

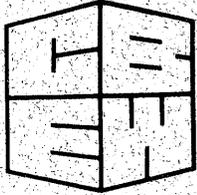
**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010**

RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma

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INDEPENDENT AUDITOR'S REPORT

December 3, 2012

Board of Directors
Rural Water District No. 5
Pawnee County
Ralston, Oklahoma

We have audited the accompanying financial statements of Rural Water District No. 5, Pawnee County, Ralston, Oklahoma (the District) as of and for the year ended December 31, 2011 and 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rural Water District No. 5, Pawnee County, Ralston, Oklahoma as of December 31, 2011 and 2010, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 3, 2012, on our consideration of the Rural Water District No. 5's internal control over financial reporting and 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 results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The District has not presented Management's Discussion and Analysis that governmental 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 (GASB), who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

CBEW Professional Group, LLP

CBEW PROFESSIONAL GROUP, LLP
Certified Public Accountants

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**STATEMENT OF NET ASSETS
December 31, 2011 and 2010**

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Assets:		
Cash and cash equivalents (Note 1)	\$ 8,271	\$ 4,505
Receivables (net of allowance for uncollectible)	2,237	5,486
Temporarily restricted:		
Cash and cash equivalents (Note 2)	-	-
Capital assets:		
Land	5,000	5,000
Water system (Note 4)	340,119	340,119
Equipment (Note 4)	33,621	32,827
Accumulated depreciation	<u>(164,933)</u>	<u>(153,826)</u>
Total assets	\$ <u>224,315</u>	\$ <u>234,111</u>
Liabilities:		
Accounts payable	\$ 4,360	\$ 2,487
Notes payable (Note 3)	<u>15,635</u>	<u>19,467</u>
Total liabilities	<u>19,995</u>	<u>21,954</u>
Net assets:		
Invested in capital assets, net of related debt	198,172	204,653
Temporarily restricted (Note 2)	-	-
Unrestricted	<u>6,148</u>	<u>7,504</u>
Total net assets	\$ <u>204,320</u>	\$ <u>212,157</u>

The accompanying notes are an integral part of the basic financial statements

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**STATEMENT OF ACTIVITIES
For the Years Ended December 31, 2011 and 2010**

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Revenues:		
Water sales	\$ 35,600	\$ 36,986
Other income	-	-
REAP Grant	-	-
	<hr/>	<hr/>
Total revenues	<u>35,600</u>	<u>36,986</u>
Expenses:		
Bank charges	38	74
Contract labor	4,575	8,912
Depreciation	11,108	9,124
Dues and subscriptions	30	30
Insurance	690	381
Licenses, permits and fees	(733)	659
Postage		450
Professional fees	1,100	2,100
Reimbursement	(999)	-
Repairs and maintenance	4,238	2,884
Office Supplies	634	2,054
Telephone	1,624	917
Utilities	2,989	2,080
Wages	6,810	-
Water production	10,122	5,767
	<hr/>	<hr/>
Total expenses	<u>42,226</u>	<u>35,432</u>
Operating income (loss)	<u>(6,626)</u>	<u>1,554</u>
Other income and expense:		
Interest income	26	72
Interest expense	(1,237)	(1,473)
	<hr/>	<hr/>
Total other income and expense	<u>(1,211)</u>	<u>(1,401)</u>
Change in net assets	(7,837)	153
Net assets - beginning of year	<u>212,157</u>	<u>212,004</u>
Net assets - end of year	<u>\$ 204,320</u>	<u>\$ 212,157</u>

The accompanying notes are an integral part of the basic financial statements

RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma

STATEMENT OF CHANGES IN NET ASSETS
For the Years Ended December 31, 2011 and 2010

	<u>Net Assets (Unrestricted)</u>	<u>Net Assets (Temporarily Restricted)</u>	<u>Total Net Assets</u>
Balance - beginning of year 12-31-09	\$ 123,039	\$ 88,965	\$ 212,004
Change in net assets	<u>89,118</u>	<u>(88,965)</u>	<u>153</u>
Balance - end of year 12-31-10	<u>\$ 212,157</u>	<u>\$ -</u>	<u>\$ 212,157</u>
Balance - beginning of year 12-31-10	\$ 212,157	\$ -	\$ 212,157
Change in net assets	<u>(7,837)</u>	<u>-</u>	<u>(7,837)</u>
Balance - end of year 12-31-11	<u>\$ 204,320</u>	<u>\$ -</u>	<u>\$ 204,320</u>

The accompanying notes are an integral part of the basic financial statements

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2011 and 2010**

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Cash flows from operating activities:		
Cash received from customers & service users	\$ 38,849	\$ 34,783
Cash payments to suppliers for goods and contractors and other services	<u>(29,245)</u>	<u>(28,573)</u>
Net cash provided by operating activities	<u>9,604</u>	<u>6,210</u>
 Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(795)	(94,275)
Proceeds from notes	-	-
Principal payments on notes	(3,832)	(3,588)
Interest paid on notes	<u>(1,237)</u>	<u>(1,473)</u>
Net cash used in capital and related financing activities	<u>(5,864)</u>	<u>(99,336)</u>
 Cash flows from investing activities:		
Interest on Investments	26	72
Net cash used in investing activities	<u>26</u>	<u>72</u>
 Net increase (decrease) in cash	3,766	(93,054)
 Cash and cash equivalents at beginning of year	<u>4,505</u>	<u>97,559</u>
 Cash and cash equivalents at end of year	<u>\$ 8,271</u>	<u>\$ 4,505</u>
 Reconciliation of operating income to net cash provided by operating activities:		
Operating income (loss)	<u>\$ (6,626)</u>	<u>\$ 1,554</u>
 Adjustments to reconcile net income to net cash provided by operating activities:		
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	11,108	9,124
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Accounts receivable	3,249	(2,203)
Increase (decrease) in liabilities:		
Water Deposits	-	(2,350)
Accounts payable	<u>1,873</u>	<u>85</u>
Total adjustments	<u>16,230</u>	<u>4,656</u>
 Net cash provided by operating activities	<u>\$ 9,604</u>	<u>\$ 6,210</u>

The accompanying notes are an integral part of the basic financial statements

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rural Water District No. 5, Pawnee County, Oklahoma (the District), was created under the provisions of Title 82, O.S. 1981, Sections 1324.1-1324.26 inclusive, for the purpose of providing water to the members it serves. Membership in the water District consists of water users who have paid the required membership and connection fees. The District is exempt from federal and state income taxes. Prior to August 19, 2003, the District was known as Ralston Water, Inc. (a Corporation). The Corporation was converted to a Rural Water District in accordance with Title 82, O.S. Sections 1324.30-1324.35 as of August 19, 2003, and the Corporation was dissolved in accordance with Title 18 O.S. Section 1097.

The membership consists of approximately 72 users, each entitled to one vote. The Board of Directors consists of 5 members serving 3-year terms. The vacant Board seats are elected at the annual meeting in November, and following, the Board of Directors meet and elect a chairman, vice-chairman, and secretary-treasurer. All Board members serve without pay. The more significant of the District's accounting policies are described below.

A. Reporting Entity

Rural Water District No. 5 is an independent, self-contained reporting entity with no associated component units. It is operated in a manner similar to a private business enterprise where the cost (expenses, including depreciation) of providing water services is financed through user charges. The District purchases all of its water from the Town of Ralston.

B. Measurement Focus, Basis of Accounting and Basis of Presentation – Fund Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP) promulgated in the United States of America. The accounting and financial reporting treatment is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation are included on the statement of net assets. The operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. Depreciation expense is provided for capital assets based upon estimated useful lives.

Financial activity is accounted for on the flow of economic resources measurement focus using the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. In compliance with the Governmental Accounting Standards Board (GASB) Statement No. 29 the district has elected to only apply Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) and Accounting Research Board (ARB) materials issued on or before November 30, 1989 that do not conflict with GASB.

C. Assets, Liabilities and Equity

1. Deposits and Investments

Oklahoma Statutes authorize the District to invest in certificates of deposit, repurchase agreements, passbooks, bankers' acceptances, and other available bank investments provided that all deposits are fully covered by approved securities pledged to secure those funds. In addition, the District can invest in direct debt securities of the United States unless such an investment is expressly prohibited by law.

All the bank deposits are held at one financial institution and are carried at cost. For purposes of statements of cash flows, the District considers cash and all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Assets, Liabilities and Equity (Continued)

1. Deposits and Investments (Continued)

The District's cash deposits, including interest-bearing certificates of deposit, are entirely covered by Federal Depository Insurance (FDIC).

2. Fair Value of Financial Instruments

The District's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and notes payable. The District's estimate of the fair value of all financial instruments does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statement of net assets. The carrying amount of these financial instruments approximates fair value because of the short maturity of these instruments.

3. Estimates

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

4. Inventories

Inventories consist primarily of water stored in lines for use in the distribution process. Inventory is expensed when purchased.

5. Capital Assets

Additions to the water storage delivery system and other equipment are recorded at cost or, if contributed property, at their estimated fair value at time of contribution. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized. The District maintains a capitalization threshold of \$500 and an estimated useful life in excess of two (2) years.

Depreciation is provided following the guidelines of the Internal Revenue Service (which is not materially different than generally accepted accounting principles). Estimated useful lives are as follows:

Water System	40 years
Water System Pumps/ Equipment	5-10 years

6. Reclassification

Certain amounts in the prior-year financial statements have been reclassified for comparative purposes to conform with the presentation in the current-year financial statements.

7. Subsequent Events

Subsequent events have been evaluated through December 3, 2012, which is the date the financial statements were available to be issued.

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010**

2. TEMPORARILY RESTRICTED ASSETS

During the year ended December 31, 2010, REAP Grant funds received during the fiscal year ended December 31, 2009 were expended on water system improvements.

3. LONG-TERM DEBT

Long-term debt consists of one note with the First National Bank of Pawnee. The note is secured by the water works system, distribution lines, pump stations, and reservoirs.

The following is a summary of long-term debt transactions during the year:

	Balance December 31, 2010	Additions	Reductions	Balance December 31, 2011
The First National Bank	\$ 19,467	-	\$ 3,832	\$ 15,635
Total	\$ 19,467	\$ -	\$ 3,832	\$ 15,635
	Balance December 31, 2009	Additions	Reductions	Balance December 31, 2010
The First National Bank	\$ 23,055	-	\$ 3,588	\$ 19,467
Total	\$ 23,055	\$ -	\$ 3,588	\$ 19,467

Annual cash requirements to amortize the notes are as follows:

<u>Year Ending</u>	
<u>December 31,</u>	
2011	5,069
2012	5,069
2013	5,069
2014	5,069
2015	5,069
Total	25,345
Less Interest	(9,710)
Note Balance	\$ 15,635

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010**

4. CAPITAL ASSETS

The following is a summary of changes in property, plant and equipment during the years ended December 31, 2011 and 2010.

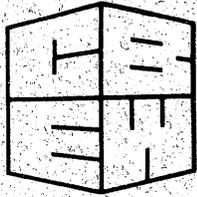
	Balance December 31, 2010	Additions	Deletions	Balance December 31, 2011
Water system	\$ 261,984	\$ -	\$ -	\$ 261,984
Land	5,000	-	-	5,000
Equipment	110,962	795	-	111,757
Total	<u>377,946</u>	<u>795</u>	<u>-</u>	<u>378,741</u>
Less accumulated depreciation	153,826	11,108	-	164,934
Net	<u>\$ 224,120</u>	<u>\$ 11,108</u>	<u>\$ -</u>	<u>\$ 213,807</u>
	Balance December 31, 2009	Additions	Deletions	Balance December 31, 2010
Water system	\$ 261,984	\$ -	\$ -	\$ 261,984
Land	5,000	-	-	5,000
Equipment	16,687	94,275	-	110,962
Total	<u>283,671</u>	<u>94,275</u>	<u>-</u>	<u>377,946</u>
Less accumulated depreciation	144,702	9,124	-	153,826
Net	<u>\$ 138,969</u>	<u>\$ 9,124</u>	<u>\$ -</u>	<u>\$ 224,120</u>

5. RISK MANAGEMENT

Rural Water District No. 5 is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District continues to carry commercial insurance for these risks, including general liability, property damage, and public officials' liability. Settled claims resulting from these risks have not exceeded the commercial insurance coverage in any of the past three fiscal years.

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Ralston, Oklahoma**

**REPORT REQUIRED BY *GOVERNMENT AUDITING STANDARDS*
December 31, 2011 and 2010**



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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**

December 3, 2012

Board of Directors
Rural Water District No. 5
Pawnee County
Ralston, Oklahoma

We have audited the basic financial statements of the Rural Water District No. 5, Pawnee County, Ralston, Oklahoma (the District), as of and for the year ended December 31, 2011, and have issued our report thereon dated December 3, 2012. 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. The District did not present the Management's Discussion and Analysis required by the Governmental Accounting Standards Board.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies in internal control over financial reporting. The finding reference numbers are 11-1, 11-2 and 11-3. 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.

Rural Water District No. 5
December 3, 2012

Compliance and Other Matters

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

The District's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's response and, according, we express no opinion on it.

We also noted certain additional matters that we have reported to management of the District in a separate letter dated December 3, 2012.

This report is intended solely for the information and use of management, all applicable federal and state agencies, and is not intended to be and should not be used by anyone other than these specified parties.

CBEW Professional Group, LLP

CBEW Professional Group, LLP
Certified Public Accountants

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Pawnee, Oklahoma**

**SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2011**

11-1. Internal Control – Segregation of Duties

Criteria: The segregation of duties and responsibilities between different individuals for custody of assets, recordkeeping for those assets and reconciliation of those asset accounts is an important control activity needed to adequately protect the district's assets and ensure accurate financial reporting.

Condition: Presently the same individual that receives utility service related cash payments is also responsible for service billing and adjustment, also balances the daily cash drawer, posts payments to subsidiary accounts receivable ledger and reconciles the monthly bank statements. In addition, only limited oversight is provided over this individual in the conduct of their daily functions. This finding was also noted in 2010.

Cause: The district's limited size and staffing resources have made it difficult for management to provide sufficient staffing to fully segregate incompatible duties in a cost-effective manner.

Effect or Potential Effect: Without sufficient segregation of duties, the risk significantly increases that errors and fraud related to utility billing and collection activities, including misappropriation of assets, could occur and not be detected within a timely basis.

Recommendation: We recommend that management and the board should consider a formal evaluation of their risks associated with this lack of duties segregation over utility cash and receivables. In response to the identified risks, consideration should be given to identifying and implementing controls that could help mitigate the risks associated with lack of segregation of duties, such as providing increased management oversight and an independent reconciliation of accounts. For example, the entity might consider soliciting the assistance of independent volunteer labor to perform certain functions including performing compensating procedures where applicable.

Responsible Official's Response: The district concurs with the recommendation, although, the cost to correct this condition might exceed the benefit, the district has made certain changes in procedures that will improve the overall lack of segregation of duties and has implemented compensating procedures as appropriate.

11-2. Internal Control – Financial Statements

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

Condition: As is the case with many smaller and medium-sized entities, the district has historically relied extensively on its independent external auditors to provide the needed expertise to assist in the preparation of the financial statements and footnotes. However, management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting, even if the auditor assists in drafting the financial statements. Accordingly the district's ability to prepare financial statements in accordance with generally accepted accounting principles (GAAP) is based, in part, on assistance from its external auditors, who cannot by definition be considered a part of the district's internal controls. This finding was also noted in 2010.

**RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Pawnee, Oklahoma**

**SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2011**

Cause: District personnel do not possess formal knowledge, expertise and education relative to preparing GAAP financial statements and related disclosures without assistance from the external auditor or another outside source. Professional standards do not require that the management possess the expertise to prepare the financial statements but to have the skills to understand them. As a result, management was able to review the financial statements and related note disclosures and sufficiently understand them to take full responsibility for them as required by professional standards.

Effect or Potential Effect: As a result of this condition, without assistance from its external auditors or another outside source, the district may lack the necessary internal controls over the preparation of financial statements in accordance with GAAP. This condition could also place the auditor in a questionable position regarding auditor independence.

Recommendation: We recommend that the district consider designing and implementing sufficient internal controls over financial reporting by obtaining the necessary knowledge, expertise and continuing education to prepare financial statements in accordance with generally accepted accounting principles without assistance from the external financial statement auditor. This could be achieved through employment of qualified accounting staff or the outsourcing of these control activities to a qualified accounting firm other than the external auditor.

Responsible Official's Response: The district concurs with the recommendation, and will strive to expand their knowledge and understanding of the presentation and disclosure requirements of the financial statements.

11-3. Internal Control – Material Adjusting Journal Entries

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

Condition: The district's trial balances for the year ended December 31, 2011, required a number of material adjusting journal entries in order for the financial statements to be prepared in accordance with GAAP. These necessary adjusting entries, identified solely as a result of the financial statement audit, included such adjustments as the following: Capitalize asset expenditures, interest payments on notes, depreciation, and accounts receivable. This finding was also noted in 2010.

Cause: The district's accounting and financial reporting staff does not possess the formal knowledge, expertise and education, relative to the complex nature of applying GAAP applicable to state and local governments, sufficient to provide reasonable assurance that the trial balances used for preparing the GAAP financial statements are complete and accurate prior to audit. As a result, management has had to rely on the external auditors to identify and correct a number of material misstatements in the trial balances. However, as required by professional standards, management had the capacity to review, understand and accept the adjusting entries proposed by the auditor in order to take full responsibility for them and the related financial statements.

RURAL WATER DISTRICT NO. 5
PAWNEE COUNTY
Pawnee, Oklahoma

SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2011

Effect or Potential Effect: As a result of this condition, without assistance from its external auditors, the district lacks the necessary internal controls over the completeness and accuracy of the trial balances that are used in the preparation of its financial statements in accordance with GAAP. This condition can result in undetected and uncorrected material misstatements in the financial statements that are not detected by management and may also not be detected by the financial statement audit. In addition, if management's intentions are to continue to rely on the external auditor to detect and correct material misstatements, this condition could place the auditor in a questionable position regarding auditor independence since management is responsible for the completeness and accuracy of the financial statements.

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

Responsible Official's Response: The district concurs with the recommendation, and will strive to expand their knowledge and understanding to identify and correct material misstatements timely in order to prepare complete and accurate financial statements.