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State Auditor & Inspector

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**BASIC FINANCIAL STATEMENTS
June 30, 2011**

**RURAL WATER DISTRICT No. 4
PAYNE COUNTY
Yale, Oklahoma**

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INDEPENDENT AUDITOR'S REPORT

September 23, 2011

Board of Directors
Rural Water District No. 4
Payne County
Yale, Oklahoma

We have audited the accompanying financial statements of Rural Water District No. 4, Payne County, Yale, Oklahoma (the District), as of and for the year ended June 30, 2011 and 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District'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 the 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 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. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rural Water District No. 4, Payne County, Yale, Oklahoma as of June 30, 2011 and 2010, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principals generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 23, 2011, on our consideration of the Rural Water District No. 4's internal control over financial reporting and 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 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 District has not presented the Management's Discussion and Analysis required by the Governmental Accounting Standards Board (GASB) that the GASB has determined is necessary to supplement, although not required to be part of, the basic financial statements.

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**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**STATEMENT OF NET ASSETS
June 30, 2011 and 2010**

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Assets:		
Cash and cash equivalents (Note 1)	\$ 131,851	\$ 121,527
Receivables (net of allowance for uncollectible of \$646)	28,174	25,375
Accrued interest receivable	79	131
Prepaid insurance	2,376	2,186
Investments	84,349	83,453
OWRA reserves	1,000	1,000
Temporarily restricted:		
Cash and cash equivalents (Note 2)	6,192	6,192
Capital assets:		
Water system, improvements and equipment, net of depreciation (Note 4)	<u>228,683</u>	<u>246,743</u>
Total assets	<u><u>\$ 482,704</u></u>	<u><u>\$ 486,607</u></u>
Liabilities:		
Accounts payable	\$ 1,129	\$ 3,466
Accrued water purchases	2,097	1,956
Accrued interest payable	73	82
Notes payable (Note 3)	<u>33,168</u>	<u>37,564</u>
Total liabilities	<u><u>36,467</u></u>	<u><u>43,068</u></u>
Net assets:		
Invested in capital assets, net of related debt	195,515	209,179
Temporarily restricted (Note 2)	6,192	6,192
Unrestricted	<u>244,530</u>	<u>228,168</u>
Total net assets	<u><u>\$ 446,237</u></u>	<u><u>\$ 443,539</u></u>

The accompanying notes are an integral part of the basic financial statements.

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**STATEMENT OF ACTIVITIES
For the Years Ended June 30, 2011 and 2010**

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Revenues:		
Water sales	\$ 177,266	\$ 156,935
Installation income	5,226	3,082
Membership income	<u>2,100</u>	<u>2,050</u>
Total revenues	<u>184,592</u>	<u>162,067</u>
Expenses:		
Accounting and legal	4,155	4,055
Advertising	240	-
Bookkeeping services	9,600	9,600
Depreciation	18,060	19,218
Dues and subscriptions	797	602
Insurance	2,272	1,895
Lab tests	260	2,040
Map Fees	-	-
Miscellaneous	352	179
Office supplies and postage	395	-
Repair and maintenance	13,402	25,376
Supplies	11,739	19,693
Subcontractor labor	27,096	21,351
Telephone	3,600	4,225
Water purchases	<u>89,787</u>	<u>73,099</u>
Total expenses	<u>181,755</u>	<u>181,333</u>
Operating income (loss)	<u>2,837</u>	<u>(19,266)</u>
Other income and expense:		
Interest income	1,647	2,072
Interest expense	<u>(1,786)</u>	<u>(2,029)</u>
Total other income and expense	<u>(139)</u>	<u>43</u>
Net income (loss)	2,698	(19,223)
Net assets - beginning of year	<u>443,539</u>	<u>462,762</u>
Net assets - end of year	<u>\$ 446,237</u>	<u>\$ 443,539</u>

The accompanying notes are an integral part of the basic financial statements.

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**STATEMENT OF CHANGES IN NET ASSETS
For the Years Ended June 30, 2011 and 2010**

	<u>Net Assets (Unrestricted)</u>	<u>Net Assets (Temporarily Restricted)</u>	<u>Total Net Assets</u>
Balance - beginning of year 6-30-09	456,570	6,192	462,762
Change in net assets	<u>(19,223)</u>	<u>-</u>	<u>(19,223)</u>
Balance - end of year 6-30-10	\$ <u>437,347</u>	\$ <u>6,192</u>	\$ <u>443,539</u>
Balance - beginning of year 6-30-10	437,347	6,192	443,539
Change in net assets	<u>2,698</u>	<u>-</u>	<u>2,698</u>
Balance - end of year 6-30-11	\$ <u>440,045</u>	\$ <u>6,192</u>	\$ <u>446,237</u>

The accompanying notes are an integral part of the basic financial statements.

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**STATEMENT OF CASH FLOWS
For the Years Ended June 30, 2011 and 2010**

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Cash flows from operating activities:		
Cash received from customers	\$ 181,842	\$ 164,001
Cash payments to suppliers for goods and contractors and other services	<u>(166,078)</u>	<u>(160,616)</u>
Net cash provided by operating activities	<u>15,764</u>	<u>3,385</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	-	(8,024)
Release of restriction on reserve account	-	-
Principal paid on debt	(4,396)	(4,246)
Interest paid on debt	<u>(1,796)</u>	<u>(1,947)</u>
Net cash used in capital and related financing activities	<u>(6,192)</u>	<u>(14,217)</u>
Cash flows from investing activities:		
Interest income	<u>752</u>	<u>781</u>
Net cash provided by investing activities	<u>752</u>	<u>781</u>
Net increase (decrease) in cash	10,324	(10,051)
Cash and cash equivalents at beginning of year	<u>121,527</u>	<u>131,578</u>
Cash and cash equivalents at end of year	<u><u>\$ 131,851</u></u>	<u><u>\$ 121,527</u></u>
Reconciliation of operation income to net cash provided by operating activities:		
Operating income (loss)	\$ <u>2,837</u>	\$ <u>(19,266)</u>
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	18,060	19,218
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	(2,750)	1,934
(Increase) decrease in prepaid expenses	(190)	(490)
Increase (decrease) in accounts payable	(2,334)	3,466
Increase (decrease) in accrued water purchases	<u>141</u>	<u>(1,477)</u>
Total adjustments	<u>12,927</u>	<u>22,651</u>
Net cash provided by operating activities	<u><u>\$ 15,764</u></u>	<u><u>\$ 3,385</u></u>

The accompanying notes are an integral part of the basic financial statements.

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Assets, Liabilities and Equity (Continued)

1. Deposits and Investments (Continued)

Custodial Credit Risk

At June 30, 2011, the District held deposits of approximately \$222,392 at financial institutions. The District's cash deposits, including interest-bearing certificates of deposit, are entirely covered by Federal Depository Insurance (FDIC) or direct obligation of the U.S. Government insured or collateralized with securities held by the District or by its agent in the District's name.

Investment Interest Rate Risk

The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Investment Credit Risk

The District has no policy that limits its investment choices other than the limitation of state law as follows:

- a. Direct obligations of the U.S. Government, its agencies and instrumentalities to which the full faith and credit of the U.S. Government is pledged, or obligations to the payment of which the full faith and credit of the State is pledged.
- b. Certificates of deposits or savings accounts that are either insured or secured with acceptable collateral with in-state financial institutions, and fully insured certificates of deposit or savings accounts in out-of-state financial institutions.
- c. With certain limitation, negotiable certificates of deposit, prime bankers acceptances, prime commercial paper and repurchase agreements with certain limitations.
- d. County, municipal or school district tax supported debt obligations, bond or revenue anticipation notes, money judgments, or bond or revenue anticipation notes of public trusts whose beneficiary is a county, municipality or school district.
- e. Notes or bonds secured by mortgage or trust deed insured by the Federal Housing Administrator and debentures issued by the Federal Housing Administrator, and in obligations of the National Mortgage Association.
- f. Money market funds regulated by the SEC and in which investments consist of the investments mentioned in the previous paragraphs (a.-d.).

The investments held at June 30, 2011 are as follows:

Type	Weighted Average Maturity (Months)	Credit Rating	Market Value	Cost
Investments				
Certificates of deposit	12.00	N/A	\$ 84,349	\$ 84,349
Total investments			<u>\$ 84,349</u>	<u>\$ 84,349</u>

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Assets, Liabilities and Equity (Continued)

1. Deposits and Investments (Continued)

Concentration of Investment Credit Risk

The District places no limit on the amount it may invest in any one issuer. The District has the following of credit risk: 100% in Certificates of Deposit (\$84,349).

2. Fair Value of Financial Instruments

The District's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and notes payable. The District's estimate of the fair value of all financial instruments does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying statement of net assets. The carrying amount of these financial instruments approximates fair value because of the short maturity of these instruments.

3. Estimates

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

4. Inventories

Inventories consist primarily of water stored in lines for use in the distribution process. Inventory is expensed when purchased.

5. Capital Assets

Additions to the water storage delivery system and other equipment are recorded at cost or, if contributed property, at their estimated fair value at time of contribution. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized. The District does not currently have a capitalization policy in place.

Depreciation has been calculated on each class of depreciable property using the straight-line method. Estimated useful lives are as follows:

Water system	40 years
Line additions	35 years
Equipment	10 years
Office equipment	10 years

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011 and 2010**

2. TEMPORARILY RESTRICTED ASSETS

Under the terms of the various note indentures with Rural Development, the District is required to make monthly contributions into a reserve account until a minimum balance of \$6,192 has been reached. The funds are temporarily restricted and are to be used for repairing or replacing damaged assets caused by unforeseen catastrophes. With prior written approval from Rural Development, the reserve funds can also be used for making improvements to the water system or for debt service. The balance at the end of the year was \$6,192.

3. LONG-TERM DEBT

Long-term debt consists of two notes with the United States Department of Agriculture, Rural Development (RD). The RD notes were issued during November 1978. The notes are secured by the water works system including distribution lines, pump stations and reservoirs. These RD notes are listed as follows:

Loan # 91-04 – Original amount of \$67,000, payable in monthly installments of \$329.00 for 40 years at 5% interest, maturing in November of 2018.

Loan # 91-06 – Original amount of \$38,000 payable in monthly installments of \$187 for 40 years at 5% interest, maturing in November of 2018.

The following is a summary of long-term debt transactions during the year:

	Balance June 30, 2010	Additions	Reductions	Balance June 30, 2011
USDA Rural Dev. - 91-04	24,076	-	2,796	21,280
USDA Rural Dev. - 91-06	13,488	-	1,600	11,888
Total	<u>\$ 37,564</u>	<u>\$ -</u>	<u>\$ 4,396</u>	<u>\$ 33,168</u>

	Balance June 30, 2009	Additions	Reductions	Balance June 30, 2010
USDA Rural Dev. - 91-04	26,777	-	2,701	24,076
USDA Rural Dev. - 91-06	15,033	-	1,545	13,488
Total	<u>\$ 41,810</u>	<u>\$ -</u>	<u>\$ 4,246</u>	<u>\$ 37,564</u>

Annual cash requirements to amortize these notes are as follows:

Year Ending June 30,	Payments Due
2012	6,192
2013	6,192
2014	6,192
2015	6,192
2016	6,192
2017-2018	12,384
Total	43,344
Less interest	(10,176)
Note balance	<u>\$ 33,168</u>

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011 and 2010**

3. LONG-TERM DEBT (Continued)

The District's debt service coverage ratios for June 30, 2011 and 2010 are 0.44% and -3.11% respectively.

	2011	2010
Net Operating Income	2,695	(19,266)
Annual Debt	6,192	6,192
Debt Coverage Ratio	0.44	(3.11)

4. CAPITAL ASSETS

The following is a summary of changes in property, plant and equipment.

	Balance June 30, 2010	Additions	Deletions	Balance June 30, 2011
Water System	\$ 687,600	\$ -	\$ -	\$ 687,600
Office Equipment	2,838	-	-	2,838
Total	690,438	-	-	690,438
Less accumulated depreciation	443,694	18,060	-	461,754
Net Capital Assets	\$ 246,744	\$ (18,060)	\$ -	\$ 228,684

	Balance June 30, 2009	Additions	Deletions	Balance June 30, 2010
Water System	\$ 679,576	\$ 8,024	\$ -	\$ 687,600
Office Equipment	2,838	-	-	2,838
Total	682,414	8,024	-	690,438
Less accumulated depreciation	424,476	19,218	-	443,694
Net Capital Assets	\$ 257,938	\$ (11,194)	\$ -	\$ 246,744

5. RISK MANAGEMENT

Rural Water District No. 4 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 continues to carry commercial insurance for these risks, including general and auto liability, property damage, and public officials liability. Settled claims resulting from these risks have not exceeded the commercial insurance coverage in any of the past three fiscal years.

6. WATER PURCHASE COMMITMENT

The governing board of Rural Water District No. 4, Payne County, Yale, Oklahoma, together with seven other cities and rural water districts located in Noble, Pawnee, and Payne Counties, Oklahoma, have jointly formed Lone Chimney Water Association. The purpose of the Association is to provide a water system for the benefit of its members and other users. The District has entered into various loan agreements with the United States Department of Agriculture, Rural Development and the Oklahoma Water Resources board to provide financing for the facility. Under the terms of the agreement regarding Rural Water District No. 4, each member has contracted to purchase a minimum amount of water from the Association during the 40-year term of the notes. In addition, each individual

RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma

NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011 and 2010

6. WATER PURCHASE COMMITMENT (Continued)

member is proportionately liable for any debts that exceed the assets of the Association to the extent of one and one-half times the percentage of ownership interest held by the entity pursuant to the agreement. The District is contingently liable for approximately 8% of the obligations of the Association, which total approximately \$2,062,063 to Rural Development and \$549,552 to ORWB at year-end. The District's contingent share of Lone Chimney Water Association's debt is \$208,929.

At June 30, 2011, Rural Water District No. 4 was obligated to purchase a minimum of 25.2 million gallons of water annually, currently at a cost of \$63,000. The rates charged for the water can be adjusted every three years as necessary to provide sufficient revenues for the Association.

Future purchase commitments at current rates are as follows:

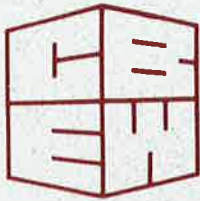
<u>June 30,</u>	<u>Amounts</u>
	<u>Due</u>
2012	\$ 63,000
2013	63,000
2014	63,000
2015	63,000
2016	63,000
2017-2021	315,000
2022-2026	315,000
2027-2031	315,000
2032	63,000
Total	\$ <u>1,323,000</u>

7. SUBSEQUENT EVENTS

Subsequent events have been evaluated through September 23, 2011, which is the date the financial statements were available to be issued.

8. PRIOR PERIOD COMPARISON

Prior period balances were stated based on prior year's audit, including minor adjustments due to formula driven calculation errors.



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**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**

September 23, 2011

Board of Directors
Rural Water District No. 4
Payne County
Yale, Oklahoma

We have audited the basic financial statements of the Rural Water District No. 4, Payne County, Yale, Oklahoma (the District), as of and for the year ended June 30, 2011, and have issued our report thereon dated September 23, 2011. 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. The District did not present the Management's Discussion and Analysis required by the Governmental Accounting Standards Board.

Internal Control Over Financial Reporting

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

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.

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. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies in internal control over financial reporting. The finding reference numbers are 11-01, 11-02 and 11-03. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District'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*.

The District's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's response and, according, we express no opinion on it.

We also noted a certain immaterial additional matter that we have reported to Board of the District in a separate letter dated September 23, 2011.

This report is intended solely for the information and use of management, all applicable federal and state agencies, and is not intended to be and should not be used by anyone other than these specified parties.

CBEW Professional Group, LLP

CBEW Professional Group, LLP
Certified Public Accountants

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended June 30, 2011**

11-1. Internal Control – Segregation of Duties

Criteria: The segregation of duties and responsibilities between different individuals for custody of assets, recordkeeping for those assets and reconciliation of those asset accounts is an important control activity needed to adequately protect the district's assets and ensure accurate financial reporting.

Condition: Presently the same individual that receives utility service related cash payments is also responsible for service billing and adjustment, also balances the daily cash drawer, posts payments to subsidiary accounts receivable ledger and reconciles the monthly bank statements. In addition, only limited oversight is provided over this individual in the conduct of their daily functions. This finding was also noted in 2009.

Cause: The district's limited size and staffing resources have made it difficult for management to provide sufficient staffing to fully segregate incompatible duties in a cost-effective manner.

Effect or Potential Effect: Without sufficient segregation of duties, the risk significantly increases that errors and fraud related to utility billing and collection activities, including misappropriation of assets, could occur and not be detected within a timely basis.

Recommendation: We recommend that management and the board should consider a formal evaluation of their risks associated with this lack of duties segregation over utility cash and receivables. In response to the identified risks, consideration should be given to identifying and implementing controls that could help mitigate the risks associated with lack of segregation of duties, such as providing increased management oversight and an independent reconciliation of accounts. For example, the entity might consider soliciting the assistance of independent volunteer labor to perform certain functions including performing compensating procedures where applicable.

Responsible Official's Response: The district concurs with the recommendation, although, the cost to correct this condition might exceed the benefit, the district has made certain changes in procedures that will improve the overall lack of segregation of duties and has implemented compensating procedures as appropriate.

11-2. Internal Control – Financial Statements

Criteria: The district's management is responsible for internal controls over financial reporting. This includes controls over the fair and complete presentation of the government's annual financial statements in accordance with GAAP. The preparation of financial statements in accordance with GAAP requires internal controls over both (1) recording, processing and summarizing accounting data (i.e., maintaining internal books and records), and (2) reporting government-wide and fund financial statements, including the related footnotes (i.e., external financial reporting). Professional audit standards clearly indicate that the external financial statement auditor cannot take responsibility for any part of management's control activities or be a component of the internal controls over financial reporting.

Condition: As is the case with many smaller and medium-sized entities, the district has historically relied extensively on its independent external auditors to provide the needed expertise to assist in the preparation of the financial statements and footnotes. However, management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting, even if the auditor assists in drafting the financial statements. Accordingly the district's ability to prepare financial statements in accordance with generally accepted accounting principles (GAAP) is based, in part, on assistance from its external auditors, who cannot by definition be considered a part of the district's internal controls. This finding was also noted in 2009.

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended June 30, 2011**

Cause: District personnel do not possess formal knowledge, expertise and education relative to preparing GAAP financial statements and related disclosures without assistance from the external auditor or another outside source. Professional standards do not require that the management possess the expertise to prepare the financial statements but to have the skills to understand them. As a result, management was able to review the financial statements and related note disclosures and sufficiently understand them to take full responsibility for them as required by professional standards.

Effect or Potential Effect: As a result of this condition, without assistance from its external auditors or another outside source, the district may lack the necessary internal controls over the preparation of financial statements in accordance with GAAP. This condition could also place the auditor in a questionable position regarding auditor independence.

Recommendation: We recommend that the district consider designing and implementing sufficient internal controls over financial reporting by obtaining the necessary knowledge, expertise and continuing education to prepare financial statements in accordance with generally accepted accounting principles without assistance from the external financial statement auditor. This could be achieved through employment of qualified accounting staff or the outsourcing of these control activities to a qualified accounting firm other than the external auditor.

Responsible Official's Response: The district concurs with the recommendation, and will strive to expand their knowledge and understanding of the presentation and disclosure requirements of the financial statements.

11-3. Internal Control – Material Adjusting Journal Entries

Criteria: The district's management is responsible for internal controls over accounting and financial reporting. This responsibility includes the design and implementation of controls over the fair and complete presentation of the district's annual financial statements in accordance with generally accepted accounting principles (GAAP) from trial balances derived from the district's accounting records. For trial balances to be both complete and accurate, the district must have effective internal controls over recording, processing, summarizing, and adjusting accounting data. As evidence of effective internal controls over accounting and financial reporting, there should generally be few, if any, material adjustments to the trial balances required that are detected and corrected solely as a result of the financial statement audit. In other words, district management should not rely on the external auditor to detect and correct material misstatements in the books and records as part of its internal controls, but rather should have its own procedures designed and in place that are independent of the external auditor to provide reasonable, although not absolute, assurance that material misstatements will be detected and corrected in its trial balances prior to audit.

Condition: The district's trial balances for the year ended December 31, 2010, required a number of material adjusting journal entries in order for the financial statements to be prepared in accordance with GAAP. These necessary adjusting entries, identified solely as a result of the financial statement audit, included such adjustments as the following: Capitalize asset expenditures, interest payments on notes, depreciation, and accounts receivable. This finding was also noted in 2009.

Cause: The district's accounting and financial reporting staff does not possess the formal knowledge, expertise and education, relative to the complex nature of applying GAAP applicable to state and local governments, sufficient to provide reasonable assurance that the trial balances used for preparing the GAAP financial statements are complete and accurate prior to audit. As a result, management has had to rely on the external auditors to identify and correct a number of material misstatements in the trial balances. However, as required by professional standards, management had the capacity to review, understand and accept the adjusting entries proposed by the auditor in order to take full responsibility for them and the related financial statements.

**RURAL WATER DISTRICT NO. 4
PAYNE COUNTY
Yale, Oklahoma**

**SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended June 30, 2011**

Effect or Potential Effect: As a result of this condition, without assistance from its external auditors, the district lacks the necessary internal controls over the completeness and accuracy of the trial balances that are used in the preparation of its financial statements in accordance with GAAP. This condition can result in undetected and uncorrected material misstatements in the financial statements that are not detected by management and may also not be detected by the financial statement audit. In addition, if management's intentions are to continue to rely on the external auditor to detect and correct material misstatements, this condition could place the auditor in a questionable position regarding auditor independence since management is responsible for the completeness and accuracy of the financial statements.

Recommendation: The district should consider designing and implementing sufficient internal controls over the completeness and accuracy of trial balances by obtaining additional knowledge, expertise, and continuing education to apply GAAP in the development of working trial balances that will be used to prepare the district's annual financial statements. This could be achieved through employment of qualified accounting staff or the outsourcing of these control activities to a qualified accounting firm other than the external auditor.

Responsible Official's Response: The district concurs with the recommendation, and will strive to expand their knowledge and understanding to identify and correct material misstatements timely in order to prepare complete and accurate financial statements.