

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY  
OKEMAH, OKLAHOMA  
ANNUAL FINANCIAL REPORT  
NOVEMBER 30, 2011

RALPH OSBORN  
CERTIFIED PUBLIC ACCOUNTANT  
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INDEPENDENT AUDITORS' REPORT

Board of Directors  
Rural Water District Number 2  
Okfuskee County  
Okemah, Oklahoma

I have audited the accompanying financial statements of the business-type activities of Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma as of and for the year ended November 30, 2011, which collectively comprise Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma's basic financial statements. These financial statements are the responsibility of Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma'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.

As discussed in Note A, Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma prepares its financial statements on a modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position-modified cash basis of the business-type activities of Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma as of November 30, 2011, and the respective changes in financial position-modified cash basis and cash flows thereof for the year ended, in conformity with the basis of accounting described in Note A.

Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma 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 March 8, 2012, on my consideration of Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma'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*

Ralph Osborn  
Certified Public Accountant  
Bristow, Oklahoma  
March 8, 2012

RURAL WATER DISTRICT NUMBER 2  
 OKFUSKEE COUNTY, OKLAHOMA  
 STATEMENT OF NET ASSETS - MODIFIED CASH BASIS  
 NOVEMBER 30, 2011

ASSETS

Current assets:	
Cash and cash equivalents	\$ 186,706
Investments	249,191
Restricted assets:	
Investments	674,809
Reserve certificates	<u>45,000</u>
Total current assets	<u>1,155,706</u>
Non-current assets:	
Capital assets:	
Land	2,000
Other capital assets, net of accumulated depreciation	<u>941,744</u>
Total non-current assets	<u>943,744</u>
Total assets	<u>2,099,450</u>

LIABILITIES

Current liabilities:	
Utility deposits	32,466
Notes payable, current	<u>7,646</u>
Total current liabilities	<u>40,112</u>
Non-current liabilities:	
Notes payable, non-current	<u>196,345</u>
Total non-current liabilities	<u>196,345</u>
Total liabilities	<u>236,457</u>

NET ASSETS

Nonspendable	739,753
Restricted for insurance reserves	45,000
Assigned for capital projects	674,809
Unassigned	<u>403,431</u>
Net assets	<u>\$ 1,862,993</u>

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

RURAL WATER DISTRICT NUMBER 2  
 OKFUSKEE COUNTY, OKLAHOMA  
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS  
 MODIFIED CASH BASIS  
 FOR THE YEAR ENDED NOVEMBER 30, 2011

OPERATING REVENUES

Charges for services:

Water charges	\$ 470,183
New connections	24,451
Other	<u>7,513</u>

Total operating revenues 502,147

OPERATING EXPENSES

Personal services	77,708
Water purchases	219,355
Contract labor	35,287
Insurance	12,189
Repairs and maintenance	38,000
Office expense	8,827
Professional services	1,700
Other	6,560
Telephone and utilities	21,046
Depreciation	<u>71,958</u>

Total operating expenses 492,630

Operating income (loss) 9,517

NON-OPERATING REVENUE (EXPENSES)

Investment income	15,694
Interest on notes payable	<u>(10,396)</u>

Total non-operating revenue (expenses) 5,298

Net income (loss) 14,815

Total net assets, beginning 1,848,178

Total net assets, ending \$ 1,862,993

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

RURAL WATER DISTRICT NUMBER 2  
 OKFUSKEE COUNTY, OKLAHOMA  
 STATEMENT OF CASH FLOWS-MODIFIED CASH BASIS  
 FOR THE YEAR ENDED NOVEMBER 30, 2011

Cash flows from operating activities	
Cash received from customers	\$ 504,067
Cash payments to employees	(77,708)
Cash payments to suppliers for goods and services	<u>(342,964)</u>
Net cash provided (used) by operating activities	<u>83,395</u>
Cash flows from capital and related financing activities	
Acquisition of fixed assets	(12,778)
Interest paid on notes payable and fiscal fees	(10,396)
Principal paid on notes payable	<u>(7,256)</u>
Net cash provided by capital and related financing activities	<u>(30,430)</u>
Cash flows from investing activities	
Transferred to investments	(924,000)
Interest revenue	<u>15,694</u>
Net cash provided (used) by investing activities	<u>(908,306)</u>
Net decrease in cash and cash equivalents	(855,341)
Cash and cash equivalents, beginning	<u>1,042,047</u>
Cash and cash equivalents, ending	<u>\$ 186,706</u>
Reconciliation of operating income (loss)	
to net cash provided by (used) by operating activities	
Operating income (loss)	\$ 9,517
Adjustments to reconcile operating income to	
net cash used by operating activities:	
Depreciation	71,958
Changes in assets and liabilities:	
Increase in utility deposits	<u>1,920</u>
Net cash provided by operating activities	<u>\$ 83,395</u>

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

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY, OKLAHOMA  
NOTES TO FINANCIAL STATEMENTS  
NOVEMBER 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rural Water District Number 2 (the "District") was created February 26, 1969 by the Board of County Commissioners of Okfuskee County, Oklahoma under the provisions of the Rural Water District Act (Title 82 Oklahoma Statutes 1961, Sections 1301 to 1321). The District is managed by a six member Board of Directors and Chairman. Members of the board are elected by the membership of the District at its annual meeting. Membership in the District is attained by paying membership dues and receiving services from the District. The activities of the District constitute the entire reporting entity. There are no other component or oversight units. The District is a political subdivision of the state of Oklahoma.

Government-Wide and Fund Financial Statements

The District is a special purpose governmental entity engaged only in business type activities. The District prepares financial statements required for enterprise funds.

Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe "how" transactions are recorded within the various financial statements. Basis of accounting refers to "when" transactions are recorded regardless of the measurement focus applied.

Measurement Focus

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

Basis of Accounting

In the financial statements, business-like activities are presented using a modified cash basis of accounting. This basis recognizes assets, liabilities, net assets/fund equity, revenues, and expenditures/expenses when they result from cash transactions with a provision for depreciation. This basis is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY, OKLAHOMA  
NOTES TO FINANCIAL STATEMENTS  
NOVEMBER 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Accounting (Continued)

As a result of the use of this modified cash basis of accounting, certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, and accrued expenses and liabilities) are not recorded in these financial statements. If the Authority utilized the basis of accounting recognized as generally accepted, the financial statements would use the accrual basis of accounting.

FUND TYPES AND MAJOR FUNDS

The District reports all activity within a single fund.

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 investments reported in the financial statements consist of Certificates of Deposits.

Capital Assets, Depreciation, and Amortization

The District's property, plant, equipment, and infrastructure with useful lives of more than one year are stated at historical cost or at estimated historical cost for those items not previously reported. The District maintains infrastructure assets records consistent with all other capital assets. Donated assets are stated at fair value on the date donated. The District generally capitalizes assets with a cost of \$2,500 or more as purchase and construction outlay 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	5-60

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY, OKLAHOMA  
NOTES TO FINANCIAL STATEMENTS  
NOVEMBER 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Compensated Absences

Full-time, permanent employees are granted personal leave in varying amounts to specified maximums depending on tenure with the District. The District does not record a liability for accrued compensated absences. Using the modified cash basis the amount paid for compensated absences is expensed as paid.

Reserves and Designations

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

Use of Estimates

The preparation of financial statements in conformity with the modified cash basis 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.

NOTE B - CASH 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 November 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 \$1,110,706 at November 30, 2011. The bank balance of the deposits at November 30, 2011 was approximately \$1,111,879.

Credit Risk

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

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY, OKLAHOMA  
NOTES TO FINANCIAL STATEMENTS  
NOVEMBER 30, 2011

NOTE B - CASH AND INVESTMENTS (Continued)

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 November 30, 2011, the District's deposits consisted of demand deposits and certificates of deposit with a maturity of 12 months or less.

NOTE C - RESERVE CERTIFICATES

The District has purchased reserve certificates totaling \$45,000 from the Oklahoma Rural Water Association Assurance Group (the Group). These certificates are on deposit in the self-insurance reserves of the Group under the Agreement Establishing the Oklahoma Rural Water Association Assurance Group entered into pursuant to the Oklahoma Interlocal Cooperation Act. The District has insurance coverage other than the self-insurance of the group. Reserve certificates may be surrendered and the deposit refunded subject to certain time and notice requirements. The certificates accrue interest at a fluctuating rate on the basis of a 360-day year at the Treasury rate plus two percent per annum. The balance in the self-insurance reserve certificates is considered reserved net assets.

NOTE D - RESTRICTED INVESTMENTS

The District reports restricted investments for use as a depreciation reserve. These investments are to be used for expense related to replacing the water system.

NOTE E - CAPITAL ASSETS

Changes in capital assets.

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

	<u>CAPITAL ASSETS, DEPRECIATED</u>				<u>Capital Assets Not Depreciated Land</u>
	<u>Buildings</u>	<u>Infrastructure &amp; Improvements Other Than Buildings</u>	<u>Furniture, Machinery, And Equipment</u>	<u>Totals</u>	
<b>PRIMARY GOVERNMENT</b>					
Business-type activities					
Balance, June 30, 2010	\$ 24,518	\$ 2,624,706	\$ 53,565	\$ 2,702,789	\$ 2,000
Increases	-	12,778	-	12,778	-
Decreases	-	-	-	-	-
Balance, June 30, 2011	<u>24,518</u>	<u>2,637,484</u>	<u>53,565</u>	<u>2,715,567</u>	<u>2,000</u>
Accumulated Depreciation					
Balance, June 30, 2010	11,160	1,656,405	34,299	1,701,864	
Increases	569	68,912	2,478	71,959	
Decreases	-	-	-	-	
Balance, June 30, 2011	<u>11,729</u>	<u>1,725,317</u>	<u>36,777</u>	<u>1,773,823</u>	
Business-type activities					
Capital Assets, Net	<u>\$ 12,789</u>	<u>\$ 912,167</u>	<u>\$ 16,788</u>	<u>\$ 941,744</u>	<u>\$ 2,000</u>

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY, OKLAHOMA  
NOTES TO FINANCIAL STATEMENTS  
NOVEMBER 30, 2011

NOTE F - NOTES PAYABLE PROPRIETARY FUND

The District has incurred debt for the expansion of the water system. On May 18, 1989, the District signed a Promissory Note with the Farmers Home Administration, United States Department of Agriculture for a loan in the principal amount of \$299,500. Interest payments were made May 18, 1990 and May 18, 1991. Beginning June 18, 1991, payments in the amount of \$1,471 became payable monthly. The loan is for a term of forty years at 5% interest. The balance due on the loan at November 30, 2011 was \$203,991.

The annual debt service requirements for the note is \$17,652 including principal and interest. The District has reserve funds sufficient to equal the annual debt service requirement.

Following is the anticipated annual debt service amounts:

<u>Year Ended November 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 7,646	\$ 10,006	\$ 17,652
2013	8,037	9,615	17,652
2014	8,448	9,204	17,652
2015	8,880	8,772	17,652
2016	9,334	8,318	17,652
2017-2021	54,343	33,917	88,260
2022-2026	69,742	18,518	88,260
2027-2030	<u>37,562</u>	<u>2,332</u>	<u>39,894</u>
Total	<u>\$ 203,992</u>	<u>\$ 100,682</u>	<u>\$ 304,674</u>

NOTE G- PENSION OBLIGATIONS

The District established a Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) plan under Section 408 (p) of the Internal Revenue Code effective January 1, 2000. All employees are eligible to participate. All contributions made under this SIMPLE plan are fully vested and nonforfeitable.

An eligible employee may make a salary reduction election to have his or her compensation for each pay period reduced by a percentage. The total amount of the reduction in the employee's compensation cannot exceed \$10,000 for any calendar year. For each calendar year, the District will contribute a matching contribution to each eligible employee's SIMPLE IRA equal to the employee's salary reduction contribution up to a limit of 3% of the employee's compensation for the calendar year. The District paid \$2,073 to employee plans during the current fiscal year on salary of \$69,768.

RURAL WATER DISTRICT NUMBER 2  
OKFUSKEE COUNTY, OKLAHOMA  
NOTES TO FINANCIAL STATEMENTS  
NOVEMBER 30, 2011

NOTE H - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance for risk of loss, including workers' compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE I - CONTRACTS

The District purchases water for resale from the Okemah Utilities Authority, Okemah, Oklahoma, under the terms of an Amended Water Purchase Contract dated December 3, 1985. The contract runs until November 1, 2025. The price paid by the District is determined based on costs incurred by the Authority in producing the water purchased. The contract contains terms defining the costs to be considered.

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 Water District Number 2  
Okfuskee County  
Okemah, Oklahoma

I have audited the financial statements-modified cash basis of the business-type activities of Rural Water District Number 2, Okfuskee County, Okemah, Oklahoma as of and for the year ended November 30, 2011, and have issued my report thereon dated March 8 , 2012 which did not include Management's Discussion and Analysis. 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, Okfuskee County, Okemah, 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, Okfuskee County, Okemah, Oklahoma's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Rural Water District Number 2, Okfuskee County, Okemah, 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 Water District Number 2, Okfuskee County, Okemah, 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, 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  
March 8, 2012