

**LEFLORE COUNTY RURAL WATER  
DISTRICT #2  
FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**LEFLORE COUNTY RURAL WATER DISTRICT #2  
DECEMBER 31, 2012 AND 2011  
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## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of **Leflore County Rural Water District #2**, which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues and expenses, changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

**Leflore County Rural Water District #2's** management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

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, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Matter**

Accounting principles generally accepted in the United States of America require that 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.

**Other Reporting Required by Governmental Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2013 on our consideration of **Leflore County Rural Water District #2'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 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* in considering **Leflore County Rural Water District #2's** internal control over financial reporting and compliance.

*Beall Barclay + Company, PLC*

**BEALL BARCLAY & COMPANY, PLC**

Certified Public Accountants

Fort Smith, Arkansas  
February 21, 2013

# **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, 2012.

### **Using the Annual Audit Report**

This annual audit report consists of a series of financial statements, and footnotes. The statements of net position and related statements of revenues and expenses, net position, 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 provide additional narrative concerning selected financial items.

### **Reporting the Utility as A Whole**

The statements of net position, and related statements of revenues and expenses, net position 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 had three capital improvement projects in progress for 2012. They are the Fuller Street project: The District installed approximately 2,485 feet of 6" water line. This project should be complete in 2013. The second project is the Hwy 271 project: Approximately 8000 feet of 6" water line was installed by Jerry's Excavation beginning on West Racetrack Rd at Gordon Lane continuing west along Hwy 271 just past the intersection of Hwy 271 and 112. This project began in September 2012 and will be completed in February 2013. The third project was the Stateline Rd water tower and pump house: The tower and pumps have been replaced with a special RPZ valve system. This is for emergency backup if needed to purchase water from Fort Smith. This project began in July 2012 and will be completed February 2013. The District has had no changes in terms of debt during 2012. The District has no outstanding loans.

Interest income for the District was considerably lower for 2012. There was a decrease in interest rates in 2012. Payroll expenses for the District were slightly higher than the previous year's payroll expenses due to the change in number of employees.

**The capital projects are as follows:**

Fuller Street Project: Approximately 2,485 feet of 6" water line has been laid in 2012. This includes the installation of three fire hydrants, six 6" valves, three 2" valves, and one air release valve. Expenses on this project for 2012 were approximately \$48,200.

Hwy 271 Project: Approximately 8,000 feet of 6" water line was installed. Expenses on this project for 2012 were approximately \$202,500.

State Line Rd Water Tower and Pump House Project: Installed RPZ valve. Expenses on this project for 2012 were approximately \$6,100.

**Other capital improvements for the year 2012:**

The Water District purchased the following items in 2012: A used Ditch Witch and Trailer - \$4,500; new copier/fax machine for the office - \$1,095; commercial metal detector - \$801; a metal door - \$1,051; barricades and signs - \$910; and microphone and hand switch - \$663.

**Operating Revenues:** Water sales and meter fees are the primary source of revenue for the District. No change in water rates for 2012. 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 2012 was 125,937,953 gallons compared to 129,723,745 gallons during 2011. The number of gallons sold in 2012 decreased due to fewer water leaks than previous year.

**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 2012 was 141,366,070 gallons compared to 151,300,910 during 2011. Water purchases decreased even though we had an unusually hot and dry summer. Water loss decreased due to the District employees promptly repairing leaks throughout the District.

**Non operating income:** The interest earned on certificates of deposit was considerably less in 2012, due to a drop in interest rates.

**Summary**

The District's financial position changed during 2012 with a net income of \$93,994. The income and cash were used for capital improvements of \$265,814. 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 2012 with \$100,000 in CDs and fixed assets of \$2,311,381 compared to \$2,047,767 in 2011. The District is in compliance with all State and Federal water quality and environmental regulations.

**LEFLORE COUNTY RURAL WATER DISTRICT #2**  
**STATEMENTS OF NET POSITION**  
**DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash on hand	\$ 224	\$ 223
Cash and cash equivalents		
Revenue	245,337	243,013
Operations and maintenance	6,681	9,330
Certificates of deposit	100,000	100,000
Accounts receivable	52,892	49,114
Interest receivable	59	72
Inventory	115,837	75,574
Prepaid expenses	8,544	7,527
	<u>529,574</u>	<u>484,853</u>
<b>RESTRICTED ASSETS</b>		
Cash and cash equivalents		
Revenue - meter deposits	<u>44,130</u>	<u>41,685</u>
<b>PROPERTY AND EQUIPMENT</b>		
Construction in progress	294,287	37,492
Real estate and right-of-way	17,250	17,250
Buildings and improvements	50,373	50,373
Office furniture and equipment	14,986	16,093
Vehicles and equipment	140,418	132,492
Water system and towers	<u>1,794,067</u>	<u>1,794,067</u>
	2,311,381	2,047,767
Less accumulated depreciation	<u>886,426</u>	<u>844,071</u>
	<u>1,424,955</u>	<u>1,203,696</u>
<b>OTHER ASSETS</b>		
Utility deposits	<u>75</u>	<u>75</u>
	<u>\$ 1,998,734</u>	<u>\$ 1,730,309</u>

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

**LIABILITIES AND NET POSITION**

	<b>2012</b>	<b>2011</b>
<b>CURRENT LIABILITIES</b>		
(Payable from Current Assets)		
Accounts payable	\$ 192,746	\$ 22,032
Payroll taxes withheld and accrued	3,820	3,223
Accrued wages	<u>1,416</u>	<u>741</u>
Total Current Liabilities (Payable from Current Assets)	<u>197,982</u>	<u>25,996</u>
<b>CURRENT LIABILITIES</b>		
(Payable from Restricted Assets)		
Customer deposits	<u>44,130</u>	<u>41,685</u>
<b>NET POSITION</b>		
Invested in capital assets	1,424,955	1,203,696
Unrestricted	<u>331,667</u>	<u>458,932</u>
	<u>1,756,622</u>	<u>1,662,628</u>
	<u>\$ 1,998,734</u>	<u>\$ 1,730,309</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, 2012 AND 2011**

	2012	2011
<b>REVENUES</b>		
Water sales, net of doubtful accounts of \$1,290 and \$2,114, respectively	\$ 598,515	\$ 603,817
Late fees	17,866	18,945
Meter fees	19,360	5,033
	<u>635,741</u>	<u>627,795</u>
 <b>COSTS OF REVENUES</b>		
Water purchases	183,953	196,691
Line maintenance	63,852	25,838
	<u>247,805</u>	<u>222,529</u>
 <b>GROSS PROFIT</b>	 <u>387,936</u>	 <u>405,266</u>
 <b>OPERATING EXPENSES</b>		
Contract labor	19,749	19,582
Deferred compensation	7,849	5,825
Depreciation and amortization	44,441	44,540
Dues and permits	3,683	1,166
Insurance	47,657	45,584
Miscellaneous	4,730	13,872
Office supplies	3,500	2,591
Payroll taxes	9,387	7,324
Postage	5,790	5,623
Printing and publication	362	683
Professional services	10,893	11,040
Telephone	3,356	3,391
Truck - gas and oil	10,499	7,411
Truck repairs	5,261	1,086
Utilities	5,420	5,684
Wages	112,129	95,728
	<u>294,706</u>	<u>271,130</u>
 <b>OPERATING INCOME</b>	 <u>93,230</u>	 <u>134,136</u>

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

	<b>2012</b>	<b>2011</b>
<b>NON-OPERATING REVENUE (EXPENSE)</b>		
Gain (loss) on disposition of assets	(114)	1,050
Forfeited deferred compensation	-	13,126
Interest income	<u>878</u>	<u>1,134</u>
	<u>764</u>	<u>15,310</u>
<b>CHANGE IN NET POSITION</b>	<u><u>\$ 93,994</u></u>	<u><u>\$ 149,446</u></u>

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

**LEFLORE COUNTY RURAL WATER DISTRICT #2**  
**STATEMENTS OF CHANGES IN NET POSITION**  
**YEARS ENDED DECEMBER 31, 2012 AND 2011**

	<b>2012</b>	<b>2011</b>
<b>BALANCE, BEGINNING OF YEAR</b>	\$ 1,662,628	\$ 1,513,182
Change in net position	<u>93,994</u>	<u>149,446</u>
<b>BALANCE, END OF YEAR</b>	<u><u>\$ 1,756,622</u></u>	<u><u>\$ 1,662,628</u></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, 2012 AND 2011**

	<b>2012</b>	<b>2011</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 634,408	\$ 636,732
Payments to vendors	(248,061)	(380,316)
Payments to employees	(119,303)	(101,417)
	<u>267,044</u>	<u>154,999</u>
<b>Net Cash From Operating Activities</b>		
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital expenditures	(265,814)	(12,107)
Proceeds from disposition of assets	-	1,050
	<u>-</u>	<u>1,050</u>
<b>Net Cash (Used For) Capital and Related Financing Activities</b>	<u>(265,814)</u>	<u>(11,057)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Forfeited deferred compensation	-	13,126
Receipts of interest	891	1,163
	<u>891</u>	<u>14,289</u>
<b>Net Cash From Investing Activities</b>		
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<u>2,121</u>	<u>158,231</u>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>294,251</u>	<u>136,020</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u><u>\$ 296,372</u></u>	<u><u>\$ 294,251</u></u>

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

2012

2011

**RECONCILIATION OF OPERATING INCOME TO NET  
CASH FROM BY OPERATING ACTIVITIES:**

Operating income	\$ 93,230	\$ 134,136
Adjustments to reconcile operating income to net cash from operating activities:		
Depreciation and amortization	44,441	44,540
Change in:		
Accounts receivable	(3,778)	6,747
Inventory	(40,263)	(26,459)
Prepaid expenses	(1,017)	(650)
Accounts payable	170,714	(4,249)
Payroll taxes withheld and accrued	597	(1,392)
Accrued wages	675	136
Customer deposits	2,445	2,190
Cash From by Operating Activities	<u>\$ 267,044</u>	<u>\$ 154,999</u>

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

**LEFLORE COUNTY RURAL WATER DISTRICT #2**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012 AND 2011**

**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, net position, 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.

***Reclassification***

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

***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.

**LEFLORE COUNTY RURAL WATER DISTRICT #2**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012 AND 2011**

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

***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.

***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, 2012 and 2011, the District had fully depreciated assets still in use with an original cost of approximately \$142,000 and \$134,500, respectively. Property and equipment includes construction in progress of \$294,287 and \$37,492 at December 31, 2012 and 2011, 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.

***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, 2012 and 2011, 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 15<sup>th</sup> of the month following the billing.

**LEFLORE COUNTY RURAL WATER DISTRICT #2**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012 AND 2011**

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

***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.

***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 \$7,849 and \$5,825 during the years ended December 31, 2012 and 2011, 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 totaling \$32,033 and \$24,184 during the years ended December 31, 2012 and 2011, respectively. The unvested deferred compensation that was forfeited and returned to the District amounted to \$ -0- and \$13,126 during the years ended December 31, 2012 and 2011, respectively.

**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, 2012 and 2011, the District has extended credit to regular customers (accounts receivable) of \$52,892 and \$49,114, 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, 2012 AND 2011**

**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 did not have any uninsured/uncollateralized deposits at December 31, 2012.

**NOTE 5: CAPITAL ASSETS**

***Changes in Property and Equipment***

A summary of changes in property and equipment follows:

	<u>Balance January 1, 2012</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Balance December 31, 2012</u>
Construction in progress	\$ 37,492	\$ 256,795	\$ -	\$ 294,287
Real estate and right-of-way	17,250	-	-	17,250
Buildings and improvements	50,373	-	-	50,373
Office furniture and equipment	16,093	1,093	2,200	14,986
Vehicles and equipment	132,492	7,926	-	140,418
Water system and towers	<u>1,794,067</u>	<u>-</u>	<u>-</u>	<u>1,794,067</u>
	<u>\$ 2,047,767</u>	<u>\$ 265,814</u>	<u>\$ 2,200</u>	<u>\$ 2,311,381</u>
Accumulated depreciation	<u>\$ 844,071</u>	<u>\$ 44,441</u>	<u>\$ 2,086</u>	<u>\$ 886,426</u>

**LEFLORE COUNTY RURAL WATER DISTRICT #2**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012 AND 2011**

**NOTE 5: CAPITAL ASSETS - CONTINUED**

	<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>

**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, 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 of **Leflore County Rural Water District #2** as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated February 21, 2013.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered **Leflore County Rural Water District #2's** internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we did identify 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 District's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. As described above, we identified certain deficiencies in internal control that we consider to be material weaknesses.

## Preparation of Financial Statements

**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.

## Segregation of Duties

**Condition:** During the year ended December 31, 2012, 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 **Leflore County Rural Water District #2's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We have noted certain matters that we have reported to management of **Leflore County Rural Water District #2** in a separate letter dated February 21, 2013.

## Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

Fort Smith, Arkansas  
February 21, 2013