

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

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RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

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Board of Directors
Rural Water District No. 3
Washington County, Oklahoma

INDEPENDENT AUDITOR'S REPORT

I have audited the accompanying financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of Washington County Rural Water District No. 3 as of and for the years ended December 31, 2011, and 2010, which collectively comprise Washington County Rural Water District No. 3's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Washington County Rural Water District No. 3'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 opinions.

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, each major fund, and the aggregate remaining fund information of Washington County Rural Water District No. 3 as of December 31, 2011, and 2010, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated April 30, 2012, on my consideration of Washington County Rural Water District No. 3's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of my 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information, on pages 3 through 8, and page 23, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

My audit was made for the purpose of forming opinions on the financial statements that collectively comprise Washington County Rural Water District No. 3's financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards and the Schedule of Findings and Questioned Costs, on pages 29 through 31, are 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 are also not a required part of the financial statements. The Schedule of Expenditures of Federal Awards, and the Schedule of Findings and Questioned Costs 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 my opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



Bruce G. Luttrell, CPA, PC

April 30, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

**Washington County Rural Water District No. 3
Management's Discussion and Analysis Report
For Fiscal Year 2011
(Ended December 31, 2011)**

Introduction

The purpose for this report is to present, from the District Manager's perspective, an assessment of the financial activities and performance of Washington County Rural Water District No. 3 (hereinafter referred to as the "District") for the audited year. The primary goal of this report is to address the critical question "Is the District as a whole better or worse off as a result of the year's activities?" It is also the goal of this report to present the findings from the audit and other critical operations information in an easy-to-read format for interpretation by the non-accountant.

The information included herein should be read in conjunction with the financial statements prepared by the District's Auditor. Also note that the currency amounts presented herein have been rounded to the nearest dollar.

Financial Highlights

- The amount of water sold in FY '11 (669,959,567 gallons) increased slightly by approximately 16 percent when compared to the previous year (sold 577,526,012 gallons in FY '10).
- Revenues from the sale of water accounted for 95 percent of all revenues. The total revenue from water sales increased by approximately 10.1 percent when compared to FY '10.
- The District expended approximately \$ 12,534,000 on new infrastructure during the year.
- The District did not improve its position with regard to total liabilities by increasing their value by \$ 12,205,427 when compared to FY '10. Total equity increased by approximately \$ 1,059,507.
- The District as a whole is much better off as a result of the year's activities.

Overview of Financial Statements

The financial statements prepared for the FY '11 audit were used to develop this report. A brief description of each statement and their purpose follows:

Statements of Financial Position [Balance Sheet] - The purpose for the "Statements of Financial Position" is to present a summary of the District's net assets. In simple terms this statement shows what we own (assets) minus what we owe (liabilities). When we compare this years Statement of Financial Position to previous years we look at how our net worth (i.e., net assets) is increasing or decreasing. This is one indicator of how the District's financial position is improving or deteriorating.

Statements of Activities - The "Statements of Activities" presents the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the year without regard to when cash was received or paid.

Statements of Cash Flows - The "Statements of Cash Flows" presents changes in cash and cash equivalents (i.e., Accounts Payable and Receivable), resulting from operational, financing and investing activities. This statement shows how the District's cash on hand changed from the beginning to the end of the year.

Condensed Financial Statements

Condensed Statement of Financial Position

	12/31/11	12/31/10	Dollar Change	Percent Change
Current and Other Assets	\$6,876,522	\$5,696,439	\$1,180,083	20.7
Capital Assets	\$25,764,921	\$13,680,070	\$12,084,851	88.3
Total Assets	\$32,641,443	\$19,376,509	\$13,264,934	68.5
Current Liabilities	\$525,195	\$150,872	\$374,323	248.1
Long-Term Liabilities	\$15,984,420	\$4,153,316	\$11,831,104	284.9
Total Liabilities	\$16,509,615	\$4,304,188	\$12,205,427	283.6
Net Assets invested in capital assets, net of related debt	\$9,414,976	\$9,437,099	\$<22,123>	<0.2>
Restricted for debt service	\$299,239	\$166,088	\$133,151	80.2
Unrestricted net assets	\$6,417,613	\$5,469,214	\$948,399	17.3
Total Net Assets	\$16,131,828	\$15,072,321	\$1,059,507	7.0

Condensed Statement of Activities

	12/31/11	12/31/10	Dollar Change	Percent Change
Operating Revenues	\$3,989,428	\$3,634,346	\$355,082	9.8
Non-operating Revenues	\$334,254	\$2,355,945	\$<2,021,691>	<85.8>
Total Revenues	\$4,323,682	\$5,990,291	\$<1,666,609>	<27.8>
Depreciation Expense	\$456,994	\$460,234	\$<3,240>	<0.7>
Other Operating Expenses	\$2,807,181	\$2,654,800	\$152,381	5.7
Total Expenses	\$3,264,175	\$3,115,034	\$149,141	4.8
Change in Net Assets	\$1,059,507	\$2,875,257	\$<1,815,750>	<63.2>
Beginning Net Assets	\$15,072,321	\$12,197,064	\$2,875,257	23.6
Ending Net Assets	\$16,131,828	\$15,072,321	\$1,059,507	7.0

Analytical Overview

Sources of Income - The District's primary sources of income are from the sale of water services. Other sources of income include interest on investments; membership fees; and collection fees. The District has no taxing power.

Growth - During the year 282 new benefit units (i.e., water meters) were sold compared to a total of 297 sold in FY '10. The District sold 669,959,567 gallons of water which represents an approximate increase of 16 percent over FY '10. The slight decrease in year-over-year benefit unit sales is likely the result of the continuing slump in the housing market and economic conditions.

Statements of Net Assets:

Total Net Assets - The *Statement of Net Assets* shows that the District's total net assets actually increased by \$ 1,059,507 when compared with FY '10. This increase represents 7 % in our total net assets. Although current assets (i.e., cash) increased by \$ 1,189,572, the District's fixed assets (i.e., land, equipment and infrastructure) actually increased by \$ 12,084,851 and the District's investments increased by \$ 300,000.

On the 2 nd page of the *Statement of Net Assets* we see that the District did not improve its position with regard to total (i.e., current and long term) liabilities by increasing their value by \$ 12,205,427 when compared to FY '10. This increase occurred primarily in the category of long term liabilities. Total equity increased by approximately \$ 1,059,507.

Statement of Revenues, Expenditures and Changes in Fund Assets:

Reviewing the *Statement of Revenues, Expenditures and Changes in Fund Assets* we can see that the District's change in net assets was \$ 1,059,507. This compares unfavorably to the net change in net assets of \$ 2,875,257 experienced in FY '10.

Revenues – The District's total operating revenues for FY '11 were \$ 3,989,428. This represents an increase of approximately \$ 355,082 or 9.8 percent over FY '10. Approximately 95 percent of our revenues (i.e., \$ 3,793,473) were derived from sale of water services.

Approximately 7.1 percent of revenues (\$ 282,000) came from membership fees. Revenues from these items were down 5 percent over FY '10.

Expenses - The District's total operating expenses were \$ 3,264,175. Excluding depreciation and amortization the total operating expenses are reduced to \$ 2,797,691. This represents an approximate increase of \$ 152,381 or 5.8 percent over FY '10.

Statement of Cash Flows:

As shown in the *Statement of Cash Flows* the District had a net increase in cash at the end of the year of \$ 676,734.

Annual Budget

As required by the District's By-Laws an Annual Budget was prepared by the District Manager for FY '11. The basis for the budget included a thorough examination of the actual results from the last several years. The budget also included certain anticipated expenses that were related to budgeted capital projects. The FY '11 Annual Budget was reviewed and approved by the Board during the Board meeting held on March 14, 2011.

Debt Administration:

The remaining balance for all promissory notes (i.e., loans) at the beginning of the year was \$ 4,242,971. All scheduled loan and interest payments through December 31, 2011 were made on time. The District increased its principal on outstanding loans by \$ 12,106,974. The balance remaining on all outstanding loans is \$ 16,349,945. The reserve accounts for the District's loans are fully funded.

Highlights of Other Critical Information:

- In Fiscal Year 2011 the District has continued to meet the new and more stringent water quality regulations. This includes monthly testing for Total Organic Carbons (TOC's) and quarterly testing for Trihalomethanes (THM's) and Haloacetic Acids (HAA's). The District is pleased to report that our water quality complied with all the regulations.
- The District installed approximately 1 mile of new 12-inch water line along Sheridan to improve water circulation in a portion of the southern central end of the distribution system.
- Caney River Raw Water Supply Project – The District continued construction on the project throughout 2011.
- The District investment in the upgrade of electrical service to the Caney River and North WTP projects was completed in 2011.
- Water Treatment Plant (WTP) Expansion Project – The District continued construction of the WTP expansion in 2011.
- Legal Action by Design Engineer of WTP Expansion Project – A formal legal action was filed against the District in 2011 by the design engineer additional fees.
- Water Service to the Owasso Medical Campus – The Districts' formal legal action against the City of Owasso for their encroachment continued unresolved during this fiscal year.
- City of Owasso Utility Relocation Projects – The District worked with the City and their representatives on relocation plans for District infrastructure locate along 86th Street North between Memorial and Districts east boundary; and at the intersection of 106th Street North and Garnett.
- Water Resources Master Planning – We started work on a new master plan for the District.

Conclusions – The District as a whole has a better financial position than a year ago. The value of our total liabilities increased while the value of our total equity increased. Our total debt service was increased by \$ 12,106,974 as a result of the Rural Development loan for the Caney River project, and the Oklahoma Water Resources Board loan for the treatment plant improvement project. We ended the year with more cash and investments (i.e., \$ 1,109,965) than we started with.

Looking Forward – As we look forward to Fiscal Year 2012 we anticipate our growth to be the same or slightly greater than that which was experienced in FY '11. We also anticipate progress on the following major capital projects:

- Water Treatment Plant (WTP) Expansion Project – Construction is expected to be completed on the expansion components of the project by the end of second quarter of FY 2012.
- Caney River Raw Water Supply Project – We anticipate construction to be completed in the second quarter of 2012.

- Water Resources Master Plan – We anticipate completing the master plan in 2012. This master plan will identify future capital needs with emphasis on priority.
- Future Water Lines – The District is planning:
 - The addition of approximately one mile of 24-inch water line.
 - The relocation of existing water lines along 86th Street North from Memorial to the District east service boundary.
 - The relocation of existing water lines at Garnett and 106th Street North to accommodate intersection improvements.

FINANCIAL STATEMENTS

**RURAL WATER DISTRICT NO. 3
WASHINGTON COUNTY, OKLAHOMA**

**STATEMENTS OF NET ASSETS
DECEMBER 31, 2011 AND 2010**

	2011	2010
ASSETS		
Current assets:		
Cash	\$ 1,542,579	\$ 865,845
Investments	4,050,500	3,750,500
Restricted cash & investments (Note 7)	299,239	166,008
Accounts receivable	341,019	352,257
Accrued interest receivable	2,008	4,605
Inventory	326,035	235,912
Prepaid insurance	48,422	45,103
Total current assets	6,609,802	5,420,230
Noncurrent assets:		
Other assets:		
Debt issue costs (Note 2)	266,720	276,209
Total other assets	266,720	276,209
Capital assets:		
Building & land	307,638	307,638
Machinery & tools	343,678	342,044
Automotive equipment	316,189	292,189
Furniture & fixtures	108,051	108,051
Lab equipment	40,706	40,706
Water treatment & distribution system	33,890,032	21,381,312
Less accumulated depreciation	(9,241,373)	(8,791,870)
Total capital assets	25,764,921	13,680,070
Total Assets	\$ 32,641,443	\$ 19,376,509

The accompanying notes to the financial

	<u>2011</u>	<u>2010</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 40,020	\$ 36,277
Accrued interest payable	119,650	24,940
Current portion of long-term debt (Note 2)	365,525	89,655
Total current liabilities	<u>525,195</u>	<u>150,872</u>
Noncurrent liabilities:		
Notes payable (Note 2)	16,349,945	4,242,971
Less: current portion	(365,525)	(89,655)
Total noncurrent liabilities	<u>15,984,420</u>	<u>4,153,316</u>
Total Liabilities	<u>16,509,615</u>	<u>4,304,188</u>
 NET ASSETS		
Invested in capital assets, net of related debt	9,414,976	9,437,099
Nonspendable	326,035	235,912
Restricted for debt service	299,239	166,008
Unassigned	6,091,578	5,233,302
Total Net Assets	<u>\$ 16,131,828</u>	<u>\$ 15,072,321</u>

statements are an integral part of this statement.

**RURAL WATER DISTRICT NO. 3
WASHINGTON COUNTY, OKLAHOMA**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Operating revenues:		
Water sales (net of adjustments)	\$ 3,793,473	\$ 3,444,516
Penalties, fees, service charges and miscellaneous	195,955	189,830
Total operating revenues	3,989,428	3,634,346
Operating expenses:		
Salaries, wages & contract labor	713,758	713,892
Payroll taxes	56,670	53,403
Employee benefits	206,303	172,141
Utilities	255,998	222,232
Telephone	12,931	11,297
Equipment expense	28,571	28,158
Depreciation	456,994	460,234
Interest expense	403,117	71,004
Vehicle expense	49,021	26,749
Building, vehicle & other insurance	63,901	62,627
Plant repair & maintenance	18,395	734
Chemicals	397,572	361,933
Travel, entertainment & miscellaneous	32,440	23,600
Licenses & fees	38,711	57,878
Plant supplies	154,957	619,515
Water purchased	88,704	92,109
Office expense & postage	71,038	63,381
Professional fees	205,604	64,657
Amortization	9,490	9,490
Total operating expenses	3,264,175	3,115,034
Net operating income	725,253	519,312
Nonoperating revenue (expense)		
New benefit units	282,000	296,800
Grant income	-	2,000,000
Interest income	62,473	64,060
Loss on sale of assets	(9,719)	(4,415)
Trustee fee	(500)	(500)
Total nonoperating revenue (expense)	334,254	2,355,945
Change in net assets	1,059,507	2,875,257
Net assets beginning of year	15,072,321	12,197,064
Net assets end of year	\$ 16,131,828	\$ 15,072,321

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

**RURAL WATER DISTRICT NO. 3
WASHINGTON COUNTY, OKLAHOMA**

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Cash flows from operating activities:		
Receipts from customers	\$ 4,000,666	\$ 3,618,597
Payments to suppliers	(2,088,300)	(1,716,787)
Payments to employees	(701,783)	(713,892)
Net cash provided (used) by operating activities	1,210,583	1,187,918
Cash flows from noncapital financing activities:		
Transfers from (to) investments	(300,000)	(1,450,500)
Transfers from (to) restricted cash and investments	(133,231)	(63,424)
Grant income	-	2,000,000
Trustee fee	(500)	(500)
Net cash provided (used) by noncapital financing activities	(433,731)	485,576
Cash flows from capital and related financing activities:		
New benefit units	282,000	296,800
Purchase of capital assets	(12,532,721)	(5,284,511)
Principal paid on capital debt	(182,624)	(48,489)
Issue new capital debt	12,289,597	3,057,872
Sales and trade assets	(18,843)	48,000
Net cash provided (used) by capital and related financing activities	(162,591)	(1,930,328)
Cash flows from investing activities:		
Interest income	62,473	64,060
Net increase (decrease) in cash and cash equivalents	676,734	(192,774)
Cash balance beginning of year	865,845	1,058,619
Cash balance end of year	\$ 1,542,579	\$ 865,845
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	\$ 725,253	\$ 519,312
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Cash flows reported in other categories:		
Depreciation expense	456,994	460,234
Amortization	9,490	9,490
Change in assets and liabilities:		
Accounts receivable	11,238	(15,749)
Accrued interest receivable	2,597	(2,240)
Inventory	(90,123)	240,260
Prepaid insurance	(3,319)	(17,749)
Accounts payable	3,743	(26,351)
Accrued interest payable	94,710	20,711
Net cash provided by operating activities	\$ 1,210,583	\$ 1,187,918

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

NOTES TO BASIC FINANCIAL STATEMENTS

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

Washington County Rural Water District Number 3 (the District) was organized in 1965, under Title 82, O.S. Supp. 1972, Sections 1324.1 to 1324.26 for the purpose of providing a water works system including all physical facilities, improvements and services necessary for executing that purpose, in Washington, Osage, Tulsa and Rogers counties. Since the District is a political subdivision of the State of Oklahoma, under Title 82, it is exempt from Federal and State income taxes.

The membership consists of approximately 8,400 benefit unit holders, each entitled to one vote. Subscribers to benefit units pay a \$ 1,000 subscription fee (\$ 750 prior to May 2005), which is non-refundable, and entitles the holder to one line from the District's water system. The Board of Directors consist of 7 members serving 3 year terms. The vacant Board seats are filled at the annual meeting in April, and following, the Board of Directors meet and elect a Chairman, Vice-Chairman, Secretary and Treasurer.

In June 1999, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The statement established a new reporting model for governments that is substantially different from prior reporting standards. 2004 was the first year that Washington County Rural Water District No. 3 reported under the new reporting model, which includes the following segments:

Management's Discussion and Analysis – provides introductory information on basic financial statements and an analytical overview of the District's financial activities.

Fund Financial Statements – provide information about the District's proprietary fund. The proprietary fund utilizes an "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of net income, financial position and cash flows. All assets and liabilities (whether current or non-current) associated with their activities are reported. Proprietary fund equity is classified as net assets.

B. BASIS OF ACCOUNTING

The District's policy is to prepare its financial statements on the accrual basis of accounting; consequently, revenue and the related assets are recognized when earned, and expenditures are recognized when the obligation is incurred.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

C. INVENTORY

During the year ended December 31, 1998, the District instituted a perpetual inventory system for supplies. The supplies on hand at year end are valued at the lower of cost or market, on a first-in, first-out basis, and included in the December 31, 2011 and 2010, financial statements at \$ 326,035 and \$ 235,912, respectively.

D. FIXED ASSETS

All fixed assets are recorded at their original acquisition cost. Depreciation is provided in the financial statements utilizing the following estimated useful lives:

	<u>Years</u>
Office Building	40
Water Plant & System	40
Furniture, Fixtures & Equipment	10
Machinery & Tools	10-15
Automotive	5
Office Equipment	5-15

A summary of the fixed asset accounts for the year ended December 31, 2011, is as follows:

	<u>Beginning</u>		<u>Additions</u>		<u>Rtmts</u>		<u>Transfers</u>		<u>Ending</u>
	<u>Balance</u>								<u>Balance</u>
Building & Land	\$ 307,638								\$ 307,638
Machinery & Tools	342,044	65,843	64,209					343,678	
Automotive	292,189	24,000						316,189	
Furniture, Fixtures & Equipment	108,051							108,051	
Lab Equipment	40,706							40,706	
Water Treatment & Distribution System	21,381,312	12,508,720						33,890,032	
Total	\$ 22,471,940	12,598,563	64,209	-				\$ 35,006,294	

E. CASH DEPOSITS

All funds are either on deposit in financial institutions insured by the Federal Deposit Insurance Corporation (FDIC) or collateralized with securities held by the District or by its agent in its name.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

F. STATEMENT OF CASH FLOWS

For purposes of the Statement of Cash Flows, the District considers demand accounts, subject to withdrawal by check, and cash on hand, as cash or cash equivalents.

G. COMPENSATED ABSENCES

All full-time employees are eligible for vacation pay, after six months service, of 2 weeks per year for 10 months through 8 years service, and 3 weeks per year for 9 years through 16 years service. Vacation pay is vested, and thus paid upon retirement or separation (with proper notice.) Vacation pay is to be taken during the year, or paid at year end, and does not carryover to the next year without Board approval. Total vacation accrued in the financial statements was approximately \$ 13,400 and \$ 13,400, at December 31, 2011 and 2010, respectively. The vacation accrued at December 31, 2011, was paid the first week of 2012. All full-time employees are eligible for sick leave, after six months service, accrued at four hours per month (6 days per year.) Employees may accrue a maximum of 120 days of sick leave. Sick leave is not vested, and is thus lost upon separation.

H. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2011 and 2010, represent charges for services provided to customers. The District utilizes the direct charge-off method of recognition of bad debts. Uncollectible accounts are an insignificant amount each year, thus there is no reserve for uncollectible accounts at December 31, 2011 and 2010.

I. INVESTMENTS

All investments are stated at cost.

J. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

K. EQUITY CLASSIFICATION

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

K. EQUITY CLASSIFICATION (continued)

assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

The District applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Fund Balance

Fund Balance is divided into five classifications based primarily on the extent to which the District is bound to observe constraints imposed upon the use of the resources in the governmental funds. The classifications are as follows:

Nonspendable – The nonspendable fund balance category includes amounts that cannot be spent because they are not in spendable form, or legally or contractually required to be maintained intact. The “not in spendable form” criterion includes items that are not expected to be converted to cash. It also includes the long-term amount of interfund loans.

Restricted – Fund balance is reported as restricted when constraints placed on the use of resources are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or is imposed by law through constitutional provisions or enabling legislation (ordinances).

Enabling legislation authorizes the District to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. Legal enforceability means that the District can be compelled by an external party such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation.

Committed - The committed fund balance classification includes amounts that can be used only for the specific purposes imposed by formal action (ordinance or resolution) of the Board of Trustees. Those committed amounts cannot be used for any other purpose unless the Board of Trustees removes or changes the specified use by taking the same type of action (ordinance or resolution) it employed to previously commit those amounts. In contrast to fund balance that is restricted by enabling legislation, committed fund balance classification may be redeployed for other purposes with appropriate due process. Constraints imposed on the use of committed amounts are imposed by the Board of Trustees, separate from the authorization to raise the

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

K. EQUITY CLASSIFICATION (continued)

underlying revenue; therefore, compliance with these constraints are not considered to be legally enforceable. Committed fund balance also incorporates contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements.

Assigned – Amounts in the assigned fund balance classification are intended to be used by the District for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the General Fund, assigned fund balance represents the remaining amount that is not restricted or committed. In the General Fund, assigned amounts represent intended uses established by the Board of Trustees or any official delegated that authority by trust indenture or ordinance.

Unassigned – Unassigned fund balance is the residual classification for the General Fund and includes all spendable amounts not contained in the other classifications. In other governmental funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

The District applies restricted resources first when expenditures are incurred for purposes for which either restricted or unrestricted (committed, assigned, and unassigned) amounts are available. Similarly, within unrestricted fund balance, committed amounts are reduced first followed by assigned, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

L. BUDGETARY DATA

In accordance with the by-laws of the District, the Board of Directors shall prepare an estimated budget for the coming year.

NOTE 2: LONG-TERM DEBT

A. RURAL DEVELOPMENT LOANS

During the previous year, the District entered into a loan agreement with the Rural Utilities Service division of the USDA for \$ 4,800,000. The loan bears interest at 3.75 %, and requires monthly payments of \$ 19,344, beginning December 17, 2010, through November 17, 2050 (forty years.) The proceeds of the loan will be utilized to acquire and construct water system improvements, namely the Caney River project. The total cost of the project will be approximately \$ 5,295,042, thus the District will provide the balance of the funds for the project (\$ 495,042.) The total balance outstanding under the loan as of December 31, 2011 and 2010, was \$ 4,139,109 and \$ 73,792, respectively.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 2: LONG-TERM DEBT (continued)

This loan requires that a reserve be established in the amount of \$ 1,934.40 per month, until a balance of \$ 232,128 is maintained. As of December 31, 2011, the District funded the reserve in full. The balance in the reserve account at December 31, 2011, was \$ 232,528.41.

During the year ended December 31, 2000, the District entered into two separate loan agreements with the Rural Economic and Community Development division of the USDA for \$ 724,200 and \$ 329,000. The loans bear interest at 5.5 %, and require monthly payments of \$ 3,737 and \$ 1,698, respectively, beginning November 4, 2000, through October 4, 2040. The proceeds of the loans were utilized to renovate and upgrade the existing north water treatment plant. The total cost of the project was approximately \$ 1,746,000. Thus, the District provided the balance of the funds for the project (approximately \$ 692,000.) The total balance outstanding under the loans as of December 31, 2011 and 2010, was approximately \$ 888,712 and \$ 904,578, respectively.

In connection with the two loans, issue costs of \$ 31,702 were incurred. These are being amortized over the life of the loans (40 years), under the straight-line method. At December 31, 2011 and 2010, accumulated amortization was \$ 8,508 and \$ 7,714, respectively.

Each of the loans require that a reserve be established in the amount of \$ 373.70 per month for the \$ 724,200 loan, until a balance of \$ 44,844 is maintained, and in the amount of \$ 169.80 per month for the \$ 329,000 loan, until a balance of \$ 20,376 is maintained. As of December 31, 2011 and 2010, the balances in the reserve accounts were \$ 65,345.50 and \$ 70,896.78, respectively.

B. OKLAHOMA WATER RESOURCES BOARD LOAN

On December 14, 2009, the District entered into a Drinking Water SRF (State Revolving Fund) promissory note, and a Trust Indenture, with the Oklahoma Water Resources Board, for \$ 17,394,645, to fund the expansion of the north water treatment plant. The total cost of the project is estimated at \$ 17,832,782. However, part of the funding (\$ 2,000,000) is from a grant from the EPA (Environmental Protection Agency) to the OWRB, under the Clean Water State Revolving Fund – American Recovery and Reinvestment Act of 2009 (ARRA.) Through December 31, 2010, a total of \$ 5,264,601 was drawn under the loan agreement, and expended. And, in accordance with the agreement with the Oklahoma Water Resources Board, \$ 2,000,000 of those proceeds were funded through the American Recovery and Reinvestment Act of 2009, and that amount of the loan principle has been forgiven, pending compliance with all ARRA regulations. Through December 31, 2011, another \$ 8,057,523 was drawn under the loan agreement, and expended.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 2: LONG-TERM DEBT (continued)

The loan requires monthly payments into a debt service fund, to be held by a trustee, who will make semi-annual payments of principal and interest to the Oklahoma Water Resources Board on March 15 and September 15, beginning no later than March 15, 2012. The loan carries interest at 2.99 %, and an administrative fee of 0.5 %, and will be payable in 360 months from the date of completion. Interest and the administrative fee began March 15, 2010. The balance outstanding under the loan at December 31, 2011 and 2010, was \$ 11,322,123 and \$ 3,264,601, respectively.

The loan is secured by the revenue derived from the operation of the system, on parity with the security interest securing the District's existing debt. OWRB has also taken a security interest in virtually all of the District's assets.

In connection with this loan, issue costs of \$ 260,920 were incurred. These are being amortized over the life of the loan (30 years) under the straight-line method. At December 31, 2011 and 2010, accumulated amortization was \$ 17,395 and \$ 8,697, respectively.

The District's schedule of rates or charges for the services of the system shall be sufficient to provide funds which, together with other revenues pledged under the loan, will provide net revenues available for debt service equal to at least 125 % of the maximum annual amount required for debt service on all obligations of the District.

C. CHANGES IN LONG-TERM DEBT

The following is a summary of changes in long-term debt for the year ended December 31, 2011.

Loan	Jan. 1, 2010	Additions	Reductions	Dec. 31, 2011	Amount Due Within One Year
RECD Loan – 724,200	624,792		10,750	614,042	11,354
RECD Loan – 329,000	279,786		5,116	274,670	5,404
RUS Loan	73,792	4,232,075	166,758	4,139,109	52,821
OWRB Loan	<u>3,264,601</u>	<u>8,057,523</u>	-	<u>11,322,124</u>	<u>295,946</u>
Total	<u>4,242,971</u>	<u>12,289,598</u>	<u>182,624</u>	<u>16,349,945</u>	<u>365,525</u>

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

D. DEBT SERVICE REQUIREMENTS

The annual debt service requirements to maturity, including principal and interest, for the long-term debt as of December 31, 2011, is as follows:

For the Year Ended December 31,	\$ 724,200 RECD Loan		\$ 329,000 RECD Loan		\$ 4,800,000 RUS Loan		OWRB Loan	
	Prin	Int	Prin	Int	Prin	Int	Prin	Int
2012	11,354	33,490	5,404	14,972	52,821	179,309	295,946	532,569
2013	11,994	32,850	5,708	14,668	54,840	177,289	306,433	522,074
2014	12,671	32,173	6,030	14,346	56,937	175,193	317,309	511,206
2015	13,386	31,458	6,371	14,005	59,114	173,016	328,562	499,953
2016	14,141	30,703	6,730	13,646	61,374	170,756	340,214	488,301
2017-2021	83,608	140,712	39,790	62,090	343,912	816,735	1,890,837	2,251,739
2022-2026	110,003	114,217	52,352	49,528	414,877	745,771	2,250,757	1,891,819
2027-2031	144,731	79,489	68,880	32,999	500,486	660,163	2,679,187	1,463,389
2032-2036	190,424	33,796	83,405	11,308	603,759	556,889	2,912,879	883,649
2037-2041	21,730	347	-	-	728,342	432,305	-	-
2042-2046	-	-	-	-	878,634	282,014	-	-
2047-2051	-	-	-	-	384,013	100,712	-	-
Totals	\$ 614,042	529,235	274,670	227,562	4,139,109	4,470,152	11,322,124	9,044,699

NOTE 3: WATER PURCHASE CONTRACT

The District purchases water from Lake Oologah (an impoundment of the Verdigris River) the Skiatook Reservoir (an impoundment of Hominy Creek) and the City of Tulsa (effective June 2006.) In connection therewith, the District has contracts with the United States Corps of Engineers and the City of Tulsa, and permits to appropriate stream water, from the Verdigris River, Hominy Creek and the Caney River, with the Oklahoma Water Resources Board.

NOTE 4: INVESTMENTS

Investments as of December 31, 2011, are summarized as follows:

	Cost	Fair Value	Carrying Value
Unrestricted:			
Certificates of Deposit	\$ 4,050,500	4,050,500	4,050,500
	\$ 4,050,500	4,050,500	4,050,500

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 5: FAIR VALUES OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments.

Cash, restricted cash, and notes payable: The carrying amounts reported in the statement of financial position approximate fair values because of the short term maturities of those instruments.

Investments: The fair values of investments are based on quoted market prices for those or similar investments.

The estimated fair values of the District's financial instruments at December 31, 2011, none of which are held for trading purposes, are as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:		
Cash	\$ 1,542,579	\$ 1,542,579
Investments	4,050,500	4,050,500
Restricted Cash & Investments	299,239	299,239
Financial liabilities:		
Notes Payable	16,349,945	16,349,945

NOTE 6: RETIREMENT PLAN

The District participated in a Money Purchase Defined Contribution Plan, administered by American Skandia through August 2006. All full time employees, once they met the plan qualifications, were eligible to participate. The District contributed 4 % of each employee's gross salary, monthly, to the plan. Employees were also eligible to contribute up to 10 % of compensation, if they chose to do so.

The employees elected to switch to a governmental Section 457 salary reduction plan in September 2006. The plan is managed by Pension Solutions. All full time employees are eligible to participate. The District contributes 4 % of each employee's gross salary, monthly, to the plan. Employees are eligible to contribute a percentage of their compensation up to a maximum amount allowed by the plan, and if they contribute at least 2 %, then the District matches that up to 2 %. All District contributions become fully vested after 1 year of service.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011

NOTE 7: RESTRICTED NET ASSETS

Net assets were restricted for debt service at December 31, 2011 and 2010, as follows:

	2011	2010
RECD Reserve	\$ 44,932	\$ 49,739
RECD Reserve	20,413	21,158
RUS Reserve – Caney River	232,529	94,643
North Treatment Plant Project Fund	264	468
North Treatment Plant Construction Fund	1,101	-
	\$ 299,239	\$ 166,008

The RECD Reserves are maintained by the District, in separate interest bearing accounts, as discussed in Note 2.A. The North Treatment Plant Project Fund, and the North Treatment Plant Construction Fund, are held in separate interest bearing accounts at a local bank.

NOTE 8: LITIGATION

The District is a party to various legal proceedings that normally occur in the course of operations. The financial statements do not include accruals or provisions for loss contingencies that may result from these proceedings. While the outcome of the above noted proceedings cannot be predicted, due to the insurance coverage maintained by the District, the District feels that any settlement or judgment not covered by insurance would not have a material adverse effect on the financial condition of the District.

NOTE 9: SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 30, 2012, which is the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION

**RURAL WATER DISTRICT NO. 3
WASHINGTON COUNTY, OKLAHOMA**

**BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED DECEMBER 31, 2011**

- UNAUDITED -

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Favorable (Unfavorable)
	Original	Final		
Beginning Budgetary Balance	\$ 5,546,678.00	\$ 5,546,678.00	\$ 4,555,128.00	\$ (991,550.00)
Operating Revenues:				
Water sales	3,636,009.00	3,636,009.00	3,804,857.73	168,848.73
Memberships	300,000.00	300,000.00	282,000.00	(18,000.00)
Penalties, fees, service charges & misc	133,250.00	133,250.00	127,628.38	(5,621.62)
Total operating revenues	<u>4,069,259.00</u>	<u>4,069,259.00</u>	<u>4,214,486.11</u>	<u>145,227.11</u>
Operating Expenses:				
Salaries	704,600.00	704,600.00	684,659.83	19,940.17
Contract labor	55,000.00	55,000.00	29,098.00	25,902.00
Payroll taxes	56,215.00	56,215.00	56,670.05	(455.05)
Retirement	37,400.00	37,400.00	37,702.06	(302.06)
Automobile	65,000.00	65,000.00	49,020.50	15,979.50
Equipment expense	67,000.00	67,000.00	28,571.24	38,428.76
Chemicals	430,000.00	430,000.00	397,571.93	32,428.07
Subscriptions / License / Fees	80,000.00	80,000.00	41,881.48	38,118.52
Education	7,000.00	7,000.00	4,827.44	2,172.56
Supplies	400,000.00	400,000.00	154,956.54	245,043.46
Office expense	58,000.00	58,000.00	49,329.07	8,670.93
Postage	38,000.00	38,000.00	35,140.53	2,859.47
Professional fees	220,000.00	220,000.00	205,603.50	14,396.50
Line Extensions	150,000.00	150,000.00	64,478.46	85,521.54
Repair & maintenance	50,000.00	50,000.00	18,394.80	31,605.20
Telephone	13,800.00	13,800.00	12,931.19	868.81
Utilities	260,000.00	260,000.00	255,998.40	4,001.60
Travel	6,000.00	6,000.00	5,006.88	993.12
Uniforms	3,000.00	3,000.00	6,004.84	(3,004.84)
Water Purchased	120,000.00	120,000.00	88,703.68	31,296.32
Insurance	220,000.00	220,000.00	232,501.80	(12,501.80)
Taxes	50.00	50.00	-	50.00
Refunds	6,000.00	6,000.00	11,384.44	(5,384.44)
Total operating expenses	<u>3,047,065.00</u>	<u>3,047,065.00</u>	<u>2,470,436.66</u>	<u>576,628.34</u>
Non-operating (income) expenses:				
Caney River project	54,600.00	54,600.00	59,707.85	(5,107.85)
Caney River loan payments	232,128.00	232,128.00	232,128.00	0.00
N. Plant loan payments	-	-	288,892.60	(288,892.60)
FmHA loan payments	65,220.00	65,220.00	65,220.00	-
Reserve account payments	7,000.00	7,000.00	-	7,000.00
N. Plant upgrade	384,000.00	384,000.00	133,508.18	250,491.82
Miscellaneous income	(100,000.00)	(100,000.00)	(68,326.32)	(31,673.68)
Interest income	(55,000.00)	(55,000.00)	(62,472.98)	7,472.98
Total non-operating (income) expenses	<u>587,948.00</u>	<u>587,948.00</u>	<u>648,657.33</u>	<u>(60,709.33)</u>
Total Expenses	<u>3,635,013.00</u>	<u>3,635,013.00</u>	<u>3,119,093.99</u>	<u>515,919.01</u>
Ending Budgetary Balance	<u>\$ 5,980,924.00</u>	<u>\$ 5,980,924.00</u>	<u>\$ 5,650,520.12</u>	<u>\$ (330,403.88)</u>

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO BUDGETARY COMPARISON SCHEDULE
For the Year Ended December 31, 2011

Budgetary Information

In accordance with the by-laws of the District, the Board of Directors shall prepare an estimated budget for the coming year.

Basis of Accounting

The budget is prepared on the same accrual basis of accounting as applied to the basic financial statements. Revenues and the related assets are recognized when earned, and expenditures are recognized when the obligation is incurred.

OTHER SUPPLEMENTARY INFORMATION

**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
Washington County, Oklahoma

I have audited the financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of Washington County Rural Water District No. 3 as of and for the years ended December 31, 2011 and 2010, which collectively comprise Washington County Rural Water District No. 3's basic financial statements and have issued my report thereon dated April 30, 2012. 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 Washington County Rural Water District No. 3's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Washington County Rural Water District No. 3's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Washington County Rural Water District No. 3'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 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 Washington County Rural Water District No. 3's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, 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.



Bruce G. Luttrell, CPA, PC

April 30, 2012

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

Board of Directors
Rural Water District No. 3
Washington County, Oklahoma

Compliance

I have audited Washington County Rural Water District No. 3'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 Washington County Rural Water District No. 3's major federal programs for the year ended December 31, 2011. Washington County Rural Water District No. 3'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 Washington County Rural Water Districts No. 3's management. My responsibility is to express an opinion on Washington County Rural Water District No. 3's compliance based on my audit.

I conducted my 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 I 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 Washington County Rural Water District No. 3's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination of Washington County Rural Water District No. 3's compliance with those requirements.

In my opinion, Washington County Rural Water District No. 3 complied, in all material respects, with the compliance 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

The management of Washington County Rural Water District No. 3 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 my audit, I considered Washington County Rural Water District No. 3's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my 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, I do not express an opinion on the effectiveness of Washington County Rural Water District No. 3'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.

My 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 over compliance that might be deficiencies, significant deficiencies, or material weaknesses. I did not identify any deficiencies in internal control over compliance that I consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, 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.

A handwritten signature in black ink, appearing to read "Bruce G. Luttrell". The signature is written in a cursive, flowing style.

Bruce G. Luttrell, CPA, PC

April 30, 2012

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

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

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>Year</u>	<u>Federal CFDA Number</u>	<u>Amount of Expenditures</u>
U.S. Environmental Protection Agency			
Passed through the Oklahoma Water Resources Board			
Capitalization Grants for Safe Drinking Water State Revolving Fund			
ORF-07-0001-DW	12-31-11	66.468	\$ 1,154,554.12
U.S. Department of Agriculture			
Passed through the Rural Utilities Service Water and Waste Disposal Systems for Rural Communities			
Project # 42-074-730746205:			
Loan # 03	12-31-11	10.760	<u>4,232,075.00</u>
 Total Expenditures of Federal Awards			 \$ 5,386,629.12

Note A: Basis of Presentation - The Schedule of Expenditures of Federal Awards includes the federal grant activity of Washington County Rural Water District No. 3 and is presented under the accrual basis of accounting.

Note B: There were no amounts passed to subrecipients.

Note C: Grantor provides adequate insurance coverage against loss on assets purchased with Federal Awards.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

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

SECTION I - SUMMARY OF AUDITOR'S RESULTS

FINANCIAL STATEMENTS

Type of auditor's report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	No
Reportable condition(s) identified not considered to be material weaknesses?	None reported
Noncompliance material to financial statements noted?	No

FEDERAL AWARDS

Internal control over major programs:	
Material weakness(es) identified?	No
Reportable condition(s) identified not considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	None reported

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>	<u>Expenditures</u>
66.468	Capitalization Grants for Safe Drinking Water State Revolving Fund	\$ 1,154,554.12
10.760	Water and Waste Disposal Systems for Rural Communities	\$ 4,232,075.00

Dollar threshold used to distinguish between Type A and Type B programs:	\$ 300,000.00
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Auditee qualified as low-risk auditee?	No
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RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

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

SECTION II - FINANCIAL STATEMENT FINDINGS

None

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters were reported.