

**RURAL WATER DISTRICT NO. 2
NOWATA COUNTY, OKLAHOMA**

ANNUAL FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

RURAL WATER DISTRICT NO. 2
NOWATA COUNTY, OKLAHOMA
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Independent Auditor's Report

Board of Directors
Rural Water District No. 2, Nowata County, Oklahoma

We have audited the statement of assets, liabilities, and net assets - modified cash basis of Rural Water District No. 2, Nowata County, Oklahoma as of December 31, 2011 and the related statements of revenues and expenses and changes in net assets and cash flows - modified cash basis 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 those 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 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 described in Note 1, Rural Water District No. 2, Nowata County, Oklahoma prepares its financial statements on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles in the United States of America.

In our opinion the financial statements referred to above, present fairly, in all material respects, the statement of assets, liabilities and net assets - modified cash basis of Rural Water District No. 2, Nowata County, Oklahoma as of December 31, 2011 and its revenues and expenses and changes in net assets and cash flows - modified cash basis, for the year then ended.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 12, 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. 2, Nowata County, 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.


Kimberlye R. Mayer, CPA, P.C.
Blackwell, Oklahoma
August 12, 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. 2, Nowata County, Oklahoma

We have audited the financial statements of Rural Water District No. 2, Nowata County, Oklahoma as of and for the year ended December 31, 2011 and have issued our report thereon dated August 12, 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. 2, Nowata County, Oklahoma has not presented the Management's Discussion and Analysis that the Governmental Accounting Standards Boards requires to supplement, although, not be a part of the basic financial statements.

Internal Control Over Financial Reporting

Management of Rural Water District No. 2, Nowata County, Oklahoma is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Rural Water District No. 2, Nowata County, 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 the Rural Water District No. 2, Nowata County, 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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses, have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

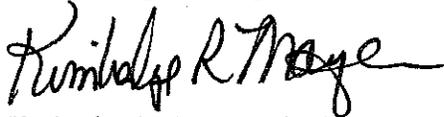
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A material weakness is a deficiency, or combination of control deficiencies, 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 consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses.

Rural Water District No. 2, Nowata County, 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. 2, Nowata County, 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*.

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

August 12, 2012

RURAL WATER DISTRICT NO. 2
NOWATA COUNTY, OKLAHOMA
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED DECEMBER 31, 2011

Material Weakness Communicated In Prior Year:

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, and because the District's spreadsheets are not being reconciled with the bank statements, the District does not have necessary controls in place to detect, prevent or correct misstatements in those financial statements.

RURAL WATER DISTRICT NO. 2
NOWATA COUNTY, OKLAHOMA
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED DECEMBER 31, 2011

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 a misstatement of the financial statements could occur and not be prevented or detected by the District's internal control.

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. 2
 NOWATA COUNTY, OKLAHOMA
 STATEMENT OF ASSETS, LIABILITIES AND NET ASSETS
 MODIFIED CASH BASIS
 DECEMBER 31, 2011

ASSETS

Current Assets:	
Cash in operating account	\$ 11,832
Certificates of deposit	<u>38,146</u>
Total Current Assets	49,978
Capital assets (net of accumulated depreciation) (Note 2)	<u>35,273</u>
Total Assets	<u><u>\$ 85,251</u></u>

LIABILITIES AND NET ASSETS

Liabilities:	\$
Net Assets:	
Invested in capital assets	35,273
Unrestricted	<u>49,978</u>
Total Net Assets	<u>85,251</u>
Total Liabilities and Net Assets	<u><u>\$ 85,251</u></u>

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

RURAL WATER DISTRICT NO. 2
NOWATA COUNTY, OKLAHOMA
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
MODIFIED CASH BASIS
YEAR ENDED DECEMBER 31, 2011

Operating Revenues:	
Water service	\$ 59,662
Late fees	374
Other income	50
Total Operating Revenues	60,086
Operating Expenses:	
Water purchases	51,554
Utilities	2,331
Repairs and maintenance	12,170
Water testing	264
Office supplies and postage	916
Insurance and bonds	569
Bookkeeping fees	4,625
Telephone	752
Depreciation	3,824
Dues and memberships	459
Other expenses	322
Total Operating Expenses	77,786
Operating Income (Loss)	(17,700)
Nonoperating Revenue (Expenses):	
Interest income	300
Memberships	7,951
Total Nonoperating Revenues	8,251
Change in Net Assets	(9,449)
Net Assets, beginning of year	94,700
Net Assets, end of year	\$ 85,251

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

RURAL WATER DISTRICT NO.2
NOWATA COUNTY, OKLAHOMA
STATEMENT OF CASH FLOWS
MODIFIED CASH BASIS
YEAR ENDED DECEMBER 31, 2011

Cash Flows From Operating Activities:	
Cash received from customers	\$ 60,086
Cash payments to suppliers for goods and services	<u>(73,962)</u>
Net cash provided (used) by operating activities	(13,876)
Cash flows from non-capital financing activities:	
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(5,062)
Membership fees	<u>7,951</u>
Net cash provided (used) by financing activities	2,889
Cash flows from investing activities:	
Interest income	300
Water system improvements	
(Increase) decrease in CD's	<u>(300)</u>
Net cash provided (used) by investing activities	<u> </u>
Net increase (decrease) in cash and cash equivalents	(10,987)
Beginning cash and cash equivalents	<u>22,819</u>
Ending cash and cash equivalents	<u><u>\$ 11,832</u></u>
Reconciliation of income (loss) from operations to net cash provided (used) by operating activities:	
Operating income or loss	\$ (17,700)
Adjustments to reconcile income (loss) from operations to net cash provided (used) by operating activities:	
Depreciation	<u>3,824</u>
Net cash provided (used) by operating activities	<u><u>\$ (13,876)</u></u>

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

RURAL WATER DISTRICT NO. 2
NOWATA COUNTY, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Nature of Organization

Rural Water District No. 2, Nowata County, Oklahoma was incorporated under the Rural Water District Act of the Oklahoma State Statutes, Title 82, 1301-1321, as amended. The District is exempt from federal and state income taxes. The purpose of the District is 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, 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 maintains its records and prepares its financial statements on the modified cash basis of accounting. Under the modified cash basis, revenues are recognized when received, rather than when earned, and expenditures are recognized when paid, rather than when incurred. Fixed assets are recorded at cost when purchased. Annual depreciation is calculated on a straight-line basis. Total depreciation for the year ended December 31, 2011 was \$3,824.

Cash and Deposits

The State of Oklahoma allows government entities to invest in the following: direct obligations of the United States 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.

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

Statement of Cash Flows

For the purposes of the Statement of Cash Flows, the District considers all checking accounts and deposit accounts with maturities of three months or less to be cash equivalents.

Budget

The District is not legally required to adopt a budget.

NOTE 2 – PROPERTY AND EQUIPMENT:

Depreciable assets are recorded at cost when purchased or constructed. Improvements are capitalized; the cost of normal maintenance and repairs that do not add to the value of the asset

RURAL WATER DISTRICT NO. 2
 NOWATA COUNTY, OKLAHOMA
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2011

NOTE 2 – PROPERTY AND EQUIPMENT (continued):

or materially extend the asset's life are expendable. Annual depreciation is calculated on a straight-line basis. The balances for depreciable assets by major category are as follows:

	12/31/10	Additions	12/31/11
Waterline system	\$ 89,323	\$ 5,062	\$ 94,385
Equipment	11,410		11,410
Software	2,800		2,800
	<u>103,533</u>	<u>5,062</u>	<u>108,595</u>
Accumulated depreciation	(69,498)	(3,824)	(73,322)
Net	<u>\$ 34,035</u>	<u>\$ 1,238</u>	<u>\$ 35,273</u>

NOTE 3 – RISK MANAGEMENT:

The District is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District manages this risk through the purchase of commercial insurance policies. Claims are recognized when it is probably that a loss has occurred and the amount of the loss can be reasonably estimated. In determining claims, events that might create claims, but for which none have been reported, are considered. There were no claims during the year ended December 31, 2011.

NOTE 4 – ESTIMATES:

The preparation of financial statements in conformity with the modified cash basis of accounting requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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 5 – CONTINGENCIES:

As of December 31, 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.

NOTE 6 – EVALUATION OF SUBSEQUENT EVENTS:

The District has evaluated subsequent events through August 12, 2012, the date which the financial statements were available to be issued.