

RURAL WATER DISTRICT NO. 3

Rooks County, Kansas

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

December 31, 2011

RURAL WATER DISTRICT NO. 3

DECEMBER 31, 2011

BOARD OF DIRECTORS

James Ochampaugh – Chairman

Don Benoit – Vice-Chairman

Roger Comeau – Secretary/Treasurer

Jimmy Jackson

Norma Braun

Darren Rubottom

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas
December 31, 2011

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MAPES & MILLER

CERTIFIED PUBLIC ACCOUNTANTS
A PARTNERSHIP OF PROFESSIONAL CORPORATIONS

JOHN D. MAPES, CPA, CHTD
DENIS W. MILLER, CPA, PA
THOMAS B. CARPENTER, CPA, PA
DON E. TILTON, CPA, PA
BRIAN S. THOMPSON, CPA, PA
REBECCA A LIX, CPA, PA

418 E HOLME
NORTON, KS 67654
(785)877-5833

P.O. BOX 266
711 3RD STREET
PHILLIPSBURG, KS 67661
(785)543-6561

P.O. BOX 508
503 MAIN STREET
STOCKTON, KS 67669
(785)425-6764

306 N POMEROY
HILL CITY, KS 67642
(785)421-2163

OTHER OFFICES:
QUINTER
WAKEENEY

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Rural Water District No. 3
2335 Highway 183
Plainville, KS 67663

We have audited the summary statement of cash receipts, expenditures, and unencumbered cash balances of Rural Water District No. 3, Rooks County, Kansas as of and for the year ended December 31, 2011. This financial statement is the responsibility of Rural Water District No. 3, Rooks County, Kansas's management. Our responsibility is to express an opinion on the financial statement based on our audit.

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, and the guidance in the Kansas Municipal Audit Guide. Those standards and guidance 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 audit provides a reasonable basis for our opinion.

As described more fully in Note 1, the Rural Water District No. 3, Rooks County, Kansas, has prepared this financial statement using accounting practices prescribed by the State of Kansas to demonstrate compliance with the cash basis laws of the State of Kansas, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statement of the variances between these statutory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statement referred to above does not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Rural Water District No. 3, Rooks County, Kansas, as of December 31, 2011, or the respective changes in its financial position and changes in cash flows, where applicable, for the year then ended.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the aggregate cash and unencumbered cash balance of the Rural Water District No. 3, Rooks County, Kansas, as of December 31, 2011, and the aggregate cash receipts and expenditures for the year then ended, on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated, October 29, 2012, on our consideration of Rural Water District No. 3, Rooks County, Kansas'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.

Our audit was conducted for the purpose of forming an opinion on the financial statement. The individual fund schedules of cash receipts and expenditures, schedule of changes in capital assets (schedules 1 and 2 as listed in the table of contents) are presented for analysis and are not a required part of the statutory financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The individual fund schedules of cash receipts and expenditures, schedule of changes in capital assets and the Schedule of Expenditure of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects, in relation to the financial statements taken as a whole.

Mapes & Miller

Certified Public Accountants

October 29, 2012
Stockton, Kansas

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Statement 1

SUMMARY OF CASH RECEIPTS, EXPENDITURES, AND UNENCUMBERED CASH
For The Year Ended December 31, 2011

FUND	Beginning Unencumbered Cash Balance	Prior Year Cancelled Encumbrances	Cash Receipts	Expenditures	Ending Unencumbered Cash Balance	Add Outstanding Encumbrances and Accounts Payable	Ending Cash Balance
Governmental Type Funds:							
Capital Projects Fund:							
Water Improvement Fund	\$ -	\$ -	\$ 701,723	\$ 1,847,804	\$ (1,146,081) *	\$ 1,190,390	\$ 44,309
Proprietary Type Funds:							
Enterprise Funds:							
Water Utility Fund	267,191	58,676	310,238	235,252	400,853	6,914	407,767
	<u>\$ 267,191</u>	<u>\$ 58,676</u>	<u>\$ 1,011,961</u>	<u>\$ 2,083,056</u>	<u>\$ (745,228)</u>	<u>\$ 1,197,304</u>	<u>\$ 452,076</u>

COMPOSITION OF CASH:

Stockton National Bank	
Stockton, Kansas	
Checking Account	\$ 264,273
Money Market Account	58,956
Money Market Account	24,460
Total Stockton National Bank	<u>347,689</u>
Midwest Community Bank	
Plainville, Kansas	
Super NOW Checking	79
Certificates of Deposit	103,308
Total Midwest Community Bank	<u>103,387</u>
High Plains Farm Credit	
Hays, Kansas	
Farm Credit Stock	<u>1,000</u>
Total Reporting Entity	<u>\$ 452,076</u>

* See Note 7 (B), (Cash Basis Exceptions)

The notes to financial statement are an integral part of this statement.

RURAL WATER DISTRICT NO.3
Rooks County, Kansas

NOTES TO THE FINANCIAL STATEMENT
December 31, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The District was incorporated on September 21, 1976. Rural Water District No. 3 was formed as a public body under the provisions of K.S.A. 82a-613 et seq and is exempt from federal and state income taxes. The purpose of the District is to acquire water and water rights, to build and acquire pipelines and other facilities; to operate the same for the purpose of furnishing water for domestic, garden, livestock and other purposes to owners and occupants of land located within the District, and to others as authorized by the by-laws.

Accounting principles generally accepted in the United States of America require government financial statements to include the primary government and its component units. Component units of a governmental entity are legally separate entities for which the primary government is considered to be financially accountable and for which the nature and significance of their relationship with the primary government are such that exclusion would cause the combined financial statements to be misleading or incomplete. The primary government is considered to be financially accountable if it appoints a majority of an organization's governing body and imposed its will on that organization. The primary government may also be financially accountable if an organization is fiscally dependent on the primary government, regardless of the authority of the organization's governing body. (i.e., there are no component units).

Basis of Presentation - Fund Accounting

The accounts of the District are organized on the basis of funds each of which is considered to be a separate accounting entity. The operations of each fund are accounted for separately. Funds are classified into three categories: governmental, proprietary, and fiduciary. Within each of these three categories there are one or more fund types. The District uses the following fund types:

Governmental Type Funds

These are funds through which most governmental functions typically are financed. The funds included in this category are as follows:

Capital Project Funds – These funds account for financial resources to be used for the acquisition or construction of major capital facilities.

Proprietary Type Funds

These funds account for operations that are self-supporting through user charges. The funds included in this category are Enterprise Funds.

Enterprise Fund – These funds are established to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Statutory Basis of Accounting

The statutory basis of accounting, as used in the preparation of these statutory basis financial statements, is designed to demonstrate compliance with the cash basis laws of the State of Kansas. Cash receipts are recognized when the cash balance of a fund is increased. Expenditures include disbursements, accounts payable, and encumbrances with disbursements being adjusted for prior year's accounts payable and encumbrances. Encumbrances are commitments related to unperformed (executory) contracts for goods and services, and are usually evidenced by a purchase order or written contract.

The District has approved a resolution that is in compliance with K.S.A. 75-1120a(c), waiving the requirement for application of generally accepted accounting principles and allowing the District to use the statutory basis of accounting.

Departure From Generally Accepted Accounting Principles in the United States of America

The basis of accounting described above results in a financial statement presentation which shows cash receipts, expenditures, cash and unencumbered cash balances. Balance sheets that would have shown noncash assets such as receivables, inventories, and prepaid expense, liabilities such as deferred revenue and matured principal and interest payable, and reservations of the fund balance are not presented. Under generally accepted accounting principles in the United States of America, encumbrances are only recognized as a reservation of fund balance; encumbrances outstanding at year end do not constitute expenditures or liabilities. Consequently, the expenditures as reported do not present the cost of goods and services received during the fiscal year in accordance with generally accepted accounting principles. Capital assets that account for the land, buildings, and equipment owned by the Rural Water District No. 3 are presented as supplemental information. Also general long-term debt and compensated absences are not presented in the financial statements.

Comparative Data

Comparative data for the prior year have been presented in the accompanying supplemental information financial statements to provide additional financial analysis.

2. RESTRICTED CASH

Under the terms of a loan resolution security agreement between the District and Farmers Home Administration the following cash is restricted for specific purposes:

	<u>2011</u>	<u>2010</u>
Cash Restricted for Reserve	\$ 59,400	\$ 59,400
Cash Available for Operations	<u>348,367</u>	<u>299,765</u>
Total Cash	<u>\$407,767</u>	<u>\$359,165</u>

3. COMPENSATED ABSENCES

The District provides two weeks of vacation and two weeks sick leave per year to the Operations Manager. No accrued benefits are paid upon termination.

4. DEPOSITS AND INVESTMENTS

K.S.A. 9-1401 establishes the depositories which may be used by the District. The statute requires banks eligible to hold the District's funds have a main or branch bank in the county in which the District is located or in an adjoining county if such institution has been designated as an official depository, and the banks provide an acceptable rate of return on funds. In addition, K.S.A. 9-1402 requires the banks to pledge securities for deposits in excess of FDIC coverage. The District has no other policies that would further limit interest rate risk.

K.S.A. 12-1675 limits the District's investment of idle funds to time deposits, open accounts, and certificates of deposit with allowable financial institutions; U.S. government securities; temporary notes; no-fund warrants; repurchase agreements; and the Kansas Municipal Investment Pool. The District has no investment policy that would further limit its investment choices.

Concentration of credit risk. State statutes place no limit on the amount the District may invest in any one issuer as long as the investments are adequately secured under K.S.A. 9-1402 and 9-1405.

Custodial credit risk – deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. State statutes require the District's deposits in financial institutions to be entirely covered by federal depository insurance or by collateral held under a joint custody receipt issued by a bank within the State of Kansas, the Federal Reserve Bank of Kansas City, or the Federal Home Loan Bank of Topeka, except during designated "peak periods" when required coverage is 50%. As of December 31, 2011 the District was undersecured at the Stockton National Bank by \$98,024.

At December 31, 2011, the District's carrying amount of deposits was \$451,076 and the bank balance was \$451,412. The bank balance was held by two banks resulting in a concentration of credit risk. Of the bank balance, \$353,388 was covered by federal depository insurance.

Custodial credit risk – investments. For an investment, this is the risk that, in the event of the failure of the issuer or counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State statutes require investments to be adequately secured.

5. RISK MANAGEMENT

Rural Water District No. 3 is exposed to various risks of loss related to torts, theft of, damage to, and destruction of asset; errors and omissions; injuries to employees and natural disaster. The District continues to carry insurance coverage to cover these risks. The District has had no significant reduction in insurance coverage from prior years. Settled claims resulting from these risks have not exceeded commercial insurance coverage for each of the past three years.

6. LOAN AND RESERVE REQUIREMENTS

As shown in Note 11, on July 14, 2009 the District entered into a promissory note agreement with Farmers Home Administration to borrow \$1,153,000 for the cost of construction of a water supply system. This agreement is secured by a real estate mortgage of the water system assets and operations.

Provisions of the loan agreement make the following requirement:

Each month the District shall transfer \$495 into a Reserve Account until such account accumulated to \$59,400. As shown in Note 2, this requirement has been met.

7. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Compliance with Kansas Statutes

- A. The District was not in compliance with K.S.A. 9-1402 which requires deposits with authorized financial institutions to be adequately secured. On December 31, 2011 the amount of deposits was \$348,024 at the Stockton National Bank which was secured by \$250,000 FDIC coverage. This results in the deposits being under secured by \$98,024.
- B. K.S.A. 10-1113 states that expenditures are to be made in compliance with the cash basis law which requires that no indebtedness be created for a fund in excess of available monies in that fund. The fund with a negative cash balance was as follows:

Water Improvement Fund

The fund mentioned above is a capital project fund where the expenditures are incurred by the District and then reimbursed by a USDA Rural Development loan and grant. K.S.A. 12-1664 allows the District to temporarily finance the project from current funds until the federal funds are received.

8. COMMITMENTS AND CONTINGENCIES

The District signed a grant agreement on April 17, 2012 with USDA Rural Development providing for a loan and grant not to exceed \$942,000 and \$843,000 respectively. The District is to provide \$120,000 towards the project. These funds will be used for development of a Zurich water system and installing a nitrate removal building and equipment. Total estimated project cost will be \$1,905,000.

9. CAPITAL PROJECTS

	<u>Project Authorization</u>	<u>Cash Disbursements and Accounts Payable To Date</u>
Water Improvement Project	\$ 1,905,000	\$ 806,065

10. SUBSEQUENT EVENTS

Management has evaluated the effects of the financial statements of subsequent events occurring through October 29, 2012 which is the date of which the financial statements were available to be issued.

11. LONG-TERM DEBT

Changes in long-term debt for the District for the year ended December 31, 2011, were as follows:

Issue	Interest Rates	Date of Issue	Amount of Issue	Date of Final Maturity	Balance Beginning of Year	Additions	Reductions/ Payments	Balance End of Year	Interest Paid
Loan Agreements									
High Plains Farm Credit	4.240%	06/01/11	900,000	08/01/12	\$ -	\$ 701,644	\$ -	\$ 701,644	\$ -
Farmers Home Administration	4.125%	07/14/09	1,153,000	07/14/49	1,135,309	-	12,346	1,122,963	46,598
Total Loan Agreements					<u>\$ 1,135,309</u>	<u>\$ 701,644</u>	<u>\$ 12,346</u>	<u>\$ 1,824,607</u>	<u>\$ 46,598</u>

Current maturities of long-term debt and interest for the next five years and in five year increments through maturity are as follows:

	2012	2013	2014	2015	2016	2017-2021	2022-2026
PRINCIPAL							
Loan Agreements	\$ 715,609	\$ 12,314	\$ 13,974	\$ 14,562	\$ 15,174	\$ 85,990	\$ 105,653
INTEREST							
Loan Agreements	58,482	41,724	44,976	44,389	43,776	208,760	189,101
Total Principal & Interest	<u>\$ 774,091</u>	<u>\$ 54,038</u>	<u>\$ 58,950</u>	<u>\$ 58,951</u>	<u>\$ 58,950</u>	<u>\$ 294,750</u>	<u>\$ 294,754</u>
	2027-2031	2032-2036	2037-2041	2042-2046	2047-2049	Total	
PRINCIPAL							
Loan Agreements	\$ 129,803	\$ 159,479	\$ 195,941	\$ 240,738	\$ 135,370	\$ 1,824,607	
INTEREST							
Loan Agreements	164,946	135,270	98,809	54,011	7,092	1,091,336	
Total Principal & Interest	<u>\$ 294,749</u>	<u>\$ 294,749</u>	<u>\$ 294,750</u>	<u>\$ 294,749</u>	<u>\$ 142,462</u>	<u>\$ 2,915,943</u>	

SUPPLEMENTARY INFORMATION

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Schedule 1

STATEMENT OF CASH RECEIPTS AND EXPENDITURES
For The Year Ended December 31, 2011
(With Comparative Amounts for the Prior Year Ended December 31, 2010)

WATER IMPROVEMENT FUND

	2011	2010
Cash Receipts:		
Miscellaneous Income	\$ 67	\$
Interest Income	12	
Loan Proceeds	701,644	
Total Cash Receipts	701,723	-
Expenditures:		
Construction Costs	1,524,459	
Engineering Fees	322,324	
Legal Fees	400	
Publications	621	
Total Expenditures	1,847,804	-
Cash Receipts Over (Under) Expenditures	(1,146,081)	-
Unencumbered Cash, Beginning	-	-
Unencumbered Cash, Ending	\$ (1,146,081)	\$ -

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Schedule 1

STATEMENT OF CASH RECEIPTS AND EXPENDITURES
For The Year Ended December 31, 2011
(With Comparative Amounts for the Prior Year Ended December 31, 2010)

WATER UTILITY FUND

	2011	2010
Cash Receipts:		
Operating Receipts		
Water Sales	\$ 172,083	\$ 134,801
Monthly Meter Fees	104,478	96,033
Late Charges and Other Revenue	5,569	5,270
Back Flow Preventer and Flow Control Charges	275	220
Other Income	4,348	8,340
Total Operating Receipts	286,753	244,664
Non-Operating Income		
Interest Income	3,485	5,105
Member Investments	20,000	40,000
USDA Grant	-	12,372
Total Non-Operating Receipts	23,485	57,477
Total Cash Receipts	310,238	302,141
Expenditures:		
Operator/Manager Salary	44,367	42,416
Secretary/Bookkeeper Salary	17,702	16,238
Director's Fees	9,908	10,270
Payroll Taxes	5,196	4,296
Auditing and Accounting	505	16,669
Bank Charges	8	-
Legal Fees	684	75
Lab Fees	399	1,070
Utilities	19,646	16,974
Operating Supplies, Maintenance and Repairs	18,446	61,277
Telephone and Internet	2,321	2,151
Postage	1,303	1,285
Office Supplies	2,638	2,037
Insurance	8,646	6,806
Vehicle Expense	12,888	8,942
Licenses, Dues and Subscriptions	262	275
Meeting Expense	1,348	1,350
Miscellaneous	745	1,175
Interest Expense	46,598	47,096
Loan Principal Payments	12,346	11,848
Zurich Project Expense		
Engineering Fees	22,000	78,852
Legal Fees	1,633	-
Easements	1,653	-
Miscellaneous	-	6,711
Capital Asset Purchases	4,010	10,653
Total Expenditures	235,252	348,466
Cash Receipts Over (Under) Expenditures	74,986	(46,325)
Unencumbered Cash, Beginning	267,191	313,516
Cancelled Prior Year Encumbrances	58,676	-
Unencumbered Cash, Ending	\$ 400,853	\$ 267,191

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Schedule 2

SCHEDULE OF CHANGES IN CAPITAL ASSETS
December 31, 2011

	Capital Assets 1/1/2011	Additions	Deductions	Capital Assets 12/31/2011
Equipment and Tools	\$ 104	\$ -	\$ -	\$ 104
Pumps, Treatment Equipment and Facilities	364,678	-	-	364,678
Wells	38,712	-	-	38,712
Transmission Lines and Storage Facilities	3,622,859	-	-	3,622,859
Easements	62,603	1,653	-	64,256
Office Equipment and Furniture	7,141	-	-	7,141
Vehicles	23,351	-	-	23,351
Buildings	251,695	4,010	-	255,705
Construction in Progress	124,180	1,810,107	-	1,934,287
Total Capital Assets	4,495,323	1,815,770	-	6,311,093
Less: Accumulated Depreciation	1,921,294	130,951	-	2,052,245
Net Capital Assets	\$ 2,574,029			\$ 4,258,848

Capital assets are recorded above at cost and are being depreciated over their estimated useful lives by use of the straight-line method. The following table reflects depreciation expense for 2011:

	Estimated Useful Life	
Equipment and Tools	10 years	\$ -
Pumps, Treatment Equipment and Facilities	10 years	4,261
Wells	30 years	610
Transmission Lines and Storage Facilities	36-40 years	114,450
Office Equipment and Furniture	5-10 years	100
Vehicles	5 years	4,670
Buildings	39 years	6,860
Total Depreciation		\$ 130,951

SINGLE AUDIT SECTION



MAPES & MILLER

CERTIFIED PUBLIC ACCOUNTANTS
A PARTNERSHIP OF PROFESSIONAL CORPORATIONS

JOHN D. MAPES, CPA, CHTD
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PHILLIPSBURG, KS 67661
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P.O. BOX 508
503 MAIN STREET
STOCKTON, KS 67669
(785)425-6764

306 N POMEROY
HILL CITY, KS 67642
(785)421-2163

OTHER OFFICES:
QUINTER
WAKEENEY

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 Directors
Rural Water District No. 3
2335 Highway 183
Plainville, KS 67663

We have audited the accompanying financial statements of Rural Water District No. 3, Rooks County, Kansas, as of and for the year ended December 31, 2011, as listed in the table of contents, and have issued our report thereon dated October 29, 2012. Our report on the financial statements disclosed that, as described in Note 1 to the financial statements, Rural Water District No. 3, Rooks County, Kansas prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the cash basis laws of the State of Kansas, which is a comprehensive basis of accounting other than generally accepted accounting principles. 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, and the guidance in the Kansas Municipal Audit Guide.

Internal Control Over Financial Reporting

Management of Rural Water District No. 3, Rooks County, Kansas is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Rural Water District No. 3, Rooks County, Kansas'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 Rural Water District No. 3, Rooks County, Kansas's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Rural Water District No. 3, Rooks County, Kansas'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 as described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting. 2011-1 and 2011-2. 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 Rural Water District No. 3, Rooks County, Kansas'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*.

Rural Water District No. 3, Rooks County, Kansas's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Rural Water District No. 3, Rooks County, Kansas's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Board of Directors and management of Rural Water District No. 3, Rooks County, Kansas, others within the entity, 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.

Mapes & Miller

Certified Public Accountants

October 29, 2012
Stockton, Kansas



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STOCKTON, KS 67669
(785)425-6764

OTHER OFFICES:
QUINTER
WAKEENEY

306 N POMEROY
HILL CITY, KS 67642
(785)421-2163

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Directors
Rural Water District No. 3
2335 Highway 183
Plainville, KS 67663

Compliance

We have audited Rural Water District No. 3, Rooks County, Kansas's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Rural Water District No. 3, Rooks County, Kansas's major federal programs for the year ended December 31, 2011. Rural Water District No. 3, Rooks County, Kansas's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Rural Water District No. 3, Rooks County, Kansas's management. Our responsibility is to express an opinion on Rural Water District No. 3, Rooks County, Kansas's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Rural Water District No. 3, Rooks County, Kansas's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Rural Water District No. 3, Rooks County, Kansas's compliance with those requirements.

In our opinion, Rural Water District No. 3, Rooks County, Kansas complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2011.

Internal Control Over Compliance

Management of Rural Water District No. 3, Rooks County, Kansas is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Rural Water District No. 3, Rooks County, Kansas's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Rural Water District No. 3, Rooks County, Kansas's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items 2011-3. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Rural Water District No. 3, Rooks County, Kansas's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Rural Water District No. 3, Rooks County, Kansas's response and, accordingly, we express no opinion on the responses.

This report is intended for the information and use of the Board of Directors and management of Rural Water District No. 3, Rooks County, Kansas, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specific parties.

Mapes & Miller

Certified Public Accountants

Stockton, Kansas
October 29, 2012

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Schedule 3

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2011

Federal Grantor/Pass-Through Grantor/ Program Title	Federal CFDA Number	Federal Expenditures
U.S. Department of Agriculture Water and Waste Disposal Systems for Rural Communities - ARRA	10.781	\$ 657,414
Total Expenditures of Federal Awards		<u>\$ 657,414</u>

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2011

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal loan and grant activity of the Rural Water District No. 3, Rooks County, Kansas and is presented on the cash basis of accounting. Therefore, amounts presented in this schedule may differ from amounts presented in, or use in the presentation of the basic financial statements.

**RURAL WATER DISTRICT NO. 3
Rooks County, Kansas**

Schedule 4

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2011**

SECTION 1 – SUMMARY OF AUDITORS’ RESULTS

FINANCIAL STATEMENTS

Type of auditors’ report issued:

In accordance with the statutory basis of accounting described in Note 1 to the financial statements.

Unqualified

Internal control over financial reporting:

- Material weaknesses identified? __ Yes x No
- Significant deficiencies identified that are not considered to be material weaknesses? x Yes __ No
- Noncompliance material to financial statements noted? __ Yes x No

FEDERAL AWARDS

Internal control over major programs:

- Material weaknesses identified? __ Yes x No
- Significant deficiencies identified that are not considered to be material weaknesses? x Yes __ No

Type of auditors’ report issued on compliance for major programs:

Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB *Circular A-133*?

__ Yes x No

Identification of major programs:

<u>CFDA NUMBER</u>	<u>NAME OF FEDERAL PROGRAM</u>
10.781	Water and Waste Disposal Systems for Rural Communities - ARRA

Dollar threshold used to distinguish between type A and type B programs:

\$300,000

Auditee qualified as low-risk auditee?

__ Yes x No

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Schedule 4
(Cont.)

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2011

SECTION II – FINANCIAL STATEMENT FINDINGS

2011-1 Segregation of Duties

Condition: The same employee performs some accounting duties and procedures that should be segregated.

Criteria: Segregation of duties should be maintained to strengthen internal control over accounting and compliance functions.

Cause: Because the entity is small, management does not feel it is feasible to hire more staff.

Effect: Lack of segregation of duties increases the risk of errors and noncompliance occurring and not being detected in a timely manner.

Recommendations: Duties of key financial and compliance personnel should be evaluated to determine if duties could be segregated.

Views of Responsible Officials and Planned Corrective Actions: We concur with the recommendation. However, the size of the entity does not make it practical to have sufficient number of employees to achieve the optimum level of internal control.

2011-2 Financial Statement Preparation

Condition: Management does not have the qualifications and training necessary to prepare the financial statements which would include the related footnote disclosures.

Criteria: Management must have controls over the preparation of the financial statements including footnote disclosures which would prevent or detect an omission/misstatement in the financial statements.

Cause: There are no procedures in place that require management to obtain the necessary qualifications and training.

Effect: The control deficiency allows for omission/misstatements in the financial statements including footnotes that may not be prevented, detected, or corrected.

Recommendations: Management would need to attend training classes and annual continuing education classes to gain an understanding on proper and complete preparation of the financial statements and footnote disclosures and to be aware of all of the current accounting standards by purchasing annual accounting subscriptions.

Views of Responsible Officials and Planned Corrective Actions: We concur with the recommendation. However, the cost of annual subscription services and the continuing education/training classes do not make it practical to obtain the competency and expertise required to correct the deficiency.

RURAL WATER DISTRICT NO. 3
Rooks County, Kansas

Schedule 4
(Cont.)

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2011

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Questioned
Costs

Department of Agriculture - CFDA No. 10.781 Water and Waste Disposal Systems For
Rural Communities - ARRA - For the Year Ended December 31, 2011

1. Internal Control Findings

2011-3 Segregation of Duties

Significant Deficiency: The significant deficiency at Finding 2011-1 also applies to this
major program.

2. Compliance Findings

None found.

SECTION IV – SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Not applicable