

MCKINNEY WATER DISTRICT  
AUDIT OF FINANCIAL STATEMENTS

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DECEMBER 31, 2011

**Craig A. Butler, CPA**  
131 North 4th Street  
Danville, Kentucky 40422



MCKINNEY WATER DISTRICT  
AUDIT OF FINANCIAL STATEMENTS

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DECEMBER 31, 2011

CRAIG A. BUTLER  
CERTIFIED PUBLIC ACCOUNTANT  
DANVILLE, KENTUCKY

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## **INDEPENDENT AUDITOR'S REPORT**

Chairman and Commissioners  
McKinney Water District  
McKinney, Kentucky 40448

I have audited the accompanying financial statements of the business-type activities of the McKinney Water District as of and for the year ended December 31, 2011. These financial statements are the responsibility of the District's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the comptroller general of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the McKinney Water District, as of December 31, 2011, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated April 24, 2012, on my consideration of the District's internal control over financial reporting and my tests of compliance with certain provisions of laws, regulations, contracts and grants. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audit.

## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 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 principally 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.

*Craig A. Butler, CPA*

Craig A. Butler  
Certified Public Accountant

Danville, Kentucky  
April 24, 2012

McKinney Water District  
Management Discussion and Analysis  
For the Year Ended December 31, 2011

The management of the McKinney Water District presents this narrative to help our readers review the accompanying annual financial statements for the year ended December 31, 2011. We have prepared this overview and analysis of the District's financial activities to add additional information to the financial schedules and the note disclosures. Our analysis will examine the financial highlights for this fiscal year and help explain the format for our readers.

**Financial Highlights**

- As of December 31, 2011, the District's assets (page 8) exceeded liabilities by \$1,383,908. This amount includes \$680,019 of resources that are invested in capital assets, net of related debt. \$703,889 of these resources are unrestricted and are available to fund the District's outstanding obligations and future programs.
- Unrestricted cash and certificate of deposit balances (page 7) as of December 31, were \$286,624 and current liabilities payable from unrestricted resources (i.e. excluding principal and interest on long term debt and customer deposits) were \$30,689.
- Net assets decreased by \$99,970 (page 9). In the prior year, net assets decreased by \$19,889. The higher decrease this year can be attributed to decreases of operating revenue of over \$23,000 and increases in operating expenses of approximately \$35,700. Water loss percentages have increased substantially over the past two years which has contributed to the District's net losses over the past two years.
- The District's total debt decreased \$43,900 for the year ended December 31, 2011 equal to the scheduled payments for the year.

**Overview of the Financial Statements**

This discussion and analysis is intended to introduce the District's financial statements. Basic financial statements include two major sections: 1) government-wide financial statements, and 2) notes to the financial statements.

The McKinney Water District is a special-purpose governmental entity. It utilizes the accrual basis of accounting applicable to all *proprietary fund types*. Revenues are recognized when earned regardless of when received and expenses are recognized when incurred regardless of when paid.

*Notes to the Financial Statements*

Notes provide additional information that is essential to a full understanding of the information included in the financial schedules. Notes provide additional details about the balances and transactions in the District's financial statements and are presented on pages 14 through 19.

**Government-wide Financial Analysis**

Net assets may serve over time as a useful indicator of a government's financial position. 49% of the District's net assets reflect its investment in capital assets (e.g. distribution system, equipment, etc), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to its customers; consequently these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The remaining 51% of the District's net assets represents its unrestricted net assets.

McKinney Water District  
Management Discussion and Analysis  
For the Year Ended December 31, 2011

The first statement in the government-wide statements is the Balance Sheet. Let's review some of the more important issues in this statement. The following table summarizes the Balance Sheet (pages 7-8).

	2011	2010
Current and other assets	\$ 817,406	\$ 868,606
Capital assets	1,803,319	1,900,996
<b>Total assets</b>	<b>2,620,725</b>	<b>2,769,602</b>
Long-term debt outstanding	1,077,800	1,123,300
Other liabilities	159,017	162,424
<b>Total liabilities</b>	<b>1,236,817</b>	<b>1,285,724</b>
Net assets:		
Invested in capital assets, net of related debt	680,019	733,796
Restricted	-	-
Unrestricted (deficit)	703,889	750,082
<b>Total Net Assets</b>	<b>\$ 1,383,908</b>	<b>\$ 1,483,878</b>

The second statement in the government-wide statements is the Statement of Revenues, Expenses, and Changes in Net Assets. The following table outlines the major components of this statement.

	2011	2010
Revenues:		
Charges for services	\$ 718,719	\$ 743,073
Grants and contributions	6,428	27,865
Rental Income	3,000	3,000
Interest earnings	3,497	4,965
Miscellaneous	20,891	19,549
<b>Total Revenues</b>	<b>752,535</b>	<b>798,452</b>
Expenses:		
Operating expenses, excluding depreciation	681,571	645,866
Depreciation	125,782	124,652
Interest and amortization	45,152	47,823
<b>Total Expenses</b>	<b>852,505</b>	<b>818,341</b>
<b>Increase (decrease) in net assets</b>	<b>\$ (99,970)</b>	<b>\$ (19,889)</b>

McKinney Water District  
Management Discussion and Analysis  
For the Year Ended December 31, 2011

Due to a rate increase in July of 2005, net assets increased each of the three fiscal years subsequent to the rate increase following several years of net asset decreases. Increased water losses experienced during the year ended December 31, 2010 contributed to the decrease in net assets. During the year ended December 31, 2011 water losses increased to 39% of water purchased. This high rate of water loss was the primary contributor to the larger decrease in net assets during the year ended December 31, 2011.

**Capital Asset and Debt Administration**

The District invests substantial resources in capital assets that support the services provided to its customers. All of the District's outstanding debt has been used to acquire or construct capital assets.

*Capital Assets*

The District's capital assets, net of accumulated depreciation are summarized below:

Land and right of ways	\$	18,043
Distribution system		1,439,498
Office furniture and fixtures		4,075
Buildings and improvements		11,837
Capitalized design and interest costs		329,866
Total, net of depreciation		\$ 1,803,319

*Long Term Debt*

The principal outstanding on the District's long-term debt is summarized in the following table.

		Total
RDA 1992 Series A Bond	\$	11,400
RDA 1992 Series B Bond		11,200
RDA 1992 Series C Bond		31,800
RDA 1992 Series D Bond		408,000
RDA 1999 Series A Bond		111,300
RDA 1999 Series B Bond		77,100
RDA 2000 Series A Bond		472,500
Total		\$ 1,123,300

The District's outstanding debt decreased \$43,900 for the year equal to the amount of the scheduled payments.

McKinney Water District  
Management Discussion and Analysis  
For the Year Ended December 31, 2011

**Economic Factors for Next Year**

During the year ended December 31, 2005, the District was granted a rate increase of approximately 23% by the Kentucky Public Service Commission in order to return to profitability and build its reserves to fund future capital projects. During the three fiscal years ended December 31, 2006, 2007, and 2008, the District made some much needed line repairs which resulted in lowered water losses and thus an increase in net income. During the year ended December 31, 2009, unusually high repair and contract labor expenses prevented the District from achieving a net asset increase. Also, during the fiscal year ended December 31, 2010, increased water losses prevented the District from achieving a net asset increase. Furthermore, due to high volumes of water loss, the District did not achieve a net asset increase for the fiscal year ended December 31, 2011. Going forward, the District will address the increased water losses and will look at any and all means to bring the losses down to an acceptable level.

**CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT**

This financial report is designed to provide customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office, McKinney, KY 40448, telephone number (606) 346-2220.

MCKINNEY WATER DISTRICT  
BALANCE SHEET  
DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2010)

	<u>2011</u>	<u>2010</u>
<u>ASSETS</u>		
Current Assets:		
Cash (Note 3)	\$ 234,372	\$ 282,732
Certificates of Deposit (Note 3)	52,252	51,630
Accounts Receivable (Net of Allowance)	52,855	61,717
Grants Receivable (No Allowance Necessary)	-	9,547
Inventory (Note 2)	34,754	46,337
Prepaid Expenses (Note 2)	<u>7,818</u>	<u>7,355</u>
 Total Current Assets	 382,051	 459,318
Non-current Assets:		
Restricted Cash (Note 3)	226,163	202,400
Restricted Certificates of Deposit (Note 3)	<u>209,008</u>	<u>206,520</u>
 Total Restricted Assets	 435,171	 408,920
Property and Equipment (Note 4):		
Land and Right of Ways	18,043	18,043
Distribution System	3,228,304	3,228,304
Other Tangible Assets	73,885	52,537
Office Furniture and Fixtures	47,961	47,961
Building and Improvements	43,179	43,179
Capitalized Design and Interest Costs	566,950	566,950
Less: Accumulated Depreciation	<u>(2,175,003)</u>	<u>(2,055,978)</u>
 Net Property and Equipment	 1,803,319	 1,900,996
Deferred Expenses (Note 2)	<u>184</u>	<u>368</u>
 Total Assets	 <u>\$ 2,620,725</u>	 <u>\$ 2,769,602</u>

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

MCKINNEY WATER DISTRICT  
BALANCE SHEET  
DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2010)

	<u>2011</u>	<u>2010</u>
<b><u>LIABILITIES</u></b>		
Current Liabilities:		
Accounts Payable	\$ 23,755	\$ 30,693
Other Current Liabilities	<u>6,934</u>	<u>5,290</u>
Total Current Liabilities	30,689	35,983
Current Liabilities Payable From Restricted Assets:		
Customer Deposits	60,540	59,275
Accrued Interest on Debt	22,288	23,266
Current Portion - Debt (Note 5)	<u>45,500</u>	<u>43,900</u>
Total Current Liabilities Payable From Restricted Assets	128,328	126,441
Non-Current Liabilities:		
Long-Term Debt (Note 5)	<u>1,077,800</u>	<u>1,123,300</u>
Total Liabilities	<u>1,236,817</u>	<u>1,285,724</u>
<b><u>NET ASSETS</u></b>		
Invested in Capital Assets, Net of Related Debt	680,019	733,796
Unrestricted	<u>703,889</u>	<u>750,082</u>
Total Net Assets	<u>1,383,908</u>	<u>1,483,878</u>
Total Liabilities and Net Assets	<u>\$ 2,620,725</u>	<u>\$ 2,769,602</u>

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

MCKINNEY WATER DISTRICT  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEAR ENDED DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2010)

	<u>2011</u>	<u>2010</u>
Operating Revenue:		
Water Sales	\$ 713,219	\$ 738,073
Connection Fees	5,500	5,000
Rental Income	3,000	3,000
Other Operating Revenue	<u>20,891</u>	<u>19,549</u>
Total Operating Revenue	742,610	765,622
Operating Expenses	<u>681,571</u>	<u>645,866</u>
Net Operating Income Before Depreciation	61,039	119,756
Depreciation (Note 2)	<u>125,782</u>	<u>124,652</u>
Net Operating Income	(64,743)	(4,896)
Non-Operating Income (Expenses):		
Intergovernmental	6,428	27,865
Interest Income	3,497	4,965
Interest Expense:		
On Long-Term Debt	(44,605)	(46,572)
Paid on Customer Deposits	(363)	(1,067)
Amortization of Bond Discount	<u>(184)</u>	<u>(184)</u>
Total Non-Operating Income (Expenses)	<u>(35,227)</u>	<u>(14,993)</u>
Change in Net Assets	(99,970)	(19,889)
Net Assets - Beginning of Year	<u>1,483,878</u>	<u>1,503,767</u>
Net Assets - End of Year	<u>\$ 1,383,908</u>	<u>\$ 1,483,878</u>

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

MCKINNEY WATER DISTRICT  
STATEMENT OF CHANGES IN NET ASSETS  
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>Tap Fees</u>	<u>Contributions In Aid Of Construction</u>	<u>Retained Deficit</u>	<u>Total</u>
Balance at January 1, 2010	\$ 211,363	\$ 1,960,460	\$ (668,056)	\$ 1,503,767
2010 Customer Contributions	-	-	-	-
2010 Net Income Before Capital Contributions	-	-	(19,889)	(19,889)
Balance at December 31, 2010	211,363	1,960,460	(687,945)	1,483,878
2011 Customer Contributions	-	-	-	-
2011 Net Income Before Capital Contributions	-	-	(99,970)	(99,970)
Balance at December 31, 2011	<u>\$ 211,363</u>	<u>\$ 1,960,460</u>	<u>\$ (787,915)</u>	<u>\$ 1,383,908</u>

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

MCKINNEY WATER DISTRICT  
STATEMENT OF OPERATING EXPENSES  
FOR THE YEAR ENDED DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2010)

	<u>2011</u>	<u>2010</u>
Source of Supply Expense:		
Water Purchases	\$ 325,333	\$ 306,075
Operation Supplies and Expense	<u>24,374</u>	<u>2,205</u>
Total	349,707	308,280
Transmission and Distribution Expense:		
Maintenance of Mains	<u>32,217</u>	<u>44,796</u>
Total	32,217	44,796
Customer Accounts Expense:		
Supplies and Postage	<u>19,509</u>	<u>18,836</u>
Total	19,509	18,836
Administrative and General:		
Salaries	132,207	123,203
Contract Labor	59,015	87,583
Insurance	14,169	11,350
Miscellaneous Expense:		
Utilities	10,618	10,363
Advertising	516	340
Bad Debts	2,562	1,915
Miscellaneous	935	435
Vehicle Gas	14,178	5,564
Payroll Taxes	10,514	9,822
Legal and Professional	18,273	5,475
Commissioners' Board and Director Fees	16,430	15,950
Other Licenses and Taxes	<u>721</u>	<u>1,954</u>
Total	<u>280,138</u>	<u>273,954</u>
Total Operating Expenses	<u>\$ 681,571</u>	<u>\$ 645,866</u>

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

MCKINNEY WATER DISTRICT  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2010)

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities:		
Receipts From Customers	\$ 751,472	\$ 757,385
Payments to Suppliers	(533,946)	(561,041)
Payments to Employees	(132,207)	(123,203)
Payments of Payroll and Other Taxes	(9,592)	(15,366)
Other Receipts (Payments)	<u>1,265</u>	<u>270</u>
Net Cash Provided by (Used in) Operating Activities	<u>76,992</u>	<u>58,045</u>
Cash Flows From Non-Capital Financing Activities:		
Interest Paid on Customer Deposits	(363)	(1,067)
Grant Receipts	<u>15,975</u>	<u>48,691</u>
Net Cash Provided by (Used in) Non-Capital Financing Activities	<u>15,612</u>	<u>47,624</u>
Cash Flows From Capital and Related Financing Activities:		
Purchase of Land and Right of Ways	-	-
Purchase of Fixed Assets/Construction in Progress	(28,105)	(12,219)
Retirement of Bonds	(43,900)	(41,800)
Interest Paid on Bonds	<u>(45,583)</u>	<u>(47,499)</u>
Net Cash Used in Financing Activities	<u>(117,588)</u>	<u>(101,518)</u>
Cash Flows From Investing Activities:		
Purchase of Certificates of Deposit	(3,110)	(4,205)
Interest Received	<u>3,497</u>	<u>4,965</u>
Net Cash Provided by (Used in) Investing Activities	<u>387</u>	<u>760</u>
Net Increase (Decrease) in Cash	(24,597)	4,911
Cash at Beginning of Year	<u>485,132</u>	<u>480,221</u>
Cash at End of Year	<u>\$ 460,535</u>	<u>\$ 485,132</u>

Continued

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

MCKINNEY WATER DISTRICT  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2010)  
Continued

	<u>2011</u>	<u>2010</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities:		
Operating Income (Loss)	\$ (64,743)	\$ (4,896)
Depreciation	125,782	124,652
Decrease (Increase) in Accounts Receivable	8,862	(8,237)
Decrease (Increase) in Inventory	11,583	(21,810)
Decrease (Increase) in Prepaid Expenses	(463)	(28)
Increase (Decrease) in Accounts Payable	(6,938)	(28,316)
Increase (Decrease) in Customer Deposits	1,265	270
Increase (Decrease) in Other Current Liabilities	<u>1,644</u>	<u>(3,590)</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 76,992</u>	<u>\$ 58,045</u>
Non-Cash Financing and Investing Activities:	None	None

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

McKinney Water District  
Notes to Financial Statements  
December 31, 2011

1. GENERAL

McKinney Water District, (the "District") is a governmental entity operated under the control of the Lincoln County Fiscal Court. The District provides water services to the rural sections of Lincoln and Casey counties.

Prior to December of 1992, the District operated as two separate legal entities: the McKinney Water Association, Inc. and the McKinney Water District. In December of 1992, pursuant to and order of the Public Service Commission of the Commonwealth of Kentucky, the District was merged with the Association, and the District annexed the territory of the Association. The District also assumed all rights and obligations of the Association.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The District uses the accrual method of accounting which focuses on the measurement of net income similar to the approach used by commercial enterprises, and revenues are recorded when earned and expenses are recorded when incurred. The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's ongoing operations. The principal operating revenues of the utility are charges to customers for water service. Also, the District recognizes as operating revenue, the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.
- B. Cash includes amounts in demand deposits only.
- C. Investments consist of certificates of deposit only and are stated at cost which approximates fair value.
- D. Receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. All receivables in excess of 90 days old comprise the accounts receivable allowance for uncollectibles.
- E. Property and equipment are stated at cost, and are depreciated over the estimated useful life of the asset using the straight-line method of depreciation. Transmission lines are being depreciated over a 33 year life; office furniture and equipment over lives of 5 to 10 years, and buildings and improvements over a 20 year life. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.
- F. Material inventory is stated at cost using the first-in, first-out (FIFO) method.
- G. Prepaid items include payments made to vendors that will benefit periods beyond the end of the fiscal year.
- H. Restricted assets represent cash for which use is limited by certain applicable bond covenants.
- I. Deferred expenses include bond issuance costs which are amortized over the life of the bonds using the straight-line method.

McKinney Water District  
Notes to Financial Statements  
December 31, 2011

3. CASH & INVESTMENTS

Cash is composed of the following as of December 31, 2011, and 2010, with restriction for use noted:

		<u>2011</u>		<u>2010</u>
Cash on Hand		\$ 120	\$	120
Cash on Deposit - Operating Account	A	105,637		123,482
Cash on Deposit - Revenue Account	B	128,615		159,130
Cash on Deposit - Customer Deposits	C	34,401		26,280
Savings Accounts:				
Debt Service Account	D	155,831		149,215
Depreciation Reserve Account	E	<u>35,931</u>		<u>26,905</u>
TOTAL		<u>\$ 460,535</u>	\$	<u>485,132</u>

The District's investments at December 31, 2011 are as follows:

<u>Type of Investment</u>		<u>Fair Value</u>		<u>Cost</u>	<u>Interest Rate</u>	<u>Maturity Date</u>
PBK Bank Certificates of Deposit:						
CD - Revenue	B	\$ 52,252	\$	52,252	1.10%	03/12/12
CD - Customer Deposits	C	104,504		104,504	1.10%	03/12/12
CD - Depreciation Reserve	E	<u>104,504</u>		<u>104,504</u>	1.10%	03/12/12
Total Certificates of Deposit		<u>\$ 261,260</u>	\$	<u>261,260</u>		

The cash and certificate of deposit balances are insured for \$250,000 by the FDIC at December 31, 2011 and 2010. Deposits in excess of \$250,000 have been collateralized by the bank as of December 31, 2011 and 2010.

- (A) The operating and maintenance account, required by the RDA bond resolution, is used to meet the current expenses of operating and maintaining the system.
- (B) The revenue account, required by the RDA bond resolution, is used for the deposit of all funds collected and for the disbursement of funds to the proper bank accounts.
- (C) The customer deposit account is used to account for deposits received from customers.
- (D) The district is required to transfer monthly to the debt service account that amount which is necessary to meet the semi-annual installments for principal and interest on the RDA bonds outstanding.
- (E) The district is required to transfer \$600 monthly to the reserve account until \$62,880 is accumulated in the fund. The use of such fund is restricted to paying the cost of repairing or replacing, making extension or improvements or when necessary for payment of principal and interest. Whenever payments are made from the fund, the monthly payment shall be resumed until the balance again reaches \$62,880. Once the balance in this account is fully funded, monthly transfers are then at the option of the District. The account is fully funded as of December 31, 2011 and 2010.

McKinney Water District  
Notes to Financial Statements  
December 31, 2011

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2011 was as follows:

Transmission Lines	2,544,994	-	-	2,544,994
Services	116,142	-	-	116,142
Meters	105,562	-	-	105,562
Hydrants	13,925	-	-	13,925
Pumps	83,993	-	-	83,993
Water Tank	363,687	-	-	363,687
Other Tangible Plant	52,538	29,298	(7,950)	73,886
Office Furniture and Fixtures	47,961	-	-	47,961
Buildings and Improvements	43,178	-	-	43,178
Capitalized Design and Interest Cost	566,951	-	-	566,951
Construction in Process	-	-	-	-
Total	<u>3,956,974</u>	<u>29,298</u>	<u>(7,950)</u>	<u>3,978,322</u>
Less accumulated depreciation for:				
Transmission Lines	(1,370,394)	(77,121)	-	(1,447,515)
Services	(68,420)	(3,520)	-	(71,940)
Meters	(76,618)	(3,199)	-	(79,817)
Hydrants	(10,385)	(422)	-	(10,807)
Pumps	(50,389)	(2,168)	-	(52,557)
Water Tank	(165,962)	(10,980)	-	(176,942)
Other Tangible Plant	(23,815)	(6,055)	6,757	(23,113)
Office Furniture and Fixtures	(39,685)	(4,201)	-	(43,886)
Buildings and Improvements	(30,132)	(1,209)	-	(31,341)
Capitalized Design and Interest Cos	(220,178)	(16,907)	-	(237,085)
Total accumulated depreciation	<u>(2,055,978)</u>	<u>(125,782)</u>	<u>6,757</u>	<u>(2,175,003)</u>
Capital Assets, Net	<u>\$ 1,900,996</u>	<u>\$ (96,484)</u>	<u>\$ (1,193)</u>	<u>\$ 1,803,319</u>

McKinney Water District  
Notes to Financial Statements  
December 31, 2011

5. LONG-TERM DEBT

The District issues bonds and pledges income derived from the acquired or constructed assets to pay debt service.

The District's debt at December 31, 2011 consists of the following:

USDA (Rural Development) - \$150,400 Principal amount Series A Bonds dated 1992 due in annual installments of \$4,800 to \$11,400 through 2012. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	\$ 11,400
USDA (Rural Development) - \$77,800 Principal amount Series B Bonds dated 1992 due in annual installments of \$2,300 to \$5,700 through 2013. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	11,200
USDA (Rural Development) - \$78,600 Principal amount Series C Bonds dated 1992 due in annual installments of \$1,600 to \$5,300 through 2018. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	31,800
USDA (Rural Development) - \$537,000 Principal amount Series D Bonds dated 1992 due in annual installments of \$5,700 to \$29,000 through 2032. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	408,000
USDA (Rural Development) - \$130,000 Principal amount Series A Bonds dated 1999 due in annual installments of \$1,400 to \$6,900 through 2038. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	111,300
USDA (Rural Development) - \$90,000 Principal amount Series B Bonds dated 1999 due in annual installments of \$900 to \$4,700 through 2038. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	77,100
USDA (Rural Development) - \$550,000 Principal amount Series 2000 Bonds dated 2000 due in annual installments of \$7,500 to \$24,500 through 2040. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	<u>472,500</u>
Total Outstanding Bonds	1,123,300
LESS: Current Portion	<u>(45,500)</u>
Long-Term Debt	<u><u>\$ 1,077,800</u></u>

McKinney Water District  
Notes to Financial Statements  
December 31, 2011

The annual requirements to amortize all bonds outstanding as of December 31, 2011 are as follows:

2012		\$	45,500
2013			36,200
2014			31,800
2015			32,800
2016			34,600
Thereafter			942,400
Total			\$ 1,123,300

Long-term liability activity for the year ended December 31, 2011 was as follows:

	<u>Beginning Balance</u>		<u>Increases</u>		<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
RDA 1992 Series A Bond	\$ 22,400	\$	-	\$	(11,000)	\$ 11,400	\$ 11,400
RDA 1992 Series B Bond	16,400		-		(5,200)	11,200	5,500
RDA 1992 Series C Bond	35,500		-		(3,700)	31,800	3,900
RDA 1992 Series D Bond	419,000		-		(11,000)	408,000	11,000
RDA 1999 Series A Bond	113,400		-		(2,100)	111,300	2,200
RDA 1999 Series B Bond	78,500		-		(1,400)	77,100	1,500
RDA 2000 Series A Bond	482,000		-		(9,500)	472,500	10,000
Long-term Debt Total	\$ 1,167,200	\$	-	\$	(43,900)	\$ 1,123,300	\$ 45,500

Principal payments on the above debt are due on January 1 of each year. In the past, the District had always paid the principal payment in December and that amount is what was reflected on the financial statements as the current portion of long-term debt. However, the District is now paying its principal payments on January 1 as scheduled. Therefore, the current portion of long-term debt now reflects the principal payments that are due on January 1 following the end of the fiscal year.

#### 6. RISK MANAGEMENT

The district is exposed to a variety of accidental losses, and has attempted to minimize its risk by carrying commercial insurance. There have been no significant reductions in coverage from coverage in the prior year.

#### 7. OTHER MATTERS

(A) The District has not been assessed or paid any property, intangible or franchise tax in prior years. Since there is some uncertainty about the taxability of a "water district", the financial statements do not reflect any liability for unpaid taxes, if any.

McKinney Water District  
Notes to Financial Statements  
December 31, 2011

	2011	2010
(B) Active Meter Customers – December 31,	1864	1866
(C) Water Loss:		
Water Purchases – Gallons	141,664,000	130,435,200
Water Sold and Used in Operations	91,741,200	93,056,100
Line Loss	49,922,800	37,379,100
Percentage of Line Loss	35.24%	28.66%

(D) Accounts Receivable Aging at December 31, 2011:

Current	\$ 55,974
30-59 Days	(3,474)
60-89 Days	355
Over 90 Days	36,329
	\$ 89,184

(E) Accounts Receivable is comprised of the following as of December 31, 2011:

Customers	\$ 89,184
Intergovernmental	-
Allowance for Bad Debts	(36,329)
	\$ 52,855

All accounts receivable 90 days and older have been included in the allowance for uncollectible accounts.

**COMPLIANCE SECTION**

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**INDEPENDENT AUDITOR'S REPORT ON  
COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Chairman and Commissioners  
McKinney Water District  
McKinney, KY

I have audited the financial statements of the McKinney Water District as of and for the year ended December 31, 2011, and have issued my report thereon dated April 24, 2012. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the District's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the District's internal control over financial reporting.

My consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described below, I identified certain deficiencies in internal control over financial reporting that I consider to be material weaknesses and other deficiencies that I consider to be significant deficiencies.

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 misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. I consider the following deficiency to be a material weakness.

1. As is common within the system of internal control of most small organizations, the accounting function of the McKinney Water District does not prepare the financial statements complete with footnotes in accordance with accounting principles generally accepted in the United States of America (GAAP). Accordingly, the District has not established internal controls over the preparation of its financial statements. This condition is considered to be a material weakness of the District's system of internal control over financial reporting.

During the course of performing an audit, it is not unusual for the auditor to prepare various journal entries to present the financial statements in accordance with the GAAP basis of accounting. This reliance on the auditor to perform this function is considered to be a material weakness in the system of internal control. SAS No. 115 does not make exceptions for reporting deficiencies that are adequately mitigated with non-audit services rendered by the auditor or deficiencies for which the remedy would be cost prohibitive.

Communication of the control deficiency above helps to emphasize that the responsibility for financial reporting rests entirely with the District and not the auditor. Stated another way, if an organization is unable to issue, without the auditor's involvement, complete financial statements with footnotes in accordance with generally accepted accounting principles and free of material misstatement, that inability is a symptom of a significant deficiency in the system of internal control.

Management's response – Management engages consultants who possess industry knowledge and expertise to provide financial and other professional services. Based on the auditor's unqualified opinion and after reading the financial statements, management believes the financial statements to be materially correct. Further, management does not think that the addition of an employee or consultant to oversee the annual financial reporting process is necessary nor would it be cost effective.

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 in charge with governance. I consider the deficiencies described below to be significant deficiencies.

1. While testing cash disbursements I noted 47 instances in which purchases made with the District's debit card had no supporting documentation to substantiate the expenditure. Most of the transactions related to fuel purchases. Even though most of the missing documentation related to immaterial items, I recommend that the District strive to improve its document retention in order to substantiate all debit card transactions.
2. During the year ended December 31, 2011, fuel expenditures nearly tripled from the previous year. Increases are expected due to rising fuel prices and because of the purchase of additional equipment during the current year. However, I believe the implementation of a "fuel purchases" policy developed by the Board would be a useful tool to ensure that all fuel purchases are being made in accordance with the wishes and intent of the Board of Commissioners.

Management's response-Management agrees with the above items and is currently taking action to require that all documentation related to debit card transactions be retained in order to substantiate all debit card purchases. Also, management is currently working on developing a fuel purchase policy and will require all future fuel purchases to be made in accordance with the new policy.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District'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 that are required to be reported under *Government Auditing Standards*. However, I noted one trend related to the financial health of the District described below.

1. Water losses have increased during the past four consecutive years as follows:

Fiscal year ended December 31, 2008	16.25%
Fiscal year ended December 31, 2009	18.56%
Fiscal year ended December 31, 2010	28.66%
Fiscal year ended December 31, 2011	38.92%

Water losses are currently being addressed by the District, and as of the date of this report, losses have improved dramatically. As of the date of this report, loss percentages are in the 16% range which will provide a tremendous financial savings for the District.

The District's response to the findings identified in my audit is described above. I did not audit the District's response and, accordingly, express no opinion on it.

This report is intended solely for the information and use of the directors, management, and applicable regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

*Craig A. Butler, CPA*

Craig A. Butler  
Certified Public Accountant

Danville, Kentucky  
April 24, 2012