

**RURAL WATER DISTRICT NO. 3
PAWNEE AND PAYNE COUNTIES, OKLAHOMA**

ANNUAL FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
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Independent Auditor's Report

Board of Directors

Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma

We have audited the accompanying financial statements of Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma as of June 30, 2011, and for the year then ended. 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 audits to obtain reasonable assurance 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 statements presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma prepared its financial statements on a modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma as of June 30, 2011, and the results of its operations and its cash flows for the year then ended in conformity with modified cash basis of accounting.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 8, 2012 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants 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 should be read in conjunction with this report in considering the results of our audit.

Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma has not presented the Management's Discussion and Analysis that the Governmental Accounting Standards Board requires to supplement, although, not be part of the basic financial statements. The omission of this information does not affect the opinion expressed in the financial statements as a whole.



Kimberlye R. Mayer, CPA, P.C.
Blackwell, Oklahoma
September 8, 2012

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

Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma

We have audited the financial statements of Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma as of and for the year ended June 30, 2011 and have issued our report thereon dated September 8, 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 financial statements were prepared on the modified cash basis of accounting which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma has not presented the Management's Discussion and Analysis that the Governmental Accounting Standards Board requires to supplement, although, not be a part of the basic financial statements.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma'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 Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's ability to initiate, authorize, record, process, or report financial data reliably in accordance with the modified cash basis of accounting such that there is more than a remote likelihood that a misstatement of the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's financial statements that is more than inconsequential will not be prevented or detected by the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do consider the significant deficiencies described in the accompanying schedule of findings and responses to be material weaknesses.

Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma'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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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*.

We noted certain matters that we reported to the management of Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma in a separate letter dated September 8, 2012.

This report is intended solely for the information and use of management, the board of directors, and others within the District, and is not intended to be and should not be used by anyone other than these specified parties.



Kimberlye R. Mayer, CPA, P.C.
Blackwell, Oklahoma
September 8, 2012

RURAL WATER DISTRICT NO. 3, PAWNEE AND PAYNE COUNTIES, OKLAHOMA
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2011

Material Weakness in Internal Control Over Financial Reporting: Inadequate Segregation of Duties:

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

Condition: Presently, the same individual is responsible for water service billings and receiving payments; making and recording deposits; maintaining billing registers; and reconciling the monthly bank statements. Only limited oversight is provided over this individual in the conduct of their daily functions.

Cause: The entity's limited size has made it difficult for management to fully segregate the duties.

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

Recommendation: The board should evaluate the risks associated with the lack of segregation of duties and consider implementing controls that could mitigate these risks.

Board's Response: The board has concluded that due to the limited number of personnel, an adequate segregation of duties is not achievable and that the cost of correcting the weakness would exceed the benefits that would be derived from it.

Material Weakness in Internal Control Over Financial Reporting: Financial Statements:

Criteria: Internal controls should be in place so that the District could prepare the financial statements, including the related note disclosures.

Condition: As part of the audit, management requested the auditors to prepare the financial statements, including the related notes. Although management reviewed, approved and accepted responsibility for those financial statements, the auditors cannot be considered part of the internal control over the preparation of the financial statements. Because the District's internal financial statements don't reflect all assets and liabilities, the District does not have necessary controls in place to detect, prevent or correct misstatements in those financial statements.

Cause: The entity's limited size and structure has made it difficult for management to obtain these skills.

Effect or Potential Effect: The absence of controls over the preparation of financial statements is considered a significant deficiency because more than a remote likelihood exists that misstatement of the financial statements could occur and not be prevented or detected by the District's internal control.

RURAL WATER DISTRICT NO. 3, PAWNEE AND PAYNE COUNTIES, OKLAHOMA
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2011

Recommendation: We recommend that the District strive to understand the presentation and disclosure requirements of the financial statements.

Board's Response: The District concurs with the recommendation, and will strive to understand the presentation and disclosure requirements of the financial statements, however, we believe the cost to obtain this knowledge would be prohibitive for the size and structure of our organization.

FINANCIAL STATEMENTS

AND

NOTES

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
STATEMENT OF ASSETS, LIABILITIES AND NET ASSETS
MODIFIED CASH BASIS
YEAR ENDED JUNE 30, 2011

ASSETS

Current Assets:	
Cash and cash equivalents	\$ 54,712
Noncurrent Assets:	
Restricted reserves (Note 1)	13,776
Capital assets (Net of accumulated depreciation) (Note 2)	318,313
Work in progress	<u>2,087</u>
Total Assets	<u>\$ 388,888</u>

LIABILITIES AND NET ASSETS

Liabilities:	
Current Liabilities:	
Notes payable, current portion (Note 3)	\$ 19,568
Noncurrent Liabilities:	
Notes payable, long term (Note 3)	<u>68,413</u>
Total Liabilities	87,981
Net Assets:	
Invested in capital assets, net of related debt	232,419
Restricted for debt service	13,776
Unrestricted	<u>54,712</u>
Total Net Assets	<u>300,907</u>
Total Liabilities and Net Assets	<u>\$ 388,888</u>

The accompanying report and notes are an integral part of these financial statements.

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
MODIFIED CASH BASIS
YEAR ENDED JUNE 30, 2011

Operating Revenues:	
Water service	\$ 218,989
Other income	2,605
Total Operating Revenues	<u>221,594</u>
Operating Expenses:	
Water purchases	106,258
Payroll	32,709
Payroll taxes	1,222
Employee benefits	5,880
Telephone	127
Professional fees	1,416
Insurance	4,258
Office supplies and postage	2,592
Repairs, maintenance and supplies	10,764
Mileage and fuel	5,594
Lab fees	249
Depreciation	29,854
Other expenses	1,867
Total Operating Expenses	<u>202,790</u>
Operating Income (Loss)	18,804
Non-operating Revenues (Expenses):	
Interest income	223
Memberships	8,000
Interest expense	(5,202)
Total Non-operating Revenue (Expense)	<u>3,021</u>
Changes in Net Assets	21,825
Net Assets, beginning of year	<u>279,082</u>
Net Assets, end of year	<u><u>\$ 300,907</u></u>

The accompanying report and notes are an integral part of these financial statements.

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
STATEMENT OF CASH FLOWS
MODIFIED CASH BASIS
YEAR ENDED JUNE 30, 2011

Cash Flows From Operating Activities:	
Cash received from customers	\$ 221,594
Cash payments to suppliers for goods and services	(140,227)
Cash payments to employees	<u>(32,718)</u>
Net cash provided (used) by operating activities	48,649
Cash flows from non-capital financing activities:	
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(10,566)
Membership fees	8,000
Principal payments	(30,107)
Interest paid	<u>(5,202)</u>
Net cash provided (used) by financing activities	(37,875)
Cash flows from investing activities:	
Interest income	<u>223</u>
Net cash provided (used) by investing activities	<u>223</u>
Net increase (decrease) in cash and cash equivalents	10,997
Beginning cash and cash equivalents	<u>43,715</u>
Ending cash and cash equivalents	<u><u>\$ 54,712</u></u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
Operating income (loss)	\$ 18,804
Adjustments to reconcile income (loss) from operations to net cash provided (used) by operating activities:	
Depreciation	<u>29,845</u>
Net cash provided (used) by operating activities	<u><u>\$ 48,649</u></u>

The accompanying report and notes are an integral part of these financial statements.

RURAL WATER DISTRICT NO. 3
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Nature of Organization

Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma was created under the Rural Water District Act, Title 82, Section 1301-1322, as amended, of the laws of the State of Oklahoma. The purpose of the District is to acquire water and water rights; to build and acquire pipelines and other facilities; and to operate the same for the purpose of furnishing water to serve the needs of owner and occupants of land located within the District, and others as authorized by the by-laws.

The District is a governed entity by a Board of Directors that acts as the authoritative and legislative body of the entity. The Board of Directors is comprised of elected board members.

Basis of Accounting

The District is classified as an Enterprise Fund. The costs of providing the water services to the public are financed mainly through user charges. The financial statements of the District have been prepared using the modified cash basis of accounting. This basis recognized assets, liabilities, net assets/fund equity, revenues, and expenditures/expenses when they result from cash transactions with a provision for depreciation. This basis is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

As a result of the use of the modified cash basis of accounting, certain assets and their related revenues, (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, and accrued expenses and liabilities) are not recorded in these financial statements.

Cash and Deposits

Cash is maintained in financial institutions which provide coverage to depositors through the Federal Deposit Insurance Corporation.

The State of Oklahoma allows government entities to invest in the following: direct obligations of the United State Government, its agencies or instrumentalities; collateralized or insured certificates of deposit; insured savings accounts or savings certificates; or county, municipal or school district direct debt.

Net Assets

Net assets present the difference between assets and liabilities in the statement of net assets. Net assets invested in capital assets are reduced by the outstanding balances of any borrowing used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are legal limitations imposed on their use by District legislation or external restrictions by creditors, grantors, laws or regulations of other governments.

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Restricted Reserves

Rural Economic and Community Development Agency requires monies to be held in reserve accounts. These reserve funds are to equal the note payments for one year. To be fully funded, these reserve funds must total \$13,776. The funds are to be used for repairing or replacing damaged assets caused by unforeseen catastrophes. The reserve funds can be used for improvements to the water system or for debt service if prior written approval is obtained from Rural Development. As of June 30, 2011 these reserve funds totaled \$13,776.

Statement of Cash Flows

For the purposes of the Statement of Cash Flows, the District considers all accounts, (excluding restricted reserves), with a maturity of three months or less to be cash equivalents.

Budget

The District is not legally required to adopt a budget.

NOTE 2 – PROPERTY, PLANT AND EQUIPMENT:

Waterline additions and extensions are recorded at cost when purchased or constructed. Depreciation is calculated on a straight-line basis over the estimated useful lives of the depreciable assets. Total depreciation for the year ended June 30, 2011 was \$29,854. The balances for depreciable assets by major category at June 30, 2011 are as follows:

	Balance 6/30/10	Additions	Deletions	Balance 6/30/11
Waterline distribution system	\$ 776,366	\$ 9,675	\$	\$ 786,041
Equipment and vehicles	67,125	900		68,025
Less accumulated depreciation	(505,899)	(29,854)		(535,753)
Net	<u>\$ 337,592</u>	<u>\$ (19,279)</u>	<u>\$</u>	<u>\$ 318,313</u>

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2011

NOTE 3 – NOTES PAYABLE:

Notes payable includes two notes with the Rural Economic and Community Development Agency. The note agreements, which mature on May 26, 2017, call for monthly payments to be made for debt retirement. The notes carry an interest rate of 5%. Collateral for these notes is the water works system. The Rural Development notes payable at June 30, 2011 consist of the following:

	91-01	91-03
Balance at 6/30/10	\$ 68,226	\$ 9,134
Principle payments	(7,836)	(1,437)
Balance at 6/30/11	\$ 60,390	\$ 7,697

On April 17, 2006, the District borrowed \$49,000 from a financial institution to pay off a draw note and to finance the purchase of a backhoe. On July 10, 2008 the District refinanced this note to include the purchase of a vehicle. The note carries an interest rate of 7 ½ % and the monthly payments are \$698. The note matures July 10, 2017. The District paid \$20,834 in principle payments in the year ended June 30, 2011.

The following is a schedule of payments due:

Year Ending <u>June 30</u>	Total
2012	\$ 22,156
2013	22,156
2014	17,966
2015	13,776
2016	12,282
2017	11,784
	100,120
Less interest	(12,139)
Net	\$ 87,981

NOTE 4 – WATER PURCHASE COMMITMENT:

The governing board of the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma, together with seven other cities and rural water districts located in Noble, Pawnee, and Payne Counties have jointly formed Lone Chimney Water Association (Association). The purpose of the Association is to provide a water system for the benefit of its members and other users. The Association has entered into various loan agreements with the USDA-Rural Development to provide financing for the facility. Under the terms of the agreement regarding the Lone Chimney Water Association, each member has contracted to purchase a minimum amount of water from the Association during the 40 year term of the notes. In addition, each individual member is

RURAL WATER DISTRICT NO. 3,
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2011

NOTE 4 – WATER PURCHASE COMMITMENT (continued)

proportionately liable for any debts that exceed the assets of the Association to the extent of one and one-half times the percentage of ownership interest held by the entity pursuant to the agreement. At June 30, 2011, the District's percentage of ownership was 5%.

At June 30, 2011, the Rural Water District No. 3, Pawnee and Payne Counties, Oklahoma, was obligated to purchase a minimum of 36 million gallons of water annually, currently at a cost of \$90,000. The rate charged for the water can be adjusted every three years to provide sufficient revenues for the Association. Future purchase commitments at current rates are as follows:

6/30/12	\$ 90,000
6/30/13	90,000
6/30/14	90,000
6/30/15	90,000
6/30/16	90,000
Thereafter	1,440,000
	<u>\$ 1,890,000</u>

NOTE 5 - ESTIMATES:

The preparation of financial statements in conformity with the modified cash basis of accounting requires the use of management 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.

NOTE 6 – RISK MANAGEMENT:

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The District purchases commercial insurance for these and other risks of loss. Settled claims have not exceeded the commercial coverage in past years.

NOTE 7 – CONTINGENCIES:

As of June 30, 2011 the District did not have any pending litigation or potential non-disclosed liabilities that management believes would have a material effect on the financial statements.

RURAL WATER DISTRICT NO. 3
PAWNEE AND PAYNE COUNTIES, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2011

NOTE 8 – EVALUATION OF SUBSEQUENT EVENTS:

The District has evaluated subsequent events through September 8, 2012, the date which the financial statements were available to be issued.