

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

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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, 2012, and 2011, 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, 2012, and 2011, and the respective changes in financial position and cash flows, where applicable, 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 29, 2013, 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.

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

Bruce G. Luttrell, CPA, PC

April 29, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

**Washington County Rural Water District No. 3
Management's Discussion and Analysis Report
For Fiscal Year 2012
(Ended December 31, 2012)**

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 Country 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 '12 (731,574,172 gallons) increased slightly by approximately 16 percent when compared to the previous year (sold 669,959,567 gallons in FY '11).
- Revenues from the sale of water accounted for 87 percent of all revenues. The total revenue from water sales increased by approximately 7 percent when compared to FY '11.
- The District expended approximately \$ 4,917,000 on new infrastructure during the year.
- The District did not improve its position with regard to total liabilities by increasing their value by \$ 2,620,277 when compared to FY '11. Total equity increased by approximately \$ 506,000.
- 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 '12 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

	12/31/12	12/31/11	Dollar Change	Percent Change
Current and Other Assets	\$5,594,247	\$6,876,522	<\$1,282,275>	<18.6>
Capital Assets	\$30,173,640	\$25,764,921	\$4,408,719	17.1
Total Assets	\$35,767,887	\$32,641,443	\$3,126,444	9.6
Current Liabilities	\$584,616	\$525,195	\$59,421	11.3
Long-Term Liabilities	\$18,545,276	\$15,984,420	\$2,560,856	16.0
Total Liabilities	\$19,129,892	\$16,509,615	\$2,620,277	15.8
Net Assets invested in capital assets, net of related debt	\$11,242,073	\$9,414,976	\$1,827,097	19.4
Restricted for debt service	\$355,157	\$299,239	\$55,918	18.7
Unrestricted net assets	\$5,040,765	\$6,417,613	<\$1,376,848>	<21.5>
Total Net Assets	\$16,637,995	\$16,131,828	\$506,167	3.1

Condensed Statement of Activities

	12/31/12	12/31/11	Dollar Change	Percent Change
Operating Revenues	\$4,262,352	\$3,989,428	\$272,924	6.8
Non-operating Revenues	\$401,444	\$334,254	\$67,190	20.1
Total Revenues	\$4,663,796	\$4,323,682	\$340,114	7.9
Depreciation Expense	\$450,773	\$456,994	<\$6,221>	<13.5>
Other Operating Expenses	\$3,706,856	\$2,807,181	\$899,675	32.0
Total Expenses	\$4,157,629	\$3,264,175	\$893,454	27.4
Change in Net Assets	\$506,167	\$1,059,507	<\$553,340>	<52.2>
Beginning Net Assets	\$16,131,828	\$15,072,321	\$1,059,507	7.0
Ending Net Assets	\$16,637,995	\$16,131,828	\$506,167	3.1

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 351 new benefit units (i.e., water meters) were sold compared to a total of 282 sold in FY '11. The District sold 731,574,172 gallons of water which represents an approximate increase of 9 percent over FY '11. The increase in year-over-year benefit unit sales is likely the result of the recovering economic conditions and a better housing market.

Statements of Net Assets:

Total Net Assets - The *Statement of Net Assets* shows that the District's total net assets actually increased by \$ 506,167 when compared with FY '11. This increase represents 3 % in our total net assets. Although current assets (i.e., cash) decreased by \$ 1,272,785, the District's fixed assets (i.e., land, equipment and infrastructure) actually increased by \$ 4,408,719 and the District's investments decreased by \$ 400,500.

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 \$ 2,620,277 when compared to FY '11. This increase occurred primarily in the category of long term liabilities. Total equity increased by approximately \$ 506,000.

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 \$ 506,167. This compares unfavorably to the net change in net assets of \$ 1,059,507 experienced in FY '11.

Revenues – The District's total operating revenues for FY '12 were \$ 4,262,352. This represents an increase of approximately \$ 272,924 or 6.8 percent over FY '11. Approximately 87 percent of our revenues (i.e., \$ 4,064,962) were derived from sale of water services.

Approximately 8 percent of revenues (\$ 351,000) came from membership fees. Revenues from these items were up 24 percent over FY '11.

Expenses - The District's total operating expenses were \$ 4,157,629. Excluding depreciation and amortization the total operating expenses are reduced to \$ 3,697,366. This represents an approximate increase of \$ 899,675 or 32 percent over FY '11.

Statement of Cash Flows:

As shown in the *Statement of Cash Flows* the District had a net decrease in cash at the end of the year of \$ 877,427.

Annual Budget

As required by the District's By-Laws an Annual Budget was prepared by the District Manager for FY '12. 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 '12 Annual Budget was reviewed and approved by the Board during the Board meeting held on March 12, 2012.

Debt Administration:

The remaining balance for all promissory notes (i.e., loans) at the beginning of the year was \$ 16,349,945. All scheduled loan and interest payments through December 31, 2012 were made on time. The District increased its principal on outstanding loans by \$ 3,125,166. The District reduced its principal on outstanding loans by \$ 543,544. The balance remaining on all outstanding loans is \$ 18,931,567. The sinking fund for the District's loans is fully funded.

Highlights of Other Critical Information:

- In Fiscal Year 2012 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.
- Caney River Raw Water Supply Project – The District continued construction on the project throughout 2012.
- Water Treatment Plant (WTP) Expansion Project – The District continued construction of the WTP expansion in 2012.
- Legal Action by Design Engineer of WTP Expansion Project – Formal legal action continued against the District in 2012 by the design engineer for additional fees.
- Water Service to the Owasso Medical Campus – The Districts' formal legal action against the City of Owasso for their encroachment has been resolved 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.
- Completed construction on approximately 1,000 linear feet on new 12-inch water line along 86th Street between Memorial and Sheridan.
- Completed an upgrade to the computer systems in the Districts main office.
- Water towers and clearwells at the water treatment plant were inspected.
- Water Resources Master Planning – We continue 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 \$ 2,581,622 as a result of the Rural Development loan for the Caney River Project and the OWRB loan for the north plant expansion project. We ended the year with less cash and investments (i.e., \$ 1,276,134) than we started with.

Looking Forward – As we look forward to Fiscal Year 2013 we anticipate our growth to be the same or slightly greater than that which was experienced in FY '12. 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 third quarter of FY 2013.
- Caney River Raw Water Supply Project – We anticipate construction to be completed in the second quarter of 2013.
- Water Resources Master Plan – We anticipate completing the master plan in 2013. This master plan will identify future capital needs with emphasis on priority.

- Water Towers and Clearwells – Repair work is expected to be completed to certain water towers and the legacy clearwell at the North Water Treatment Plant.
- Future Water Lines – The District is planning:
 - The addition of approximately one mile of 24-inch water line.
 - The relocation of existing water lines at Garnett and 106th Street North to accommodate intersection improvements.
 - The relocation of certain water lines along Highway 11 north of Skiatook.

FINANCIAL STATEMENTS

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

**STATEMENTS OF NET ASSETS
DECEMBER 31, 2012 AND 2011**

	2012	2011
ASSETS		
Current assets:		
Cash	\$ 665,152	\$ 1,542,579
Investments	3,650,000	4,050,500
Restricted cash & investments (Note 7)	301,032	299,239
Accounts receivable	368,427	341,019
Accrued interest receivable	859	2,008
Inventory	302,697	326,035
Prepaid insurance	48,850	48,422
Total current assets	5,337,017	6,609,802
Noncurrent assets:		
Other assets:		
Debt issue costs (Note 2)	257,230	266,720
Total other assets	257,230	266,720
Capital assets:		
Building & land	307,638	307,638
Machinery & tools	322,336	343,678
Automotive equipment	316,189	316,189
Furniture & fixtures	116,212	108,051
Lab equipment	40,706	40,706
Water treatment & distribution system	38,696,314	33,890,032
Less accumulated depreciation	(9,625,755)	(9,241,373)
Total capital assets	30,173,640	25,764,921
Total Assets	\$ 35,767,887	\$ 32,641,443

The accompanying notes to the financial

	<u>2012</u>	<u>2011</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 51,155	\$ 40,020
Accrued interest payable	147,170	119,650
Current portion of long-term debt (Note 2)	386,291	365,525
Total current liabilities	<u>584,616</u>	<u>525,195</u>
Noncurrent liabilities:		
Notes payable (Note 2)	18,931,567	16,349,945
Less: current portion	(386,291)	(365,525)
Total noncurrent liabilities	<u>18,545,276</u>	<u>15,984,420</u>
Total Liabilities	<u>19,129,892</u>	<u>16,509,615</u>
 NET ASSETS		
Invested in capital assets, net of related debt	11,242,073	9,414,976
Nonspendable	302,697	326,035
Restricted for debt service	355,157	299,239
Unassigned	4,738,068	6,091,578
Total Net Assets	<u>\$ 16,637,995</u>	<u>\$ 16,131,828</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, 2012 AND 2011**

	2012	2011
Operating revenues:		
Water sales (net of adjustments)	\$ 4,064,962	\$ 3,793,473
Penalties, fees, service charges and miscellaneous	197,390	195,955
Total operating revenues	4,262,352	3,989,428
Operating expenses:		
Salaries, wages & contract labor	753,772	713,758
Payroll taxes	60,602	56,670
Employee benefits	198,220	180,116
Utilities	296,117	255,998
Telephone	14,579	12,931
Equipment expense	2,843	28,571
Depreciation	450,773	456,994
Interest expense	663,809	403,117
Vehicle expense	57,764	49,021
Building, vehicle & other insurance	89,852	90,088
Plant repair & maintenance	50,837	18,395
Chemicals	497,552	397,572
Travel, entertainment & miscellaneous	31,563	32,440
Licenses & fees	25,578	38,711
Plant supplies	310,344	154,957
Water purchased	312,450	88,704
Office expense & postage	72,407	71,038
Professional fees	259,077	205,604
Amortization	9,490	9,490
Total operating expenses	4,157,629	3,264,175
Net operating income	104,723	725,253
Nonoperating revenue (expense)		
New benefit units	351,000	282,000
Grant income	-	-
Interest income	33,765	62,473
Gain on sale of assets	17,179	(9,719)
Trustee fee	(500)	(500)
Total nonoperating revenue (expense)	401,444	334,254
Change in net assets	506,167	1,059,507
Net assets beginning of year	16,131,828	15,072,321
Net assets end of year	\$ 16,637,995	\$ 16,131,828

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, 2012 AND 2011**

	2012	2011
Cash flows from operating activities:		
Receipts from customers	\$ 4,234,944	\$ 4,000,666
Payments to suppliers	(2,882,524)	(2,088,300)
Payments to employees	(752,128)	(701,783)
Net cash provided (used) by operating activities	600,292	1,210,583
Cash flows from noncapital financing activities:		
Transfers from (to) investments	400,500	(300,000)
Transfers from (to) restricted cash and investments	(1,793)	(133,231)
Grant income	-	-
Trustee fee	(500)	(500)
Net cash provided (used) by noncapital financing activities	398,207	(433,731)
Cash flows from capital and related financing activities:		
New benefit units	351,000	282,000
Purchase of capital assets	(4,917,313)	(12,532,721)
Principal paid on capital debt	(543,544)	(182,624)
Issue new capital debt	3,125,166	12,289,597
Sales and trade assets	75,000	(18,843)
Net cash provided (used) by capital and related financing activities	(1,909,691)	(162,591)
Cash flows from investing activities:		
Interest income	33,765	62,473
Net increase (decrease) in cash and cash equivalents	(877,427)	676,734
Cash balance beginning of year	1,542,579	865,845
Cash balance end of year	\$ 665,152	\$ 1,542,579
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	\$ 104,723	\$ 725,253
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Cash flows reported in other categories:		
Depreciation expense	450,773	456,994
Amortization	9,490	9,490
Change in assets and liabilities:		
Accounts receivable	(27,408)	11,238
Accrued interest receivable	1,149	2,597
Inventory	23,338	(90,123)
Prepaid insurance	(428)	(3,319)
Accounts payable	11,135	3,743
Accrued interest payable	27,520	94,710
Net cash provided by operating activities	\$ 600,292	\$ 1,210,583

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, 2012

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 8,500 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, 2012

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, 2012 and 2011, financial statements at \$ 302,697 and \$ 326,035, 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, 2012, is as follows:

	<u>Beginning</u>	<u>Additions</u>	<u>Rtmnts</u>	<u>Transfers</u>	<u>Ending</u>
	<u>Balance</u>				<u>Balance</u>
Building & Land	\$ 307,638				\$ 307,638
Machinery & Tools	343,678	102,870	124,212		322,336
Automotive	316,189				316,189
Furniture, Fixtures & Equipment	108,051	8,161			116,212
Lab Equipment	40,706				40,706
Water Treatment & Distribution System	<u>33,890,032</u>	<u>4,806,282</u>			<u>38,696,314</u>
Total	<u>\$ 35,006,294</u>	<u>4,917,313</u>	<u>124,212</u>	<u>-</u>	<u>\$ 39,799,395</u>

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, 2012

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 10 months service, of 2 weeks per year for 10 months through 8 years service, 3 weeks per year for 9 years through 14 years service, and 4 weeks beginning in the 15th year of 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 \$ 19,700 and \$ 13,400, at December 31, 2012 and 2011, respectively. The vacation accrued at December 31, 2012, was paid the first week of 2013. 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, 2012 and 2011, 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, 2012 and 2011.

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, 2012

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, such as inventory. 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, 2012

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, 2012 and 2011, was \$ 4,551,065 and \$ 4,139,109, respectively.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

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. During the year ended December 31, 2011, the District funded the reserve in full. The balance in the reserve account at December 31, 2012 and 2011, was \$ 233,805.84 and \$ 232,528.41, respectively.

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, 2012 and 2011, was approximately \$ 871,950 and \$ 888,712, 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, 2012 and 2011, accumulated amortization was \$ 9,302 and \$ 8,508, 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, 2012 and 2011, the balances in the reserve accounts were \$ 65,704.49 and \$ 65,345.50, 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. During the year ended December 31, 2012, another \$ 2,650,286 was drawn under the loan agreement, and expended, and principal of \$ 463,857 was paid on the loan.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

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, 2012 and 2011, was \$ 13,508,552 and \$ 11,322,123, 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, 2012 and 2011, accumulated amortization was \$ 26,093 and \$ 17,395, 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, 2012.

Loan	Jan. 1, 2012	Additions	Reductions	Dec. 31, 2012	Amount Due Within One Year
RECD Loan – 724,200	614,042		11,357	602,685	11,995
RECD Loan – 329,000	274,670		5,405	269,265	5,708
RUS Loan	4,139,109	474,880	62,924	4,551,065	62,146
OWRB Loan	<u>11,322,124</u>	<u>2,650,286</u>	<u>463,858</u>	<u>13,508,552</u>	<u>306,442</u>
Total	<u>16,349,945</u>	<u>3,125,166</u>	<u>543,544</u>	<u>18,931,567</u>	<u>386,291</u>

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

D. DEBT SERVICE REQUIREMENTS

The annual debt service requirements to maturity, including principal and interest, for the long-term debt as of December 31, 2012, 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
2013	11,994	32,850	5,708	14,668	62,146	169,983	259,688	467,321
2014	12,671	32,173	6,030	14,346	64,522	167,607	268,897	458,112
2015	13,386	31,458	6,371	14,005	66,989	165,141	278,434	448,575
2016	14,141	30,703	6,730	13,646	69,550	162,579	288,308	438,701
2017	14,939	29,906	7,109	13,267	72,209	159,920	298,532	428,477
2018-2022	88,324	135,896	42,035	59,845	404,628	756,019	1,659,179	1,975,864
2023-2027	116,208	108,012	55,305	46,574	488,122	672,526	1,975,002	1,660,041
2028-2032	152,895	71,325	72,765	29,116	588,844	571,803	2,350,943	1,284,100
2033-2037	178,127	23,322	67,212	7,124	710,350	450,297	2,798,442	836,601
2038-2042	-	-	-	-	856,929	303,719	3,331,127	303,916
2043-2047	-	-	-	-	1,033,753	126,895	-	-
2048-2052	-	-	-	-	133,023	1,680	-	-
Totals	\$ 602,685	495,645	269,265	212,591	4,551,065	3,708,169	13,508,552	8,301,708

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, 2012, are summarized as follows:

	Cost	Fair Value	Carrying Value
Unrestricted:			
Certificates of Deposit	\$ 3,650,000	3,650,000	3,650,000
	\$ 3,650,000	3,650,000	3,650,000

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2012

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, 2012, none of which are held for trading purposes, are as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:		
Cash	\$ 611,027	\$ 611,027
Investments	3,650,000	3,650,000
Restricted Cash & Investments	355,157	355,157
Financial liabilities:		
Notes Payable	18,931,567	18,931,567

NOTE 6: RETIREMENT PLAN

The District participates in a governmental Section 457 salary reduction plan. 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, 2012

NOTE 7: RESTRICTED NET ASSETS

Net assets were restricted for debt service at December 31, 2012 and 2011, as follows:

	2012	2011
RECD Reserve	\$ 45,179	\$ 44,932
RECD Reserve	20,525	20,413
RUS Reserve – Caney River	233,806	232,529
North Treatment Plant Project Fund	148	264
North Treatment Plant Construction Fund	1,374	1,101
	\$ 301,032	\$ 299,239

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 29, 2013, 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, 2012**

- UNAUDITED -

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Favorable (Unfavorable)
	Original	Final		
Beginning Budgetary Balance	\$ 5,383,233.90	\$ 5,383,233.90	\$ 6,091,578.00	\$ 708,344.10
Operating Revenues:				
Water sales	3,891,785.00	3,891,785.00	4,073,335.72	181,550.72
Memberships	300,000.00	300,000.00	351,000.00	51,000.00
Penalties, fees, service charges & misc	127,350.00	127,350.00	134,073.13	6,723.13
Total operating revenues	<u>4,319,135.00</u>	<u>4,319,135.00</u>	<u>4,558,408.85</u>	<u>239,273.85</u>
Operating Expenses:				
Salaries	726,950.00	726,950.00	751,172.26	(24,222.26)
Contract labor	40,000.00	40,000.00	2,600.00	37,400.00
Payroll taxes	58,266.00	58,266.00	60,602.47	(2,336.47)
Retirement	39,000.00	39,000.00	39,014.59	(14.59)
Automobile	65,000.00	65,000.00	57,763.75	7,236.25
Equipment expense	60,000.00	60,000.00	2,843.23	57,156.77
Chemicals	480,000.00	480,000.00	497,552.12	(17,552.12)
Subscriptions / License / Fees	80,000.00	80,000.00	27,843.64	52,156.36
Education	7,000.00	7,000.00	10,039.22	(3,039.22)
Supplies	320,000.00	320,000.00	310,344.10	9,655.90
Office expense	58,000.00	58,000.00	45,411.93	12,588.07
Postage	40,000.00	40,000.00	38,326.52	1,673.48
Professional fees	230,000.00	230,000.00	259,077.20	(29,077.20)
Line Extensions	80,000.00	80,000.00	26,157.97	53,842.03
Repair & maintenance	50,000.00	50,000.00	50,836.98	(836.98)
Telephone	13,800.00	13,800.00	14,578.92	(778.92)
Utilities	360,000.00	360,000.00	296,116.70	63,883.30
Travel	6,000.00	6,000.00	6,909.08	(909.08)
Uniforms	3,500.00	3,500.00	1,527.24	1,972.76
Water Purchased	10,000.00	10,000.00	312,450.19	(302,450.19)
Insurance	280,000.00	280,000.00	248,496.84	31,503.16
Taxes	50.00	50.00	50.00	-
Refunds	10,000.00	10,000.00	8,373.53	1,626.47
Total operating expenses	<u>3,017,566.00</u>	<u>3,017,566.00</u>	<u>3,068,088.48</u>	<u>(50,522.48)</u>
Non-operating (income) expenses:				
Caney River project	55,000.00	55,000.00	58,369.65	(3,369.65)
Caney River loan payments	232,128.00	232,128.00	232,128.00	-
N. Plant loan payments	864,000.00	864,000.00	419,126.88	444,873.12
FmHA loan payments	65,220.00	65,220.00	65,220.00	-
Reserve account payments	-	-	-	-
N. Plant upgrade	80,000.00	80,000.00	155,673.60	(75,673.60)
Miscellaneous income	(80,000.00)	(80,000.00)	(80,495.92)	495.92
Interest income	(65,000.00)	(65,000.00)	(33,764.64)	(31,235.36)
Total non-operating (income) expenses	<u>1,151,348.00</u>	<u>1,151,348.00</u>	<u>816,257.57</u>	<u>335,090.43</u>
Total Expenses	<u>4,168,914.00</u>	<u>4,168,914.00</u>	<u>3,884,346.05</u>	<u>284,567.95</u>
Ending Budgetary Balance	<u>\$ 5,533,454.90</u>	<u>\$ 5,533,454.90</u>	<u>\$ 6,765,640.80</u>	<u>\$ 1,232,185.90</u>

**RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma**

**NOTES TO BUDGETARY COMPARISON SCHEDULE
For the Year Ended December 31, 2012**

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, 2012 and 2011, which collectively comprise Washington County Rural Water District No. 3's basic financial statements and have issued my report thereon dated April 29, 2013. 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.

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 29, 2013