

Lincoln County Rural Water District No. 3
Lincoln County, Oklahoma
For the Year ended December 31, 2010 and 2011

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INDEPENDENT AUDITOR'S REPORT

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

I have audited the accompanying financial statements of the business-type activities of Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma, as of and for the year ended December 31, 2010, and December 31, 2011, which collectively comprise Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma's basic financial statements as listed on the table of contents. These financial statements are the responsibility of the Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma's, management. My responsibility is to express my opinion on these financial statements based on my audit.

I conducted my 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 I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

As discussed in Note 2, Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma, prepares 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.

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position-modified cash basis of the business-type activities of Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma, as of December 31, 2010, and December 31, 2011, and the respective changes in financial position-modified cash basis and cash flows thereof for the years ended, in conformity with the basis of accounting described in Note 2.

In accordance with *Government Auditing Standards*, I have also issued my report dated July 6, 2012, on my consideration of the District's internal control over financial reporting and my 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 my 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 audits performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of my audit.

A handwritten signature in black ink, appearing to read "Bill Ford".

Bill Ford, C.P.A.

July 6, 2012

LINCOLN COUNTY RURAL WATER DISTRICT No. 3
 LINCOLN COUNTY, OKLAHOMA
 STATEMENT OF NET ASSETS - MODIFIED CASH BASIS
 DECEMBER 31, 2010 and 2011

<u>ASSETS</u>	<u>2010</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 78,063	\$ 66,248
Total current assets	<u>78,063</u>	<u>66,248</u>
Restricted assets:		
Cash and cash equivalents	<u>30,391</u>	<u>30,392</u>
Total restricted assets	<u>30,391</u>	<u>30,392</u>
Non-current assets:		
Deferred debt expense, net	6,937	6,670
Capital assets:		
Land	6,190	6,190
Construction in progress	0	30,314
Other capital assets, net of accumulated depreciation	<u>1,098,895</u>	<u>1,186,239</u>
Total non-current assets	<u>1,112,022</u>	<u>1,229,413</u>
Total assets	<u>\$1,220,476</u>	<u>\$1,326,053</u>
 <u>LIABILITIES</u>		
Current liabilities:		
Payroll taxes	718	718
Notes payable, current	<u>8,528</u>	<u>8,983</u>
Total current liabilities	<u>9,246</u>	<u>9,701</u>
Non-current liabilities:		
Notes payable, non-current	<u>415,026</u>	<u>406,043</u>
Total non-current liabilities	<u>415,026</u>	<u>406,043</u>
Total liabilities	<u>424,272</u>	<u>415,744</u>
 <u>NET ASSETS</u>		
Nonspendable capital assets, net of related debt	681,531	807,717
Restricted for debt service	30,391	30,392
Unassigned	<u>84,282</u>	<u>72,200</u>
Total net assets	<u>\$ 796,204</u>	<u>\$ 910,309</u>

See accompanying notes to financial statements

LINCOLN COUNTY RURAL WATER DISTRICT No. 3
 LINCOLN COUNTY, OKLAHOMA
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
 IN FUND NET ASSETS - MODIFIED CASH BASIS
 FOR THE YEAR ENDED DECEMBER 31, 2010 and 2011

<u>Operating Revenues</u>	<u>2010</u>	<u>2011</u>
Charges for services:		
Water charges	\$ 143,036	\$ 154,188
Other	<u>7,300</u>	<u>11,879</u>
Total operating revenues	<u>150,336</u>	<u>166,067</u>
 <u>Operating Expenses</u>		
Purchased water	42,843	51,514
Salaries	29,900	30,000
Utilities	2,363	2,569
Operating supplies	4,688	2,336
Repairs and maintenance	9,315	5,187
Water samples	420	287
Telephone expense	2,351	2,205
Office supplies	2,261	2,485
Insurance and bonds	6,460	6,555
Professional fees	2,152	2,000
Dues, fees, and permits	494	1,055
Travel	3,872	4,240
Payroll taxes	2,287	2,295
Other expenses	12	14
Amortization	267	267
Depreciation	<u>36,508</u>	<u>34,834</u>
Total operating expenses	<u>146,193</u>	<u>147,843</u>
Operating income (loss)	<u>4,143</u>	<u>18,224</u>
 <u>Non-operating Revenue (Expenses)</u>		
Interest income	778	546
Interest on notes payable	<u>(22,274)</u>	<u>(21,843)</u>
Total non-operating revenue (expenses)	<u>(21,496)</u>	<u>(21,297)</u>
Income (loss) before contributions and transfers	<u>(17,353)</u>	<u>(3,073)</u>
Capital contributions	<u>0</u>	<u>117,178</u>
Change in net assets	<u>(17,353)</u>	<u>114,105</u>
Total net assets, beginning	<u>813,557</u>	<u>796,204</u>
 Total net assets, ending	 <u>\$796,204</u>	 <u>\$ 910,309</u>

See accompany notes to the financial statements

LINCOLN COUNTY RURAL WATER DISTRICT No. 3
 LINCOLN COUNTY, OKLAHOMA
 STATEMENTS OF CASH FLOWS - MODIFIED CASH BASIS
 FOR THE YEAR ENDED DECEMBER 31, 2010 and 2011

<u>Cash Flows from Operating Activities</u>	<u>2010</u>	<u>2011</u>
Cash received from members and others	\$ 150,336	\$ 166,067
Cash paid to suppliers and employees	<u>(109,496)</u>	<u>(112,742)</u>
Net cash provided (used) by operating activities	<u>40,840</u>	<u>53,325</u>
 <u>Cash Flows from Capital and Related Financing Activities</u>		
Principal paid on notes payable	(8,098)	(8,529)
Interest paid on notes payable	(22,274)	(21,843)
Capital contributions	<u>0</u>	<u>117,178</u>
Net cash provided (used) by capital & related financing activities	<u>(30,372)</u>	<u>86,806</u>
 <u>Cash Flows from Investing Activities</u>		
(Increase) decrease in restricted assets	(1)	(1)
Interest earned	778	546
(Acquisition) disposition of capital assets	<u>0</u>	<u>(152,491)</u>
Net cash provided (used) by investing activities	<u>777</u>	<u>(151,946)</u>
Net increase (decrease) in cash and cash equivalents	11,245	(11,815)
Cash and cash equivalents, beginning	<u>66,818</u>	<u>78,063</u>
Cash and cash equivalents, ending	<u>\$ 78,063</u>	<u>\$ 66,248</u>
 <u>Reconciliation of operating income (loss) to net cash provided (need)</u>		
<u>by operating activities:</u>		
Operating income (loss)	\$ 4,143	\$ 18,224
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Amortization	267	267
Depreciation	36,508	34,834
Increase (decrease) in payroll taxes	<u>(78)</u>	<u>0</u>
Total adjustments	<u>36,697</u>	<u>35,101</u>
Net cash provided (used) by operating activities	<u>\$ 40,840</u>	<u>\$ 53,325</u>

See accompanying notes to financial statements

LINCOLN COUNTY RURAL WATER DISTRICT No. 3
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2011

1. ORGANIZATION

Lincoln County Rural Water District No. 3 (the District) was organized under Title 82, §1324.1 *Oklahoma Statutes*, on October 24, 1988, as a political subdivision of Lincoln County, Oklahoma. The District supplies water to member users living within the district and constructs and maintains all water lines and other related property and equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting and reporting policies applied in the preparation of the accompanying financial statements for the year ended December 31, 2010 and 2011, are as follows:

Government-Wide and Fund Financial Statements - The District is a special purpose governmental entity engaged only in business type activities. The District prepares financial statements required for enterprise funds.

Measurement Focus and Basis of Accounting - Measurement focus is a term used to describe “how” transactions are recorded within the various financial statements. Basis of accounting refers to “when” transactions are recorded regardless of the measurement focus applied.

Measurement Focus:

In the financial statements business-like activities are presented using the economic resources measurement focus, within the limitations of the modified cash basis of accounting. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or non-current, financial, or non-financial) associated with their activities are reported. Fund equity is classified as net assets.

Basis of Accounting:

In the financial statements, business-like activities are presented using a modified cash basis of accounting. This basis recognizes 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 this 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. If the District utilized the basis of accounting recognized as generally accepted, the financial statements would use the accrual basis of accounting.

Fund Types and Major Funds - The District reports all activity within a single fund.

Property and Equipment - Acquisition and construction costs of property and equipment are capitalized, and depreciation is provided on a straight-line basis over the estimated useful lives of the property and equipment as follows:

<u>Type of Assets</u>	<u>Years</u>
Water line system	50
Building and improvements	20
Fencing	10
Equipment and truck	5

Contributed Capital - Amounts received by the District from member units and proceeds received as contributions in aid of construction from other entities as grants are recorded as contributed capital.

Use of Estimates - Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets, liabilities, and equity, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Debt Issuance Costs - Debt issuance costs are deferred and amortized over the term of the debt using the straight-line method, which approximates the effective interest method.

Income Tax Status - The District is a political instrumentality of Lincoln County, Oklahoma, and therefore, exempt from income taxes under the *Internal Revenue Code*.

Compensated Absences - Personal leave in varying amounts are granted by the District. The District does not record a liability for accrued compensated absences. Using the modified cash basis the amount paid for compensated absences is expensed as paid.

3. CASH AND INVESTMENTS

The District's investment policies are governed by state statute. Permissible investments include direct obligations of the United States Government and Agencies; certificates of deposit of savings and loan associations, and bank and trust companies; and savings accounts or savings certificates of saving and loan associations, and trust companies. The District considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Collateral is required for demand deposits and certificates of deposit for all accounts not covered by federal deposit insurance.

Deposits and Investments - The District's cash deposits and investments at December 31, 2010 and 2011, were completely insured by federal deposit insurance. Therefore, the District's cash deposits and investments at December 31, 2010 and 2011, were not exposed to Custodial Credit Risk, Investment Credit Risk, Investment Interest Rate Risk, or Concentration of Investment Credit Risk.

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2010 and 2011, were as follows:

	<u>Balance</u> <u>1/1/10</u>	<u>Increases</u> <u>2010</u>	<u>Increases</u> <u>2011</u>	<u>Balance</u> <u>12/31/11</u>
Capital assets not being depreciated:				
Land	\$ 6,190			\$ 6,190
Total capital assets not being depreciated	<u>6,190</u>			<u>6,190</u>
Other capital assets:				
Water line system	\$1,514,505		\$122,178	\$1,636,683
Building/improvements	7,736			7,736
Fencing	3,000			3,000
Equipment and truck	<u>27,656</u>			<u>27,656</u>
Total other capital assets	<u>1,552,897</u>		<u>122,178</u>	<u>1,675,075</u>
Total capital assets	<u>1,559,087</u>		<u>122,178</u>	<u>1,681,265</u>
Construction in progress	<u>0</u>		<u>30,314</u>	<u>30,314</u>
Less accumulated depreciation for:				
Water line system	393,623	30,290	30,697	454,610
Building/improvements	3,096	387	387	3,870
Fencing	2,100	300	300	2,700
Equipment and truck	<u>18,675</u>	<u>5,531</u>	<u>3,450</u>	<u>27,656</u>
Total accumulated depreciation	<u>417,494</u>	<u>36,508</u>	<u>34,834</u>	<u>488,836</u>
Capital assets, net	<u>\$1,141,593</u>	<u>\$(36,508)</u>	<u>\$117,658</u>	<u>\$1,222,743</u>

Depreciation expense for the year ended December 31, 2010 and 2011, were \$36,508 and \$36,508, respectively. The above investment for water lines includes interest capitalized during construction of \$19,887. The District replaced and moved some water lines during the year at a cost of \$122,178. The Oklahoma Department of Transportation reimbursed the District \$117,178.

5. DEBT ISSUANCE COSTS

During the year ended December 31, 1997, the District paid \$10,675 in legal fees related to issuing debt in conjunction with building a water line. These legal fees have been capitalized and are being amortized over the life of the loans. For the years ended December 31, 2010 and 2011, \$267 in amortization expense were recognized.

6. LONG-TERM DEBT

The District had the following long-term debt as of December 31, 2010 and 2011:

Notes Payable:	<u>2010</u>	<u>2011</u>
Note 91-01, U.S. Department of Agriculture - Rural Development dated October 31, 1995, for the amount of \$442,500. Payments of \$2,244 per month for 40 years including interest at 5.25%. Secured by all business assets.	\$372,531	\$364,981
Note No. 91-03, U.S. Department of Agriculture - Rural Development, dated May 28, 1997, for the amount of \$60,000. Payments of \$287 per month for 40 years including interest at 4.875%. Only interest - no principal - was paid the first year. Secured by all business assets.	<u>51,023</u>	<u>50,045</u>
Total Long-Term Debt	<u>\$423,554</u>	<u>\$415,626</u>

Changes in long-term debt during the year ended December 31, 2010 and 2011, were as follows:

	Balance at 1/1/10	Decreases	Balance at 12/31/10	Decreases	Balance at 12/31/11
Note 91-01-Rural Development	\$379,697	\$ (7,166)	\$372,531	\$(7,550)	\$364,981
Note 91-03-Rural Development	<u>51,955</u>	<u>(932)</u>	<u>51,023</u>	<u>(978)</u>	<u>50,045</u>
Total notes payable	<u>\$431,652</u>	<u>\$ (8,098)</u>	<u>\$423,554</u>	<u>\$(8,528)</u>	<u>\$415,026</u>

Annual payments required to amortize the above outstanding debt over the next five years and thereafter, are as follows:

Year Ended	Note 91-01 <u>Rural Development</u>		Note 91-03 <u>Rural Development</u>		Total <u>Notes Payable</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
12/31						
2010	\$ 7,164	\$ 19,764	\$ 932	\$ 2,512	\$ 8,096	\$ 22,276
2011	7,550	19,378	978	2,466	8,528	21,844
2012	7,956	18,872	1,027	2,417	8,983	21,289
2013	8,384	18,544	1,078	2,366	9,462	20,910
2014	8,835	18,093	1,132	2,312	9,967	20,405
Thereafter	<u>332,642</u>	<u>218,545</u>	<u>45,876</u>	<u>29,944</u>	<u>378,518</u>	<u>248,489</u>
	<u>\$372,531</u>	<u>\$313,196</u>	<u>\$51,023</u>	<u>\$42,017</u>	<u>\$423,554</u>	<u>\$355,213</u>

7. COMPENSATED ABSENCES

The District has not reported an amount for accrued compensated absences. Under the modified cash basis of accounting, payments for vacation and sick leave are expensed as paid.

8. RESERVE ACCOUNT

Section 4(d) of the loan agreement with Rural Development stipulates that the District establish a reserve account for repairs and replacement of the system. An amount equal to ten (10%) percent of the monthly debt service payments shall be transferred monthly to the reserve account until the balance reaches an amount equal to the annual debt service payments, or \$30,372.

The reserve account, including accumulated interest earned thereon, is shown as restricted cash on the statement of net assets - modified cash basis. The respective balances of the reserve account as of December 31, 2010, and 2011 are \$30,291 and \$30,292.

9. 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; injuries to employees; and natural disasters. The District carries commercial insurance for risk of loss, including workers' compensation.

10. CONTRACTS

The District purchases water for resale from the Chandler Municipal Authority, Chandler, Oklahoma. The price paid by the District is determined based on costs incurred by the Authority in producing the water purchased. The contract contains terms defining the costs to be considered.

11. SUBSEQUENT EVENTS

The District completed and moved into a new building as of March 31, 2012.

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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

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

I have audited the financial statements-modified cash basis of the business-type activities of Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma, as of and for the year ended December 31, 2010, and December 31, 2011, which collectively comprise Lincoln County Rural Water District No. 3, Lincoln County, Oklahoma's basic financial statements and have issued my report thereon dated July 6, 2012. The financial statements were prepared on a modified cash basis of accounting, a comprehensive basis of accounting other than accounting principles generally accepted in the United States and is not intended to be presented in conformity with United States generally accepted accounting principles.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the District's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinions on the financial statements, but not for expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the District's internal control over financial reporting.

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

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, I 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 my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

I noted certain matters that I reported to management of Lincoln County Rural Water District #3 in a separate letter dated July 6, 2012.

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



Bill Ford, C.P.A.

July 6, 2012