

RURAL SEWER DISTRICT NUMBER 1
ROGERS COUNTY
VERDIGRIS, OKLAHOMA
ANNUAL FINANCIAL REPORT
JUNE 30, 2011

RALPH OSBORN, CPA
P. O. BOX 1015
BRISTOW, OKLAHOMA 74010
918-367-2208
FAX 918-367-1034

INDEPENDENT AUDITORS' REPORT

To The Honorable Members of the Board of Directors
Rural Sewer District Number 1, Rogers County
Verdigris, Oklahoma

I have audited the accompanying financial statements of the business-type activities of Rural Sewer District Number 1, Rogers County, Verdigris, Oklahoma as of and for the year ended June 30, 2011, which collectively comprise Rural Sewer District Number 1's basic financial statements. These financial statements are the responsibility of Rural Sewer District Number 1's management. My responsibility is to express an 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.

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Rural Sewer District Number 1 as of June 30, 2011, and the respective changes in financial position and cash flows where appropriate, thereof, in conformity with accounting principles generally accepted in the United States of America.

Rural Sewer District Number 1 has not presented Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statement.

In accordance with *Government Auditing Standards*, I have also issued my report dated October 3, 2011, on my consideration of Rural Sewer District Number 1'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 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 my audit.



Ralph Osborn
Certified Public Accountant
Bristow, Oklahoma
October 3, 2011

RURAL SEWER DISTRICT NUMBER 1
 ROGERS COUNTY
 VERDIGRIS, OKLAHOMA
 STATEMENT OF NET ASSETS
 JUNE 30, 2011

ASSETS

Current assets:

| | | |
|---------------------------|----|----------------|
| Cash and cash equivalents | \$ | 72,398 |
| Investments | | 50,103 |
| Accounts receivable | | 39,480 |
| Prepaid Expenses | | 6,489 |
| Deposits | | 250 |
| Restricted assets | | |
| Debt service funds | | 197,734 |
| Total current assets | | <u>366,454</u> |

Non-current assets

| | | |
|---|--|------------------|
| Deferred debt expense, net | | 20,813 |
| Capital assets: | | |
| Land | | 46,325 |
| Capital assets, net of accumulated depreciation | | <u>1,728,224</u> |
| Total non-current assets | | <u>1,795,362</u> |
| Total assets | | <u>2,161,816</u> |

LIABILITIES

Current liabilities:

| | | |
|---------------------------|--|---------------|
| Accounts payable | | 4,466 |
| Accrued interest | | 8,422 |
| Notes payable, current | | 66,409 |
| Total current liabilities | | <u>79,297</u> |

Non-current liabilities:

| | | |
|-------------------------------|--|------------------|
| Notes payable, non-current | | <u>1,349,067</u> |
| Total non-current liabilities | | <u>1,349,067</u> |
| Total liabilities | | <u>1,428,364</u> |

NET ASSETS

| | | |
|--|--|-------------------|
| Nonspendable | | 413,217 |
| Restricted for debt service | | 246,142 |
| Unassigned | | <u>74,093</u> |
| Net assets of business-type activities | | <u>\$ 733,452</u> |

See accompanying notes to financial statements.

RURAL SEWER DISTRICT NUMBER 1
 ROGERS COUNTY
 VERDIGRIS, OKLAHOMA
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEAR ENDED JUNE 30, 2011

OPERATING REVENUES

| | |
|--------------------------|----------------|
| Charges for services: | |
| Wastewater charges | \$ 378,678 |
| Membership benefit units | 32,250 |
| Miscellaneous | <u>142</u> |
| Total operating revenues | <u>411,070</u> |

OPERATING EXPENSES

| | |
|--------------------------|----------------|
| Contract management fees | 84,000 |
| Contract operator fees | 24,000 |
| Vehicle expense | 2,365 |
| Repair and maintenance | 18,995 |
| Professional fees | 11,281 |
| Insurance | 7,309 |
| License and permits | 3,560 |
| Office | 7,205 |
| Rent | 6,350 |
| Utilities and telephone | 42,142 |
| Depreciation | <u>119,903</u> |

 Total operating expenses 327,110

 Operating income (loss) 83,960

NON-OPERATING REVENUE (EXPENSES)

| | |
|------------------------------------|-----------------|
| Amortization of debt issue cost | (1,700) |
| Investment earnings | 2,169 |
| Interest on notes payable and fees | <u>(66,759)</u> |

 Total non-operating revenue (expenses) (66,290)

Change in net assets 17,670

Total net assets, beginning 715,782

Total net assets, ending \$ 733,452

See accompanying notes to financial statements.

RURAL SEWER DISTRICT NUMBER 1
 ROGERS COUNTY
 VERDIGRIS, OKLAHOMA
 STATEMENT OF CASH FLOWS
 FOR THE YEAR ENDED JUNE 30, 2011

| | |
|--|-------------------|
| Cash flows from operating activities | |
| Cash received from customers | \$ 408,887 |
| Cash payments to suppliers for goods and services | <u>(208,566)</u> |
| Net cash provided (used) by operating activities | <u>200,321</u> |
| Cash flows from capital and related financing activities | |
| Acquisition of fixed assets | (240,115) |
| Interest paid on notes payable and fiscal fees | (66,759) |
| Principal paid on notes payable | <u>(61,346)</u> |
| Net cash used for capital and related financing activities | <u>(368,220)</u> |
| Cash flows from investing activities | |
| Transfer from investments | 994 |
| Investment earnings | <u>2,169</u> |
| Net cash provided by investing activities | <u>3,163</u> |
| Net decrease in cash and cash equivalents | (164,736) |
| Cash and cash equivalents, beginning | <u>434,868</u> |
| Cash and cash equivalents, ending | <u>\$ 270,132</u> |
| Reconciliation of operating income (loss) to net cash provided by (used) by operating activities | |
| Operating income (loss) | \$ 83,960 |
| Adjustments to reconcile operating income to net cash used by operating activities: | |
| Depreciation | 119,903 |
| Changes in assets and liabilities: | |
| Increase in accrued receivables | (2,183) |
| Increase in prepaid expense | (71) |
| Decrease in accounts payable | <u>(1,288)</u> |
| Net cash provided by operating activities | <u>\$ 200,321</u> |

See accompanying notes to financial statements.

RURAL SEWER DISTRICT NUMBER 1
ROGERS COUNTY
VERDIGRIS, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rural Sewer District Number 1 (the "District") was created by the Board of County Commissioners of Rogers County, Oklahoma under the provisions of the Rural Water Districts Act (Title 82, Oklahoma Statutes 1961, Sections 1301 to 1321). The District is managed by the five member Board of Directors. Members of the board are elected by the membership of the District at annual meetings. Membership in the District is attained by purchasing membership benefit units and receiving services from the District. The activities of the District constitute the entire reporting entity. There are no other component or oversight units.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The District's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

The financial statements report using the economic resources measurement focus and the accrual basis of accounting. Reimbursements are reported as reductions to expenses. Revenues are recorded when earned and expenses recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating income reported in financial statements include revenues and expenses related to the primary, continuing operations of the District. Principal operating revenues are charges to customers for sales or services. Principal operating expenses are the cost of providing goods or services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

FUND TYPES AND MAJOR FUNDS

The District is reported as a single enterprise fund.

Investments

The District follows Governmental Accounting Standards Board (GASB) Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," which requires marketable securities to be carried at fair value. The District considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The District's investments consist of a certificate of deposit.

RURAL SEWER DISTRICT NUMBER 1
ROGERS COUNTY
VERDIGRIS, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventories and Prepaids

Inventories consist of expendable supplies held for consumption stated on a first-in, first-out basis. They are reported at cost which is recorded as an expenditure at the time individual inventory items are used. The District has not maintained inventory records, however, the value of inventory on hand at June 30, 2011 is not believed to be material.

Prepaids record payments to vendors that benefit future reporting periods and are also reported on the consumption basis.

Capital Assets, Depreciation, and Amortization

The District's property, plant, and equipment, with useful lives of more than one year are stated at historical cost and comprehensively reported in the financial statements. Donated assets are stated at fair value on the date donated. The District generally capitalizes assets with cost of \$2,500 or more as purchase and construction outlays occur. The cost of normal maintenance and repairs that do not add to the assets value or materially extend useful lives are not capitalized. Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are moved from the respective accounts, and the resulting gain or loss is recorded in operations.

Estimated useful lives, in years, for depreciable assets are as follow:

| | |
|-------------------------------------|------|
| Buildings | 5-60 |
| Improvements, other than buildings | 2-50 |
| Mobile equipment | 3-40 |
| Furniture, machinery, and equipment | 3-30 |
| Utility system | 5-50 |

Reserves and Designations

Reserves represent those portions of net assets not available for expenditure or legally segregated for a specific future use. Designated net assets represent tentative plans for future use of financial resources.

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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

RURAL SEWER DISTRICT NUMBER 1
ROGERS COUNTY
VERDIGRIS, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

NOTE B - DEPOSITS WITH FINANCIAL INSTITUTIONS AND INVESTMENTS

Custodial Credit Risk

Custodial credit risk is the risk that in the event of failure of counterparty, the District will not be able to recover the value of its deposits or investments. Deposits are exposed to custodial credit risk if they are uninsured and uncollateralized. Investment securities are exposed to custodial credit risk if they are uninsured, are not registered in the name of the District, and are held by counterparty or the counterparty's trust department but not in the name of the District. The District's policy requires that all deposits and investments in excess of amounts covered by federal deposit insurance be fully collateralized by the entity holding the deposits or investments. As of June 30, 2011, all of the Districts deposits and investments were either covered by federal deposit insurance or were fully collateralized.

Deposits

The District had deposits at financial institutions with a carrying amount of approximately \$320,235 at June 30, 2011. The bank balance of the deposits at June 30, 2011 was approximately \$320,235.

Credit Risk

Fixed-income securities are subject to credit risk. However, the District did not have fixed income securities at June 30, 2011.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Board of Directors monitor's the investment performance on an ongoing basis to limit the District's interest rate risk. As of June 30, 2011, the District's deposits consisted of demand deposits and certificates of deposit with a maturity of 12 months or less.

Note C - ACCOUNTS RECEIVABLE

The District records the total due on accounts owed for services unpaid at June 30. Any uncollectible amounts are written-off as they become uncollectible. The District believes any amount of uncollected receivables will not be material.

Note D - RESTRICTED ASSETS

The District has restricted certain assets held in accounts of a trustee bank obtained as a result of the issue of its revenue bonds. The accounts are to be used for a debt reserve and a sinking fund for use in paying debt principal and interest. Amounts are as follows:

| | |
|-----------------------------|-------------------|
| Restricted for debt service | \$ 197,734 |
| Total | <u>\$ 197,734</u> |

RURAL SEWER DISTRICT NUMBER 1
 ROGERS COUNTY
 VERDIGRIS, OKLAHOMA
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011

Note E - PREPAID EXPENSE

The District records insurance premiums paid for future periods as prepaid expense.

Note F - CAPITAL ASSETS

The following table provides a summary of changes in capital assets:

| | <u>CAPITAL ASSETS, DEPRECIATED</u> | | | | <u>Assets Not Depreciated Land</u> |
|--------------------------|------------------------------------|--|--|---------------------|--|
| | <u>Buildings</u> | <u>Improvements Other Than Buildings</u> | <u>Furniture, Machinery, And Equipment</u> | <u>Totals</u> | |
| Balance, June 30, 2010 | \$ 9,280 | \$ 2,618,346 | \$ 215,063 | \$ 2,842,689 | \$ - |
| Increases | 200,252 | 39,863 | - | 240,115 | 46,325 |
| Decreases | - | - | - | - | - |
| Balance, June 30, 2011 | <u>209,532</u> | <u>2,658,209</u> | <u>215,063</u> | <u>3,082,804</u> | |
| Accumulated Depreciation | | | | | |
| Balance, June 30, 2010 | 232 | 1,118,822 | 115,623 | 1,234,677 | |
| Increase | 464 | 103,050 | 16,389 | 119,903 | |
| Decreases | - | - | - | - | |
| Balance, June 30, 2011 | <u>696</u> | <u>1,221,872</u> | <u>132,012</u> | <u>1,354,580</u> | |
| Capital Assets, Net | <u>\$ 208,836</u> | <u>\$ 1,436,337</u> | <u>\$ 83,051</u> | <u>\$ 1,728,224</u> | <u>\$ 46,325</u> |

Note G - DEFERRED DEBT EXPENSE

The Verdigris Public Works Authority (the Authority), Verdigris, Oklahoma issued its Capital Improvement Revenue Bonds, Series 2003, dated October 1, 2003, in the amount of \$490,000. The purpose of the bond issue was to provide funds for constructing office facilities to be leased to the District and to provide improvements to the District's sewer system. The District signed a guaranty agreement for the bonds on September 1, 2003. Payments of debt service requirements are made directly from the District to the trustee bank. The District, based on the use of the funds and the guarantee, has reported the bond issue as a note payable.

The bond issue had costs relating to the issuance of the bonds totaling \$19,288 and a bond discount of \$14,700. These costs are being amortized over the 20 year life of the bond issue. The District recorded \$1,700 amortization cost during the current period. Net deferred debt expense at June 30, 2011 was \$20,813.

RURAL SEWER DISTRICT NUMBER 1
 ROGERS COUNTY
 VERDIGRIS, OKLAHOMA
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011

Note H - NOTES PAYABLE

The District has incurred indebtedness for the expansion of system facilities. The following is a summary of note payable transactions for the year ended June 30, 2011.

| | Payable at <u>July 1, 2010</u> | Addition/ <u>Retirements</u> | Balance at <u>June 30, 2011</u> |
|-----------------------|-----------------------------------|---------------------------------|------------------------------------|
| Rural Development | \$ 643,701 | \$ (15,806) | \$ 627,895 |
| Water Resources Board | 418,121 | (30,540) | 387,581 |
| Revenue Bonds | 415,000 | (15,000) | 400,000 |
| | <u>\$ 1,476,822</u> | <u>\$ (61,346)</u> | <u>\$ 1,415,476</u> |

A brief description of the outstanding notes payable at June 30, 2011 is set forth below:

| <u>Outstanding</u> | <u>Amount</u> |
|---|---------------------|
| Rural Development loan number 9201, dated February 9, 1994, original loan amount of \$781,700, interest rate of 5.375%, term of 40 years, monthly installments of \$4,034 until February 2034 | \$ 627,895 |
| Oklahoma Water Resources Board loan dated June 13, 2001, original loan amount of \$630,000, interest rate 3.2%, principal payments vary, matures in September 2021 | 387,581 |
| Revenue bonds through The Verdigris Public Works Authority dated October 1, 2003 in the amount of \$490,000, interest rate 4% to 6.25%, principal payable annually until October 2023 | <u>400,000</u> |
| Total | 1,415,476 |
| Less current portion | <u>66,409</u> |
| Net non-current portion | <u>\$ 1,349,067</u> |

The annual debt service requirement including principal and interest, is as follows:

| <u>June 30</u> | <u>Year Ended</u> | | <u>Total</u> |
|----------------|---------------------|-------------------|---------------------|
| | <u>Principal</u> | <u>Interest</u> | |
| 2012 | \$ 66,409 | \$ 59,927 | \$ 126,336 |
| 2013 | 68,294 | 62,919 | 131,213 |
| 2014 | 70,225 | 60,064 | 130,289 |
| 2015 | 72,239 | 57,132 | 129,371 |
| 2016 | 74,318 | 54,137 | 128,455 |
| 2017-2021 | 446,494 | 222,680 | 669,174 |
| 2022-2026 | 323,811 | 123,540 | 447,351 |
| 2027-2031 | 185,978 | 56,062 | 242,040 |
| 2032-2034 | 107,708 | 7,572 | 115,280 |
| Total | <u>\$ 1,415,476</u> | <u>\$ 704,033</u> | <u>\$ 2,119,509</u> |

The District has a loan reserve for the Rural Development loan in the amount of \$48,408. This amount equals the annual payment required on the note.

RURAL SEWER DISTRICT NUMBER 1
ROGERS COUNTY
VERDIGRIS, OKLAHOMA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

Note I - DEBT SERVICE COVERAGE

The Oklahoma Water Resource Board loan requires the District maintain a schedule of charges, fees, and rates sufficient to produce annual net revenues not less than 1.25 times annual debt service requirements after payment of all operating and maintenance expense.

Ratio of net revenue to debt service follows:

| | |
|------------------------------------|-------------------|
| Operating Revenue | \$ 411,070 |
| Operating Expenses | <u>(207,207)</u> |
| Revenue Available For Debt Service | <u>\$ 203,863</u> |
| Annual Debt Service | <u>\$ 131,213</u> |
| Coverage Ratio | 1.56 to 1 |

Note J - EMPLOYEE BENEFITS

The District operates through contracted services. It does not have employees.

Note K - 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; and natural disasters. The District carries commercial insurance for risk of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note L - LITIGATION

The District is party to various legal proceedings which normally occur in governmental operations. These legal proceedings are not likely to have a material adverse impact on the District. The District retains legal council for legal proceedings. The District may also be represented by attorneys retained by its insurance carrier.

Note M - FEDERAL AND STATE GRANTS

In the normal course of operations, the District receives grant funds from various federal and state agencies. The grant programs are subject to audit by agents of the granting authorities the purpose of which is to ensure compliance with conditions precedent to the granting of the funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

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*

To the Board of Directors
Rural Sewer District Number 1
Verdigris, Oklahoma

I have audited the financial statements of the business-type activities of Rural Sewer District Number 1, Rogers County, Verdigris, Oklahoma, as of and for the year ended June 30, 2011, which collectively comprise Rural Sewer District Number 1's basic financial statements and have issued my report thereon dated October 3, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered Rural Water District Number 2, Okmulgee County, Preston, Oklahoma's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Rural Water District Number 2, Okmulgee County, Preston, Oklahoma's internal control over financial reporting. Accordingly, I do not express an opinion of the effectiveness of Rural Water District Number 2, Okmulgee County, Preston, Oklahoma'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 Rural Sewer District Number 1, Rogers County, Verdigris, Oklahoma'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*.

This report is intended solely for the information and use of management, the Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,



Ralph Osborn
Certified Public Accountant
Bristow, Oklahoma
October 3, 2011