **Rural Water and Sewer District No. 20**

**Financial Statements and Independent Auditor's Reports**

**As of and for the Year Ended December 31, 2013**



**2013**

**RURAL WATER AND SEWER DISTRICT NO 20  
PITTSBURG COUNTY, OKLAHOMA**

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Jeff Click	Chairman
Jeff Melton	Vice-Chairman
Micki Lloyd	Secretary
Steve Winner	Treasurer

## Anne Marie Elfrink, MS, CPA

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### INDEPENDENT AUDITOR'S REPORT

To the Members of the Board  
Rural Water and Sewer District No. 20  
Pittsburg County, Oklahoma

I was engaged to audit the accompanying financial statements of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District"), as of December 31, 2013 and for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

#### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to error or fraud.

#### **Auditor's Responsibility**

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. Because of the significance of the matter described in the "Transactions with Related Parties" paragraph to the overall financial statement presentation, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

#### **Transactions with Related Parties**

As discussed in footnote 3, the District was created to serve a startup planned community and was entirely financed by the developer who also served as the Chairman of the Board of Trustees until May, 2013 as well as operational manager for the District. Because of the startup nature of the entity, I was unable to determine that there was sufficient delineation between the District's transactions and those of the developer. As is often inherent with related party transactions, it may not be possible to determine whether a particular transaction would have taken place if the parties had not been related, or what the terms and conditions would have been. This includes the purchase of the utility system from the developer in the current year at a price determined by the developer. As discussed in footnote 6, the District was in the early stages of development and did not have the working capital to support operations without financial support from the developer.

**Disclaimer of Opinion**

Because of the significance of the matters described in the Transactions with Related Parties paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

**Management's Discussion and Analysis Omitted**

Management has omitted the management discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, I have also issued my report dated January 11, 2016, on my consideration of the District's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.



Anne Marie Elfrink, MS, CPA

Tulsa, Oklahoma  
January 11, 2016

**Statement of Net Position – December 31, 2013**

**Assets**

Current assets:	
Cash and cash equivalents	\$ 3,301
Accounts receivable	2,848
Inventory - water meters	1,688
Total noncurrent assets	7,837
Noncurrent assets:	
Capital assets, net	950,857
Total assets	958,694

**Liabilities**

Current liabilities:	
Accounts payable	7,972
Advances payable - related party	65,166
Accrued interest - related party	14,823
Total current liabilities	87,961
Noncurrent liabilities:	
Note payable - related party	966,139
Total liabilities	1,054,100

**Net Position**

Net investment in capital assets (deficit)	(15,282)
Unrestricted (deficit)	(80,124)
Total net position (deficit)	\$ (95,406)

See accompanying notes to the basic financial statements

**Statement of Revenue, Expense and Change in Net Position – Year Ended December 31, 2013**

**Operating Revenues**

Charges for sales and services:		
Water	\$	6,472
Sewer		6,302
Sanitation		3,607
Tap Fees		<u>24,750</u>
Total operating revenues		<u>41,131</u>

**Operating Expenses**

Costs of sales and services:		
Water purchases		10,055
Sanitation contractor		3,121
Operations and maintenance		22,290
Depreciation		<u>15,282</u>
Total operating expenses		<u>50,748</u>
Operating loss		<u>(9,617)</u>

**Nonoperating Expense**

Organizational costs		34,777
Interest expense		<u>14,823</u>
Total nonoperating expense		<u>49,600</u>
Change in net position		<u>(59,217)</u>
Net position - beginning of year		(36,189)
Net position - end of year	\$	<u><u>(95,406)</u></u>

See accompanying notes to the basic financial statements

**Statement of Cash Flows – Year Ended December 31, 2013**

**Cash flows from operating activities:**

Receipts from customers	\$	38,283
Payments to suppliers		<u>(27,982)</u>
Cash provided by operating activities		<u>10,301</u>

**Cash flows from noncapital financing activities:**

Received from related party		26,900
Payments of organizational expenses		<u>(34,777)</u>
Net cash used in noncapital financing activities		<u>(7,877)</u>

**Cash flows from capital financing activities:**

Proceeds from capital debt		966,139
Purchases of capital assets		<u>(966,139)</u>
Net cash provided by capital financing activities		<u>-</u>

Net increase in cash and cash equivalents 2,424

Beginning cash and cash equivalents 877

Ending cash and cash equivalents \$ 3,301

**Reconciliation of change in net position to cash provided by operating activities:**

Operating loss	\$	(9,617)
Increase in:		
Accounts receivable		(2,848)
Inventory		(488)
Accounts payable		7,972
Depreciation		<u>15,282</u>
	\$	<u>10,301</u>

See accompanying notes to the basic financial statements

## **Notes to the Basic Financial Statements**

### **1. Summary of Significant Accounting Policies**

#### **A. Financial Reporting Entity**

The Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma (“District”) was incorporated on August 15, 2012 under Title 82, Section 1324.1 as amended, of the laws of the State of Oklahoma. The District is exempt from Federal and State income tax. The purpose of the District is to provide water and sewer services to the owners and occupants of property located within the District which primarily includes the Town of Carlton Landing, and others as authorized by law.

The District is governed by a board of four directors, elected by a majority vote of the homeowners present at the meeting in which the vote is taken. Elected positions include Chairman, Vice-Chairman, Secretary, and Treasurer.

#### **B. Basis of Presentation**

The accounting policies of Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma conform to the basic principles of governmental accounting and financial reporting set forth by the Governmental Accounting Standards Board (GASB).

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 refers to how transactions are recorded within the various financial statements. Basis of accounting refers to when transactions are recorded regardless of the measurement focus applied.

The District’s financial statements use the economic resources measurement. The District utilizes the basis of accounting generally accepted in the United States. Under this basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used.

**D. Assets, Liabilities, and Net Position**

Cash and cash equivalents

For the purpose of the statement of cash flows, the District considers all cash on hand, demand deposit accounts, interest bearing checking accounts, and time deposit accounts including certificates of deposit with maturities of three months or less to be cash and cash equivalents.

Capital Assets and Depreciation

Depreciable assets are recorded at cost when purchased or constructed. Improvements are capitalized; the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not. Depreciation is calculated on a straight-line basis over the estimated useful lives of the depreciable assets.

Capital assets consist of utility infrastructure with an estimated useful life of 50 years. A capitalization threshold of \$2,000 is used to report capital assets.

Due to related party

The District was formed to provide services to a planned community in Pittsburg County, Oklahoma known as the Town of Carlton Landing. Startup expenses financed by the developer and working capital advances that are expected to be repaid from the District's resources are reported as liabilities on the statement of net position.

Note payable – related party

All long-term debt is reported as incurred and consists of a note payable to the developer of the planned community the District serves in exchange for assumption of ownership and operation of the water and sewer systems constructed by the developer.

Net position

Net position is divided into three components:

- a. *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 attributed to the acquisition, construction, or improvement of those assets.
- b. *Restricted net position* – Consists of net assets with constraints placed on the use by 1) external groups such as creditors, grantors, contributors, or laws and regulations of other governments, or 2) law through constitutional provisions or enabling legislation.

c. *Unrestricted net position*- All other net assets that do not meet the definition of “restricted” or “net investment in capital assets”.

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

**E. Revenues and expenses**

Operating Revenues – Operating revenues include activities that have the characteristics of exchange transactions, such as service fees.

Nonoperating revenues – Nonoperating revenues include activities that have the characteristics of nonexchange transactions such as grants from other governments, gifts and contributions, and other revenue sources that are defined as nonoperating revenue.

Operating Expenses – Operating expenses are those that are essential for delivery of services to the District’s customers.

Nonoperating Expenses - Nonoperating expenses are those that relate to the financing of the District’s activity, such as interest expense, and non-recurring and/or unusual expenses such as startup costs.

**2. Detailed Notes on Transaction Classes/Accounts**

**A. Cash and investments**

Deposits and investments - State statutes govern the District’s investment policy. Permissible investments include direct obligations of the United States Government and Agencies; certificates of deposit of savings and loan associations, and bank and trust companies. Collateral is required for demand deposits and certificates of deposit for all amounts not covered by federal deposit insurance. Investments are stated at cost plus accrued interest.

Custodial Credit Risk – 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 does not have a written policy for custodial credit risk. At December 31, 2013, all of the District’s cash was held in a demand account bearing no interest and was fully covered by federal deposit insurance.

**B. Capital assets and depreciation**

For the year ended December 31, 2013, capital asset balances changed as follows:

	<u>Balance at</u> <u>12/31/2012</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at</u> <u>12/31/2013</u>
Capital Assets:				
Sewer system	\$ -	\$ 673,530	\$ -	\$ 673,530
Water system	-	292,609	-	292,609
Total capital assets	-	966,139	-	966,139
Less accumulated depreciation	-	(15,282)	-	(15,282)
Net capital assets	<u>\$ -</u>	<u>\$ 950,857</u>	<u>\$ -</u>	<u>\$ 950,857</u>

**C. Long Term Debt**

For the year ended December 31, 2013, the District's long-term debt changed as follows:

	<u>Balance at</u> <u>12/31/2012</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at</u> <u>12/31/2013</u>
Note payable	\$ -	\$ 966,139	\$ -	\$ 966,139

At December 31, 2013, the District's long term debt consisted of the following note:

Note payable to Humphreys Partners 2009, LLC, dated September 10, 2013 in the original amount of \$1,361,000 and amended on August 15, 2015 to the amount of \$966,139 retroactively, with a fixed interest rate of 5.0%, and payable monthly in the amount equal to the excess of the District's monthly revenues less operating expenses, with payments beginning July 31, 2015. Payments may be waived at the option of the note holder; interest continues to accrue \$966,139

**3. Related Party Transactions**

The District was financed by and had significant transactions with the developer of the planned community it serves, Humphrey Partners 2009, LLC. In addition, the water and sewer system infrastructure was constructed by the developer and sold to the District at an amount determined by the developer.

**4. Risk Management**

The District is exposed to various risks of loss related to torts, errors, and omissions. At this time, the District carries no surety bonds or other types of insurance.

**5. Commitments and Contingencies**

The District is not involved in any legal proceedings, which normally occur in the course of operations, at this time. While legal proceedings cannot be foreseen, the District believes that

any settlement or judgment would not have a material effect on the financial condition of the District.

**6. Going Concern**

The District was in the early stages of operations commencement as of December 31, 2013, and did not have the working capital to support operations. Management believes that, as new homes are built, the membership base and planned fee structure should be adequate to support ordinary operations, including amortization of debt.

**7. Subsequent Events**

Effective January 1, 2014, the District has entered into an agreement with Carlton Landing Enterprises, LLC, an entity owned by the developer, to provide management services, including personnel and support staff.

Management has evaluated events and transactions that occurred after the balance sheet date for potential recognition and disclosure through January 11, 2016, the date on which the financial statements were available to be issued.

Anne Marie Elfrink, MS, CPA

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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 Members of the Board  
Rural Water and Sewer District No. 20  
Pittsburg County, Oklahoma

I have audited the financial statements of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District"), as of December 31, 2013 and for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued my report thereon, including a disclaimer of opinion, dated January 11, 2016. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered the District's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the District's internal control over financial reporting.

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

My 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. I consider the following deficiencies described in the accompanying *Schedule of Findings and Management Responses* to be material weaknesses: [2013-01, 2013-02, 2013-03] Given the above described limitations, other material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

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

### **Purpose of This Report**

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District'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 District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Anne Marie Elfrink, MS, CPA

Tulsa, Oklahoma  
January 11, 2016

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**SCHEDULE OF FINDINGS AND MANAGEMENT RESPONSES**

This schedule is presented as an addendum to accompany the *“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”*. Consideration of items listed should be made in conjunction with that report.

2013-01 – Water Meter Inventory and Control

CONDITION: The District was not able to provide an inventory of all water meters purchased, including both the ones in inventory as well as those that had been placed in service. This is continued from 2012.

CRITERIA: Water meters are the primary mechanism for measurement of both water and sewer services to be billed to customers. For this reason, there should be a comprehensive system of control over their installation, including a responsible party for each active meter.

CAUSE OF CONDITION: The District is newly formed and formal operating procedures had not been established as of December 31, 2013.

POTENTIAL EFFECT OF CONDITION: Users of water and sewer services may not be properly identified and billed, causing a loss of revenues to the District.

RECOMMENDATION: A comprehensive inventory of all water meters purchased to date be established, including the location of the meter, whether or not it is active, and the responsible party for any active meters.

RESPONSE: The District has developed a water meter control system that was implemented in September 2015.

2013-02 – Related Party Transactions

CONDITION: The District is managed by the principal developer of a planned community who also finances operating shortages. In addition, there are journal entries entered that record expenses and related payable to the developer for which there is no supporting document. Expenditures are not approved by an independent Board prior to commitment or occurrence. The developer is the only signatory on the bank account. This is continued from 2012.

CRITERIA: A related party relationship may result in transactions that would not ordinarily take place between unrelated parties or would be subject to different terms and conditions.

CAUSE OF CONDITION: Since the District is a startup entity, it lacked sufficient working capital to cover necessary expenses without significant involvement from the developer.

POTENTIAL EFFECT OF CONDITION: Transactions may not be accurately reflected or may not reflect the true economic substance of the event.

RECOMMENDATION: The District should increase efforts to assure that business is transacted in an independent and “arm’s length” manner. For example, increased efforts to recruit and encourage participation of membership landowners who are independent of the developer, giving consideration to having two signatures (other than a related party) required on each check, and expenditures above a certain amount should be submitted to the Board for approval in advance of commitment.

RESPONSE: New independent board officers were elected at the May 2013 meeting. The District is aware of the necessity to increase the independence of oversight and participation of landowners as the growth of the planned community continues and new members become eligible, including the development of policies and procedures to assure good segregation of duties and internal controls.

2013-03 – Risk Management

CONDITION: As of the date of this report, the District did not have insurance in place that protected the district and the Board of Directors from risk of loss.

CRITERIA: The District should have insurance policies in place that include fidelity bonds for anyone with access to cash, errors and omissions insurance for Board officers and members, general liability insurance, and property insurance for any property owned by the District.

CAUSE OF CONDITION: Since the District is a startup entity with few assets, it did not have the capital necessary to fund the purchase of insurance.

POTENTIAL EFFECT OF CONDITION: The District or District Board members could be named as a party in law suit that could be costly to defend and impair the District's ability to continue to provide essential services to its members.

RECOMMENDATION: The District should consult with its attorney regarding recommended protection and consider the need for insurance as described above.

RESPONSE: The District had not established insurance coverage as of the date of this report and was not aware of a requirement to do so, but will consider consulting with its attorney regarding the necessity.