

AUDIT REPORT

TRI-COUNTY RURAL WATER DISTRICT #2

SEPTEMBER 30, 2016



KERSHAW CPA & ASSOCIATES, PC

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

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

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

TRI-COUNTY RURAL WATER DISTRICT #2
SEPTEMBER 30, 2016

TABLE OF CONTENTS

	<u>PAGE</u>
FINANCIAL SECTION:	
INDEPENDENT AUDITOR'S REPORT	3-4
BASIC FINANCIAL STATEMENTS:	
EXHIBIT A STATEMENT OF NET POSITION - MODIFIED CASH BASIS	5
EXHIBIT B STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION - MODIFIED CASH BASIS	6
EXHIBIT C STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS	7
NOTES TO THE FINANCIAL STATEMENTS	8-16
INDEPENDENT AUDITOR'S 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>	17-19
SCHEDULE OF FINDINGS	20-21

KERSHAW CPA & ASSOCIATES, PC

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

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

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

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Tri-County Rural Water District #2
Earlsboro, Oklahoma

Report on the Financial Statements

We were engaged to audit the accompanying modified cash basis financial statements of the Tri-County Rural Water District #2 as of and for the fiscal year ended September 30, 2016, 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.

Basis for Disclaimer of Opinion

The District has been trying to rebuild its accounting system after a fire destroyed the original records in May 2015. During the current year, the District was able to make adjustments to the general ledger to reconcile cash and certificate of deposit information. However, the other balance sheet accounts, including capital assets, receivables and payables have not been reconciled.

KERSHAW CPA & ASSOCIATES, PC

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

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

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

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 February 10, 2017, on our consideration of the Tri-County Rural Water District #2'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 Tri-County Rural Water District #2'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

February 10, 2017

TRI-COUNTY RURAL WATER DISTRICT #2
STATEMENT OF NET POSITION - MODIFIED CASH BASIS
SEPTEMBER 30, 2016

	2016
<u>ASSETS</u>	
<u>Current Assets:</u>	
Cash and cash equivalents	\$ 39,328
Investments - Certificates of Deposit	497,924
Total Current Assets	537,251
<u>Capital Assets:</u>	
Land	9,045
Other Capital Assets	8,097,246
Less: Accumulated Depreciation	(3,950,909)
Total Capital Assets	4,155,382
TOTAL ASSETS	\$ 4,692,633
<u>LIABILITIES & NET POSITION</u>	
<u>Current Liabilities:</u>	
Current Portion of Long-Term Debt	\$ 37,328
Renter meter deposits	1,540
Total Current Liabilities	38,868
<u>Long-term Liabilities:</u>	
Notes Payable - USDA Rural Development	1,877,322
Less: Current Portion of Long-Term Debt	(37,328)
Total Long-term Liabilities	1,839,994
TOTAL LIABILITIES	1,878,862
<u>Net Position:</u>	
Net investment in capital assets	2,278,060
Restricted for debt service	95,976
Unrestricted	439,735
TOTAL NET POSITION	2,813,771
TOTAL LIABILITIES & NET POSITION	\$ 4,692,633

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

TRI-COUNTY RURAL WATER DISTRICT #2
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION - MODIFIED CASH BASIS
FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2016

	2016
<u>Operating Revenue:</u>	
Water and sewer sales	\$ 965,215
Miscellaneous	45,056
Total Operating Revenue	1,010,271
<u>Operating Expenses:</u>	
Compensation and burden	392,418
Water Purchases	51,911
Operations and maintenance	212,362
Fuel and auto expense	28,169
Utilities	109,713
Engineering	6,291
Insurance	30,995
Professional services	32,532
Office supplies and expenses	28,773
Depreciation	194,574
Bad Debt	660
Other	52,688
Total Operating Expenses	1,141,086
Operating Income (Loss)	(130,816)
Other Revenues and (Expenses):	
Membership Fees	43,299
Insurance Income	80,220
Interest Income	1,838
Interest Expense	(59,600)
Total Other Revenues and (Expenses)	65,757
Net Income (Loss) Before Contributions	(65,059)
Capital Contributions	-
Change in Net Position	(65,059)
Total Net Position, Beginning of Year	2,896,151
Total Net Position, Prior Year Adjustment	(17,321)
Total Net Position, End of Year	\$ 2,813,771

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

**TRI-COUNTY RURAL WATER DISTRICT #2
STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2016**

	2016
<u>Cash Flows from Operating Activities:</u>	
Cash Receipts from Customers	\$ 1,010,271
Payments to Suppliers and Laborers for Goods & Services	(946,512)
Net Cash Provided (Used) by Operating Activities	63,758
<u>Cash Flows from Capital & Related Financing Activities:</u>	
Additions to Capital Assets	(337,328)
Capital Contributions, including Insurance Proceeds	80,220
Membership Fees	43,299
Loan Proceeds	87,931
Principal paid on Debt	(36,376)
Interest paid on Debt	(59,600)
Net Cash Provided (Used) by Capital & Related Financing Activities	(221,854)
<u>Cash Flows from Investing Activities:</u>	
(Increase)Decrease in Investments	71,824
Interest Income	1,838
Net Cash Provided (Used) by Investing Activities	73,662
Net Increase (Decrease) in Cash and Cash Equivalents	(84,434)
Cash & Cash Equivalents, Beginning of Year	141,082
Cash & Cash Equivalents, Prior Year Adjustment	(17,321)
Cash & Cash Equivalents, End of Year	\$ 39,328
<u>Reconciliation of operating income (loss) to net cash provided</u>	
<u>operating activities:</u>	
Operating Income (Loss)	\$ (130,816)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities	
Depreciation	194,574
Net Cash Provided (Used) by Operating Activities	\$ 63,758

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

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

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. Organization & Reporting Entity

The Tri-County Rural Water District #2 (the "District") was organized on June 4, 1984 under the Rural Water, Sewer, Gas and Solid Waste Management District Act, Title 82, 1324.3 of the laws of the State of Oklahoma. The District was organized to acquire water and water rights; to build and acquire waterlines and other facilities; and to operate the same for the purpose of furnishing water to serve the needs of owners and occupants of land located within the District (including Pottawatomie, Seminole and Lincoln Counties), in accordance with the adopted by-laws.

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).

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

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 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

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

statements for proprietary fund types would use the accrual basis of accounting.

D. Financial Position

Cash and Cash Equivalents

For the purpose of financial reporting, cash and cash equivalents includes all demand and savings accounts and certificates of deposit or short-term investments with an original maturity of three months or less.

Capital Assets (Property, Plant & Equipment)

Property and equipment are recorded at cost as of the date of acquisition. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	10-40 years
Furniture, fixtures and equipment	5-10 years
Waterline system	10-40 years

Purchases of capital items in excess of \$2,000.00 that increase the capacity or operation efficiency or extend the useful life of any asset are capitalized. Repairs and maintenance are expensed as incurred.

Income Taxes

The District is conducting its affairs as a local government and has no provisions for income tax.

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

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

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 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.

Use of Estimates

The preparation of financial statements in conformity with the modified cash basis of accounting used by the District requires management to make estimates and assumptions that affect certain reported amounts and disclosures; accordingly, actual results could differ from those estimates.

NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

As a local government unit, the District is subject to various federal, state, and local laws and contractual regulations. In accordance with Government Auditing Standards, the auditor has issued a report on his consideration of the District's internal control over financial reporting and tested its compliance with certain provisions

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

of laws, regulations, contracts and grants. That report is an integral part of an audit performed in compliance with Government Auditing Standards and should be read in conjunction with this report in considering the results of the audit.

Deficit Fund Balance or Retained Earnings

As indicated in the financial statements, there are no fund balance or retained earnings deficits for the District for this fiscal year.

NOTE 3 - CASH AND INVESTMENTS

Custodial Credit Risk

At September 30, 2016, the District held deposits of approximately \$537,251 at financial institutions. The District's cash deposits, including interest-bearing certificates of deposit are covered by Federal Depository Insurance (FDIC) or direct obligation of the U.S. Government insured or collateralized with securities held by the District or by its agent in the District's name.

Investment Interest Rate Risk

The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Investment Credit Risk

The District has no policy that limits its investment choices other than the limitation of state law as follows:

- a. Direct obligations of the U.S. Government, its agencies and instrumentalities to which the full faith and credit of the U.S. 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

TRI-COUNTY RURAL WATER DISTRICT #2
 NOTES TO FINANCIAL STATEMENTS
 SEPTEMBER 30, 2016

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 4 - RESTRICTED ASSETS

The loan agreements 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 installments (\$95,976), after which deposits may be suspended, except to replace withdrawals. The District cannot withdraw funds from the reserve account without USDA approval.

NOTE 5 - CAPITAL ASSETS

Capital asset activity, for the fiscal year ended September 30, 2016, was as follows:

	Balance at Sept. 30, 2015	Additions	Deductions	Balance at Sept. 30, 2016
Land	\$ 9,045	\$ -	\$ -	\$ 9,045
Water treatment plant	1,851,951	-	-	1,851,951
Building	89,010	-	-	89,010
Furniture & equipment	268,568	28,918	-	297,486
Waterline system	5,550,389	-	-	5,550,389
Construction in progress	-	308,410	-	308,410
Subtotal	7,768,963	337,328	-	8,106,291
Less: Accum. Depr.	(3,756,335)	(194,574)	-	(3,950,909)
Total Capital Assets (Net of Depreciation)	<u>\$ 4,012,628</u>	<u>\$ 142,754</u>	<u>\$ -</u>	<u>\$ 4,155,382</u>

NOTE 6 - LONG TERM DEBT

The District has note 91-01 dated April 5, 2004 with the USDA Rural Development, with an original amount of \$600,000 due in monthly installments of \$2,652 beginning Maye 2004 through April 2044 at an interest rate of 4.375%.

The District also has note 91-02 dated November 2, 2012 with the USDA Rural Development, with an original amount of \$1,553,930 due in monthly installments of \$5,346 beginning December 2, 2012 and continuing thereafter at an interest rate of 2.75%.

TRI-COUNTY RURAL WATER DISTRICT #2
 NOTES TO FINANCIAL STATEMENTS
 SEPTEMBER 30, 2016

Changes in Long-Term Debt

The following is a summary of changes in long-term debt for the year ended September 30, 2016:

	Balance at September 30, 2015	Additions	Deductions	Balance at September 30, 2016
USDA Note 91-01	\$ 477,364	\$ -	\$ 11,163	\$ 466,200
USDA Note 91-02	\$ 1,348,403	\$ 87,931	\$ 25,213	\$ 1,411,122
Total Long-Term Debt	<u>\$ 1,825,767</u>	<u>\$ 87,931</u>	<u>\$ 36,376</u>	<u>\$ 1,877,322</u>

Debt Services Requirements to Maturity

USDA Note 91-01:

Year Ended September 30,	Principal	Interest	Annual Payment
2017	\$ 11,660	\$ 20,164	\$ 31,824
2018	12,180	19,644	31,824
2019	12,724	19,100	31,824
2020	13,292	18,532	31,824
2021	13,885	17,939	31,824
2022-2026	79,294	79,826	159,120
2027-2031	98,644	60,476	159,120
2032-2036	122,716	36,404	159,120
2037-2040	101,805	8,071	109,876
Total	<u>\$ 466,200</u>	<u>\$ 280,156</u>	<u>\$ 746,356</u>

USDA Note 91-02:

Year Ended September 30,	Principal	Interest	Annual Payment
2017	\$ 25,668	\$ 38,484	\$ 64,152
2018	26,383	37,769	64,152
2019	27,118	37,034	64,152
2020	27,873	36,279	64,152
2021	28,649	35,503	64,152
2022-2026	155,667	165,093	320,760
2027-2031	178,585	142,175	320,760
2032-2036	204,876	115,884	320,760
2037-2041	235,038	85,722	320,760
2042-2046	269,641	51,119	320,760
2047-2050	231,624	12,602	244,227
Total	<u>\$ 1,411,122</u>	<u>\$ 757,665</u>	<u>\$ 2,168,787</u>

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

NOTE 7 - 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

The restricted net position includes amounts related to Note 4 above.

NOTE 8 - CONTINGENCIES

Litigation

According to management there were no known contingent liabilities at September 30, 2016, which would have a material effect on the financial statements.

Grant Program Involvement

In the normal course of operations, the District participates in various Federal or State grant or 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 - LEASE COMMITMENTS

The District has a 60 month operating lease for office equipment. Minimum lease rental payments follow.

Year Ended September 30,	Mail Folder
2017	\$1,440

NOTE 10 - WATER LEASE

The District has entered into a 50-year lease agreement with a private party that expires on December 31, 2052, for the purpose of purchasing water for the duration of the agreement. The cost of water purchased per 1,000 gallons is as follows:

January 1, 2002-December 31, 2010:	\$ 0.0393
------------------------------------	-----------

TRI-COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

January 1, 2011-December 31, 2028: Adjusted annually
January 1, 2029-December 31, 2052: Price renegotiated

The District entered into a perpetual lease agreement with a private party on May 16, 2002, for the purpose of water, for the consideration of \$0.393 per 1,000 gallons sold.

NOTE 11 - SUBSEQUENT EVENTS

The District did not have any subsequent events through February 10, 2017, which is the date the financial statements were issued, for events requiring recording or disclosure in the financial statements for the year ending September 30, 2016.

NOTE 12 - PRIOR YEAR ADJUSTMENT

Prior year adjustments were made as follows:

Decreased Cash	<u>(\$17,321)</u>
Total Adjustments to Total Net Position	(\$17,321)

KERSHAW CPA & ASSOCIATES, PC

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

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

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

INDEPENDENT AUDITOR'S 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
Tri-County Rural Water District #2
Earlsboro, 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 Tri-County Rural Water District #2 as of and for the year ended September 30, 2016, 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 February 15 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 Tri-County Rural Water District #2'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 Tri-County Rural Water District #2's internal control. Accordingly, we do not express an opinion on the effectiveness of Tri-County Rural Water District #2'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

KERSHAW CPA & ASSOCIATES, PC

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

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

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

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.

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 16-01 and 16-02.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Tri-County Rural Water District #2'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*.

Tri-County Rural Water District #2's Response to Findings

Tri-County Rural Water District #2's response to the findings identified in our audit is described in the accompanying Schedule of Findings. Tri-County Rural Water District #2'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.

KERSHAW CPA & ASSOCIATES, PC

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

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

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

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

February 10, 2017

TRI-COUNTY RURAL WATER DISTRICT #2
SCHEDULE OF FINDINGS
SEPTEMBER 30, 2016

INTERNAL CONTROL FINDINGS:

Item 16-01: Segregation of Duties

Criteria: A good system of internal control requires a proper segregation of duties to prevent one person from being in a position to authorize, execute, and record the same transaction.

Condition: Due to the size of the District's major areas of internal control, that would be prevalent in a larger District, such segregation of duties is not available for this size operation. Duties are concentrated in the hands of a few individuals, who are responsible for all phases of the accounting functions. Because of this lack of division of responsibility, internal control is determined to be weak, and in some instances, non-existent.

Cause/Effect: Due to the limited number of personnel, a breach of internal controls could occur and not be detected in the normal course of operations.

Recommendation: The Board should continue to be actively involved in the operations of the District.

Response: The Board continues to be actively involved in the operations of the District.

Item 16-02: Bank Reconciliations

Criteria: Internal control refers to the methods and procedures used to provide reasonable assurance regarding the achievement of objectives in the following categories: Safeguarding assets, Ensuring validity of financial records and reports, Promoting adherence to policies, procedures, regulations and laws, and Promoting effectiveness and efficiency of operations. Internal control also refers to how an entity processes, summarizes and records the financial transactions. In general terms, internal controls are simply good business practices.

Condition: The District has not allowed personnel the resources to consistently and accurately perform monthly bank reconciliations during the audit year. Bank reconciliations were performed, however, the reconciled figure does not reconcile to the general ledger.

TRI-COUNTY RURAL WATER DISTRICT #2
SCHEDULE OF FINDINGS
SEPTEMBER 30, 2016

Cause/Effect: The financial statements contain misstatements and omit financial information.

Recommendation: Monthly bank reconciliations need to be performed on each bank account and the balance agree with that reflected in the financial statements.

Response: The District is aware of the problem and has made a lot of progress in the last year of correcting this finding.