

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

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RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

CONTENTS

	Page No.
INDEPENDENT AUDITOR'S REPORT	1-2
REQUIRED SUPPLEMENTARY INFORMATION: Management's Discussion and Analysis	3-8
BASIC FINANCIAL STATEMENTS:	
Statements of Net Assets	9-10
Statements of Revenues, Expenses, and Changes in Fund Net Assets	11
Statements of Cash Flows	12
Notes to the Financial Statements	13-23
REQUIRED SUPPLEMENTARY INFORMATION:	
Budget Comparison Schedule	24
Notes to Budgetary Comparison Schedule	25
OTHER SUPPLEMENTARY INFORMATION:	
Auditor's 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	26-27

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

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, 2013 and 2012, and the related notes to the financial statements, which collectively comprise Washington County Rural Water District No. 3's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express opinions 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

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, 2013 and 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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 24, 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued my report dated April 28, 2014, on my consideration of Washington County Rural Water District No. 3's, internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Washington County Rural Water District No. 3's, internal control over financial reporting and compliance.



Bruce G. Luttrell, CPA, PC

April 28, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

**Washington County Rural Water District No. 3
Management's Discussion and Analysis Report
For Fiscal Year 2013
(Ended December 31, 2013)**

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 '13 (649,559,927 gallons) decreased slightly by approximately 11 percent when compared to the previous year (sold 731,574,172 gallons in FY '12).
- Revenues from the sale of water accounted for 80.1 percent of all revenues. The total revenue from water sales decreased by approximately 2.5 percent when compared to FY '12.
- The District expended approximately \$ 860,000 on new infrastructure during the year.
- The District improved its position with regard to total liabilities by decreasing their value by \$ 428,000 when compared to FY '12. Total equity increased by approximately \$ 728,000.
- 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 '13 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

	12/31/13	12/31/12	Dollar Change	Percent Change
Current and Other Assets	\$5,503,576	\$5,594,247	<\$90,671>	1.6
Capital Assets	\$30,567,732	\$30,173,640	\$394,092	1.3
Total Assets	\$36,071,308	\$35,767,887	\$303,421	0.8
Current Liabilities	\$559,628	\$584,616	<\$24,988>	4.3
Long-Term Liabilities	\$18,144,932	\$18,545,276	<\$400,344>	2.2
Total Liabilities	\$18,704,560	\$19,129,892	<\$425,332>	2.2
Net Assets invested in capital assets, net of related debt	\$12,064,402	\$11,242,073	\$822,329	7.3
Restricted for debt service	\$368,524	\$355,157	\$13,367	3.8
Unrestricted net assets	\$4,933,822	\$5,040,765	<\$106,943>	2.1
Total Net Assets	\$17,366,748	\$16,637,995	\$728,753	4.4

Condensed Statement of Activities

	12/31/13	12/31/12	Dollar Change	Percent Change
Operating Revenues	\$4,154,515	\$4,262,352	<\$107,837>	2.5
Non-operating Revenues	\$796,825	\$401,444	\$395,381	98.5
Total Revenues	\$4,951,340	\$4,663,796	\$287,544	6.2
Depreciation Expense	\$466,086	\$450,773	\$15,313	3.4
Other Operating Expenses	\$3,756,501	\$3,706,856	\$49,645	1.3
Total Expenses	\$4,222,587	\$4,157,629	\$64,958	1.6
Change in Net Assets	\$728,753	\$506,167	\$222,586	44.0
Beginning Net Assets	\$16,637,995	\$16,131,828	\$506,167	3.1
Ending Net Assets	\$17,366,748	\$16,637,995	\$728,753	4.4

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 361 new benefit units (i.e., water meters) were sold compared to a total of 351 sold in FY '12. The District sold 649,559,927 gallons of water which represents an approximate decrease of 11 percent over FY '12. The slight increase in year-over-year benefit unit sales is likely the result of a better housing market compared to the previous year.

Statements of Net Assets:

Total Net Assets - The *Statement of Net Assets* shows that the District's total net assets actually increased by \$ 728,753 when compared with FY '12. This increase represents 4.4 % in our total net assets. Although current assets (i.e., cash) increased by \$ 109,609, the District's fixed assets (i.e., land, equipment and infrastructure) actually increased by \$ 394,092 and the District's investments decreased by \$ 300,000.

On the 2 nd page of the *Statement of Net Assets* we see that the District improved its position with regard to total (i.e., current and long term) liabilities by decreasing their value by \$ 425,332 when compared to FY '12. This decrease occurred primarily in the category of long term liabilities. Total equity increased by approximately \$ 728,000.

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 \$ 728,753. This compares favorably to the net change in net assets of \$ 506,167 experienced in FY '12.

Revenues – The District's total operating revenues for FY '13 were \$ 4,154,515. This represents a decrease of approximately \$ 107,000 or 2.5 percent over FY '12. Approximately 80 percent of our revenues (i.e., \$ 3,964,340) were derived from sale of water services.

Approximately 7.3 percent of revenues (\$ 361,000) came from membership fees. Revenues from these items were up 2.8 percent over FY '12.

Expenses - The District's total operating expenses were \$ 4,222,587. Excluding depreciation and amortization the total operating expenses are reduced to \$ 3,747,011. This represents an approximate increase of \$ 49,645 or 1.3 percent over FY '12.

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 \$ 190,609.

Annual Budget

As required by the District's By-Laws an Annual Budget was prepared by the District Manager for FY '13. 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 '13 Annual Budget was reviewed and approved by the Board during the Board meeting held on March 11, 2013.

Debt Administration:

The remaining balance for all promissory notes (i.e., loans) at the beginning of the year was \$ 18,931,567. A total of \$ 224,088 additional principal was drawn on loans during the year, and all scheduled loan and interest payments through December 31, 2013 were made on time. The District reduced its principal on outstanding loans by \$ 652,325. The balance remaining on all outstanding loans is \$ 18,503,330. The sinking fund for the District's loans is fully funded.

Highlights of Other Critical Information:

- In Fiscal Year 2013 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. We did have one monitoring violation for the number of bacteriological samples taken in the month of September 2013. We errantly collected 14 of the required 15 samples.
- Caney River Raw Water Supply Project – Although the project is functional all the final construction tasks on the project have not been completed. Legal action filed by the Contractor against the District is in progress.
- Water Treatment Plant (WTP) Expansion Project – The District continued construction of the WTP expansion in 2013.
- Legal Action by Design Engineer of WTP Expansion Project – Formal legal action continued against the District in 2013 by the design engineer for additional fees.
- City of Owasso Utility Relocation Projects – The District worked with the City and their representatives on the construction of water line relocations for District infrastructure located along 86th Street North between Memorial and Districts east boundary. The relocation work was completed and reimbursement was received by the District in early 2013. The District also worked with the City on the relocation of water lines near the intersection of 106th Street North and Garnett.
- Two (2) water towers in the distribution system and the both clearwells at the North WTP were cleaned during 2013.
- Water Resources Master Planning – We continue work on a new master plan for the District.
- 24-inch Water Line Extension – The District started construction on a 24-inch water line extension along 129th East Avenue from 126th Street North to approximately 116th Street North.
- South Booster Pump Station – The District upgraded some of the infrastructure at the South Booster pump station in 2013.

Conclusions – The District as a whole has a better financial position than a year ago. The value of our total liabilities decreased while the value of our total equity increased. Our total debt service increased by \$ 130,291 for the year. We ended the year with less cash and investments (i.e., \$ 96,024) than we started with.

Looking Forward – As we look forward to Fiscal Year 2014 we anticipate our growth to be the same or slightly greater than that which was experienced in FY '13. We also anticipate progress on the following major capital projects:

- Water Treatment Plant (WTP) Expansion Project – We anticipate that the new WTP will be put into production in the second quarter of 2014. Construction on the remainder of the project is expected to be completed in the fourth quarter of FY 2014.

- Caney River Raw Water Supply Project – We anticipate the remaining construction to be completed in the second or third quarter of 2014.
- Water Resources Master Plan – We anticipate completing the master plan in 2014. This master plan will identify future capital needs with emphasis on priority.
- Water Towers – Repair work is expected to be completed to certain water towers.
- Future Water Lines – The District is planning:
 - The completion of the 24-inch water line along 129th East Avenue from 126th Street North to approximately 116th Street North.
 - The relocation of existing water lines at Garnett and 106th Street North to accommodate intersection improvements.
 - The relocation of certain water lines along 176th Street North at Skalall Creek.

FINANCIAL STATEMENTS

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

**STATEMENTS OF NET ASSETS
DECEMBER 31, 2013 AND 2012**

	2013	2012
ASSETS		
Current assets:		
Cash	\$ 801,636	\$ 611,027
Investments	3,350,000	3,650,000
Restricted cash & investments (Note 7)	368,524	355,157
Accounts receivable	382,173	368,427
Accrued interest receivable	519	859
Inventory	302,697	302,697
Prepaid insurance	50,287	48,850
Total current assets	5,255,836	5,337,017
Noncurrent assets:		
Other assets:		
Debt issue costs (Note 2)	247,740	257,230
Total other assets	247,740	257,230
Capital assets:		
Building & land	307,638	307,638
Machinery & tools	322,336	322,336
Automotive equipment	345,200	316,189
Furniture & fixtures	116,212	116,212
Lab equipment	40,706	40,706
Water treatment & distribution system	39,527,481	38,696,314
Less accumulated depreciation	(10,091,841)	(9,625,755)
Total capital assets	30,567,732	30,173,640
Total Assets	\$ 36,071,308	\$ 35,767,887

The accompanying notes to the financial

	<u>2013</u>	<u>2012</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 55,387	\$ 51,155
Accrued interest payable	145,843	147,170
Current portion of long-term debt (Note 2)	358,398	386,291
Total current liabilities	<u>559,628</u>	<u>584,616</u>
Noncurrent liabilities:		
Notes payable (Note 2)	18,503,330	18,931,567
Less: current portion	(358,398)	(386,291)
Total noncurrent liabilities	<u>18,144,932</u>	<u>18,545,276</u>
Total Liabilities	<u>18,704,560</u>	<u>19,129,892</u>
 NET ASSETS		
Invested in capital assets, net of related debt	12,064,402	11,242,073
Nonspendable	302,697	302,697
Restricted for debt service	368,524	355,157
Unassigned	4,631,125	4,738,068
Total Net Assets	<u>\$ 17,366,748</u>	<u>\$ 16,637,995</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, 2013 AND 2012**

	2013	2012
Operating revenues:		
Water sales (net of adjustments)	\$ 3,964,340	\$ 4,064,962
Penalties, fees, service charges and miscellaneous	190,175	197,390
Total operating revenues	4,154,515	4,262,352
Operating expenses:		
Salaries, wages & contract labor	799,816	753,772
Payroll taxes	63,835	60,602
Employee benefits	215,228	198,220
Utilities	362,443	296,117
Telephone	15,345	14,579
Equipment expense	10,194	2,843
Depreciation	466,086	450,773
Interest expense	685,319	663,809
Vehicle expense	74,140	57,764
Building, vehicle & other insurance	90,770	89,852
Plant repair & maintenance	39,533	50,837
Chemicals	519,372	497,552
Travel, entertainment & miscellaneous	25,625	31,563
Licenses & fees	29,322	25,578
Plant supplies	323,419	310,344
Water purchased	230,393	312,450
Office expense & postage	73,225	72,407
Professional fees	189,032	259,077
Amortization	9,490	9,490
Total operating expenses	4,222,587	4,157,629
Net operating income	(68,072)	104,723
Nonoperating revenue (expense)		
New benefit units	361,000	351,000
Settlement of encroachment lawsuit	420,000	-
Interest income	16,325	33,765
Gain on sale of assets	-	17,179
Trustee fee	(500)	(500)
Total nonoperating revenue (expense)	796,825	401,444
Change in net assets	728,753	506,167
Net assets beginning of year	16,637,995	16,131,828
Net assets end of year	\$ 17,366,748	\$ 16,637,995

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, 2013 AND 2012**

	2013	2012
Cash flows from operating activities:		
Receipts from customers	\$ 4,140,769	\$ 4,234,944
Payments to suppliers	(2,953,525)	(2,882,524)
Payments to employees	(791,678)	(752,128)
Net cash provided (used) by operating activities	395,566	600,292
Cash flows from noncapital financing activities:		
Transfers from (to) investments	300,000	400,500
Transfers from (to) restricted cash and investments	(13,367)	(55,918)
Settlement of encroachment lawsuit	420,000	-
Trustee fee	(500)	(500)
Net cash provided (used) by noncapital financing activities	706,133	344,082
Cash flows from capital and related financing activities:		
New benefit units	361,000	351,000
Purchase of capital assets	(860,178)	(4,917,313)
Principal paid on capital debt	(652,325)	(543,544)
Issue new capital debt	224,088	3,125,166
Sales and trade assets	0	75,000
Net cash provided (used) by capital and related financing activities	(927,415)	(1,909,691)
Cash flows from investing activities:		
Interest income	16,325	33,765
Net increase (decrease) in cash and cash equivalents	190,609	(931,552)
Cash balance beginning of year	611,027	1,542,579
Cash balance end of year	\$ 801,636	\$ 611,027
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	\$ (68,072)	\$ 104,723
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Cash flows reported in other categories:		
Depreciation expense	466,086	450,773
Amortization	9,490	9,490
Change in assets and liabilities:		
Accounts receivable	(13,746)	(27,408)
Accrued interest receivable	340	1,149
Inventory	0	23,338
Prepaid insurance	(1,437)	(428)
Accounts payable	4,232	11,135
Accrued interest payable	(1,327)	27,520
Net cash provided by operating activities	\$ 395,566	\$ 600,292

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, 2013

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 9,500 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, 2013

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, 2013 and 2012, financial statements at \$ 302,697 and \$ 302,697, 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:

	Years
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, 2013, is as follows:

	Beginning Balance	Additions	Rtmts	Transfers	Ending Balance
Building & Land	\$ 307,638				\$ 307,638
Machinery & Tools	322,336				322,336
Automotive	316,189	29,011			345,200
Furniture, Fixtures & Equipment	116,212				116,212
Lab Equipment	40,706				40,706
Water Treatment & Distribution System	38,696,314	831,167			39,527,481
Total	\$ 39,799,395	860,178	-	-	\$ 40,659,573

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, 2013

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 \$ 19,200 and \$ 19,700, at December 31, 2013 and 2012, respectively. The vacation accrued at December 31, 2013, was paid the first week of 2014. 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, 2013 and 2012, 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, 2013 and 2012.

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, 2013

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, 2013

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 was utilized to acquire and construct water system improvements, namely the Caney River project. The total cost of the project was approximately \$ 6,300,000, thus the District provided the balance of the funds for the project (\$ 1,500,000.) The total balance outstanding under the loan as of December 31, 2013 and 2012, was \$ 4,488,529 and \$ 4,551,065, respectively.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

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, 2013 and 2012, was \$ 235,083.26 and \$ 233,805.84, 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, 2013 and 2012, was approximately \$ 746,018 and \$ 871,950, respectively.

In connection with the settlement of the encroachment lawsuit during the current year (discussed in Note 8), the remainder of the settlement (\$ 104,186.83) after reimbursing the District's legal fees, was paid on the principal of the \$ 329,000 loan.

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, 2013 and 2012, accumulated amortization was \$ 10,093 and \$ 9,300, 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, 2013 and 2012, the balances in the reserve accounts were \$ 66,063.47 and \$ 65,704.49, 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, 2012, a total of \$ 15,972,410 was drawn under the loan agreement, and expended, and principal of \$ 463,858 had been paid on the loan. And, in accordance with the agreement with the Oklahoma Water Resources Board, \$ 2,000,000 of those proceeds were funded through the

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

NOTE 2: LONG-TERM DEBT (continued)

American Recovery and Reinvestment Act of 2009, and that amount of the loan principle has been forgiven, pending compliance with all ARRA regulations. During the year ended December 31, 2013, another \$ 224,088 was drawn under the loan agreement, and expended, and principal of \$ 463,857 was paid on the loan.

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, 2013 and 2012, was \$ 13,268,783 and \$ 13,508,552, 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, 2013 and 2012, accumulated amortization was \$ 34,789 and \$ 26,092, 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. The District was in compliance with this requirement during the years ending December 31, 2013 and 2012.

C. CHANGES IN LONG-TERM DEBT

The following is a summary of changes in long-term debt for the year ended December 31, 2013.

Loan	Jan. 1, 2013	Additions	Reductions	Dec. 31, 2013	Amount Due Within One Year
RECD Loan – 724,200	602,685		11,997	590,688	12,671
RECD Loan – 329,000	269,265		113,935	155,330	12,307
RUS Loan	4,551,065		62,536	4,488,529	64,522
OWRB Loan	<u>13,508,552</u>	<u>224,088</u>	<u>463,857</u>	<u>13,268,783</u>	<u>268,898</u>
Total	<u>18,931,567</u>	<u>224,088</u>	<u>652,325</u>	<u>18,503,330</u>	<u>358,398</u>

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

D. DEBT SERVICE REQUIREMENTS

The annual debt service requirements to maturity, including principal and interest, for the long-term debt as of December 31, 2013, 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
2014	12,671	32,173	12,307	8,069	64,522	167,607	268,897	458,112
2015	13,386	31,458	13,001	7,375	66,989	165,141	278,434	448,575
2016	14,141	30,703	13,735	6,641	69,550	162,579	288,308	438,701
2017	14,939	29,906	14,509	5,867	72,209	159,920	298,532	428,477
2018	15,781	29,063	15,328	5,048	74,970	157,160	309,119	417,889
2019-2023	93,306	130,914	86,450	11,308	420,098	740,550	1,718,020	1,917,024
2024-2028	122,763	101,457	-	-	506,784	653,864	2,045,043	1,590,000
2029-2033	161,520	62,700	-	-	611,357	549,291	2,434,316	1,200,727
2034-2038	142,181	14,421	-	-	737,509	423,139	2,897,686	737,357
2039-2043	-	-	-	-	889,691	270,957	2,730,428	197,525
2044-2048	-	-	-	-	974,850	87,980	-	-
Totals	\$ 590,688	462,795	155,330	44,308	4,488,529	3,538,188	13,268,783	7,834,387

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, 2013, are summarized as follows:

	Cost	Fair Value	Carrying Value
Unrestricted:			
Certificates of Deposit	\$ 3,350,000	3,350,000	3,350,000
	\$ 3,350,000	3,350,000	3,350,000

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

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, 2013, none of which are held for trading purposes, are as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:		
Cash	\$ 801,636	\$ 801,636
Investments	3,350,000	3,350,000
Restricted Cash & Investments	368,524	368,524
Financial liabilities:		
Notes Payable	18,503,330	18,503,330

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, 2013

NOTE 7: RESTRICTED NET ASSETS

Net assets were restricted for debt service at December 31, 2013 and 2012, as follows:

	2013	2012
RECD Reserve	\$ 45,426	\$ 45,179
RECD Reserve	20,638	20,525
RUS Reserve – Caney River	235,083	233,806
North Treatment Plant Project Fund	150	148
North Treatment Plant Construction Fund	1,414	1,374
Interest Reserve	<u>65,813</u>	<u>54,125</u>
	<u>\$ 368,524</u>	<u>\$ 355,157</u>

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, the North Treatment Plant Construction Fund, and the Interest Reserve 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.

During the current year, the encroachment lawsuit was settled with the City of Owasso. The City of Owasso paid the District \$ 420,000. The District retained \$ 315,813.17 for reimbursement for its legal fees, and the remaining \$ 104,186.83 was paid to Rural Development to be applied to the principal of the \$ 329,000 loan.

NOTE 9: LEASE

In December 2013, the District entered into an operating lease agreement for a skid steer. The lease includes monthly payments of \$ 2,355, for two years. The lease includes a purchase option, at any time, for \$ 64,380, and allows the District to apply all rentals paid towards the

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

NOTE 9: LEASE (continued)

purchase price. The annual lease payments are as follows:

<u>Year Ending</u>	<u>Total</u>
2014	\$ 28,260
2015	<u>28,260</u>
Total lease obligations	<u>\$ 56,520</u>

NOTE 10: SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 28, 2014, 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, 2013**

- UNAUDITED -

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Favorable (Unfavorable)
	Original	Final		
Beginning Budgetary Balance	\$ 4,738,068.00	\$ 4,738,068.00	\$ 4,738,068.00	\$ -
Operating Revenues:				
Water sales	4,245,045.03	4,245,045.03	3,972,733.03	(272,312.00)
Memberships	330,000.00	330,000.00	361,000.00	31,000.00
Penalties, fees, service charges & misc	128,350.00	128,350.00	128,971.77	621.77
Total operating revenues	<u>4,703,395.03</u>	<u>4,703,395.03</u>	<u>4,462,704.80</u>	<u>(240,690.23)</u>
Operating Expenses:				
Salaries	774,675.00	774,675.00	789,232.32	(14,557.32)
Contract labor	40,000.00	40,000.00	10,583.69	29,416.31
Payroll taxes	63,110.78	63,110.78	63,834.81	(724.03)
Retirement	41,000.00	41,000.00	40,217.98	782.02
Automobile	77,000.00	77,000.00	74,140.45	2,859.55
Equipment expense	60,000.00	60,000.00	10,194.35	49,805.65
Chemicals	500,000.00	500,000.00	519,372.19	(19,372.19)
Subscriptions / License / Fees	80,000.00	80,000.00	32,322.41	47,677.59
Education	7,000.00	7,000.00	5,682.44	1,317.56
Supplies	340,000.00	340,000.00	323,419.29	16,580.71
Office expense	65,000.00	65,000.00	44,496.54	20,503.46
Postage	45,000.00	45,000.00	37,449.89	7,550.11
Professional fees	250,000.00	250,000.00	189,031.79	60,968.21
Line Extensions	80,000.00	80,000.00	285,697.22	(205,697.22)
Repair & maintenance	85,000.00	85,000.00	39,533.45	45,466.55
Telephone	15,000.00	15,000.00	15,345.16	(345.16)
Utilities	360,000.00	360,000.00	362,442.66	(2,442.66)
Travel	7,500.00	7,500.00	4,985.89	2,514.11
Uniforms	3,500.00	3,500.00	3,513.23	(13.23)
Water Purchased	12,000.00	12,000.00	230,393.10	(218,393.10)
Insurance	300,313.19	300,313.19	265,500.02	34,813.17
Taxes	50.00	50.00	50.00	-
Refunds	10,000.00	10,000.00	8,393.15	1,606.85
Total operating expenses	<u>3,216,148.97</u>	<u>3,216,148.97</u>	<u>3,355,832.03</u>	<u>(139,683.06)</u>
Non-operating (Income) expenses:				
Caney River project	33,000.00	33,000.00	16,951.34	16,048.66
Caney River loan payments	232,128.00	232,128.00	232,128.00	-
N. Plant loan payments	947,882.65	947,882.65	937,936.29	9,946.36
FmHA loan payments	65,220.00	65,220.00	169,406.83	(104,186.83)
N. Plant upgrade	80,000.00	80,000.00	113,166.92	(33,166.92)
Miscellaneous income	(80,000.00)	(80,000.00)	(61,202.75)	(18,797.25)
Settlement of encroachment lawsuit	-	-	(420,000.00)	420,000.00
Interest income	(35,000.00)	(35,000.00)	(16,325.41)	(18,674.59)
Total non-operating (Income) expenses	<u>1,243,230.65</u>	<u>1,243,230.65</u>	<u>972,061.22</u>	<u>271,169.43</u>
Total Expenses	<u>4,459,379.62</u>	<u>4,459,379.62</u>	<u>4,327,893.25</u>	<u>131,486.37</u>
Ending Budgetary Balance	<u>\$ 4,982,083.41</u>	<u>\$ 4,982,083.41</u>	<u>\$ 4,872,879.55</u>	<u>\$ (109,203.86)</u>

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO BUDGETARY COMPARISON SCHEDULE
For the Year Ended December 31, 2013

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

**INDEPENDENT AUDITOR'S 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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the 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, 2013 and 2012, and the related notes to the financial statements, which collectively comprise Washington County Rural Water District No. 3's basic financial statements and have issued my report thereon dated April 28, 2014.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered Washington County Rural Water District No. 3's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, I do not express an opinion on the effectiveness of Washington County Rural Water District No. 3's internal control.

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. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Bruce G. Luttrell, CPA, PC

April 28, 2014