

**LEFLORE COUNTY RURAL WATER
DISTRICT #2
FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010**

LEFLORE COUNTY RURAL WATER DISTRICT #2
DECEMBER 31, 2011 AND 2010
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Leflore County Rural Water District #2
Pocola, Oklahoma

We have audited the accompanying financial statements of **Leflore County Rural Water District #2** as of and for the years ended December 31, 2011 and 2010. These financial statements are the responsibility of **Leflore County Rural Water District #2'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 audits 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 audits provide 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 **Leflore County Rural Water District #2** as of December 31, 2011 and 2010, and the results of its operations 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 our report dated February 15, 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 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 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 and 4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with evidence sufficient to express an opinion or provide any assurance.

Beall Barclay + Company, PLC
BEALL BARCLAY & COMPANY, PLC
Certified Public Accountants

Fort Smith, Arkansas
February 15, 2012

LeFlore County Rural Water District No. 2

P.O. BOX 398 – POCOLA, OKLAHOMA 74902

LeFlore County Rural Water District #2 was incorporated in 1966. It is run by five Board Members, which each hold a 3 year term and is elected at the annual meeting held the Third Thursday in February.

MANAGEMENT DISCUSSION AND ANALYSIS

Our discussion and analysis of LeFlore County Rural Water District #2's financial performance provides an overview of the utility's financial activities for the twelve months ended December 31, 2011.

Using the Annual Audit Report

This annual audit report consists of a series of financial statements, footnotes and supplementary information. The balance sheets and related statements of revenues and expenses, fund balance, and cash flows provide information about the activities of the District as a whole and present a longer-term view of the District finances. The footnotes and supplementary information provide additional narrative concerning selected financial items.

Reporting the Utility as A Whole

The balance sheets, and related statements of revenues and expenses, fund balance and cash flows report information about the District's activities and include all assets and liabilities using the accrual basis of accounting. All current revenue and expenses are taken into consideration, regardless of when cash was received or paid. These accounting practices are similar to the accounting methods used by most private sector companies.

Financial Highlights

The District has one capital improvement project in progress. This is the Fuller Street project. The District has installed approximately 1000 feet of 6" water line since this project started in late 2010 beginning at Kelly Street and proceeding west on Fuller Street. Progress on this project in 2011 wasn't what the District anticipated on due to employee turnover and the numerous water line breaks throughout the water system caused by the very hot dry summer. The District has had no changes in terms of debt during 2011. The District has no outstanding loans.

Interest income for the District was considerably lower for 2011. There was a decrease in interest rates in 2011. Wages for the District was slightly lower than the previous year's wages due to the change in employees throughout the year.

The capital projects are as follows:

Fuller Street Project: Approximately 1000 feet of 6" water line has been laid since project began and expenses on this project for 2011 are approximately \$2,730.

Other capital improvements for the year 2011:

The Water District purchased the following items in 2011: New office computer \$673.83, New handheld device and upgrade for reading meters \$4500.00, Metal roof \$1,850, New 18" Stihl Chain Saw and concrete blade-\$553.98, Tool Box for Truck Bed \$1,133.00 and Transode Transmitter \$666

Operating Revenues: Water sales and meter fees are the primary source of revenue for the District. No change in water rates for 2011. They are as follows:

| Gallons of Water | Rate per 1,000 gallons |
|------------------|--------------------------|
| 0 – 1,000 | \$12.00 (Minimum charge) |
| 1,001 – 5,000 | \$ 3.00 |
| 5,001 – 10,000 | \$ 3.15 |
| > 10,000 | \$ 3.30 |

The actual number of gallons sold during 2011 was 129,723,745 gallons compared to 128,553,940 gallons during 2010. The number of gallons sold in 2011 increased due to a very dry season and a number of water leaks throughout the District.

Operating Expenses: Insurance continues to consistently increase at a faster pace. The largest expense item of the District is water purchases. The actual number of gallons purchased during 2011 was 151,300,910 gallons compared to 157,714,860 during 2010. Water purchases decreased slightly even though we had an unusually hot and dry summer. Water loss decreased slightly due to the District employees repairing numerous leaks throughout the District.

Non operating income: The interest earned on certificates of deposit was considerably less than 2010, due to the decrease in interest rates.

Summary

The District's financial position changed during 2011 with a net income of \$149,446. The income and cash were used for capital improvements of \$12,107. It is management's opinion that the present water rates (see chart above) are adequate to fund operations and maintenance and needed capital improvements at this time. The District ended the year 2011 with \$100,000 in CDs and fixed assets of \$2,047,767 compared to \$2,039,260 in 2010. The District is in compliance with all State and Federal water quality and environmental regulations.

LEFLORE COUNTY RURAL WATER DISTRICT #2
BALANCE SHEETS
DECEMBER 31, 2011 AND 2010

| | 2011 | 2010 |
|----------------------------------|---------------------|---------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash on hand | \$ 223 | \$ 224 |
| Cash and cash equivalents | | |
| Revenue | 243,013 | 88,481 |
| Operations and maintenance | 9,330 | 7,820 |
| Certificates of deposit | 100,000 | 100,000 |
| Accounts receivable | 49,114 | 55,861 |
| Interest receivable | 72 | 101 |
| Inventory | 75,574 | 49,115 |
| Prepaid expenses | 7,527 | 6,877 |
| | <hr/> | <hr/> |
| Total Current Assets | 484,853 | 308,479 |
| | <hr/> | <hr/> |
| RESTRICTED ASSETS | | |
| Cash and cash equivalents | | |
| Revenue - meter deposits | 41,685 | 39,495 |
| | <hr/> | <hr/> |
| PROPERTY AND EQUIPMENT | | |
| Construction in progress | 37,492 | 34,762 |
| Real estate and right-of-way | 17,250 | 17,250 |
| Buildings and improvements | 50,373 | 48,523 |
| Office furniture and equipment | 16,093 | 15,419 |
| Vehicles and equipment | 132,492 | 129,239 |
| Water system and towers | 1,794,067 | 1,794,067 |
| | <hr/> | <hr/> |
| | 2,047,767 | 2,039,260 |
| Less accumulated depreciation | 844,071 | 803,131 |
| | <hr/> | <hr/> |
| | 1,203,696 | 1,236,129 |
| | <hr/> | <hr/> |
| OTHER ASSETS | | |
| Utility deposits | 75 | 75 |
| Deferred compensation - unvested | 24,184 | 31,469 |
| | <hr/> | <hr/> |
| | 24,259 | 31,544 |
| | <hr/> | <hr/> |
| | <u>\$ 1,754,493</u> | <u>\$ 1,615,647</u> |

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

| | 2011 | 2010 |
|--|------|------|
|--|------|------|

LIABILITIES AND FUND EQUITY

CURRENT LIABILITIES

(Payable from Current Assets)

| | | |
|---|---------------|---------------|
| Accounts payable | \$ 22,032 | \$ 26,281 |
| Payroll taxes withheld and accrued | 3,223 | 4,615 |
| Accrued wages | <u>741</u> | <u>605</u> |
| Total Current Liabilities (Payable from Current Assets) | <u>25,996</u> | <u>31,501</u> |

CURRENT LIABILITIES

(Payable from Restricted Assets)

| | | |
|-------------------|---------------|---------------|
| Customer deposits | <u>41,685</u> | <u>39,495</u> |
|-------------------|---------------|---------------|

LONG-TERM LIABILITIES

Deferred compensation payable

| | | |
|--|---------------|---------------|
| | <u>24,184</u> | <u>31,469</u> |
|--|---------------|---------------|

FUND EQUITY

Invested in capital assets

| | | |
|--|-----------|-----------|
| | 1,203,696 | 1,236,129 |
|--|-----------|-----------|

Unrestricted fund equity

| | | |
|--|----------------|----------------|
| | <u>458,932</u> | <u>277,053</u> |
|--|----------------|----------------|

| | | |
|--|------------------|------------------|
| | <u>1,662,628</u> | <u>1,513,182</u> |
|--|------------------|------------------|

| | | |
|--|---------------------|---------------------|
| | <u>\$ 1,754,493</u> | <u>\$ 1,615,647</u> |
|--|---------------------|---------------------|

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

LEFLORE COUNTY RURAL WATER DISTRICT #2
STATEMENTS OF REVENUES AND EXPENSES
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | 2011 | 2010 |
|-------------------------------|----------------|----------------|
| REVENUES | | |
| Water sales | \$ 605,931 | \$ 588,775 |
| Late fees | 18,945 | 19,135 |
| Membership fees | 5,033 | 8,118 |
| | <u>629,909</u> | <u>616,028</u> |
| COSTS OF REVENUES | | |
| Water purchases | 196,691 | 205,224 |
| Line maintenance | 25,838 | 44,328 |
| | <u>222,529</u> | <u>249,552</u> |
| GROSS PROFIT | <u>407,380</u> | <u>366,476</u> |
| OPERATING EXPENSES | | |
| Contract labor | 19,582 | 19,529 |
| Deferred compensation | 5,825 | 8,833 |
| Depreciation and amortization | 44,540 | 49,404 |
| Doubtful accounts | 2,114 | 627 |
| Dues and permits | 1,166 | 3,479 |
| Insurance | 45,584 | 63,329 |
| Miscellaneous | 13,872 | 3,874 |
| Office supplies | 2,591 | 4,731 |
| Payroll taxes | 7,324 | 8,819 |
| Postage | 5,623 | 7,119 |
| Printing and publication | 683 | 586 |
| Professional services | 11,040 | 10,504 |
| Telephone | 3,391 | 3,445 |
| Truck - gas and oil | 7,411 | 5,386 |
| Truck repairs | 1,086 | 1,823 |
| Utilities | 5,684 | 5,010 |
| Wages | 95,728 | 115,289 |
| | <u>273,244</u> | <u>311,787</u> |
| OPERATING INCOME | <u>134,136</u> | <u>54,689</u> |

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

| | 2011 | 2010 |
|--|--------------------------|-------------------------|
| NON-OPERATING REVENUE (EXPENSE) | | |
| Gain (loss) on disposition of assets | 1,050 | (411) |
| Forfeited deferred compensation | 13,126 | - |
| Interest income | <u>1,134</u> | <u>1,523</u> |
| | <u>15,310</u> | <u>1,112</u> |
| NET INCOME | <u><u>\$ 149,446</u></u> | <u><u>\$ 55,801</u></u> |

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

LEFLORE COUNTY RURAL WATER DISTRICT #2
STATEMENTS OF CHANGES IN FUND EQUITY
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | 2011 | 2010 |
|-----------------------------------|---------------------|---------------------|
| BALANCE, BEGINNING OF YEAR | \$ 1,513,182 | \$ 1,457,381 |
| Net income | <u>149,446</u> | <u>55,801</u> |
| BALANCE, END OF YEAR | <u>\$ 1,662,628</u> | <u>\$ 1,513,182</u> |

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

LEFLORE COUNTY RURAL WATER DISTRICT #2
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011 AND 2010

| | 2011 | 2010 |
|---|--------------------------|--------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from customers | \$ 636,732 | \$ 606,422 |
| Payments to vendors | (380,316) | (396,195) |
| Payments to employees | <u>(101,417)</u> | <u>(126,562)</u> |
| Net Cash From Operating Activities | <u>154,999</u> | <u>83,665</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Capital expenditures | (12,107) | (70,618) |
| Proceeds from disposition of assets | <u>1,050</u> | <u>-</u> |
| Net Cash (Used For) Capital and Related Financing Activities | <u>(11,057)</u> | <u>(70,618)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Forfeited deferred compensation | 13,126 | - |
| Receipts of interest | <u>1,163</u> | <u>1,760</u> |
| Net Cash From Investing Activities | <u>14,289</u> | <u>1,760</u> |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 158,231 | 14,807 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | <u>136,020</u> | <u>121,213</u> |
| CASH AND CASH EQUIVALENTS, END OF YEAR | <u><u>\$ 294,251</u></u> | <u><u>\$ 136,020</u></u> |

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

| | 2011 | 2010 |
|---|-------------------|------------------|
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Operating income | \$ 134,136 | \$ 54,689 |
| Adjustments to reconcile operating income to net cash from operating activities: | | |
| Depreciation and amortization | 44,540 | 49,404 |
| Change in: | | |
| Accounts receivable | 6,747 | (11,149) |
| Inventory | (26,459) | (10,312) |
| Prepaid expenses | (650) | (362) |
| Accounts payable | (4,249) | 1,966 |
| Payroll taxes withheld and accrued | (1,392) | (301) |
| Accrued wages | 136 | (2,440) |
| Customer deposits | 2,190 | 2,170 |
| Cash Provided by Operating Activities | <u>\$ 154,999</u> | <u>\$ 83,665</u> |

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

LEFLORE COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Leflore County Rural Water District #2 (the District) was organized to provide suitable water to customers in the City of Pocola, Oklahoma and the surrounding community. Treated water is acquired solely from the Poteau Valley Improvement Authority and transmitted in District water lines to the customers.

Fund Accounting

The accounts of the District are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures/expenses. Government resources are allocated to and accounted for in individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled. The fund in these financial statements is a proprietary fund, described as follows:

Proprietary Funds

Enterprise funds – 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 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, public safety, management control, accountability, or other purposes.

Basis of Accounting

The District's policy is to prepare its financial statements on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Revenues are recognized in the period in which they are earned. Expenses are recognized in the period in which they are incurred. Operating revenues in the Enterprise fund are those revenues that are generated from the primary operations of the fund. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations of the fund. All other expenses are reported as non-operating expenses. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Subsequent Events

Subsequent events are evaluated through the date the financial statements were available to be issued, which is the date of the Independent Auditors' Report.

LEFLORE COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Property and Equipment

Property and equipment is stated at cost. Depreciation of property and equipment is computed on the straight-line method over the estimated useful lives of the assets, which range from three to fifty years. At December 31, 2011 and 2010, the District had fully depreciated assets still in use with an original cost of approximately \$134,500 and \$126,000, respectively. Property and equipment includes construction in progress of \$37,492 and \$34,762 at December 31, 2011 and 2010, respectively. These amounts will not be depreciated until they are completed and placed in service.

Inventory

Inventory is stated at the lower of cost (first-in, first-out method) or market. Inventory consists primarily of pipe and related supplies.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

The District is a public body and, as such, is exempt from income taxes under Section 501(a) of the Internal Revenue Code and a similar state statute.

Cash Equivalents

For purposes of the Statements of Cash Flows, cash equivalents are short-term highly liquid investments with original maturities of three months or less which are readily convertible to known amounts of cash. At December 31, 2011 and 2010, the District had no cash equivalents. Those accounts considered to be cash and cash equivalents are shown under that heading and as "Cash on hand" in the accompanying Balance Sheets.

Accounts Receivable

The District considers accounts receivable to be fully collectible. Accordingly, no allowance for doubtful accounts is deemed necessary. If accounts become uncollectible, they will be charged to operations when that determination is made. Determination of uncollectibility is made by management based on knowledge of individual customers and consideration of such factors as current economic conditions. Credit extended to customers is generally uncollateralized. Past-due status is based on contractual terms. Past-due accounts are charged a \$5 late fee for accounts not paid by the 15th of the month following the billing.

LEFLORE COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Long-lived Assets

Financial Accounting Standards Board (FASB) Accounting Standards Codification (Codification) Topic *Property, Plant and Equipment*, Section *Subsequent Measurement* requires that long-lived assets and certain identifiable intangibles held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The application of this Codification Topic has not materially affected the District's reported earnings, financial condition or cash flows.

NOTE 2: EMPLOYEE BENEFITS

In October 1987, the District established a deferred compensation (defined contribution) plan for its employees. Under this plan, up to 10% of the gross wages of all participating employees may be withheld to be contributed to the plan, and the District contributes 8% of each employee's gross wages to the plan. Net deferred compensation charged against income amounted to \$5,825 and \$8,833 during the years ended December 31, 2011 and 2010, respectively.

Employees must be employed ten years to be fully vested. New employees hired from the date of the plan forward have the option of whether or not to participate in the plan with the written consent of the District. The unvested portion of deferred compensation is jointly held, by the District and the employee, in individual savings accounts and shown as Deferred compensation – unvested in the Other Assets section of the Balance Sheets. During the years ended December 31, 2011 and 2010, unvested deferred compensation of \$13,126 and \$-0-, respectively, was forfeited and returned to the District.

NOTE 3: CONCENTRATION OF CREDIT RISK AND MAJOR SUPPLIERS

The District has no formal policy on managing credit risk. Financial instruments that potentially subject the District to credit risk consist primarily of accounts receivable. The District provides water services to commercial and residential users within the Pocola area. At December 31, 2011 and 2010, the District has extended credit to regular customers (accounts receivable) of \$49,114 and \$55,861, respectively.

The District purchases all of its water from one supplier.

Significant losses are covered by commercial insurance for all major programs for which the District retains risk of loss. For insured programs, there have been no significant reductions in insurance coverage.

LEFLORE COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 4: CASH AND RESTRICTED CASH

Deposits in financial institutions are financial instruments that could potentially subject the District to a risk of accounting loss to the extent of the uninsured/uncollateralized portion of those deposits. The District maintains deposit balances in two financial institutions and at times may exceed federally insured limits. The District has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on deposits. The District did not have any uninsured/uncollateralized deposits at December 31, 2011.

NOTE 5: CAPITAL ASSETS

Changes in Property and Equipment

A summary of changes in property and equipment follows:

| | <u>Balance January 1, 2011</u> | <u>Additions</u> | <u>Deletions/ Transfers</u> | <u>Balance December 31, 2011</u> |
|--------------------------------|--|------------------|---------------------------------|--|
| Construction in progress | \$ 34,762 | \$ 2,730 | \$ - | \$ 37,492 |
| Real estate and right-of-way | 17,250 | - | - | 17,250 |
| Buildings and improvements | 48,523 | 1,850 | - | 50,373 |
| Office furniture and equipment | 15,419 | 674 | - | 16,093 |
| Vehicles and equipment | 129,239 | 6,853 | (3,600) | 132,492 |
| Water system and towers | <u>1,794,067</u> | <u>-</u> | <u>-</u> | <u>1,794,067</u> |
| | <u>\$ 2,039,260</u> | <u>\$ 12,107</u> | <u>\$ (3,600)</u> | <u>\$ 2,047,767</u> |
| Accumulated depreciation | <u>\$ 803,131</u> | <u>\$ 44,540</u> | <u>\$ (3,600)</u> | <u>\$ 844,071</u> |

LEFLORE COUNTY RURAL WATER DISTRICT #2
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 5: CAPITAL ASSETS - CONTINUED

| | <u>Balance January 1, 2010</u> | <u>Additions</u> | <u>Deletions/ Transfers</u> | <u>Balance December 31, 2010</u> |
|--------------------------------|--|------------------|---------------------------------|--|
| Construction in progress | \$ 1,700 | \$ 34,762 | \$ (1,700) | \$ 34,762 |
| Real estate and right-of-way | 17,250 | - | - | 17,250 |
| Buildings and improvements | 48,523 | - | - | 48,523 |
| Office furniture and equipment | 15,419 | - | - | 15,419 |
| Vehicles and equipment | 125,073 | 4,596 | (430) | 129,239 |
| Water system and towers | <u>1,761,107</u> | <u>31,260</u> | <u>1,700</u> | <u>1,794,067</u> |
| | <u>\$ 1,969,072</u> | <u>\$ 70,618</u> | <u>\$ (430)</u> | <u>\$ 2,039,260</u> |
| Accumulated depreciation | <u>\$ 753,746</u> | <u>\$ 49,404</u> | <u>\$ (19)</u> | <u>\$ 803,131</u> |

NOTE 6: SEGMENT INFORMATION

Segment information for the years ended December 31, 2011 and 2010 was as follows:

| | 2011 | 2010 |
|------------------------|-------------|-------------|
| OPERATING REVENUES | \$ 629,909 | \$ 616,028 |
| DEPRECIATION | 44,540 | 49,404 |
| OPERATING INCOME | 134,136 | 54,689 |
| NET INCOME | 149,446 | 55,801 |
| PROPERTY AND EQUIPMENT | | |
| Additions | 12,107 | 70,618 |
| Deletions | (3,600) | (430) |
| TOTAL ASSETS | 1,754,493 | 1,615,647 |
| LONG-TERM DEBT | - | - |
| WORKING CAPITAL | 458,857 | 276,978 |
| TOTAL FUND EQUITY | 1,662,628 | 1,513,182 |

**INDEPENDENT AUDITORS' 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
Leflore County Rural Water District #2
Pocola, Oklahoma

We have audited the financial statements of **Leflore County Rural Water District #2** as of and for the year ended December 31, 2011, and have issued our report thereon dated February 15, 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.

Internal Control Over Financial Reporting

Management of **Leflore County Rural Water District #2** 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 opinions 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 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 below, 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 combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described below to be material weaknesses.

Segregation of Duties

Condition: As a part of the audit engagement, we assisted management in the preparation of the District's financial statements. Although management reviewed and approved the financial statements and related footnotes, management's current system of internal control lacks adequate controls to ensure the propriety and completeness of disclosure in the footnotes.

Criteria and Cause: Internal control over financial reporting includes management's controls over the preparation of financial statements and related footnotes. An auditor can assist in assembling or drafting the financial statements and related footnotes; however, an auditor cannot be part of the District's internal control. Management does not have internal controls in place to ensure the propriety and completeness of the information in the financial statements, including disclosure in the related footnotes.

Effect: Under the current process, errors or omissions in the footnote disclosures to the financial statements might not be prevented or detected and corrected on a timely basis by the District's management.

Recommendation: We understand that management feels that its current controls over the preparation of financial statements are adequate and that implementing additional controls is not practical or feasible with the District's current staff and resources. We recommend that management continue to evaluate the cost/benefit of improving internal control over the preparation of financial statements and implement additional controls as considered necessary.

Preparation of Financial Statements

Condition: During the year ended December 31, 2011, there was not a complete segregation of duties related to certain financial transactions, including receiving cash, preparing deposits, reconciling bank statements, and recording all transactions and adjustments to the general ledger.

Criteria and Cause: A proper segregation of duties is an integral part of any internal control system. Ideally, duties should be segregated to prevent one person from being in a position to authorize transactions, record transactions and maintain custody of assets of the District. Our review of the District's financial reporting system disclosed that, primarily due to the limited number of accounting personnel, there are inherent limitations in the District's controls in this regard.

Effect: A lack of proper segregation of duties increases the risk that errors or fraud may occur and not be detected in a timely manner.

Recommendation: While we realize that the District does not presently have the staff necessary to achieve a complete segregation of duties, and that the employment of additional personnel for the purpose of segregating duties may not be possible from a cost-benefit standpoint, we believe there are certain instances where duties can and should be reassigned to ensure that no one employee has access to both physical assets and the related accounting records or to all phases of a transaction. We recommend that the Board work closely with management to determine ways to reassign duties with existing personnel to maximize segregation of duties.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatements, 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*.

We noted certain other matters that we reported to management in a separate letter dated February 15, 2012.

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

Beall Barclay + Company, PLC
BEALL BARCLAY & COMPANY, PLC
Certified Public Accountants

Fort Smith, Arkansas
February 15, 2012