THE POTEAU VALLEY IMPROVEMENT AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2012 AND 2011

THE POTEAU VALLEY IMPROVEMENT AUTHORITY

JUNE 30, 2012 AND 2011

CONTENTS

BEALL BARCLAY

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Board of Trustees
The Poteau Valley Improvement Authority
Wister, Oklahoma

We have audited the accompanying balance sheets of **The Poteau Valley Improvement Authority** (the Authority) as of June 30, 2012 and 2011, and the related statements of revenues and expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **The Poteau Valley Improvement Authority** as of June 30, 2012 and 2011, 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 August 7, 2012 on our consideration of **The Poteau Valley Improvement Authority'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* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 7 and the budgetary comparison schedule on pages 20 and 21 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Beall Barclay & Company, PLC

BEALL BARCLAY & COMPANY, PLC
Certified Public Accountants

Fort Smith, Arkansas
August 7, 2012

THE POTEAU VALLEY IMPROVEMENT AUTHORITY

Management's Discussion and Analysis

Our discussion and analysis of The Poteau Valley Improvement Authority's (the Authority's) financial performance provides an overview of the Authority's financial activities for the fiscal years ended June 30, 2012 and June 30, 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 the Statements of Revenues, Expenses and Changes in Net Assets (on pages 8-11) provide information about the activities of The Authority as a whole and present a longer-term view of the Authority's finances. The footnotes and supplementary information provide additional narrative concerning selected financial items.

Reporting the Utility As A Whole

The Balance Sheets and the Statements of Revenues, Expenses and Changes in Net Assets report information about the Authority'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 Authority had several capital improvement projects in progress. In the fiscal year 2009-2010 and 2010-2011, we spent $63,614 on the River Intake and in fiscal year 2011-2012, $338,840 was spent. The 2-20" river crossings were completed this year at a cost of $387,446.

The Authority has two projects ongoing that are "source water protection" projects. The first is a joint demo project with EPA, Corps of Engineers and the Secretary of Environment to improve water quality in Lake Wister. We have installed aeration equipment and floating wetlands in Quarry Island Cove. The project has cost approximately $132,556. An EPA grant of $75,000 was awarded. The Authority is providing the balance with cash and in-kind service. This project is complete, while long term maintenance is ongoing.

The second is also a "source water protection" project. The Authority has contracted with U.S.G.S. and The Water Resource Board to monitor nutrients, suspended sediment, and river flows. Meanwhile, the Authority has contracted with Bioxdesign to monitor nutrients in the lake. This will be a four year project with an approximate cost of $442,500. The Authority has three contributors for this project; The Choctaw Nation, City of Poteau and AES Shady Point. They have committed to $110,000 a year for four years.

Note: It should be noted that when comparing project cost and expenditures stated in the financial highlights section, with the current financial statement that the current financial statement covers only what was spent in that fiscal year, while the analysis given here is for the project in total.

Variations Between Original and Actual Budget Results

The 2011-2012 budget was based on expected income and capital improvements expenditures. The budgeted amount for repairs and maintenance of $949,000 included amounts budgeted for capital expenditures. Some larger improvement projects included in the original budget were not completed in this fiscal year.

Capital Improvement Projects

The Authority has several projects in progress that will span several budget years. New river intake is part of the five year plan; engineering plans, state and Federal permits were acquired in the 2010-2011 budget year. The project was let for bid in June 2011. The low bid was $334,000 for the structure only; a change order was added for a center wall for $74,128. The remainder of the project will be done by The Authority; i.e. 24" raw water line from the intake to the plant and the electrical work. The 20" river crossing is part of system improvement. The first crossing was let for bid in April 2011 for $123,740. The second river crossing was added to the first contract by change order for labor only, material will be provided by The Authority.

Long-term Debt Activity

During the year 2003-2004, the Authority refinanced all of the debt outstanding into one loan with the Bank of Oklahoma. This loan carries a fixed interest rate of 4.04%. Since that time regular monthly payments have been made on this loan, and savings in interest expense is reflected on the Statements of Revenues, Expenses and Changes in Net Assets.

Operating Revenues

Water sales are the primary source of revenue for the Authority. Each year the 15 entities The Authority provides water to make requests for the amount of water they will need for the coming year. The Authority's management will use the requested amount and historical data of each entity to refine the amount to an expected amount. The budget is based on expected revenue. Expected sales for 2011-2012 were $2,652,000.

Actual revenue was $2,579,432. This is down slightly from 2010-2011 when expected revenue was $2,400,000, and actual revenue was $2,657,953. The largest influence on water sales is the weather. This year total gallons sold were 1,984,178,160 compared to 2,044,579,690 gallons in 2010-2011. The City of Heavener is an on demand water user. For 2010-2011 fiscal year, they purchased 39,691,600 gallons, due to several malfunctions with their intake. For 2011-2012 fiscal year, they have only purchased 4,236,400 gallons due to completion of an expansion project at the Heavener water plant. This will mean a drop in sales in the years to come for the Authority. This will be offset by the addition of a new purchaser; the City of Keota has plans to join the Authority and should buy 15 to 20 million gallons a year.

Non-Operating Income

The interest on CD's and Capital Improvement Funds was slightly higher in 2011-2012 due to the interest rate. Total received was $16,952 compared to $12,695 for 2010-2011.

Operating Expenses

Expenses are estimated and budgeted for each year. They include chemicals, electrical, salaries, repairs and maintenance, insurance and depreciation. For 2011-2012, total operating expenses were $2,057,782 compared to $2,183,326 for the 2010-2011 year.

Raw water storage cost increased in the fiscal year 2011-2012 to $22,616 compared to $11,834 in fiscal year 2010-2011. The Authority's water storage contract with the Corps of Engineers requires the Authority to pay a percentage of Corps maintenance of the dam. The percentage paid is tied to the amount of water stored. The Authority has doubled the amount of stored water in the lake. The added cost is not known at this time as the Corps is working on the contract. The new storage contract will cost much more than the old storage contract, because the Corps will charge a higher percentage rate on all new storage contracts.

Salaries are up by 3% due to merit, cost of living raises and overtime. Truck expense went down slightly. In the fiscal year 2011-2012, truck expenses were $27,907 compared to fiscal year 2010-2011 truck expenses of $32,342. Repairs and maintenance expenses are down by $91,110, due to repairs on a Bull Gear, dozer, intake pumps and frequency drive in fiscal year 2010-2011. Repairs and maintenance for fiscal year 2011-2012 was $80,242 compared to fiscal year 2010-2011 repairs and maintenance of $171,352. Operating expense will continue to rise as energy cost rise; also plant equipment is aging and wearing.

Summary

The Authority began fiscal year 2011-2012 with $2,978,693 in CDs and Capital Improvement Funds and Fixed Assets of $21,698,297 compared to 2010-2011 with $2,595,662 in CDs and Capital Improvement Funds and Fixed Assets of $21,644,292.

The Authority has fixed assets of $22,415,954 and $2,737,236 in CDs and Capital Improvement Funds at the end of fiscal year 2011-2012. The decrease in the CDs and Capital Improvement Fund of $241,457 is due to 2-20" river crossings and work on the river intake (See graph on page 7). The Authority is in compliance with all State and Federal water quality and environmental regulations. It is management's opinion that the present rate of $1.30 per thousand gallons is adequate to fund operation and maintenance and needed capital improvements for the next year.

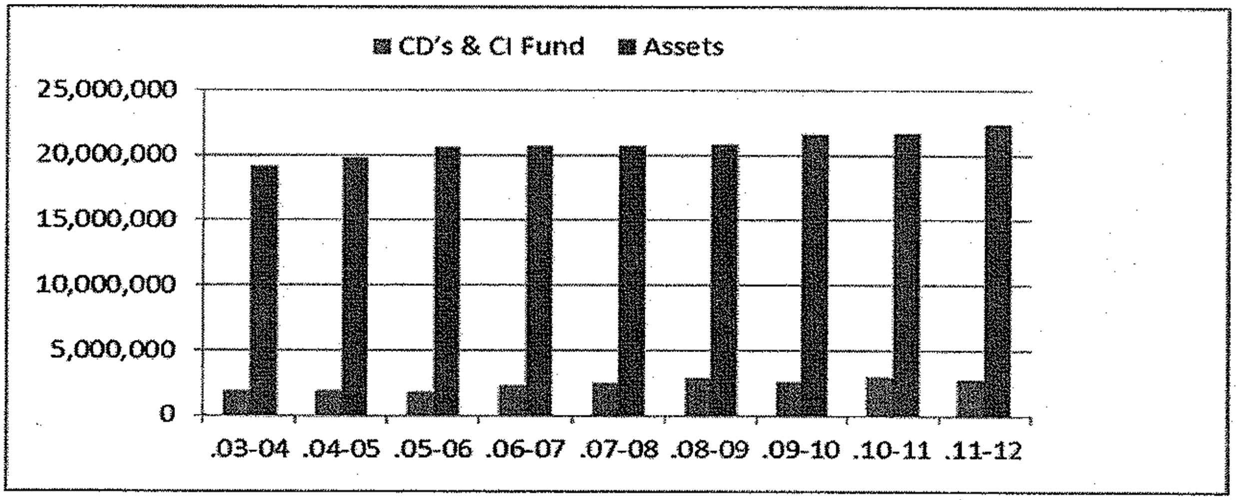
The Authority has a 5 year plan for Plant Improvements, adopted 2012-2013.

Work Completed	Year Completed	Estimated Cost	Funds Spent on 5 yr. plan	
12" Line toward Sunset Corner	FY 05-06	75,000	87,585	1
Backwash Tank and Plant Piping	FY 06-07	237,000	255,419	1
90' Clarifier Repair	FY 06-07	90,000	93,090	1
Panama Pump Station Upgrade	FY 06-07	43,000	36,151	1
Additional Intake Pump	FY 08-09	80,000	30,510	1
Demolition of Old Intake	FY 09-10	150,000	85,000	1
Pocola Line Material & Boring Only	FY 09-10	410,409	757,813	1
60' Clarifier Repair	FY 10-11	60,000	40,516	1
Source Water Protection Plan	FY 10-11	73,488	73,488	1
2-20" River Crossings	FY 11-12	274,240	387,275	1
	Sub. Total	1,493,137	1,846,847	
Work in Progress				
New Intake 11-12/12-13		724,000	402,454	2
Source Water Protection Plan	FY 11-12		170,035	2
	Sub. Total		572,489	
Revised Plan				
* 9000' 18" line Panama & Brazil Creek Crossing		600,000		
GAC pilot $8,000. per test X 2		16,000		
* Powdered Activated Carbon Feeder		200,000		
* Relocate 18" line around College		300,000		
2-12" River Crossings		300,000		
Bokoshe Pump Station		250,000		
7000' 18" line to Panama		350,000		
New 1 MG Clearwell & Dist. Pump		1,500,000		
100' Clarifer & 4 Filters		2,600,000		
	Total	8,333,137	2,419,336	
Balance of Projects		5,913,801		

(1) Projects Completed
(2) Projects in Progress
* Projects Planned for FY 2012-2013

Regulatory Outlook

The Authority is in compliance with present EPA Rules. The 2010 Long Term II Enhanced Surface Water Treatment Rule has come and gone with the Authority in compliance. (We will have to test again in 2014 for the rule.) Stage II Disinfection By-Products Rule 2013 system evaluation has been completed in 2010. The evaluation determined the Authority may be able to comply. The purchase water systems failed but only by about 20-30% of the limit. Rather than change disinfection practices at the plant the purchase water systems are willing to make changes in their systems to limit the production of disinfection by-products. The Authority will install a new activated carbon feeder at the plant that will allow a great deal more carbon to be fed to the raw water for organic carbon removal.



At year end	CD's & CI Fund	Fixed assets before depreciation
2011-2012	$ 2,737,236	$ 22,415,954
2010-2011	2,978,693	21,698,297
2009-2010	2,595,662	21,644,292
2008-2009	2,860,026	20,816,800
2007-2008	2,495,364	20,688,078
2006-2007	2,240,851	20,756,459
2005-2006	1,766,581	20,568,730
2004-2005	1,917,450	19,820,809
2003-2004	1,936,294	19,179,433

THE POTEAU VALLEY IMPROVEMENT AUTHORITY
BALANCE SHEETS
JUNE 30, 2012 AND 2011

	2012	2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,879,315	$ 3,140,132
Accounts receivable	267,488	268,915
Prepaid expenses	84,685	75,711
Total Current Assets	3,231,488	3,484,758
PROPERTY, PLANT AND EQUIPMENT		
Land	75,734	75,734
Construction in progress	405,569	78,279
Water plant buildings, facilities, and improvements	7,159,804	7,159,804
Storage tanks	2,010,525	2,010,525
Water lines	10,968,290	10,580,844
Machinery and equipment	1,545,565	1,545,565
Trucks and trailers	233,070	230,149
Office equipment	17,397	17,397
	22,415,954	21,698,297
Less accumulated depreciation	9,861,401	9,347,985
	12,554,553	12,350,312
OTHER ASSETS		
Loan issuance costs, net of accumulated amortization of $56,498 and $49,580, respectively	19,602	26,520
Deposits	20	20
	19,622	26,540
	$ 15,805,663	$ 15,861,610

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

	2012	2011
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current portion of long-term debt	$ 410,567	$ 394,189
Accounts payable	9,709	48,248
Accrued liabilities	5,804	21,351
Total Current Liabilities	426,080	463,788
LONG-TERM DEBT	834,076	1,244,695
Total Liabilities	1,260,156	1,708,483
NET ASSETS		
Invested in capital assets net of related debt	4,145,660	3,547,178
Net assets - unrestricted	3,235,597	3,441,699
	7,381,257	6,988,877
Contributed capital	7,164,250	7,164,250
	14,545,507	14,153,127
	$ 15,805,663	$ 15,861,610

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

THE POTEAU VALLEY IMPROVEMENT AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Water sales	$ 2,579,432	$ 2,657,953
Miscellaneous income	2,488	3,041
	2,581,920	2,660,994
OPERATING EXPENSES		
Chemicals	328,078	327,589
Depreciation and amortization	541,006	522,415
Engineering services	2,440	17,720
Equipment rental	-	110
Insurance	168,897	162,835
Laundry	4,483	4,005
Legal and accounting	14,989	16,652
Licenses/fees/school	1,851	2,021
Management expenses	977	1,642
Office supplies	988	976
Payroll taxes	34,458	31,351
Plant supplies	12,076	10,714
Postage and freight	1,047	1,104
Radio control	5,040	5,040
Raw water lease	22,616	11,834
Repairs and maintenance	80,242	171,352
Research	-	78,511
Retirement plan contributions	55,579	50,202
Salaries	398,804	386,176
Telephone	4,386	4,136
Testing and lab supplies	27,057	25,509
Truck expenses	27,907	32,342
Trust fees and service charges	750	420
Utilities	323,536	317,695
Water easements	575	975
	2,057,782	2,183,326
OPERATING INCOME	524,138	477,668

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

	2012	2011
NON-OPERATING REVENUES (EXPENSE)		
Source water monitoring income	95,000	83,750
Source water monitoring expense	(187,118)	(72,097)
Gain on sale of equipment	1,185	810
Interest income	16,952	12,695
Interest expense	(57,777)	(72,130)
	(131,758)	(46,972)
CHANGE IN NET ASSETS	392,380	430,696
NET ASSETS, BEGINNING OF YEAR	6,988,877	6,558,181
NET ASSETS, END OF YEAR	$ 7,381,257	$ 6,988,877

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

THE POTEAU VALLEY IMPROVEMENT AUTHORITY
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 2,580,859	$ 2,662,060
Payments to vendors	(1,109,906)	(1,291,484)
Payments to employees	(413,024)	(383,853)
Payments to retirement plan	(55,579)	(50,202)
Other receipts	2,488	3,041
Net Cash From Operating Activities	1,004,838	939,562
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital expenditures	(738,329)	(71,969)
Proceeds from sale of equipment	1,185	810
Principal payments on long-term debt	(394,241)	(378,756)
Interest paid	(59,104)	(74,589)
Net Cash (Used For) Capital and Related Financing Activities	(1,190,489)	(524,504)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net source water monitoring	(92,118)	11,653
Receipts of interest	16,952	12,695
Net Cash From (Used For) Investing Activities	(75,166)	24,348
NET CHANGE IN CASH AND CASH EQUIVALENTS	(260,817)	439,406
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,140,132	2,700,726
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 2,879,315	$ 3,140,132

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

	2012	2011
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES:		
Operating income	$ 524,138	$ 477,668
Adjustments to reconcile operating income to net cash from operating activities:		
Depreciation and amortization	541,006	522,415
Change in:		
Accounts receivable	1,427	4,107
Prepaid expenses	(8,974)	(4,826)
Accounts payable	(38,539)	(62,125)
Accrued liabilities	(14,220)	2,323
Total adjustments	480,700	461,894
Net Cash From Operating Activities	$ 1,004,838	$ 939,562

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

The Poteau Valley Improvement Authority ("the Authority") is a trust created under the provisions of Title 60, Oklahoma Statutes 1961, Sections 176 to 180, inclusive, the Oklahoma Trust Act and other applicable statutes of the State of Oklahoma.

Fund Type

The Authority is an enterprise fund, 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 (expenses, including depreciation) 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 or revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Basis of Accounting

The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred, regardless of the timing of the related cash flows.

Under this basis of accounting and measurement focus, the Authority applies all Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989 that are developed for business enterprises, unless those pronouncements conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements.

Operating revenues and expenses are distinguished from other revenues (expenses) items. Operating revenues and expenses generally result from providing services in connection with the principal ongoing operations of the Authority. All revenue and expenses not meeting this definition are reported as other revenues (expenses) but remain a major component of the overall revenues and expenses of the Authority.

Property, Plant and Equipment

Property, plant and equipment is stated at cost. Depreciation of property, plant, and equipment is computed on the straight-line method over the estimated useful lives of the assets, which range from three to fifty years. The Authority had fully depreciated assets still in use with an original cost of $1,845,138 and $1,835,986 at June 30, 2012 and 2011, respectively.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Capitalization of Interest Costs

The Authority capitalizes interest costs as part of the total acquisition costs of construction related to the addition to and/or improvement of facilities. Interest costs capitalized include only the interest incurred during the construction period on debt used to finance the project. The interest capitalization period commences with the first expenditure for the project and continues until the constructed project is substantially complete and ready for its intended use, at which time interest capitalization ceases.

Cash Equivalents

For purposes of the Statements of Cash Flows, the Authority considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

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.

Accounts Receivable

The Authority 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. Amounts are considered past-due when not paid within by the 25th of the month. Past-due accounts are assessed a 10% late charge.

Long-Lived Assets

FASB 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 Authority's reported earnings, financial condition or cash flows.

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.

NOTE 2: CASH AND CASH EQUIVALENTS

Deposits in financial institutions are financial instruments that could potentially subject the Authority to a risk of accounting loss to the extent of the uninsured/uncollateralized portion of those deposits. At June 30, 2012, all deposits were in two financial institutions and carried at cost. The amounts of these deposits are displayed on the Balance Sheet as "Cash and cash equivalents."

	Bank Balance	Book Balance
Insured (FDIC)	$ 479,239	$ 391,979
Collateralized	2,489,806	2,487,236
Uninsured/uncollateralized	-	-
	$ 2,969,045	$ 2,879,215

Also included in "Cash and cash equivalents" on the Balance Sheet at June 30, 2012 is petty cash amounting to $100.

NOTE 3: RETIREMENT SYSTEM

The Authority participates in the Oklahoma Public Employees Retirement System. Contributions to the retirement system are made by the Authority as required by law. During the years ended June 30, 2012 and 2011, amounts equal to 14% of employee wages were contributed to the system with no percentage adjustment at different wage levels. In addition to the amounts contributed by the Authority during the years ended June 30, 2012 and 2011, employees must contribute 6% of their monthly compensation to the system.

NOTE 4: CONTRIBUTED CAPITAL

The Authority has received grants from various sources over the years to make additions and improvements to its water system and facilities. The Authority is not obligated to repay these funds. Therefore, these funds are considered to be contributed capital.

NOTE 5: CONCENTRATION OF CREDIT RISK

The Authority sells water to various local water districts in the Poteau, Oklahoma area. The Authority operates from its primary facilities in Wister, Oklahoma. The Authority grants credit to customers, all of whom are local water districts, located in the vicinity of the operating location.

The Authority had extended credit to regular customers (accounts receivable) of $267,488 and $268,915 at June 30, 2012 and 2011, respectively.

NOTE 6: LONG-TERM DEBT

Long-term debt at June 30, 2012 and 2011 consisted of:

	Balance July 1, 2011	Additions	Reductions	Balance June 30, 2012	Current portion June 30, 2012	Long-term portion June 30, 2012
Bank of Oklahoma	$ 1,638,884	$ -	$ 394,241	$ 1,244,643	$ 410,567	$ 834,076

	Balance July 1, 2010	Additions	Reductions	Balance June 30, 2011	Current portion June 30, 2011	Long-term portion June 30, 2011
Bank of Oklahoma	$ 2,017,640	$ -	$ 378,756	$ 1,638,884	$ 394,189	$ 1,244,695

The Bank of Oklahoma note is collateralized by a first lien on revenues with monthly payments of $37,779, including interest at 4.04%, and a maturity date of May 4, 2015. The note requires the Authority to maintain certain financial covenants. The Authority capitalized issuance costs associated with this note in the amount of $76,100 and is amortizing those costs over the term of the note.

Interest paid during the years ended June 30, 2012 and 2011 amounted to $59,104 and $74,589, respectively.

At June 30, 2012, the Authority was in substantial compliance with all covenants.

Annual requirements to amortize outstanding debt are as follows:

Years ending June 30,	Principal	Interest	Total
2013	$ 410,567	$ 42,778	$ 453,345
2014	427,464	25,881	453,345
2015	406,612	8,288	414,900
	$ 1,244,643	$ 76,947	$ 1,321,590

NOTE 7: NONCASH TRANSACTIONS

There were no noncash transactions during the year ended June 30, 2012.

During the year ended June 30, 2011, the Authority wrote off fully depreciated equipment no longer in service with an original cost of $1,053.

NOTE 8: RELATED PARTIES

During the year ended June 30, 2004, the Authority entered into an agreement with an employee and relatives of the employee to dispose of sludge generated by the Authority on the employee's property as part of a test project to determine whether the sludge is suitable for growing Bermuda grass for sod farms. Under the agreement, the Authority is responsible for dumping and spreading the sludge until such time as representatives from the Kerr Center for Sustainable Agriculture determine sufficient buildup has taken place. At that time, Bermuda grass will be planted. The Authority will be responsible for providing irrigation to the plot and for maintaining the necessary research records. The agreement was set to expire in February 2006, at which time the agreement could have been renewed, if approved by all parties. Upon expiration of the contract, a verbal agreement was entered into for an undetermined amount of time.

NOTE 9: DESIGNATED CASH

As of June 30, 2012 and 2011, the Authority's Board of Trustees designated $620,094 and $1,115,235, respectively, of unrestricted cash for capital improvements.

NOTE 10: CHANGES IN PROPERTY, PLANT AND EQUIPMENT

Changes in property, plant, and equipment during the years ended June 30, 2012 and 2011 are as follows:

	Balance July 1, 2011	Additions	Deletions	Transfers	Balance June 30, 2012
Land	$ 75,734	$ -	$ -	$ -	$ 75,734
Construction in progress	78,279	340,040	-	(12,750)	405,569
Water plant buildings, facilities and improvements	7,159,804	-	-	-	7,159,804
Storage tanks	2,010,525	-	-	-	2,010,525
Water lines	10,580,844	374,696	-	12,750	10,968,290
Machinery and equipment	1,545,565	-	-	-	1,545,565
Trucks and trailers	230,149	23,593	20,672	-	233,070
Office equipment	17,397	-	-	-	17,397
	21,698,297	738,329	20,672	-	22,415,954
Less: accumulated depreciation	9,347,985	534,088	20,672	-	9,861,401
	$ 12,350,312	$ 204,241	$ -	$ -	$ 12,554,553

NOTE 10: CHANGES IN PROPERTY, PLANT AND EQUIPMENT – CONTINUED

	Balance July 1, 2010	Additions	Deletions	Transfers	Balance June 30, 2011
Land	$ 75,734	$ -	$ -	$ -	$ 75,734
Construction in progress	804,549	26,095	-	(752,365)	78,279
Water plant buildings, facilities and improvements	7,146,683	14,174	1,053	-	7,159,804
Storage tanks	2,010,525	-	-	-	2,010,525
Water lines	9,820,555	7,924	-	752,365	10,580,844
Machinery and equipment	1,545,565	-	-	-	1,545,565
Trucks and trailers	223,284	23,776	16,911	-	230,149
Office equipment	17,397	-	-	-	17,397
	21,644,292	71,969	17,964	-	21,698,297
Less: accumulated depreciation	8,850,452	515,497	17,964	-	9,347,985
	$ 12,793,840	$ (443,528)	$ -	$ -	$ 12,350,312

NOTE 11: COMMITTMENTS

During the year ended June 30, 2011, the Authority entered into agreements with The Choctaw Nation, City of Poteau and AES Shady Point, LLC to monitor the source water obtained by the Authority from Lake Wister. The above entities have agreed to share the cost of the project over a four year period. The monitoring services are being performed in conjunction with the United States Department of the Interior, U.S. Geological Survey (USGS). The Authority entered into an agreement dated August 10, 2010 to pay the USGS $392,300 over a four year period beginning August 10, 2010 for services related to the source water monitoring project. As of June 30, 2012, $148,625 has been paid toward this agreement.

SUPPLEMENTARY INFORMATION

THE POTEAU VALLEY IMPROVEMENT AUTHORITY
BUDGETARY COMPARISON SCHEDULE
YEAR ENDED JUNE 30, 2012

	BUDGET	ACTUAL	VARIANCE
OPERATING REVENUES			
Water sales	$ 2,652,000	$ 2,579,432	$ 72,568
Miscellaneous income	-	2,488	(2,488)
	2,652,000	2,581,920	70,080
OPERATING EXPENSES			
Chemicals	350,000	328,078	21,922
Depreciation and amortization	450,000	541,006	(91,006)
Engineering services	10,000	2,440	7,560
Equipment rental	1,000	-	1,000
Insurance	176,000	168,897	7,103
Laundry	6,500	4,483	2,017
Legal and accounting	18,000	14,989	3,011
Licenses/fees/school	2,500	1,851	649
Management expenses	2,000	977	1,023
Office supplies	2,000	988	1,012
Payroll taxes	33,500	34,458	(958)
Plant supplies	15,000	12,076	2,924
Postage and freight	1,200	1,047	153
Radio control	5,100	5,040	60
Raw water lease	13,000	22,616	(9,616)
Repairs and maintenance	104,000	80,242	23,758
Research	20,000	-	20,000
Retirement plan contributions	55,000	55,579	(579)
Salaries	443,500	398,804	44,696
Telephone	5,000	4,386	614
Testing and lab supplies	40,000	27,057	12,943
Truck expenses	35,000	27,907	7,093
Trust fees and service charges	1,000	750	250
Utilities	388,500	323,536	64,964
Water easements	1,000	575	425
	2,178,800	2,057,782	121,018
OPERATING INCOME	473,200	524,138	(50,938)

THE POTEAU VALLEY IMPROVEMENT AUTHORITY
BUDGETARY COMPARISON SCHEDULE
YEAR ENDED JUNE 30, 2012

	BUDGET	ACTUAL	VARIANCE
NON-OPERATING REVENUES (EXPENSE)			
Source water monitoring income	110,000	95,000	15,000
Source water monitoring expense	(225,000)	(187,118)	(37,882)
Gain on sale of equipment	-	1,185	(1,185)
Interest income	16,000	16,952	(952)
Interest expense	(59,200)	(57,777)	(1,423)
	(158,200)	(131,758)	(26,442)
CHANGE IN NET ASSETS	$ 315,000	$ 392,380	$ (77,380)
ADDITIONAL AMOUNTS BUDGETED:			
Large repairs, reoccurring maintenance and capital outlays	$ 845,000	$ 738,329	$ 106,671
Principal on long-term debt	394,200	394,241	(41)

NOTE 1: **BUDGET**

The budget for the Authority is prepared on the accrual basis of accounting. The budget is approved by the Authority's Board of Trustees. The original budget approved is the same as the final budget.

BEALL BARCLAY

CERTIFIED PUBLIC ACCOUNTANTS

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 Trustees
The Poteau Valley Improvement Authority
Wister, Oklahoma

We have audited the financial statements of **The Poteau Valley Improvement Authority** (the Authority) as of and for the year ended June 30, 2012, and have issued our report thereon dated August 7, 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 the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority'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 Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority'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 Organization's financial statements will not be prevented, or detected and corrected on a timely basis.

Our 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. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Preparation of Financial Statements

Condition: As a part of the audit engagement, we assisted management in the preparation of the Authority'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 Authority'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 Authority's management.

Recommendation: We understand management feels its current controls over the preparation of financial statements are adequate and implementing additional controls is not practical or feasible with the Authority's current staff and resources. We recommend 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: We noted that there is no review or approval of general journal entries posted to the accounting system by an individual that is separate from the posting of the entry. We also noted that access to the accounting system is not user specific and that all users have unrestricted access to all the ledgers and transaction posting abilities of the accounting system.

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 organization. Our review of the Authority's financial reporting system disclosed that, primarily due to the limited number of accounting personnel, there are inherent limitations in the Authority'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 the Authority does not presently have the staff necessary to achieve a complete segregation of duties, and 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 the Board of Directors 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 Authority'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*.

This report is intended solely for the information and use of the Board of Directors, management, and Federal and State awarding agencies and pass-through entities 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
August 7, 2012