

**CUSTER COUNTY RURAL WATER
DISTRICT NO. 3**

**FINANCIAL STATEMENTS
AND AUDITOR'S REPORT**

JUNE 30, 2012 AND 2011

CUSTER COUNTY RURAL WATER
DISTRICT NO. 3

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Custer County Rural Water District No. 3
Custer, Oklahoma

We have audited the basic financial statements of the Custer County Rural Water District No. 3 as of June 30, 2012 and 2011, (as restated), 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 audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Custer County Rural Water District No. 3 as of June 30, 2012 and 2011, and the respective changes in financial position and its cash flows for the years 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 August 29, 2012, on our consideration of the District's internal control over financial reporting and our

tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and important for assessing the results of our audit.

The District has not presented the management's discussion and analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

McCulley & McCulley

Weatherford, Oklahoma

August 29, 2012

**CUSTER COUNTY RURAL WATER DISTRICT NO. 3
BALANCE SHEETS**

	June 30,	
ASSETS	2012	2011
Current Assets		
Petty Cash	\$ 50	\$ 50
Cash in Bank	173,409	110,366
Certificates of Deposit	137,544	135,793
Accounts Receivable, Net	18,629	28,989
Prepaid Expenses	8,926	8,507
Total Current Assets	338,558	283,705
Restricted Assets		
Cash - Meter Deposits	18,100	15,600
Total Restricted Assets	18,100	15,600
Inventory	8,402	5,530
Other Assets	1,115	1,115
Capital Assets, Net of Accumulated Depreciation	889,069	906,930
TOTAL ASSETS	\$ 1,255,244	\$ 1,212,880
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts Payable	\$ 923	\$ 914
Accrued Compensated Absences	1,452	1,452
Customer Meter Deposits	18,100	15,600
Deferred Revenue	10,800	10,500
Total Current Liabilities	31,275	28,466
Long-Term Liabilities	0	0
Total Liabilities	31,275	28,466
Net Assets		
Invested in Capital Assets, Net of Related Debt	889,069	906,930
Unrestricted and Designated	334,900	277,484
Total Net Assets	1,223,969	1,184,414
TOTAL LIABILITIES AND NET ASSETS	\$ 1,255,244	\$ 1,212,880

The accompanying notes are an integral part of these statements.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	June 30,	
	2012	2011
Operating Revenues		
Water Sales	\$ 275,450	\$ 266,792
Membership Income	16,000	11,000
Installation & Connection Charges	3,057	2,585
Late Charges	2,830	3,197
Other Revenue	2,768	2,727
Total Operating Revenues	300,105	286,301
Operating Expenses		
Cost of Water	41,026	42,035
Salaries and Wages	76,421	74,950
Pension Plan	8,500	9,784
Payroll Taxes	6,406	6,154
Depreciation	43,304	37,481
Repairs and Maintenance	7,725	5,737
Insurance	11,910	10,901
Transportation	12,296	12,462
Utilities	11,910	10,068
Operating Supplies	31,699	29,142
Telephone	4,524	4,265
Office Supplies	3,038	3,489
Professional Services	1,531	11,358
Licenses, Dues, and Subscriptions	940	4,100
Director Fees	1,800	1,900
Miscellaneous Expense	668	160
Total Operating Expenses	263,698	263,986
Operating Income Before		
Nonoperating Revenues (Expenses)	36,407	22,315
Nonoperating Revenues (Expenses)		
Interest Income	2,041	2,732
Sales of Assets	1,107	
Increase in Net Assets	\$ 39,555	\$ 25,047

The accompanying notes are an integral part of these statements.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	<u>June 30,</u>	
	<u>2012</u>	<u>2011</u>
Net Assets		
Beginning of Year	\$ 1,184,414	\$ 1,159,367
Increase in Net Assets For the Year Then Ended	<u>39,555</u>	<u>25,047</u>
End of Year	<u>\$ 1,223,969</u>	<u>\$ 1,184,414</u>

The accompanying notes are an integral part of these statements.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	June 30,	
	2012	2011
Cash Flows from Operating Activities		
Cash Received from Customers	\$ 303,127	\$ 288,401
Cash Paid for Goods and Services	(119,339)	(144,614)
Cash Paid to Employees	(91,327)	(90,888)
Net Cash Provided by Operating Activities	92,461	52,899
Cash Flows from Noncapital Financing Activities		
Cash Flows From Investing Activities		
Purchase of Capital Assets	(26,485)	(25,466)
Purchase of Inventory	(1,830)	(5,530)
Sales of Assets	1,107	
Interest Received on Cash and Cash Equivalents	2,041	2,732
Net Cash (Used for) Investing Activities	(25,167)	(28,264)
Cash Flows from Financing Activities		
Net Cash (Used for) Financing Activities	0	0
Net Increase in Cash and Cash Equivalents	67,294	24,635
Cash and Cash Equivalents		
Beginning of Year	261,809	237,174
End of Year	\$ 329,103	\$ 261,809
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$ 36,407	\$ 22,315
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	43,304	37,481
Changes in Assets & Liabilities:		
(Increase) in Accounts Receivable	10,138	(6,650)
Increase in Allowance for Loss	222	
(Increase) Decrease in Prepaid Expenses	(419)	(211)
(Decrease) in Accounts Payable	9	(2,136)
Increase in Accrued Compensated Absences	0	
Increase in Deferred Revenue	300	
Increase in Customer Meter Deposits	2,500	2,100
Total Adjustments	56,054	30,584
Net Cash Provided By Operating Activities	\$ 92,461	\$ 52,899

The accompanying notes are an integral part of these statements.

**CUSTER COUNTY RURAL WATER DISTRICT NO. 3
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDING JUNE 30, 2012 AND 2011**

Note 1 - Significant Accounting Policies.

The accounting policies of the Custer County Rural Water District No. 3 (the District) conform to accounting principles generally accepted in the United States of America applicable to government organizations. 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The following is a summary of the more significant policies.

A. The Reporting Entity.

The District provides water to its members within its geographic boundaries. The District is governed by a seven member Board of Directors who are elected by the participating members. These financial statements include all of the funds under the control of the Board of Directors relevant to the operations of the District.

B. Basis of Presentation.

The accounts of governmental entities are organized on the basis of funds or account groups, each of which is considered to be a separate accounting entity. The operations of each fund have a separate set of accounts which are comprised of each fund's assets, liabilities, fund equity, revenues and expenses. The activities of the District are organized into a single fund, an enterprise fund (proprietary fund type).

Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, accountability, or other purposes.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDING JUNE 30, 2012 AND 2011

Note 1 - Significant Accounting Policies (continued).

C. Basis of Accounting.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement focus applied.

Enterprise funds use the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when the obligation is incurred.

D. Policy Regarding Use of Financial Accounting Standard Board (FASB) Pronouncements.

The District applies all applicable Government Accounting Standards Board (GASB) pronouncements as well as the pronouncements issued on or before November 30, 1989, by the FASB or predecessor Boards, unless those pronouncements conflict with or contradict GASB pronouncements.

E. Allowance for Losses.

Allowance for losses on receivables are recorded when management believes a receivable is uncollectible. Management periodically reviews its receivables to determine what is collectible. At June 30, 2012 and 2011, management has set an allowance for loss of \$222 for 2012 and none for 2011.

F. Inventory.

Inventory consists of items purchased and held by the District for use to construct a line extension. It is valued at cost.

G. Capital Assets.

All capital assets are valued at historical cost. Capital assets with a historical cost > \$500 are depreciated on the straight-line basis over the estimated useful life of the asset. A summary of the capital assets and the service lives by type of asset at June 30, 2012 and 2011, are as follows:

<u>Estimated Useful Life</u>	
Wells, Lines and Buildings	10 - 65 yrs.
Vehicles	5 yrs.
Furniture and Fixtures	3 - 5 yrs.
Pumps and Equipment	3 - 5 yrs.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDING JUNE 30, 2012 AND 2011

Note 1 - Significant Accounting Policies (continued).

H. Accrued Compensated Absences.

The District has established a compensated absences policy which gives all full time employees compensation for vacation leave. This policy gives two weeks vacation leave for those with one year of continuous employment and three weeks for those with ten years or more. Vacation leave will be paid whether taken or not at the end of the calendar year. Employees may also earn one calendar day per month sick leave which can accumulate to 36 days, along with 3 personal days each year that cannot be accumulated. Unused sick leave or personal days will not be paid to the employee. These financial statements accrue only for the unused vacation leave.

I. Net Assets.

Net assets are classified into three components:

1. Invested in capital assets, net of related debt - Consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any notes payable attributable to these assets.
2. Restricted net assets - Consists of net assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional revisions or enabling legislation.
3. Unrestricted net assets - All other net assets that do not meet the definition of the other two above. These include amounts designated by management for a particular purpose.

J. Operating Revenues and Expenses.

Operating revenues and expenses consist of those revenues that result from the ongoing principal operations of the District. Operating revenues consist primarily of charges for services. Nonoperating revenues and expenses consist of those revenues and expenses that are related to financing and investing type of activities and result from nonexchange transactions or ancillary activities.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDING JUNE 30, 2012 AND 2011

Note 2 - Cash in Bank and Certificates of Deposit.

Cash in bank includes the District's demand deposits and savings accounts. The District's certificates of deposit are recorded at cost, which approximates market value. Certificates of deposit are authorized investments for the District. The District uses the state statutes as a deposit policy for custodial credit risk. The District has custodial credit risk which is defined as the risk that in the event of a bank failure, the District's deposits may not be returned to it. The Federal Government has increased the federal deposit insurance to \$250,000. All of the District's deposits at June 30, 2012 and 2011, are secured by federal deposit insurance, collateralized by the bank's agent in the District's name, or uninsured and not collateralized as noted below.

	JUNE 30	
	2012	2011
Carrying Balance	\$329,053	\$261,759
Bank Balance	340,110	296,966
Insured	340,110	296,966

For the purpose of the Statement of Cash Flows, the District considers cash and cash equivalents to be petty cash, cash in bank, certificates of deposit, and restricted assets.

Note 3 - Accounts Receivable, Net.

Accounts receivable consists of the amounts owed to the District by customers for water sales, late fees and memberships, net of any allowance for loss. At June 30, 2012, an allowance for loss has been established of \$222. None was established for 2011.

Note 4 - Restricted Assets.

Restricted cash - meter deposits consist of cash restricted for customer deposits and which are offset by a related liability payable.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEARS ENDING JUNE 30, 2012 AND 2011

Note 5 - Capital Assets.

Capital assets and its changes consist of the following:

	June 30, 2011	Additions	Deletions	June 30, 2012
Tank Sites - Land *	\$ 5,000	\$	\$	\$ 5,000
Office Building - Land *	2,154			2,154
Wells, Lines & Buildings	1,664,999	26,485	(1,042)	1,690,442
Vehicles	27,903			27,903
Furniture and Fixtures	12,119			12,119
Pumps and Equipment	<u>54,891</u>		<u>(6,682)</u>	<u>48,209</u>
Total Capital Assets	<u>1,767,066</u>	<u>26,485</u>	<u>(7,724)</u>	<u>1,785,827</u>
Less Accumulated Depreciation for:				
Wells, Lines & Buildings	(790,401)	(34,404)		(824,805)
Vehicles	(22,710)	(2,397)		(25,107)
Furniture and Fixtures	(9,829)	(1,135)		(10,964)
Pumps and Equipment	<u>(37,196)</u>	<u>(5,368)</u>	<u>6,682</u>	<u>(35,882)</u>
Total Accumulated Depr.	<u>(860,136)</u>	<u>(43,304)</u>	<u>6,682</u>	<u>(896,758)</u>
Net Capital Assets	<u>\$ 906,930</u>	<u>\$ (16,819)</u>	<u>\$ (1,042)</u>	<u>\$ 889,069</u>
	June 30, 2010	Additions	Deletions	June 30, 2011
Tank Sites - Land *	\$ 5,000	\$	\$	\$ 5,000
Office Building - Land *	2,154			2,154
Wells, Lines & Buildings	1,648,864	16,135		1,664,999
Vehicles	27,903			27,903
Furniture and Fixtures	13,470	2,370	(3,721)	12,119
Pumps and Equipment	<u>50,424</u>	<u>6,961</u>	<u>(2,494)</u>	<u>54,891</u>
Total Capital Assets	<u>1,747,815</u>	<u>25,466</u>	<u>(6,215)</u>	<u>1,767,066</u>
Less Accumulated Depreciation for:				
Wells, Lines & Buildings	(759,657)	(30,744)		(790,401)
Vehicles	(20,313)	(2,397)		(22,710)
Furniture and Fixtures	(12,417)	(1,133)	3,721	(9,829)
Pumps and Equipment	<u>(36,483)</u>	<u>(3,207)</u>	<u>2,494</u>	<u>(37,196)</u>
Total Accumulated Depr.	<u>(828,870)</u>	<u>(37,481)</u>	<u>6,215</u>	<u>(860,136)</u>
Net Capital Assets	<u>\$ 918,945</u>	<u>\$ (12,015)</u>	<u>\$ -0-</u>	<u>\$ 906,930</u>

* non-depreciable assets

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDING JUNE 30, 2012 AND 2011

Note 6 - Other Assets.

Other assets consists of a reserve certificate issued by the Oklahoma Rural Water Association Assurance Group. It earns a variable rate of interest and can be redeemed by the District upon written demand (providing the net assets of the Oklahoma Rural Water Association Assurance Group equal or exceed \$125,000). The total amount of this reserve certificate is \$1,000. The balance of other assets is utility deposits paid.

Note 7 - Deferred Revenue.

Pasture Meters are billed on an annual basis in advance. The amount in the financial statements for deferred revenue represents the unearned portion of these prepaid meters as of June 30, 2012 and 2011.

Note 8 - Related Party Transactions.

The District has an agreement to rent the backhoe owned by one of their employees on a hourly rate. This is done whenever it is needed to repair or replace a water line. Payments to the employee for the year ended June 30, 2012 and 2011, totaled \$7,725 and \$5,737, respectively.

Note 9 - Pension Plan.

On August 4, 1992, the Board of Directors approved a Simplified Employee Pension plan for any full-time employee. The District has established a monthly contribution of 15% to comply with Internal Revenue Service regulations. The employees length of service requirement to be eligible for this plan is six months. Employees are not required to contribute to this plan. For the fiscal year ending June 30, 2012 and 2011, the total employer contributions amounted to \$8,500 and \$ 9,784, respectively. Covered salaries for fiscal year 2012 and 2011 totaled \$56,817 and \$65,230, respectively. Total salaries for fiscal year 2012 and 2011 were \$76,421 and \$74,950, respectively.

Note 10 - Risk Management.

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omission; injuries to employees; and natural disasters. The District purchases commercial insurance to reduce their risk of loss. This insurance has a \$1,000 deductible for capital assets (except for the generators), personal injuries, and errors & omissions. The generators have a \$250 deductible.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEARS ENDING JUNE 30, 2012 AND 2011

Note 11 - Net Assets - Designated or Restricted.

On November 4, 1997, the District's Board of Directors designated the District's savings accounts and certificate of deposits to be used for system improvements, expansions, and emergencies. Designated net assets totaled \$151,136 and \$147,701 for the year ending June 30, 2012 and 2011, respectively.

Note 12 - Restated June 30, 2011 Financial Statements.

The following shows the effects of the restatement of the financial statements for June 30, 2011, as a result of adjusting inventory for \$5,530 not previously reported.

<u>Balance Sheet</u>	<u>As Previously Reported</u>	<u>As Restated</u>
Inventory	\$ -0-	\$ 5,530
Total Assets	1,207,350	1,212,880
Net Assets Unrestricted	271,954	277,484
Total Net Assets	1,178,884	1,184,414
Total Liab. & Net Assets	1,207,350	1,212,880
 <u>Statement of Activities</u>		
Operating Supplies	34,672	29,142
Total Operating Exp.	269,516	263,986
Operating Income before Nonoperating Inc. (Exp)	16,785	22,315
Increase in Net Assets	19,517	25,047
 <u>Statement of Changes in Net Assets</u>		
Increase in Net Assets	19,517	25,047
Net Assets, End of Year	1,178,884	1,184,414
 <u>Statement of Cash Flows</u>		
Cash Paid for Goods & Services	(150,144)	(144,614)
Net Cash Provided by Operating Activities	47,369	52,899
Purchase of Inventory	-0-	(5,530)
Net Cash (Used for) Investing Activities	(22,734)	(28,264)
Operating Income	16,785	22,315

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**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**

Board of Directors
Custer County Rural Water District No. 3
Custer, Oklahoma

We have audited the basic financial statements of the Custer County Rural Water District No. 3 for the year ended June 30, 2012, and have issued our report dated August 29, 2012. The District has not presented the management's discussion and analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of the basic financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Custer County Rural Water District No. 3 is responsible for establishing and maintaining effective 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 auditing procedures 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 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.

Our consideration of the 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 significant deficiencies or material weaknesses. Therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the Schedule of Findings and Responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We considered the deficiencies described in the accompanying Schedule of Findings and Responses as item 1 to be a material weakness.

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 the 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 findings identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit the District's response, and accordingly, we express no opinion on it.

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

McCulley & McCulley

Weatherford, Oklahoma

August 29, 2012

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2012

1. Lack of Segregation of Duties.

CONDITION AND EFFECT - The District does not have adequate segregation of duties since it only has one office employee. Material errors or fraud could occur and not be found in a timely manner.

RECOMMENDATION - The District should segregate the duties to the extent possible should new employees be hired.

RESPONSE - The District has surety bond insurance to reduce any risk of loss. The District believes the cost of hiring additional employees is not economically feasible.

CUSTER COUNTY RURAL WATER DISTRICT NO. 3
UPDATE ON PRIOR YEAR'S SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2012

1. Lack of Segregation of Duties.

CONDITION AND EFFECT - The District does not have adequate segregation of duties since it only has one office employee. Material errors or fraud could occur and not be found in a timely manner.

RECOMMENDATION - The District should segregate the duties to the extent possible should new employees be hired.

RESPONSE - The District has surety bond insurance to reduce any risk of loss. The District believes the cost of hiring additional employees is not economically feasible.

UPDATED COMMENT - Situation is the same. Comment repeated.