

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

Bruce G. Luttrell, CPA, PC
Certified Public Accountant

P.O. Box 2173
Stillwater, OK 74076
(405) 743-1040

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	13-24
REQUIRED SUPPLEMENTARY INFORMATION:	
Budget Comparison Schedule	25
Notes to Budgetary Comparison Schedule	26
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	27-28

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 of Washington County Rural Water District No. 3 as of and for the years ended December 31, 2015 and 2014, 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 of Washington County Rural Water District No. 3 as of December 31, 2015 and 2014, 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 26, 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 25, 2016, 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 25, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

**Washington County Rural Water District No. 3
Management's Discussion and Analysis Report
For Fiscal Year 2015
(Ended December 31, 2015)**

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 '15 (643,253,088 gallons) decreased slightly by approximately 3 percent when compared to the previous year (sold 662,659,058 gallons in FY '14).
- Revenues from the sale of water accounted for 88.2 percent of all revenues. The total revenue from water sales increased by approximately 8.8 percent when compared to FY '14.
- The District expended approximately \$ 1,045,000 on new infrastructure during the year.
- The District improved its position with regard to total liabilities by decreasing their value by \$ 70,767 when compared to FY '14. Total equity increased by approximately \$ 1,056,000 (including \$ 906,234 in contributed developments.)
- 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 '15 audit were used to develop this report. A brief description of each statement and their purpose follows:

Statements of Net Position [Balance Sheet] - The purpose for the “Statements of Net 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 Net 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 net position is improving or deteriorating.

Statements of Revenue, Expenses, and Changes in Fund Net Position - The “Statements of Revenue, Expenses, and Changes in Fund Net Position” 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

	12/31/15	12/31/14	Dollar Change	Percent Change
Current and Other Assets	\$ 5,221,474	\$5,074,944	\$ 146,530	2.89
Capital Assets	\$31,307,381	\$30,467,965	\$ 839,416	2.76
Total Assets	\$36,528,855	\$35,542,909	\$ 985,946	2.78
Current Liabilities	\$ 606,796	\$597,080	\$ 9,716	1.6
Long-Term Liabilities	\$17,648,333	\$17,728,816	\$ <80,483>	0.5
Total Liabilities	\$18,255,129	\$18,325,896	\$ <70,767>	0.4
Net Assets invested in capital assets, net of related debt	\$13,273,315	\$12,367,340	\$ 905,975	7.3
Restricted for debt service	\$ 330,174	\$319,673	\$ 10,501	3.3
Unrestricted net assets	\$ 4,670,237	\$4,530,000	\$ 140,237	3.1
Total Net Assets	\$18,273,726	\$17,217,013	\$ 1,056,713	6.1

Condensed Statement of Activities

	12/31/15	12/31/14	Dollar Change	Percent Change
Operating Revenues	\$ 4,699,991	\$4,277,830	\$ 422,161	9.9
Non-operating Revenues	\$ 1,232,969	\$362,969	\$ 870,000	239.7
Total Revenues	\$ 5,932,960	\$4,640,799	\$ 1,292,161	27.8
Depreciation Expense	\$ 1,112,026	\$931,770	\$ 180,256	19.3
Other Operating Expenses	\$ 3,764,221	\$3,611,024	\$ 153,197	4.2
Total Expenses	\$ 4,876,247	\$4,542,794	\$ 333,453	7.3
Change in Net Assets	\$ 1,056,713	\$98,005	\$ 958,708	978.2
Beginning Net Assets	\$17,217,013	\$17,119,008	\$ 98,005	0.6
Ending Net Assets	\$18,273,726	\$17,217,013	\$ 1,056,713	6.1

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 314 new benefit units (i.e., water meters) were sold compared to a total of 346 sold in FY '14. The District sold 643,253,088 gallons of water, which represents an approximate decrease of 3 percent over FY '14 likely the result of a wetter year in FY '15. The slight decrease in year-over-year benefit unit sales is likely the result of a slowing housing market compared to the previous year.

Statements of Net Position:

Total Net Position - The *Statement of Net Position* shows that the District's total net assets actually *increased* by \$ 985,946 when compared with FY '14. This *increase* represents 2.8 % in our total net assets. Current assets (i.e., cash) *increased* by \$ 146,530, the District's fixed assets (i.e., land, equipment and infrastructure) actually *increased* by \$ 839,416, and the District's investments stayed the same.

On page 10 of the *Statement of Net Position* we see that the District *improved* its position with regard to total (i.e., current and long term) liabilities by *decreasing* their value by \$ 70,767 when compared to FY '14. This *decrease* occurred primarily in the category of *long term liabilities*. Total equity *increased* by approximately \$ 1,056,000.

Statement of Revenues, Expenses and Changes in Fund Net Position:

Reviewing the *Statement of Revenues, Expenses and Changes in Fund Net Position* we can see that the District's change in net position was \$ 1,056,713. This compares favorably to the net change in net position of \$ 98,005 experienced in FY '14.

Revenues – The District's total operating revenues for FY '15 were \$ 4,699,991. This represents an *increase* of approximately \$ 422,161 or 9.9 percent over FY '14. Approximately 88.2 percent of our revenues (i.e., \$ 4,437,790) were derived from sale of water services.

Approximately 6.3 percent of revenues (\$ 314,000) came from membership fees. Revenues from these items were *down* 8.9 percent over FY '14.

Expenses - The District's total operating expenses were \$ 4,876,247. Excluding depreciation the total operating expenses are reduced to \$ 3,764,221. This represents an approximate *increase* of \$ 153,197 or 4.2 percent over FY '14.

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 \$ 223,144.

Annual Budget

As required by the District's By-Laws, an Annual Budget was prepared by the District Manager for FY '15. 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 '15 Annual Budget was reviewed and approved by the Board during the Board meeting held on March 9, 2015.

Debt Administration:

The remaining balance for all promissory notes (i.e., loans) at the beginning of the year was \$ 18,100,625. Another \$ 476,238 was drawn on the OWRB loan, and all scheduled loan and interest payments through December 31, 2015 were made on time. The District reduced its principal on outstanding loans by \$ 66,559 (net.) The balance remaining on all outstanding loans is \$ 18,034,066. The sinking fund for the District's loans is fully funded.

Highlights of Other Critical Information:

- In Fiscal Year 2015 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 – Legal action filed by the Contractor against the District is in progress.
- Water Treatment Plant (WTP) Expansion Project – Construction work continued in 2015 and wrapped up in September with the successful completion of a seven (7) day test. The one (1) warranty period began upon completion and acceptance of the seven (7) day test.
- Discharge Permit – The District successfully renewed its discharge permit for the North WTP.
- Legal Action by Design Engineer of WTP Expansion Project – Formal legal action continued against the District in 2015 by the design engineer for additional fees.
- Maintenance repair work was completed on the Miller tower in 2015.
- Water Resources Master Planning – We continue work on a new master plan for the District.
- 24-inch Water Line Extension – The District completed construction on a 24-inch water line extension along 129th East Avenue from 126th Street North to approximately 116th Street North.
- Oologah Raw Water Line – The District worked with AEP/PSO to complete the relocation of approximately 3,000 linear feet of raw water line across the AEP/PSO Oologah Power Station.
- ODOT Water Line Relocation Project on Highway 11 – The District completed work on the design plans for the relocation of 4 and 2-inch water lines along Highway 11 near the Osage Drive intersection.

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 was decreased by \$ 66,559. We ended the year with more cash and investments (i.e., \$ 233,645) than we started with.

Looking Forward – As we look forward to Fiscal Year 2016 we anticipate our growth to be the same or slightly greater than that which was experienced in FY '15. We also anticipate progress on the following major capital projects:

- Water Treatment Plant (WTP) Expansion Project – We will continue to work with the construction contractor on warranty period issues through September 2016.
- Caney River Raw Water Supply Project: We anticipate progress on the lawsuit for this project.
- Caney River Bank Erosion Remediation – We anticipate completing work on bank remediation on the upstream east bank.

- Water Resources Master Plan – We anticipate completing the master plan in 2016. This master plan will identify future capital needs with emphasis on priority.
- Scott Tower Booster Pump Station – Design and construction work will be completed in FY '16 for a new booster pump station.
- Future Water Lines – The District is planning:
 - The District will continue to work with AEP/PSO to complete the balance of work remaining on this project (e.g., easement, record drawings and final approval)
 - Expected construction for relocation of certain water lines along Highway 11.
 - The District will complete the water line replacement/upgrade along 3954 Road north of 186th Street North.
- Water Quality Regulations
 - Long Term 2 Surface Water Treatment Rule (LT2) – Testing will begin for the second phase of the LT2 regulations in the fourth quarter of 2016.
 - Revised Total Coliform Rule (TCR) – Revisions to the TCR plan will become effective April 1, 2016.

FINANCIAL STATEMENTS

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

**STATEMENTS OF NET POSITION
DECEMBER 31, 2015 AND 2014**

	2015	2014
ASSETS		
Current assets:		
Cash	\$ 949,153	\$ 726,009
Investments	3,150,000	3,150,000
Restricted cash & investments (Note 7)	330,174	319,673
Accounts receivable	451,184	407,322
Accrued interest receivable	493	508
Inventory	286,523	419,626
Prepaid insurance	53,947	51,806
Total current assets	5,221,474	5,074,944
Noncurrent assets:		
Other assets:		
Capital assets:		
Building & land	307,638	307,638
Machinery & tools	363,546	322,336
Automotive equipment	340,778	340,778
Furniture & fixtures	116,212	116,212
Lab equipment	40,706	40,706
Water treatment & distribution system	42,225,259	40,315,027
Less accumulated depreciation	(12,086,758)	(10,974,732)
Total capital assets	31,307,381	30,467,965
Total Assets	\$ 36,528,855	\$ 35,542,909

The accompanying notes to the financial

	<u>2015</u>	<u>2014</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 79,143	\$ 79,241
Accrued interest payable	141,920	146,030
Current portion of long-term debt (Note 2)	385,733	371,809
Total current liabilities	<u>606,796</u>	<u>597,080</u>
Noncurrent liabilities:		
Notes payable (Note 2)	18,034,066	18,100,625
Less: current portion	(385,733)	(371,809)
Total noncurrent liabilities	<u>17,648,333</u>	<u>17,728,816</u>
Total Liabilities	<u>18,255,129</u>	<u>18,325,896</u>
 NET POSITION		
Invested in capital assets, net of related debt	13,273,315	12,367,340
Nonspendable	286,523	419,626
Restricted for debt service	330,174	319,673
Unassigned	4,383,714	4,110,374
Total Net Position	<u>\$ 18,273,726</u>	<u>\$ 17,217,013</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 POSITION
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014**

	2015	2014
Operating revenues:		
Water sales (net of adjustments)	\$ 4,437,790	\$ 4,085,432
Penalties, fees, service charges and miscellaneous	262,201	192,398
Total operating revenues	4,699,991	4,277,830
Operating expenses:		
Salaries, wages & contract labor	860,909	832,434
Payroll taxes	66,085	65,708
Employee benefits	221,763	231,324
Utilities	345,963	347,556
Telephone	13,642	12,733
Equipment expense	30,733	38,630
Depreciation	1,112,026	931,770
Interest expense	675,276	657,934
Vehicle expense	49,212	57,133
Building, vehicle & other insurance	100,760	93,828
Plant repair & maintenance	135,249	134,140
Chemicals	534,600	730,184
Travel, entertainment & miscellaneous	36,717	35,854
Licenses & fees	34,056	30,888
Plant supplies	275,479	58,500
Water purchased	14,065	15,854
Office expense & postage	107,107	78,231
Professional fees	262,605	190,093
Total operating expenses	4,876,247	4,542,794
Net operating income	(176,256)	(264,964)
Nonoperating revenue (expense)		
New benefit units	314,000	346,500
Contribution of developments	906,234	-
Interest income	13,235	14,200
Gain on sale of assets	-	2,769
Trustee fee	(500)	(500)
Total nonoperating revenue (expense)	1,232,969	362,969
Change in net position	1,056,713	98,005
Net position beginning of year	17,217,013	17,119,008
Net position end of year	\$ 18,273,726	\$ 17,217,013

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, 2015 AND 2014**

	2015	2014
Cash flows from operating activities:		
Receipts from customers	\$ 4,656,129	\$ 4,252,681
Payments to suppliers	(2,807,516)	(2,886,296)
Payments to employees	(829,936)	(819,124)
Net cash provided (used) by operating activities	1,018,677	547,261
Cash flows from noncapital financing activities:		
Transfers from (to) investments	-	200,000
Transfers from (to) restricted cash and investments	(10,501)	48,851
Trustee fee	(500)	(500)
Net cash provided (used) by noncapital financing activities	(11,001)	248,351
Cash flows from capital and related financing activities:		
New benefit units	314,000	346,500
Purchase of capital assets	(1,045,208)	(832,003)
Principal paid on capital debt	(542,797)	(568,258)
Issue new capital debt	476,238	165,553
Sales and trade assets	-	2,769
Net cash provided (used) by capital and related financing activities	(797,767)	(885,439)
Cash flows from investing activities:		
Interest income	13,235	14,200
Net increase (decrease) in cash and cash equivalents	223,144	(75,627)
Cash balance beginning of year	726,009	801,636
Cash balance end of year	\$ 949,153	\$ 726,009
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	\$ (176,256)	\$ (264,964)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Cash flows reported in other categories:		
Depreciation expense	1,112,026	931,770
Amortization	-	-
Change in assets and liabilities:		
Accounts receivable	(43,862)	(25,149)
Accrued interest receivable	15	11
Inventory	133,103	(116,929)
Prepaid insurance	(2,141)	(1,519)
Accounts payable	(98)	23,854
Accrued interest payable	(4,110)	187
Net cash provided by operating activities	\$ 1,018,677	\$ 547,261

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, 2015

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Washington County Rural Water District Number 3 (the District) complies with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations.) The accounting and reporting framework and the more significant accounting policies established in GAAP and used by the District are discussed below.

A. REPORTING ENTITY

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 9,600 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.

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.

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, 2015 and 2014, financial statements at \$ 286,523 and \$ 407,322, 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:

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

	<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, 2015, is as follows:

	<u>Beginning</u>		<u>Additions</u>		<u>Rtmts</u>		<u>Transfers</u>		<u>Ending</u>
	<u>Balance</u>							<u>Balance</u>	
Building & Land	\$ 307,638							\$ 307,638	
Machinery & Tools	322,336	41,210						363,546	
Automotive	340,778							340,778	
Furniture, Fixtures & Equipment	116,212							116,212	
Lab Equipment	40,706							40,706	
Water Treatment & Distribution System	<u>40,315,027</u>	<u>1,910,232</u>						<u>42,225,259</u>	
Total	<u>\$ 41,442,697</u>	<u>1,951,442</u>		-		-		<u>\$ 43,394,139</u>	

E. DEPOSITS AND INVESTMENTS

Custodial Credit Risk - Custodial credit risk related to deposits exists when the District holds deposits that are uninsured and uncollateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the District's name, or collateralized without a written or approved collateral agreement. Exposure to custodial credit risk related to investments exists when the District holds investments that are uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the District's name. The District's policy for custodial credit risk is to secure its uninsured deposits with collateral. As of December 31, 2015, \$ 4,179,327 of the District's bank balances was exposed to custodial credit risk as follows:

Collateralized with securities held by the banks' trust department but not in the District's name	\$ 4,179,327
--	--------------

Investment Credit Risk - The District has no investment policy that limits its investments choices other than the limitation of state law as follows:

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- a) Direct obligations of the U.S. Government, its agencies or instrumentalities to which the full faith and credit of the U.S. Government is pledged, or obligations to the payment of which the full faith and credit of the State is pledged.
- b) Certificates of deposit or savings accounts that are either insured or secured with acceptable collateral with in-state financial institutions, and fully insured certificates of deposit or savings accounts in out-of-state financial institutions.
- c) With certain limitation, negotiable certificates of deposit, prime bankers acceptances, prime commercial paper, and repurchase agreements with certain limitations.
- d) County, municipal, or school district tax-supported debt obligation, bond or revenue anticipation notes, money judgments, or bond or revenue anticipation notes of public trusts whose beneficiary is a county, a municipality, or school district.
- e) Notes or bonds secured by mortgage or trust deed insured by the Federal Housing Administrator and debentures issued by the Federal Housing Administrator, and in obligations of the National Mortgage Association.
- e) Money market funds regulated by the Securities and Exchange Commission and in which investments consist of the investments mentioned in the previous paragraphs a,b,c, and d.

Investment Interest Rate Risk – the District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Concentration of Credit Risk – The District places no limit on the amount it may invest in any one issuer. Since the District has all investments in certificates of deposit, there is no concentration of investment credit risk exposure.

The deposits and investments held at December 31, 2015, are as follows:

Type	Maturity (Months)	Credit Rating	Market Value	Cost
Cash Deposits	N/A	N/A	1,279,327	1,279,327
Investments				
Certificates of Deposit	12	N/A	<u>3,150,000</u>	<u>3,150,000</u>
Total Deposits and Investments			<u>4,429,327</u>	<u>4,429,327</u>

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

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

Employees must complete one (1) year of continuous service before earning two (2) weeks of vacation time per calendar year. Employees who have completed two (2) years through five (5) years of continuous service will earn three (3) weeks of vacation time per calendar year. Beginning in the sixth (6) year of continuous service, employees will earn four (4) weeks of vacation time per calendar year. Beginning in the twentieth (20) year of continuous service, employees will earn five (5) weeks of vacation time per calendar year. Vacation time is computed on a calendar year basis.

Vacation pay is vested, and thus paid upon retirement or separation (with two weeks' notice.) Vacation time is to be taken during the calendar year. Employees are required to utilize at least one-half of earned vacation time. The remaining vacation time will be paid at year end, and does not carry over to the next year without Board approval. The vacation accrued at December 31, 2015, was paid the first week of 2016.

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, 2015 and 2014, 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, 2015 and 2014.

I. INVESTMENTS

Investments classified in the financial statements, consist entirely of certificates of deposit whose original maturity term exceeds three months. Investments are carried at cost, which approximated fair value.

J. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period (such as estimated useful lives in determining depreciation expense.) Accordingly, actual results could differ from those estimates.

K. CASH AND CASH EQUIVALENTS

For the purpose of financial reporting, “cash and cash equivalents” include all demand and savings accounts and certificates of deposit or short-term investments with an original maturity of three months or less.

L. EQUITY CLASSIFICATION

Net Assets

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

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 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.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

M. BUDGETARY DATA

In accordance with the by-laws of the District, the Board of Directors prepare a budget, under the accrual basis of accounting.

NOTE 2: LONG-TERM DEBT

A. RURAL DEVELOPMENT LOANS

During a 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, 2015 and 2014, was \$ 4,356,208 and \$ 4,413,080, respectively.

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, 2015 and 2014, was \$ 237,308 and \$ 236,254, 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, 2015 and 2014, was approximately \$ 694,998 and \$ 717,066, 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, 2015 and 2014, the balances in the reserve accounts were \$ 66,689 and \$ 66,392, respectively.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 2: LONG-TERM DEBT (continued)

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, 2013, a total of \$ 16,196,498 was drawn under the loan agreement, and expended, and principal of \$ 927,715 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 American Recovery and Reinvestment Act of 2009, and that amount of the loan principle will be forgiven, pending compliance with all ARRA regulations. During the year ended December 31, 2014, another \$ 165,552 was drawn under the loan agreement, and expended, and principal of \$ 463,857 was paid on the loan. During the current year, another \$ 476,238 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, 2015 and 2014, was \$ 12,982,859 and \$ 12,970,478, 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.

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, 2015 and 2014.

C. CHANGES IN LONG-TERM DEBT

The following is a summary of changes in long-term debt for the year ended December 31, 2015.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 2: LONG-TERM DEBT (continued)

C. CHANGES IN LONG-TERM DEBT

Loan	Jan. 1, 2015	Additions	Reductions	Dec. 31, 2015	Amount Due Within One Year
RECD Loan – 724,200	575,936		11,310	564,626	14,141
RECD Loan – 329,000	141,131		10,758	130,373	13,734
RUS Loan	4,413,080		56,872	4,356,208	69,550
OWRB Loan	12,970,478	476,238	463,857	12,982,859	288,308
Total	18,100,625	476,238	542,797	18,034,066	385,733

D. DEBT SERVICE REQUIREMENTS

The annual debt service requirements to maturity, including principal and interest, for the long-term debt as of December 31, 2015, 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
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	16,671	28,173	16,192	4,184	77,836	154,294	320,082	406,927
2020	17,612	27,232	17,106	3,270	80,812	151,318	331,433	395,575
2021-2025	104,130	120,090	53,503	3,854	452,835	707,813	1,842,035	1,793,007
2026-2030	137,004	87,216	-	-	546,274	614,422	2,192,665	1,442,379
2031-2035	180,256	43,964	-	-	658,997	501,650	2,610,036	1,025,007
2036-2040	64,092	2,816	-	-	794,979	365,668	3,106,855	528,189
2044-2044	-	-	-	-	959,020	201,627	1,683,794	51,550
2046-2050	-	-	-	-	568,726	29,037	-	-
Totals	\$ 564,626	399,163	130,373	28,864	4,356,208	3,205,488	12,982,859	6,927,701

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

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. 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, 2015, are summarized as follows:

	Cost	Fair Value	Carrying Value
Unrestricted:			
Certificates of Deposit	\$ 3,150,000	3,150,000	3,150,000
	\$ 3,150,000	3,150,000	3,150,000
	\$ 3,150,000	3,150,000	3,150,000

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, 2015, none of which are held for trading purposes, are as follows:

	Carrying Amount	Fair Value
Financial assets:		
Cash	\$ 949,153	\$ 949,153
Investments	3,150,000	3,150,000
Restricted Cash & Investments	330,174	330,174
Financial liabilities:		
Notes Payable	18,034,066	18,034,066

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

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.

NOTE 7: RESTRICTED NET ASSETS

Net assets were restricted for debt service at December 31, 2015 and 2014, as follows:

	2015	2014
RECD Reserve	\$ 45,856	\$ 45,426
RECD Reserve	20,833	20,638
RUS Reserve – Caney River	237,308	235,083
North Treatment Plant Project Fund	151	150
North Treatment Plant Construction Fund	1,525	1,414
Interest Reserve	24,501	65,813
	\$ 330,174	\$ 368,524

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.

RURAL WATER DISTRICT NO. 3
Washington County, Oklahoma

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2015

NOTE 9: NEW ACCOUNTING PRONOUNCEMENTS

In June 2012, the Governmental Accounting Standards Board issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for financial statements for periods beginning after June 15, 2014. GASB Statement No. 68 addresses improved reporting on pensions provided by state and local governments. The District adopted GASB Statement No. 68 during the current year. The adoption had no impact of the District's financial report.

NOTE 10: SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 25, 2016, 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, 2015**

- UNAUDITED -

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Favorable (Unfavorable)
	Original	Final		
Beginning Budgetary Balance	\$ 3,780,499	\$ 3,780,499	\$ 3,798,223	\$ 17,724
Operating Revenues:				
Water sales	4,666,545	4,666,545	4,453,878	(212,667)
Memberships	340,000	340,000	314,000	(26,000)
Penalties, fees, service charges & misc	129,350	129,350	140,543	11,193
Total operating revenues	<u>5,135,895</u>	<u>5,135,895</u>	<u>4,908,421</u>	<u>(227,474)</u>
Operating Expenses:				
Salaries	851,182	851,182	838,050	13,132
Contract labor	20,000	20,000	22,859	(2,859)
Payroll taxes	69,741	69,741	66,085	3,656
Retirement	43,500	43,500	41,554	1,946
Automobile	85,000	85,000	49,212	35,788
Equipment expense	60,000	60,000	30,733	29,267
Chemicals	800,000	800,000	534,600	265,400
Subscriptions / License / Fees	40,000	40,000	36,381	3,619
Education	10,000	10,000	7,746	2,254
Supplies	375,000	375,000	275,479	99,521
Office expense	64,000	64,000	78,099	(14,099)
Postage	48,000	48,000	45,817	2,183
Professional fees	225,000	225,000	262,605	(37,605)
Line Extensions	80,000	80,000	71,152	8,848
Repair & maintenance	100,000	100,000	135,249	(35,249)
Telephone	14,000	14,000	13,642	358
Utilities	385,000	385,000	345,963	39,037
Travel	8,000	8,000	6,249	1,751
Uniforms	3,500	3,500	3,873	(373)
Water Purchased	25,000	25,000	14,065	10,935
Insurance	332,000	332,000	280,633	51,367
Taxes	50	50	50	-
Refunds	7,800	7,800	16,088	(8,288)
Total operating expenses	<u>3,646,773</u>	<u>3,646,773</u>	<u>3,176,184</u>	<u>470,589</u>
Non-operating (income) expenses:				
Caney River project	7,800	7,800	22,003	(14,203)
Caney River loan payments	232,128	232,128	232,128	-
N. Plant loan payments	947,883	947,883	925,334	22,549
FmHA loan payments	65,220	65,220	65,220	-
N. Plant upgrade	62,000	62,000	106,735	(44,735)
Miscellaneous income	(70,000)	(70,000)	(121,658)	51,658
Interest income	(15,000)	(15,000)	(13,235)	(1,765)
Total non-operating (income) expenses	<u>1,230,031</u>	<u>1,230,031</u>	<u>1,216,527</u>	<u>13,504</u>
Total Expenses	<u>4,876,804</u>	<u>4,876,804</u>	<u>4,392,711</u>	<u>484,093</u>
Ending Budgetary Balance	<u>\$ 4,039,590</u>	<u>\$ 4,039,590</u>	<u>\$ 4,313,933</u>	<u>\$ 274,343</u>

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

**NOTES TO BUDGETARY COMPARISON SCHEDULE
For the Year Ended December 31, 2015**

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 of Washington County Rural Water District No. 3 as of and for the years ended December 31, 2015 and 2014, 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 25, 2016.

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 25, 2016