

McCREARY COUNTY WATER DISTRICT

P.O. Box 488
Whitley City, KY 42653
(606) 376-2540

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PUBLIC SERVICE
COMMISSION

November 4, 2013

Jeff Cline
Annual Report Branch
Public Service Commission
P.O. Box 615
Frankfort, KY. 40602-0615

RE: McCreary County Water District
December 31, 2012 and 2011 Annual Report
Water & Sewer Divisions

Dear Mr. Cline:

Please find enclosed is the McCreary County Water District Independent Auditor's Report and Combined Financial Statements December 31, 2012 and 2011 for both the water and sewer divisions.

If you have any questions, please feel free to contact me at (606) 376-2540.

Sincerely,



Stephen T. Owens, Manager/Supt.
McCreary County Water District

STO/kt

Enclosure

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COMMISSION

McCreary County Water District,
Water and Sewer Divisions

* * * *

Independent Auditor's Report
and Combined Financial Statements
December 31, 2012 and 2011

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
BASIC FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011

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**McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012 AND 2011**

Our discussion and analysis of the McCreary County Water District, Water and Sewer Divisions' financial performance provides an overview of the Company's financial activities for the years ended December 31, 2012 and 2011. This information is presented in conjunction with the audited financial statements that follow this section.

Financial Highlights

For the year ended December 31, 2012, total operating and non-operating revenues (including capital contributions) totaled \$4,061,030 and operating expenses and non-operating expenses amounted to \$5,221,709, creating a decrease in net position of \$1,160,679. At year end, net position totaled \$33,869,740 of which \$31,590,801 (net of related debt) was invested in capital assets, and \$811,120 was restricted for debt service and construction. This left a net amount of \$1,467,819 of unrestricted net position.

For the year ended December 31, 2011, total operating and non-operating revenues (including capital contributions) totaled \$5,493,755 and operating expenses and non-operating expenses amounted to \$5,005,080, creating an increase in net position of \$488,675. At year end, net position totaled \$35,030,419 of which \$32,606,634 (net of related debt) was invested in capital assets, and \$1,311,115 was restricted for debt service and construction. This left a net amount of \$1,112,670 of unrestricted net position.

Overview of the Financial Statements

This report consists of Management's Discussion and Analysis, Financial Statements and Supplementary information. The Financial Statements include notes which explain in detail some of the information included in the Financial Statements.

Required Financial Statements

The financial statements of McCreary County Water District, Water and Sewer Divisions report information of the Company using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The Statement of Net Position includes all of utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to utility creditors (liabilities). It also provides the basis for evaluation of the capital structure of the utility and assessing the liquidity and financial flexibility of the utility.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Position. This statement measures the success of utility's operations over the past year and can be used to determine whether the utility has successfully recovered all its costs through its user fees and other charges, profitability and credit worthiness.

The final required financial statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012 AND 2011

Condensed Comparative Financial Analysis:

McCreary County Water District
Water and Sewer Divisions
Statement of Net Position-Summary
December 31, 2012 and 2011

Assets	<u>2012</u>	<u>2011</u>
Total Current Assets	\$ 1,750,020	\$ 1,634,169
Total Restricted Assets	811,120	1,311,115
Net Capital Assets	42,227,200	41,610,563
Other Non-Current Assets	198,559	58,376
Total Assets	<u>\$ 44,986,899</u>	<u>\$ 44,614,223</u>
Liabilities		
Total Current Liabilities	\$ 782,011	\$ 898,408
Total Non-current Liabilities	10,335,148	8,685,396
Total Liabilities	<u>\$ 11,117,159</u>	<u>\$ 9,583,804</u>
Net Position:		
Invested in capital assets, net of related debt	\$ 31,590,801	\$ 32,606,634
Restricted for debt service and construction	811,120	1,311,115
Unrestricted	1,467,819	1,112,670
Total Net Position	<u>\$ 33,869,740</u>	<u>\$ 35,030,419</u>

The largest portion per year (93.27% and 93.08% respectively) of the utility's net position reflects its investment in capital assets, less any related debt used to acquire those assets still outstanding. The utility used these capital assets to provide services to citizens and consumers; consequently, these assets are not available for future spending.

Restricted net position per year (2.39% and 3.74% respectively) represent resources that are subject to external restrictions on how they may be used.

The balance per year (4.34% and 3.18% respectively) of unrestricted net position may be used to meet the utility's ongoing obligations to citizens, consumers and creditors.

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012 AND 2011

McCreary County Water District
Water and Sewer Divisions
Statement of Operations
For the Years Ended December 31, 2012 and 2011

	2012	2011
Total operating revenues	\$ 3,874,970	\$ 3,574,204
Total operating expenses	4,877,581	4,647,333
Operating loss	(1,002,611)	(1,073,129)
Total non-operating revenue (expenses)	(273,734)	270,996
Loss before capital contributions	(1,276,345)	(802,133)
Capital contributions	115,666	1,290,808
Change in net position	(1,160,679)	488,675
Beginning of year	35,030,419	34,541,744
End of year	\$ 33,869,740	\$ 35,030,419

During 2012, net position decreased by \$1,160,679 and consisted of operating loss of (\$1,002,611), net non-operating revenue and expenses of (\$273,734) and capital contributions of \$115,666.

During 2011, net position increased by \$488,675 and consisted of operating loss of (\$1,073,129), net non-operating revenues and expenses of \$270,996 and capital contributions of \$1,290,808.

Capital Asset Changes

At December 31, 2012, the Utility had invested \$42,227,200 in capital assets, net of accumulated depreciation. This amount represents a net increase of \$616,637 from the previous year. The net increase consisted of additions to capital assets of \$2,176,578 less depreciation expense of \$1,559,941. The additions were mainly financed with proceeds of capital grants.

At December 31, 2011, the Utility had invested \$41,610,563 in capital assets, net of accumulated depreciation. This amount represents a net increase of \$268,124 from the previous year. The net increase consisted of additions to capital assets of \$1,211,487 less disposals of \$15,120 less depreciation expense of \$1,464,491. The additions were mainly financed with proceeds of capital grants.

Debt Administration

At December 31, 2012, the utility had total debt equal to \$10,636,399 which consisted of \$10,494,306 of bonds outstanding, \$137,923 of notes payable, and capital leases of \$4,170. At the beginning of the year total debt equaled \$9,003,929. The increase in debt was due to finishing construction for various upgrades and additions which exceeded scheduled principal payments on preexisting debt of \$287,113.

At December 31, 2011, the utility had total debt equal to \$9,003,929, which consisted of \$8,819,179 of bonds outstanding, \$156,353 of note payables, and capital leases of \$28,397. At the beginning of the year total debt equaled \$9,265,342. The decrease in debt was from new borrowing of \$38,463 net of scheduled principal payments on preexisting debt of \$299,876.

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012 AND 2011

Request for Information

This financial report is designed to provide our customers and creditors with a general overview of McCreary County Water District, Water and Sewer Divisions' finances and to demonstrate utility's accountability for the funds it receives. If you have any questions about this report or need any additional information, please contact the McCreary County Water District, Whitley City, Kentucky.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
McCreary County Water District
Water and Sewer Divisions
Whitley City, Kentucky 42653

Report on the Financial Statements

We have audited the accompanying combined financial statements of the business-type activities of McCreary County Water District, Water and Sewer Divisions as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District'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

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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 we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit includes 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.

McCreary County Water District
Water and Sewer Divisions
Whitley City, Kentucky 42653
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Accordingly, we 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.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of McCreary County Water District, Water and Sewer Divisions as of December 31, 2012 and 2011, and the respective changes in financial position and cash flows for the years then ended in conformity 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 information on pages 1 through 4 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. We 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 our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the combined financial statements that collectively comprise McCreary County Water District, Water and Sewer Divisions' basic financial statements as a whole. The accompanying combining statements of net position and revenues, expenses and changes in net position are presented for purposes of additional analysis, and are not a required part of the combined financial statements of the McCreary County Water District, Water and Sewer Divisions.

McCreary County Water District
Water and Sewer Divisions
Whitley City, Kentucky 42653
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The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 2013, on our consideration of McCreary County Water District, Water and Sewer Divisions' internal control over financial reporting and on our 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 our 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 compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering McCreary County Water District's internal control over financial reporting and compliance.

Faulkner, King & Wenz, PSC

October 24, 2013

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
COMBINED STATEMENTS OF NET POSITION
DECEMBER 31, 2012 and 2011

ASSETS

	2012	2011
Current assets:		
Cash and cash equivalents	\$ 894,539	\$ 666,386
Unbilled revenues	204,602	181,512
Accounts receivable	383,055	379,368
Other receivables	9,181	200,978
Inventory	229,154	167,220
Prepaid expenses	29,489	38,705
Total current assets	1,750,020	1,634,169
Non-current assets:		
Restricted assets:		
Cash	517,535	1,204,069
Investments	293,585	107,046
Capital assets:		
Utility plant	56,297,068	55,754,183
Less accumulated depreciation	(16,005,112)	(14,455,071)
Construction in process	1,935,244	311,451
Bond issue costs, net	198,559	58,376
Total non-current assets	43,236,879	42,980,054
Total assets	\$ 44,986,899	\$ 44,614,223

LIABILITIES

Current liabilities:		
Accounts payable	\$ 154,713	\$ 340,862
Accrued interest	200,478	122,712
Taxes payable	16,388	19,024
Other accrued expenses	71,832	68,671
Customer deposits	37,349	28,606
Capital equipment lease - current	4,170	26,523
Notes payable - current	43,773	41,902
Revenue bonds - current portion	253,308	250,108
Total current liabilities	782,011	898,408
Non-current liabilities:		
Capital equipment lease - non current	-	1,874
Notes payable - long term	94,150	114,451
Revenue bonds - net current portion	10,240,998	8,569,071
Total non-current liabilities	10,335,148	8,685,396
Total liabilities	\$ 11,117,159	\$ 9,583,804

NET POSITION

Invested in capital assets, net		
of related debt	\$ 31,590,801	\$ 32,606,634
Restricted for debt service and construction	811,120	1,311,115
Unrestricted	1,467,819	1,112,670
Total net position	\$ 33,869,740	\$ 35,030,419

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

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
COMBINED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011

	2012	2011
Operating revenues		
Residential sales	\$ 2,258,435	\$ 2,054,881
Commercial sales	307,012	305,865
Industrial sales	5,023	4,794
Governmental sales	1,200,348	1,135,289
Other sales	104,152	73,375
Total operating revenues	3,874,970	3,574,204
Operating expenses		
General and administrative costs	162,989	165,645
Payroll and related expenses	1,927,070	1,885,142
Repairs and maintenance	117,442	93,271
Other supplies and expenses	1,104,425	1,035,585
Depreciation and amortization	1,565,655	1,467,690
Total operating expenses	4,877,581	4,647,333
Operating loss	(1,002,611)	(1,073,129)
Nonoperating revenues (expenses)		
Interest income	19,418	26,420
Other income	50,976	581,193
Gain on sale of fixed assets	-	21,130
Interest expense	(344,128)	(357,747)
Net nonoperating revenues (expenses)	(273,734)	270,996
Loss before contributions	(1,276,345)	(802,133)
Capital grants received	115,666	1,290,808
Change in net position	(1,160,679)	488,675
Total net position beginning of year	35,030,419	34,541,744
Total net position end of year	\$ 33,869,740	\$ 35,030,419

The accompanying notes are an integral part of the financial statements



McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
COMBINED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (1,002,611)	\$ (1,073,129)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	1,565,655	1,467,690
Change in assets and liabilities:		
Decrease in receivables	166,784	43,585
(Increase) in inventories	(61,934)	(10,868)
(Increase) decrease in prepaids	9,216	(1,281)
(Decrease) increase in accounts payable	(186,149)	21,972
Increase in customer deposits	8,743	4,488
Increase(decrease) in accrued expenses	525	(14,924)
Net cash provided by operating activities	\$ 500,229	\$ 437,533

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the McCreary County Water District, Water and Sewer Divisions (the District) are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The existing hierarchy provides that accounting guidance should first be sought in statements of the Governmental Accounting Standards Board (GASB). If the GASB has not issued a standard applicable to a situation, then pronouncements of the Financial Accounting Standards Board (FASB) and Accounting Principles Board (APB) issued on or before November 30, 1989 are presumed to apply. The following is a summary of the more significant policies:

Reporting Entity

The District, consisting of McCreary County Water District Water Division, and McCreary County Water District Sewer Division has been consolidated for reporting purposes. The entities share the same board of commissioners, central offices and employees.

The District is a special district formed for the express purpose of providing water and sewer service within the confines of McCreary County, Kentucky and East Pine Knot Estates. McCreary County Fiscal Court appoints an independent board of commissioners to govern the district. The District operates as an independent entity in that it: is legally separate; holds corporate powers of organization; the Fiscal Court does not impose their will upon the District; and the District does not impose financial benefit or burden upon the Fiscal Court.

Basis of Presentation

GASB Statement of Accounting Standards No. 34, as amended by GASB 63, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB 34) established standards for external financial reporting for all state and local governmental entities which includes a statement of net position, a statement of revenues, expenses and changes in net position and a statement of cash flows. It requires the classification of net position into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt - This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of "invested in capital assets, net of related debt." Rather, that portion of the debt is included in the same net position component as the unspent proceeds.
- Restricted - This component of net position consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted - This component of net position consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The District is an individual fund and is accounted for as a business-type activity fund. It is financed and operated in a manner similar to a private business enterprise where the intent of the governing body is that costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed primarily through user charges.

Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made, regardless of the measurement focus applied. The District's financial statements are prepared on the accrual basis of accounting. By utilizing this method, revenues are recognized when they are earned, and expenses are recognized as they are incurred.

Operating income reported in the financial statements includes revenues and expenses related to the continuing operation of the fund. Principal operating revenues are charges to customers for sales or services. Principal operating expenses are the costs of providing goods or services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

When both restricted and unrestricted resources are available for use it is the District's policy to use restricted resources first, then unrestricted resources as needed.

Use of Estimates and Assumptions

In preparing financial statements that conform with generally accepted accounting principles, management makes estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Accordingly, actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the allowance for doubtful accounts for accounts receivable.

Compensated Absences

Vacation - Vacation days are accrued at the following rate:

- 5 days per year for years 0-3
- 10 days per year for years 3-10
- 15 days per year for years 10-15
- 20 days per year for years 15-xx

These days are carried over if unused; however, all employees must take five days of vacation per year.

Sick - Employees earn one sick day for every two months of employment and may carry over a total of twelve days.

These unpaid compensated absences, if applicable, are recorded as accrued liabilities.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all highly liquid investments with maturity of ninety days or less to be cash equivalents.

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable

Trade accounts receivable are stated at the amount management expects to collect from balances outstanding at year-end. Management closely monitors outstanding balances and writes off balances that are deemed to be uncollectible. The allowance for doubtful accounts of \$131,900 and \$113,155 for the years ended December 31, 2012 and 2011 has been established to reserve for those balances that the entity believes to be uncollectible.

Inventories

Inventories are stated at the lower of cost or market on the basis of "first-in, first-out" (FIFO) inventory method.

Capital and operating grants

Grants that are restricted to the purchase of capital assets are recorded as other income, per GASB 33. The District received \$115,666 and \$1,290,808 in grants for the years ended December 31, 2012 and 2011 respectively.

Unamortized Debt Discount, Issuance Expense, and Deferred Amount from Refunding

Original issue discounts, debt issuance expenses, and deferred amounts from the advance refunding of outstanding revenue certificates are appropriately deferred and amortized over the remaining terms of the applicable debt issues (or life of the old debt, whichever is shorter, for deferred amounts from the advance refunding) using the bonds outstanding method, which approximated the interest method. The amortization expense was \$5,714 and \$3,199 for the years ended December 31, 2012 and 2011 respectively.

Capital Assets

Utility plant is stated at original cost and depreciated over its estimated useful lives using the straight-line method. Expenditures for maintenance and repairs are expensed when incurred. Renewals and betterments are capitalized. The range of useful lives used in computing depreciation is:

<u>Classification</u>	<u>Range of lives</u>
Buildings	40 years
Water systems	40 years
Machinery & equipment	5 years

Total depreciation expense was \$1,559,941 and \$1,464,491 for the years ended December 31, 2012 and 2011 respectively.

Date of Management's Review

Subsequent events were evaluated through October 24, 2013, which is the date the financial statements were available to be issued.

NOTE 2 - CASH DEPOSITS AND INVESTMENTS

The investment policies of the District are governed by State statute. Major provisions of the District's investment policy include: depositories must be FDIC insured banking institutions; depositories must fully insure or collateralize all demand and time deposits and repurchase agreements; and securities collateralizing repurchase agreements are to be held by independent third parties.

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 2 - CASH DEPOSITS AND INVESTMENTS (CONTINUED)

Bank Deposits

The fair market value of deposits and investments was equivalent to the reported values. All deposits are checking or savings accounts. The carrying amount of the District's bank deposits was \$1,410,133 and \$1,869,455 for the years ended December 31, 2012 and 2011 respectively and the respective bank balances totaled \$1,612,438 and \$1,931,309 respectively for the years then ended. The bank balances are covered by \$500,000 of FDIC insurance. The remaining bank balances were fully collateralized. The deposits are categorized to give an indication of the level of risk assumed by the District at year end. The categories are described as follows:

- Category 1 - Insured
- Category 2 - Collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.
- Category 3 - Collateralized with securities held by the pledged financial institution in the institution's name.

Deposits at December 31, 2012, categorized by level of risk, are:

	Risk Category			Bank Balance	Book Value
	1	2	3		
Unrestricted deposits					
Operating accounts	\$ 107,199	\$ -	\$ 416,352	\$ 523,551	\$ 448,079
Depreciation funds	317,801		126,718	444,519	444,519
Restricted deposits					
Debt service funds	-	-	442,435	442,435	442,535
Construction funds	-	-	-	-	-
Depreciation funds	75,000	-	-	75,000	75,000
Total deposits	<u>\$ 500,000</u>	<u>\$ -</u>	<u>\$ 985,505</u>	<u>\$ 1,485,505</u>	<u>\$1,410,133</u>

Deposits at December 31, 2011, categorized by level of risk, are:

	Risk Category			Bank Balance	Book Value
	1	2	3		
Unrestricted deposits					
Operating accounts	\$ 106,516	\$ -	\$ 485,574	\$ 592,090	\$ 530,236
Depreciation funds	-		135,150	135,150	135,150
Restricted deposits					
Debt service funds		-	809,809	809,809	809,809
Construction funds		-	-	-	-
Depreciation funds	393,484	-	776	394,260	394,260
Total deposits	<u>\$ 500,000</u>	<u>\$ -</u>	<u>\$ 1,431,309</u>	<u>\$ 1,931,309</u>	<u>\$1,869,455</u>

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 2 - CASH DEPOSITS AND INVESTMENTS (CONTINUED)

The District also had \$1,941 and \$1,000 of petty cash on hand for the years ended December 31, 2012 and 2011 respectively.

Investments

At December 31, 2012 and 2011, the District's investments included the Federated Treasury Obligations Fund (a money market fund). The investments are categorized to give an indication of the level of risk assumed by the District at year end. The categories are described as follows:

- Category 1 - Investments that are insured, registered or for which the securities are held by the District or its agent in the District's name.
- Category 2 - Uninsured and unregistered investments for which the securities are held by the bank's trust departments or agents in the District's name.
- Category 3 - Uninsured and unregistered investments for which the securities are held by the banks, or by their trust departments or agents but not in the District's name.

Investments at December 31, 2012 categorized by level of risk, are:

	Risk Category			Book Value	Fair Value
	1	2	3		
Treasury MM Fund	<u>\$293,585</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$293,585</u>	<u>\$293,585</u>
Total investments	<u>\$293,585</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$293,585</u>	<u>\$293,585</u>

Investments at December 31, 2011, categorized by level of risk, are:

	Risk Category			Book Value	Fair Value
	1	2	3		
Treasury MM Fund	<u>\$107,046</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$107,046</u>	<u>\$107,046</u>
Total investments	<u>\$107,046</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$107,046</u>	<u>\$107,046</u>

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 3 - RESTRICTED ASSETS

The restricted assets in the accompanying financial statements are restricted as to use by ordinance (Note 7), external parties or by board designation. A schedule of restricted assets at December 31, 2012 and 2011 are:

A schedule of restricted assets at December 31, 2012 are:

	Cash	Investments at cost	Total
Debt service funds	\$ 442,535	\$ -	\$ 442,535
Construction funds	-	-	-
Depreciation funds	75,000	-	75,000
Treasury MM fund	-	293,585	293,585
Total restricted assets	<u>\$ 517,535</u>	<u>\$ 293,585</u>	<u>\$ 811,120</u>

A schedule of restricted assets at December 31, 2011 are:

	Cash	Investments at cost	Total
Debt service funds	\$ 809,809	\$ -	\$ 809,809
Construction funds	-	-	-
Depreciation funds	394,260	-	394,260
Treasury MM fund	-	107,046	107,046
Total restricted assets	<u>\$ 1,204,069</u>	<u>\$ 107,046</u>	<u>\$ 1,311,115</u>

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 4 - CAPITAL ASSETS

The following represents the activity for the year ended December 31, 2012:

	Balance 12/31/2011	Additions	Disposals	Transfers	Balance 12/31/2012
Operating fixed assets:					
Land	\$ 255,769	\$ -	\$ -	\$ -	\$ 255,769
Buildings & Improvements	17,021,176	40,192	-	-	17,061,368
Treatment equipment	3,249,813	3,377	-	-	3,253,190
Distributions	22,122,622	24,163	-	408,475	22,555,260
Services/meters	3,631,994	28,400	-	-	3,660,394
Other equipment	<u>9,472,809</u>	<u>48,178</u>	<u>(9,900)</u>	<u>-</u>	<u>9,511,087</u>
	55,754,183	144,310	(9,900)	408,475	56,297,068
Accumulated depreciation	<u>(14,455,071)</u>	<u>(1,559,941)</u>	<u>9,900</u>	<u>-</u>	<u>(16,005,112)</u>
	41,299,112	(1,415,631)	-	408,475	40,291,956
Construction in progress	<u>311,451</u>	<u>2,032,268</u>	<u>-</u>	<u>(408,475)</u>	<u>1,935,244</u>
Utility plant, net	<u>\$41,610,563</u>	<u>\$ 616,637</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$42,227,200</u>

The following represents the activity for the year ended December 31, 2011:

	Balance 12/31/2010	Additions	Disposals	Transfers	Balance 12/31/2011
Operating fixed assets:					
Land	\$ 167,799	\$ 87,970	\$ -	\$ -	\$ 255,769
Buildings & Improvements	17,021,176	-	-	-	17,021,176
Treatment equipment	3,249,813	-	-	-	3,249,813
Distributions	21,967,967	151,878	-	2,777	22,122,622
Services/meters	2,685,832	7,600	-	938,562	3,631,994
Other equipment	<u>9,060,486</u>	<u>48,621</u>	<u>(33,600)</u>	<u>397,302</u>	<u>9,472,809</u>
	54,153,073	296,069	(33,600)	1,338,641	55,754,183
Accumulated depreciation	<u>(13,009,060)</u>	<u>(1,464,491)</u>	<u>18,480</u>	<u>-</u>	<u>(14,455,071)</u>
	41,144,013	(1,168,422)	(15,120)	1,338,641	41,299,112
Construction in progress	<u>198,426</u>	<u>1,451,666</u>	<u>-</u>	<u>(1,338,641)</u>	<u>311,451</u>
Utility plant, net	<u>\$41,342,439</u>	<u>\$ 283,244</u>	<u>\$ (15,120)</u>	<u>\$ -</u>	<u>\$41,610,563</u>

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 5 - LONG-TERM DEBT

Outstanding long-term debt consists of revenue bonds collateralized by the revenues of the District, and two capital leases for equipment. Revenues of the District are to be used first to pay operating and maintenance expenses and second to establish and maintain the revenue bond funds. The District is in compliance with all significant financial requirements as of December 31, 2012.

The District's bonded indebtedness and other long-term debt at December 31, 2012 and 2011, are summarized as follows:

<u>Bond issue</u>	<u>Rate</u>	<u>Original Issue</u>	<u>Principal O/S 2012</u>	<u>Principal O/S 2011</u>
Water District				
Takeuchi Financial	7.200%	\$ 38,463	\$ 2,034	\$ 25,521
Forcht Bank	3.300%	128,075	51,576	77,244
RD 1993 Series A	4.500%	794,000	-	620,000
RD 1997 Series A	4.500%	390,000	-	319,500
RD 2001 Series A	4.500%	2,500,000	-	2,220,000
RD 2005 Series A	4.125%	750,000	697,500	707,000
RD 2008 Series A	4.125%	325,000	313,500	317,500
RD 2008 Series A	4.125%	150,000	144,700	146,500
RD Series 2012 D	Variable	3,205,000	3,205,000	-
RD Series 2012 D-1	Variable	1,935,000	1,799,256	-
KIA CD2-01	1.000% *	1,510,000	1,013,850	1,083,658
KRWFC	Variable	2,050,000	1,456,000	1,525,000
Sewer District				
RD 1997 Series A	4.500%	972,000	-	815,000
RD 2002 Series A	4.500%	850,000	-	766,000
RD 2005 Series A	4.125%	290,000	269,500	273,500
RD Series 2012 D	Variable	1,595,000	1,595,000	-
N/P - Bank of McCreary Co.	6.000%	167,000	86,347	102,596
IOS Capital	7.130%	<u>11,482</u>	<u>2,136</u>	<u>4,910</u>
		17,661,020	10,636,399	9,003,929
Less current maturities			<u>(301,251)</u>	<u>(318,533)</u>
Total long-term debt			<u>\$10,335,148</u>	<u>\$ 8,685,396</u>

* The original issue of the KIA CD2-01 loan is \$1,510,000. As of December 31, 2012, the District had borrowed \$1,474,999 of the original amount.

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 5 - LONG-TERM DEBT (CONTINUED)

The District's bonded indebtedness and other long-term debt at December 31, 2012 is detailed as follows:

	Principal Balance 12/31/2011		Borrowings	Principal Payments		Principal Balance 12/31/2012		Current	Long-Term		
Water District											
Takeuchi Fin.	\$	25,521	\$	-	\$	23,487	\$	2,034	\$	-	
Forcht Bank		77,244		-		25,668		51,576		26,518	25,058
1993 Series A		620,000		-		620,000		-		-	-
1997 Series A		319,500		-		319,500		-		-	-
2001 Series A		2,220,000		-		2,220,000		-		-	-
2005 Series A		707,000		-		9,500		697,500		10,000	687,500
2008 Series A		317,500		-		4,000		313,500		4,000	309,500
2008 Series A		146,500		-		1,800		144,700		1,800	142,900
2012 Series D		-		3,205,000		-		3,205,000		60,000	3,145,000
2012 Series D1		-		1,799,256		-		1,799,256		-	1,799,256
KRWFC		1,525,000		-		69,000		1,456,000		73,000	1,383,000
KIA CD2-01		1,083,658		-		69,808		1,013,850		70,508	943,342
Sewer District											
1997 Series A		815,000		-		815,000		-		-	-
2002 Series A		766,000		-		766,000		-		-	-
2005 Series A		273,500		-		4,000		269,500		4,000	265,500
2012 Series D		-		1,595,000		-		1,595,000		30,000	1,565,000
N/P - BOMC		102,596		-		16,249		86,347		17,255	69,092
IOS Capital		4,910		-		2,774		2,136		2,136	-
		<u>\$9,003,929</u>		<u>\$ 6,599,256</u>		<u>\$ 4,966,786</u>		<u>\$10,636,399</u>		<u>\$ 301,251</u>	<u>\$10,335,148</u>

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 5 - LONG-TERM DEBT (CONTINUED)

The District's bonded indebtedness and other long-term debt at December 31, 2011 is detailed as follows:

	Principal Balance 12/31/2010		Principal Payments	Principal Balance 12/31/2011		Current	Long-Term
		Borrowings					
Water District							
Takeuchi Fin.	\$ -	\$ 38,463	\$ 12,942	\$ 25,521	\$ 23,487	\$ 2,034	
Forcht Bank	102,077	-	24,833	77,244	25,652	51,592	
1993 Series A	635,000	-	15,000	620,000	16,000	604,000	
1997 Series A	326,500	-	7,000	319,500	7,000	312,500	
2001 Series A	2,257,000	-	37,000	2,220,000	39,000	2,181,000	
2005 Series A	716,500	-	9,500	707,000	9,500	697,500	
2008 Series A	321,300	-	3,800	317,500	4,000	313,500	
2008 Series A	148,300	-	1,800	146,500	1,800	144,700	
KRWFC	1,594,000	-	69,000	1,525,000	69,000	1,456,000	
KIA CD2-01	1,152,773	-	69,115	1,083,658	69,808	1,013,850	
Sewer District							
1997 Series A	831,000	-	16,000	815,000	17,000	798,000	
2002 Series A	778,000	-	12,000	766,000	13,000	753,000	
2005 Series A	277,000	-	3,500	273,500	4,000	269,500	
N/P - BOMC	117,928	-	15,332	102,596	16,250	86,346	
IOS Capital	7,964	-	3,054	4,910	3,036	1,874	
	<u>\$9,265,342</u>	<u>\$ 38,463</u>	<u>\$ 299,876</u>	<u>\$ 9,003,929</u>	<u>\$ 318,533</u>	<u>\$8,685,396</u>	

The long-term debt service requirements are as follows:

Year	Principal		Interest		Total	
	Water	Sewer	Water	Sewer	Water	Sewer
2013	\$ 249,996	\$ 51,255	\$ 255,195	\$ 29,184	\$ 505,191	\$ 80,439
2014	276,283	66,889	227,239	27,773	503,522	94,662
2015	289,675	68,920	279,602	26,299	569,277	95,219
2016	295,732	70,100	272,989	24,714	568,721	94,814
2017	302,797	60,266	267,425	23,052	570,222	83,318
2018-2022	1,660,327	276,170	1,240,389	106,966	2,900,716	383,136
2023-2027	1,606,486	327,667	1,046,464	93,736	2,652,950	421,403
2028-2032	1,251,600	390,667	871,729	77,222	2,123,329	467,889
2033-2037	1,100,100	405,833	740,838	56,702	1,840,938	462,535
2038-2042	898,700	204,580	643,073	30,828	1,541,773	235,408
2043-2047	510,500	28,500	638,561	3,782	1,149,061	32,282
2048-2051	243,356	-	358,634	-	601,990	-
	<u>\$8,685,552</u>	<u>\$1,950,847</u>	<u>\$6,842,138</u>	<u>\$ 500,258</u>	<u>\$15,527,690</u>	<u>\$2,451,105</u>

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 5 - LONG-TERM DEBT (CONTINUED)

2005 Series A - McCreary County Water District Waterworks Revenue Bond, dated August 31, 2005, due in annual installments through April 1, 2045, bearing an interest rate of 4.125%.

2008 Series A - McCreary County Water District Waterworks Revenue Bond, dated April 8, 2008, due in annual installments through April 8, 2048 bearing an interest rate of 4.125%

2008 Series A - McCreary County Water District Waterworks Revenue Bond, dated April 8, 2008, due in annual installments through April 8, 2048 bearing an interest rate of 4.125%

KRWFC - McCreary County Water District Waterworks Revenue Bond, dated March 24, 2004, due in annual installments through January 1, 2030, bearing a variable interest rate.

KIA CD2-01 Fund C - As of December 31, 2005 the District had drawn \$1,474,999 on a KIA loan secured by a pledge of revenues. The loan bears an interest rate of 1.00% with a life of twenty years maturing in 2025.

Forcht Bank - Installment loan dated November 10, 2009, due in monthly installments through November 10, 2014, bearing an interest rate of 3.30%.

2012 Series D - McCreary County Water District Waterworks Revenue Bond, dated May 30, 2012, due in annual installments through January 1, 2040 bearing a variable interest rate.

2012 Series D1 - McCreary County Water District Waterworks Revenue Bond, dated September 30, 2012, due in annual installments through April 1, 2052 bearing an interest rate of 1.875%.

2012 Series D - McCreary County Water District Sewer System Revenue Bond, dated May 30, 2012, due in annual installments through February 1, 2041, bearing a variable interest rate.

2005 Series A - McCreary County Water District Sewer System Revenue Bond, dated August 31, 2005, due in annual installments through January 1, 2045, bearing an interest rate of 4.125%.

Bank of McCreary County - Installment loan dated February 9, 2007, due in bi-annual installments through February 9, 2017, bearing an interest rate of 6.0%.

Takeuchi Financial - A capital lease was started on May 15, 2011 for the use of equipment purchased from Wilson Equipment Company. The lease bears an interest rate of 7.2% with a life of twenty months ending on January 15, 2013.

IOS Capital - A capital lease was started on July 16, 2009 for the use of equipment purchased from IKON Office Solutions. The lease bears an interest rate of 7.13% with a life of four years ending on July 16, 2013.

As reflected on page 20, the District paid off five separate bond issues, all bearing interest rates of 4.5%, with the proceeds of the various 2012 debt obligations at lower interest rates.

McCREARY COUNTY WATER DISTRICT
 WATER AND SEWER DIVISIONS
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2012 and 2011

NOTE 6 - NET POSITION

GASB Statement No. 34 (As amended by GASB 63) requires the delineation of Net Position as Invested in Property, Plant and Equipment (capital investments), Restricted and Unrestricted.

The balance of capital investments represents funds that have been used to acquire pump stations, storage facilities, meter stations, etc., constructed and operated by the District, net of outstanding debt. The balance was \$31,590,801 and \$32,606,634 for the years ended December 31, 2012 and 2011 respectively.

The District has the following restricted net position that is reserved in accordance with the District's various bond ordinances (Note 7):

	<u>2012</u>	<u>2011</u>
Construction	\$ -0-	\$ -0-
Depreciation	75,000	394,260
Debt Service	442,535	809,809
Treasury MM Fund	<u>293,585</u>	<u>107,046</u>
Total Restricted	<u>\$ 811,120</u>	<u>\$ 1,311,115</u>

The District has a balance of \$1,467,819 and \$1,112,670 for unrestricted net position at December 31, 2012 and 2011 respectively.

NOTE 7 - COMPLIANCE WITH BOND ORDINANCES

The District is in compliance with its bond ordinances that require the District to maintain certain reserves and restricted assets as follows:

Bond and Interest Fund - In order to fund the McCreary County Water District and Water Sewer debt, the District makes deposits into these funds to pay for current maturing principal portions and associated interest of bond issues.

Bond Sinking Funds - McCreary County Water District is required by ordinances to transfer funds into various sinking funds for future debt retirement.

Depreciation Fund - The bond resolutions authorizing the bond issues of the water and sewer system require transfers into various depreciation funds to be used for plant acquisitions, extensions and extraordinary repairs and maintenance. Transfers can cease when the fund balance reaches specified levels. The balance in the depreciation fund as of December 31, 2012 and 2011 equaled \$519,519 and \$529,410 respectively. The required balance is \$75,000 and \$394,260 respectively.

Construction Funds - The District is required to transfer funds into various funds for the use of funding future projects.

NOTE 8 - PENSION PLAN

The District has elected to participate in the County Employees' Retirement System (CERS) which is administered by the Board of Trustees of the Kentucky Retirement Systems. This is a multi-employer defined benefit plan that covers substantially all regular full-time employees of county, school board, municipal and other local agencies electing to participate. Upon election to participate in the CERS, each employee has the option to participate. However, all subsequent employees must participate and the employer is required to continue participation.

McCREARY COUNTY WATER DISTRICT
WATER AND SEWER DIVISIONS
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011

NOTE 8 - PENSION PLAN (CONTINUED)

The District had a total of 27 and 25 employees at December 31, 2012 and 2011 covered by the CERS who contributed 5.00%. The employer contributed 18.96% through June, and 19.55% through December of 2012 and 16.93% through June, and 18.96% through December in 2011. The District's contribution was \$184,535 and \$187,862 for the years ended December 31, 2012 and 2011 respectively while the employees contributed \$47,883 and \$54,263 for the years then ended respectively.

The amount shown below as "actuarial accrued liability" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems (PERS). The measure is independent of the actuarial funding method used to determine contributions to the System.

Vesting in a retirement benefit begins immediately upon entry into the System. The participant has a fully vested interest after the completion of sixty months of service, twelve of which are current service. At a minimum, terminated employees are refunded their contributions with credited interest at 3% compounded annually through June 30, 1981, 6% thereafter through June 30, 1986 and 4% thereafter. All required contributions were paid at year end or within thirty (30) days thereafter. The percentage of the District's contribution to total employers' contribution in the CERS for the year is not known.

The CERS total actuarial accrued liability was \$12,149,560,000 and the net assets available for the benefits were \$7,294,615,000 as of June 30, 2012, which is the latest information available. Also see Note 11.

NOTE 9 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the District also carries commercial insurance for all other risks of loss such as workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three calendar years.

NOTE 10 - FAIR VALUE MEASUREMENTS

FASB Statement No. 157, *Fair Value Measurements*, as codified by Accounting Standards Codification (ASC) 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels: Level 1 inputs consist of unadjusted quoted prices in active markets for identical assets and have the highest priority, and Level 3 inputs have the lowest priority. The District uses appropriate valuation techniques based on the available inputs to measure the fair value of its investments. When available, the District measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. No Level 2 or 3 inputs were used by the District.

Level 1 Fair Value Measurements

The fair value of the Federated Treasury Obligations Fund (a money market fund) is based on quoted net asset values of the investments held by the District at year-end.

McCREARY COUNTY WATER DISTRICT
 WATER AND SEWER DIVISIONS
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2012 and 2011

NOTE 10 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table sets forth by level, within the fair value hierarchy, the District's assets at fair value:

Assets at Fair Value as of December 31, 2012

	Level 1	Level 2	Level 3	Total
Treasury MM fund	<u>\$293,585</u>	-	-	<u>\$293,585</u>
Total assets at fair value	<u>\$293,585</u>	-	-	<u>\$293,585</u>

Assets at Fair Value as of December 31, 2011

	Level 1	Level 2	Level 3	Total
Treasury MM fund	<u>\$107,046</u>	-	-	<u>\$107,046</u>
Total assets at fair value	<u>\$107,046</u>	-	-	<u>\$107,046</u>

NOTE 11 - SUBSEQUENT EVENTS

In June 2012 the GASB approved a pair of related Statements that reflect substantial improvements to the accounting and financial reporting of pensions by state and local governments and pension plans. Statement No. 67, Financial Reporting for Pension Plans, addresses financial reporting for state and local government pension plans.

The guidance contained in these Statements will change how governments calculate and report the costs and obligations associated with pensions in important ways. It is designed to improve the decision - usefulness of reported pension information and to increase the transparency, consistency, and comparability of pension information across governments.

Under the pension standards now in effect, cost-sharing employers have not been required to present actuarial information about pensions. Instead, information has been required to be presented in the pension plan's own financial statements for all of the participating governments combined. Through its research, the GASB concluded that the needs of users of information regarding cost-sharing employers do not differ significantly from those interested in single and agent employers. Therefore, the GASB believes it is important to give users of the financial statements of cost-sharing employers access to better, more transparent financial information. Consequently, under the new standards the GASB is requiring that cost-sharing governments report a net pension liability, pension expense, and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective mounts for all the governments in the plan.

Statement No. 67 will take effect for pension plans in fiscal years beginning after June 15, 2013 (that is, for years ended June 30, 2014 or later).

**MCCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
COMBINING STATEMENT OF NET POSITION
DECEMBER 31, 2012**

	McCreary County		Eliminations	Total
	Water	Sewer		
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 881,860	\$ 12,679	\$	\$ 894,539
Unbilled revenues	162,346	42,256		204,602
Accounts receivable, net	307,922	75,133		383,055
Other receivables	2,047	7,134		9,181
Due from associated division	510,573	-	(510,573)	-
Inventory	172,655	56,499		229,154
Prepaid expenses	29,489	-		29,489
Total current assets	<u>2,066,892</u>	<u>193,701</u>	<u>(510,573)</u>	<u>1,750,020</u>
Non-current assets:				
Restricted cash and cash equivalents	278,957	238,578		517,535
Investments	293,585	-		293,585
Capital assets:				
Utility plant	37,814,429	18,482,639		56,297,068
Less accumulated depreciation	(11,720,929)	(4,284,183)		(16,005,112)
Construction in process	1,935,244	-		1,935,244
Bond issue costs, net	150,058	48,501		198,559
Total non-current assets	<u>28,751,344</u>	<u>14,485,535</u>		<u>43,236,879</u>
Total assets	<u>\$ 30,818,236</u>	<u>\$ 14,679,236</u>	<u>\$ (510,573)</u>	<u>\$ 44,986,899</u>
LIABILITIES				
Current liabilities:				
Accounts payable	\$ 104,598	\$ 50,115	\$	\$ 154,713
Accrued interest	154,673	45,805		200,478
Due to associated division	-	510,573	(510,573)	-
Taxes payable	14,331	2,057		16,388
Other accrued expenses	64,349	7,483		71,832
Customer deposits	37,349	-		37,349
Capital equipment lease - current	4,170	-		4,170
Notes payable - current	26,518	17,255		43,773
Revenue bonds - current portion	219,308	34,000		253,308
Total current liabilities	<u>625,296</u>	<u>667,288</u>	<u>(510,573)</u>	<u>782,011</u>
Non-current liabilities:				
Notes payable - long term	25,058	69,092		94,150
Revenue bonds - net current portion	8,410,498	1,830,500		10,240,998
Total non-current liabilities	<u>8,435,556</u>	<u>1,899,592</u>		<u>10,335,148</u>
Total liabilities	<u>\$ 9,060,852</u>	<u>\$ 2,566,880</u>	<u>\$ (510,573)</u>	<u>\$ 11,117,159</u>
NET POSITION				
Invested in capital assets, net of related debt	\$ 19,343,192	\$ 12,247,609	\$	\$ 31,590,801
Restricted for debt service and construction	572,542	238,578		811,120
Unrestricted	1,841,650	(373,831)		1,467,819
Total net position	<u>\$ 21,757,384</u>	<u>\$ 12,112,356</u>	<u>\$ -</u>	<u>\$ 33,869,740</u>

See Independent Auditor's Report.

McCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2012

	McCreary County		Total
	Water	Sewer	
Operating revenues			
Residential sales	\$ 2,019,766	\$ 238,669	\$ 2,258,435
Commercial sales	195,507	111,505	307,012
Industrial sales	2,751	2,272	5,023
Governmental sales	760,624	439,724	1,200,348
Other sales and fees	63,554	40,598	104,152
Total operating revenues	<u>3,042,202</u>	<u>832,768</u>	<u>3,874,970</u>
Operating expenses			
General and administrative costs	134,563	28,426	162,989
Payroll and contractual services	1,524,892	402,178	1,927,070
Repairs and maintenance	-	117,442	117,442
Other supplies and expenses	800,961	303,464	1,104,425
Depreciation and amortization	981,380	584,275	1,565,655
Total operating expenses	<u>3,441,796</u>	<u>1,435,785</u>	<u>4,877,581</u>
Operating (loss)	<u>(399,594)</u>	<u>(603,017)</u>	<u>(1,002,611)</u>
Nonoperating revenues (expenses)			
Interest income	13,980	5,438	19,418
Other income	50,976	-	50,976
Gain on sale of fixed assets	-	-	-
Interest expense	(260,424)	(83,704)	(344,128)
Total nonoperating revenues	<u>(195,468)</u>	<u>(78,266)</u>	<u>(273,734)</u>
Loss before contributions	(595,062)	(681,283)	(1,276,345)
Capital grants received	<u>115,666</u>	<u>-</u>	<u>115,666</u>
Change in net position	(479,396)	(681,283)	(1,160,679)
Total net position on December 31, 2011	<u>22,236,780</u>	<u>12,793,639</u>	<u>35,030,419</u>
Total net position on December 31, 2012	<u>\$ 21,757,384</u>	<u>\$ 12,112,356</u>	<u>\$ 33,869,740</u>

See Independent Auditor's Report

MCCREARY COUNTY WATER DISTRICT,
WATER AND SEWER DIVISIONS
COMBINING STATEMENT OF CASH FLOWS (CONTINUED)
DECEMBER 31, 2012

	Water	Sewer	Total
Reconciliation of operating loss to net cash provided by operating activities:			
Operating loss	\$ (399,594)	\$ (603,017)	\$ (1,002,611)
Adjustments to reconcile operating loss to net cash provided by operating activities:			
Depreciation and amortization	981,380	584,275	1,565,655
Change in assets and liabilities:			
Decrease in receivables	159,364	7,420	166,784
(Increase) in inventories	(35,717)	(26,217)	(61,934)
(Increase) decrease in prepaids	9,216	-	9,216
(Decrease) increase in accounts payable	(189,918)	3,769	(186,149)
Increase in customer deposits	8,743	-	8,743
Increase(decrease) in accrued expenses	3,806	(3,281)	525
	<u>\$ 537,280</u>	<u>\$ (37,051)</u>	<u>\$ 500,229</u>
Net cash provided (used) by operating activities:			

See Independent Auditor's Report.

Supplemental Information

McCreary County Water District
 Schedule of Expenditures of Federal Awards
 December 31, 2012

Pass-through Grantor/ Program Title	Federal CFDA #	Program/Award	Award Amount	Receipts FYE 12/31/12	Expenditures FYE 12/31/12
United States Department of the Army Passed through Corp of Engineers	12.127	ARRA - Corp of Engineers Williamsburg Street Sewer Project COE Grant	903,100	14,062	14,062
Rural Development	10.760	Rural Development Water Plant 1 Upgrade Loan / Grant	<u>2,705,000</u>	<u>1,799,256</u>	<u>1,799,256</u> Major
		Total	<u>3,608,100</u>	<u>1,813,318</u>	<u>1,813,318</u>

Notes to Schedule of Expenditures of Federal Awards

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of McCreary County Water District under programs of the federal government for the year ended December 31, 2012. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of McCreary County Water District, it is not intended to and does not present the financial position, changes in net assets, or cash flows of McCreary County Water District.

Note 2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Pass-through entity identifying numbers are presented where available.

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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 Commissioners
McCreary County Water District
Water and Sewer Divisions
Whitley City, Kentucky 42653

We 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 combined financial statements of the business-type activities of the McCreary County Water District, Water and Sewer Divisions (the District), as of and for the year ended December 31, 2012, and the related notes to the financial statements which collectively comprise the District's basic financial statements and have issued our report thereon dated October 24, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions 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, we do not express an opinion on the effectiveness of the District'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.

Our 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 our audit we did not identify any deficiencies in internal control that we 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 the District's financial statements are free of material misstatement, we 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

Board of Commissioners
McCreary County Water District
Water and Sewer Divisions
Whitley City, Kentucky 42653
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those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our 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 our 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.

Faulkner, King & Wenz, PSC

October 24, 2013

FAULKNER, KING & WENZ, PSC
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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

McCreary County Water District
Whitley City, Kentucky

Report on Compliance for Each Major Federal Program

We have audited the compliance of McCreary County Water District, Water and Sewer divisions, with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012. McCreary County Water District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion for each of McCreary County Water District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about McCreary County Water District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of McCreary County Water District's compliance.

Opinion on Each Major Federal Program

In our opinion, McCreary County Water District, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

Report on Internal Control Over Compliance

Management of McCreary County Water District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered McCreary County Water District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance with each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of McCreary County Water District's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.

A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

McCreary County Water District
Whitley City, Kentucky
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The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Faulkner, King & Wenz, PSC

October 24, 2013

McCreary County Water District
Schedule of Findings and Questioned Costs
Year Ended December 31, 2012

A. Summary of Audit Results

1. The auditor's report expresses an unqualified opinion on the financial statements of McCreary County Water District.
2. No significant deficiencies, material weaknesses, or instances of noncompliance were reported or identified during the audit of the financial statements.
3. No significant deficiencies, material weaknesses, instances of noncompliance, or other audit findings relating to the audit of the major federal award programs were reported or identified, which are required to be reported under section .510(a) of OMB A-133.
4. We have issued an unqualified opinion on compliance for major programs.
5. The programs tested as major programs are as follows:

RD Grant	10.760
RD Loan	10.760
6. The threshold for distinguishing Types A and B programs was \$300,000.
7. McCreary County Water District was not determined to be a low-risk auditee.

B. Findings - Financial Statements Audit

None

C. Findings and Questioned Costs - Major Federal Award Program Audit

None