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MORGAN COUNTY WATER DISTRICT

AUDIT OF FINANCIAL STATEMENTS

For The Years Ended December 31, 2012 and 2011

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Independent Auditors' Report

To the Board of Directors
Morgan County Water District
West Liberty, Kentucky

We have audited the accompanying financial statements of the business-type activities of Morgan County Water 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 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 an opinion on these financial statements based on our audit. We conducted our 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 we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgments, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, 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.

To the Board of Directors
Morgan County Water District
West Liberty, Kentucky

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Morgan County Water District, as of December 31, 2012, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis and budgetary comparison information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2013 on our consideration of the District's 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

March 19, 2013

**MORGAN COUNTY WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2012 and 2011**

	2012	2011
ASSETS		
CURRENT ASSETS		
Cash - Unrestricted	\$ 6,590	\$
Cash - Restricted	164,684	162,208
Accounts Receivable	81,996	79,561
Unbilled Receivables	43,957	44,593
Allowance For Doubtful Accts.	(8,011)	(8,011)
Prepaid Insurance	7,412	7,412
 Total Current Assets	 296,628	 285,763
NONCURRENT ASSETS		
Prepaid Capital Lease (Net of Accumulated Amortization of \$4,276)	419,088	
Cash - Restricted	235,527	153,256
 Total Noncurrent Assets	 654,615	 153,256
PROPERTY AND EQUIPMENT		
Water Lines	20,172,162	20,172,162
Accum. Depr. Water Lines	(3,192,533)	(2,788,611)
Building		124,112
Accum. Depr. Building		(22,336)
Office Equipment	1,099	8,410
Accum. Depr. Office Equipment	(1,099)	(8,410)
Equipment And Vehicles	472,403	472,403
Accum. Depr. Equipment And Vehicles	(254,226)	(210,335)
Land	74,200	74,200
 Total Property And Equipment	 17,272,006	 17,821,595
 TOTAL ASSETS	 \$ 18,223,249	 \$ 18,260,614

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

**MORGAN COUNTY WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2012 and 2011**

	2012	2011
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Bank Overdraft	\$	\$ 3,592
Accrued Interest	97,986	99,624
Accrued Expenses	56,719	53,429
Accrued Salaries	3,000	3,000
Accounts Payable-Retirement	2,842	4,286
Bonds Payable	66,910	62,780
Total Current Liabilities	227,457	226,711
LONG-TERM LIABILITIES		
Compensated Absences	10,953	8,611
Bonds Payable	3,981,420	4,048,330
	3,992,373	4,056,941
OTHER LIABILITIES		
Customer Deposits	18,133	16,232
TOTAL LIABILITIES	4,237,963	4,299,884
NET POSITION:		
Restricted For Debt Service	164,684	162,208
Restricted For Depreciation Reserve	207,449	126,857
Restricted For Construction	6,649	6,639
Unrestricted	(4,017,680)	(4,093,789)
Invested In Capital Assets, Net Of Related Debt	17,624,184	17,758,815
TOTAL NET POSITION	13,985,286	13,960,730
TOTAL LIABILITIES AND NET POSITION	\$ 18,223,249	\$ 18,260,614

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

MORGAN COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION
For The Years Ended December 31, 2012 and 2011

	2012	2011
OPERATING REVENUES		
Water Collection	\$ 1,065,310	\$ 1,149,838
Sales Tax	(1,462)	(1,486)
Utility And Local Tax	(30,676)	(29,342)
State Reimb. Relocation Projects	21,449	17,872
Tap-On Fees	56,340	42,150
Miscellaneous	31,704	12,273
Net Operating Revenues	1,142,665	1,191,305
OPERATING EXPENSES		
Advertising	486	420
Bank Charges	13	153
Depreciation	447,813	450,916
Fuel	18,159	16,381
Insurance	37,421	35,108
Miscellaneous	5,388	3,399
Office Supplies	23,076	2,234
Outside Services	27,244	20,741
Payroll Taxes	11,562	11,455
Postage	11,274	11,224
Repairs & Maintenance	14,582	6,266
Retirement	28,767	26,698
Salaries	163,031	153,115
Supplies & Testing	118,025	64,919
Travel		681
Uniforms	1,780	2,174
Unemployment Insurance	266	271
Utilities and Telephone	33,933	44,443
Water Line Relocation	23,307	17,061
Water Purchased	426,271	621,926
Worker's Compensation	3,174	4,342
Total Operating Expenses	1,395,572	1,493,927
NET OPERATING INCOME	\$ (252,907)	\$ (302,622)

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION
For The Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
NON OPERATING REVENUES (EXPENSES)		
Interest and Amortization Expense	\$ (174,653)	\$ (173,245)
Interest Income	398	923
Grant Proceeds	30,265	
Fiscal Court Contribution	6,485	
Rental Income	<u>650</u>	<u>5,660</u>
Total Other Income (Expenses)	(136,855)	(166,662)
EXTRAORDINARY ITEM		
Gain (Loss) on Disposal of Capital Assets	<u>414,318</u>	<u> </u>
Change In Net Position	24,556	(469,284)
Total Net Position - Beginning (Restated)	<u>13,960,730</u>	<u>14,430,014</u>
Total Net Position - Ending	<u><u>\$ 13,985,286</u></u>	<u><u>\$ 13,960,730</u></u>

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
For The Years Ended December 31, 2012 and 2011**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments From Customers	\$ 1,119,851	\$ 1,218,989
State Reimb. Relocation Projects	21,449	17,872
Miscellaneous Income	31,704	12,273
Payments To Vendors	(748,436)	(861,831)
Payments For Payroll And Related Expenses	(230,865)	(219,039)
Net Cash Provided/(Used) By Operating Activities:	193,703	168,264
 CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Fiscal Court Contributions	6,485	
Rental Income	650	5,660
Net Cash Provided/(Used) By Non-Capital Financing Activities	7,135	5,660
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Reduction In Accounts Payable Construction		(13,519)
Interest	(172,015)	(174,654)
Net (Deposits)/Withdrawals Into Or From Bond Sinking Fund	(2,476)	14,997
Net (Deposits)/Withdrawals Into Or From Dep. Reserve Fund	(80,592)	29,262
Net (Deposits)/Withdrawals Into Or From Cash - Construction	(10)	13,468
Net (Deposits)/Withdrawals Customer Deposit Account	(1,669)	932
Net Customer Deposits (Returned)/Collected	1,901	(1,830)
Grant Proceeds	30,265	
Prepaid Capital Lease	(423,364)	
Insurance Related Expenditures	(37,468)	
Insurance Proceeds	553,562	
Reduction In Bonds Payable	(62,780)	(62,000)
Net Cash Provided/(Used) By Capital And Related Financing Activities	\$ (194,646)	\$ (193,344)

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
For The Years Ended December 31, 2012 and 2011**

	2012	2011
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash Received From Interest	\$ 398	\$ 923
Net Cash Provided/(Used) By Investing Activities	398	923
INCREASE/(DECREASE) IN CASH	6,590	(18,497)
CASH AT BEGINNING OF YEAR		18,497
CASH AT END OF YEAR	\$ 6,590	\$ 0
Reconciliation Of Net Operating Income To Net Cash Provided By Operating Activities:		
Net Operating Income	\$ (252,907)	\$ (302,622)
Adjustments To Reconcile Net Operating Income To Net Cash Provided By Operating Activities:		
Depreciation	447,813	450,916
Changes In Assets/Liabilities:		
Accounts Receivable	(2,435)	17,160
Unbilled Receivables	636	4,119
Prepaid Expenses		(851)
Bank Overdraft	(3,592)	3,592
Accrued Expenses	3,290	(10,126)
Accrued Salaries		88
Accrued Payroll Taxes		(181)
Accounts Payable Retirement	(1,444)	447
Compensated Absences	2,342	
Allowance For Doubtful Accounts		5,722
Net Cash Provided/Used By Operating Activities	\$ 193,703	\$ 168,264

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
For The Years Ended December 31, 2012 and 2011**

<u>Supplementary Information</u>	<u>2012</u>	<u>2011</u>
Total Interest Cost	<u>\$ 172,015</u>	<u>\$ 174,654</u>

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

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Morgan County Water District (the District) is presented to assist in understanding the District's financial statements. The financial statements and notes are representations of the District's management, who are responsible for their integrity and objectivity. These accounting policies, as applied to the aforementioned financial statements, conform to generally accepted accounting principles applicable to governmental units.

Organization & Activity

The Morgan County Water District was created in accordance with Chapter 74 of the Kentucky Revised Statutes in February 1992. The purpose of the District is to provide water service to residents of Morgan County.

Financial Reporting Entity

The District complies with GASB Statements No. 14, "The Financial Reporting Entity" and No. 39, "Determining Whether Certain Organizations Are Component Units." These Statements establish standards for defining and reporting on the financial reporting entity. They define component units as legally separate organizations for which the officials of the primary government are financially accountable and other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The District is not considered a component unit of any other governmental unit for financial reporting purposes.

The District considered all potential component units in determining what organizations should be included in its financial statements. Based on an evaluation of the established criteria, management determined that there were no component units to include in the District's financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The basic financial statements provide information about the District's business-type activities. The financial statements for the business-type activities are also often referred to as enterprise fund financial statements.

"Measurement Focus" is an accounting term used to describe which transaction and types of balances are recorded within the various financial statements. The expression, "Basis of Accounting", refers to when transactions or events are recorded regardless of measurement focus applied.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Because of the “businesslike” characteristics of the District’s operations, the accompanying financial statements report the economic resources measurement focus and the accrual basis of accounting. The accounting objective of the “economic resources” measurement focus is the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net position.

Under full accrual accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred or economic asset used, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The District utilizes an enterprise fund to record its financial operating activities. In governmental accounting, the enterprise fund is used to account for operations that are financed and operated in a manner similar to private business or where the Board has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management accountability.

As the means for delivering services to its customers, the District utilizes an office building, infrastructure, office equipment, equipment and vehicles. To provide the resources that are necessary to pay for water services and the related support functions, the District charges its customers monthly user fees, which are based on the specific level of services that they are receiving. Because the operations of the District closely mirror those of a typical, commercial company, its accounting records reflect a similar approach for measuring its business activity.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the preparation of the financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governmental entities also have the option of following subsequent private-sector guidance in accounting for and reporting on its operations, subject to the same limitation. The District has elected not to follow subsequent private-sector guidance.

The District’s various bond resolutions or ordinances require the establishment of certain accounts, which are referred to as “funds”. These required accounts are maintained as part of accounting records of the Water Fund. They include the Sinking Fund (Debt Service), Revenue Fund and Depreciation Reserve Fund (Repairs and Maintenance). These are not “funds” as the term is used in generally accepted accounting principles, but are separate “accounts” used to delineate the accounting and reporting for bond related money and repayment security requirements. The balances and activity that occur in these various accounts represent

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

specific segments of the Water Utility enterprise fund as reported in the District's financial statements.

The enterprise fund used by the District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the District's ongoing operations. The principal operating revenues are charges to customers for sales and services that are provided to them. The District also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water 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 nonoperating revenues and expenses.

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 they are needed.

Budgeting

The District prepares annual operating budgets for the managerial control of expenditures and for the monitoring of cash flows during the fiscal year. Project-length budgets, which generally encompass more than one fiscal year, are also prepared for major construction projects. Both the operating and project-length expenditure plans are prepared on the cash basis of accounting, which significantly differs from the accrual basis of accounting that the District uses in the preparation of its financial statements.

These managerial budgets that are prepared for operations each year or at the inception of a major construction project are not adopted by the Board as legally imposed restrictions on expenditures. Basically, the operating budgets provide management with a tool for estimating and monitoring cash flows in each fiscal period. Accordingly, budgetary comparisons are not presented in the accompanying financial statements.

Allowance for Doubtful Accounts

An allowance for doubtful accounts has been established for utility accounts receivables that are 30+ days delinquent at year-end. Bills are due by the tenth of each month. It is the policy of the District to shut off water service seven days after the due date. Customer deposits held are applied to outstanding bills.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts and Unbilled Receivables

Accounts receivable are stated at face amount. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed on December 27, 2012 was for customer usage from approximately November 15 through December 15, 2012. The entire amount is considered accounts receivable as of December 31, 2012. The billing mailed on January 23, 2013 was for usage from approximately December 15, 2012 through January 15, 2013. Fifty percent of this billing is considered unbilled receivables at December 31, 2012.

Deposits and Investments

KRS 66.480 authorizes the District to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Property, Plant and Equipment

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., water distribution systems, sewer collection systems and similar items) are reported as a component of noncurrent assets in the basic financial statement. Capital assets are generally defined by the District as being those assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

The reported value excludes the costs of normal maintenance and repairs that are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate.

Depreciation is charged as an expense against operations. Capital assets of the authority are depreciated using the straight-line method over their estimated useful lives in years as set forth as follows.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, Plant and Equipment (Continued)

<u>Category</u>	<u>Life in years</u>
Buildings	10-75
Equipment and Vehicles	3-25
Water Lines	10-50
Office Equipment	3-25

The depreciation expense provided on proprietary fund assets during the period ended December 31, 2012 is \$447,813.

Capitalized Interest On Indebtedness

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is reflected in the capitalized value of the asset constructed. The total interest expense incurred by the District during the current fiscal year was \$170,377. Of this year's amount, \$0 was considered to be capitalized interest.

Cash and Cash Equivalents

For the purpose of these financial statements, cash and cash equivalents consist of cash on hand, demand and savings deposits and certificates of deposit.

Inventory and Prepaid Items

The District does not maintain an inventory of supplies. Supplies are purchased as needed.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. An example of a prepaid item for the District is property and liability insurance premiums.

Restricted Net Position

Some of the District's assets have certain constraints that have been placed on how they can be used. By definition, restricted assets are cash or other assets, whose use in whole or in part are restricted for specific purposes bound by virtue of contractual agreements, legal requirements or enabling legislation.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Restricted Net Position (Continued)

Certain proceeds of the District's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net as position because their use is limited by applicable bond covenants. The "debt service" accounts are used to segregate resources accumulated for debt service payments over the next twelve months. The "depreciation reserve" account is used to report resources set aside to meet unexpected contingencies or to fund asset renewals, replacements and extensions.

Federal Income Tax

The District is exempt from federal income tax.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B - RESTRICTIONS ON CASH

Bond Sinking Fund

Deposits into Bond Sinking Funds are required to be made monthly in order to accumulate funds for payment of bond principle and interest. At December 31, 2012, \$164,672 was required to be on deposit to meet payments of interest and principal due on bonds at January 1, 2013. The balance in this account at December 31, 2012 was \$164,684.

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various bond documents. The District was required to deposit \$1,625 per month into the account. At December 31, 2012, \$138,263 was required to be on deposit. The District had \$207,449 on deposit in this account for the purpose of maintaining the water system.

MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE B - RESTRICTIONS ON CASH (CONTINUED)

Restricted Cash Accounts

The District is required to maintain special deposit accounts for customer deposits, construction projects, and long-term debt obligations. The following is a listing of restricted cash accounts of the District:

Customer Deposit Accounts	\$ 21,429
Bond and Interest Sinking Fund	164,684
Depreciation Reserve Fund	207,449
Construction Account	<u>6,649</u>
Total Restricted Cash Accounts	<u>\$ 400,211</u>

NOTE C - CASH AND INVESTMENTS

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the District and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. As of December 31, 2012, these requirements were met.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the District's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240(4). As of December 31, 2012, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE D - PROPERTY, PLANT AND EQUIPMENT

The District's property, plant and equipment consist of the following:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Primary Government:				
<u>Business-Type Activities:</u>				
Capital Assets Not Being Depreciated:				
Land	\$ 74,200	\$	\$	\$ 74,200
Total Capital Assets Not Being Depreciated	74,200			74,200
Capital Assets, Being Depreciated:				
Buildings and Improvements	124,112		(124,112)	
Office Equipment	8,410		(7,311)	1,099
Vehicles and Equipment	472,403			472,403
Waterlines	<u>20,172,162</u>			<u>20,172,162</u>
Total Capital Assets Being Depreciated	20,777,087		(131,423)	20,645,664
Less Accumulated Depreciation for:				
Buildings and Improvements	(22,336)		22,336	
Office Equipment	(8,410)		7,311	(1,099)
Vehicles and Equipment	(210,335)	(43,891)		(254,226)
Waterlines	<u>(2,788,611)</u>	<u>(403,922)</u>		<u>(3,192,533)</u>
Total Accumulated Depreciation	<u>(3,029,692)</u>	<u>(447,813)</u>	<u>29,647</u>	<u>(3,447,858)</u>
Total Capital Assets, Being Depreciated, Net	<u>17,747,395</u>	<u>(447,813)</u>	<u>(101,776)</u>	<u>17,197,806</u>
Business-Type Activities Capital Assets, Net	<u>\$ 17,821,595</u>	<u>\$ (447,813)</u>	<u>\$ (101,776)</u>	<u>\$ 17,272,006</u>

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE

The following is a summary of the long-term debt transactions of the Morgan County Water District for the year ended December 31, 2012

<u>Water Utility Fund</u> <u>Revenue Bonds</u>	<u>2012</u>	<u>2011</u>
Bonds payable – Beginning	\$ 4,111,110	\$ 4,173,110
Bonds retired	<u>(62,780)</u>	<u>(62,000)</u>
Bonds payable - Ending	<u>\$ 4,048,330</u>	<u>\$ 4,111,110</u>

Bonds payable at December 31, 2012 consists of the following issues:

\$300,000 Water revenue bonds, Series A 1993 maturing through January 1, 2033, with interest at 5.0 percent	\$ 226,000
\$17,000 Water revenue bonds, Series B 1993, maturing through January 1, 2033, with interest at 5.0 percent	12,940
\$375,000 Water revenue bonds, Series 1995, maturing through January 1, 2035, with interest at 4.5 percent	293,500
\$75,000 Water revenue bonds, Series 1999, maturing through January 1, 2039, with interest at 4.5 percent	64,100
\$332,000 Water revenue bonds, Series 2001, maturing through January 1, 2040, with interest at 3.25 percent	279,500
\$300,000 Water revenue bonds, Series 2002, maturing through January 1, 2042, with interest at 4.50 percent	270,700
\$600,000 Water revenue bonds, Series 2003, maturing through January 1, 2043, with interest at 4.375 percent	550,000
\$1,000,000 Water revenue bonds, Series 2006, maturing through January 1, 2045, with interest at 4.125 percent	939,000
\$1,446,000 Water revenue bonds, Series 2008, maturing through January 1, 2048, with interest at 4.125 percent	<u>1,412,590</u>
Total	<u>\$ 4,048,330</u>

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

Bond Collateralization Requirements

According to Bond documents, the Bonds shall be payable solely out of the gross revenues of the System. In addition to the revenue pledge securing the Bonds, a lien is created and granted in favor of the Bond owners on all contracts and on all other rights of the District pertaining to the System.

Compliance with Bond Ordinances

The bond ordinances contain significant limitations and restrictions on annual debt service requirements, maintenance of and flow of monies through various restricted accounts, minimum amounts to be maintained in various sinking funds and minimum revenue bond coverages. Funds held in the various reserves at December 31, 2012, required by the revenue bond ordinances are reported in the accompanying financial statements as restricted cash.

Sinking Fund Requirements

Sinking fund requirements are equal to the debt service requirements. The annual requirements to amortize all bonds as of December 31, 2012, according to the bond documents, including interest payments are as follows:

WATER REVENUE BOND - SERIES A 1993

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 7,000	\$ 11,300	\$ 18,300
2014	7,000	10,950	17,950
2015	7,000	10,600	17,600
2016	8,000	10,250	18,250
2017	8,000	9,850	17,850
2018	8,000	9,450	17,450
2019	9,000	9,050	18,050
2020	9,000	8,600	17,600
2021	10,000	8,150	18,150
2022	10,000	7,650	17,650
2023	11,000	7,150	18,150
2024	11,000	6,600	17,600
2025	12,000	6,050	18,050
2026	11,000	5,450	16,450

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND – SERIES A 1993 (CONTINUED)

2027	12,000	4,900	16,900
2028	13,000	4,300	17,300
2029	13,000	3,650	16,650
2030	14,000	3,000	17,000
2031	15,000	2,300	17,300
2032	15,000	1,550	16,550
2033	16,000	800	16,800
	<u>\$ 226,000</u>	<u>\$ 141,600</u>	<u>\$ 367,600</u>

WATER REVENUE BOND - SERIES B 1993

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 360	\$ 647	\$ 1,007
2014	380	629	1,009
2015	400	610	1,010
2016	420	590	1,010
2017	440	569	1,009
2018	460	547	1,007
2019	480	524	1,004
2020	510	500	1,010
2021	530	475	1,005
2022	560	448	1,008
2023	590	420	1,010
2024	620	391	1,011
2025	650	360	1,010
2026	680	327	1,007
2027	720	293	1,013
2028	750	257	1,007
2029	790	220	1,010
2030	830	180	1,010
2031	870	139	1,009
2032	910	95	1,005
2033	990	50	1,040
	<u>\$ 12,940</u>	<u>\$ 8,271</u>	<u>\$ 21,211</u>

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND - SERIES 1995

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 7,500	\$ 13,208	\$ 20,708
2014	8,000	12,870	20,870
2015	8,000	12,510	20,510
2016	9,000	12,150	21,150
2017	9,000	11,745	20,745
2018	9,500	11,340	20,840
2019	10,000	10,913	20,913
2020	10,000	10,463	20,463
2021	11,000	10,013	21,013
2022	11,000	9,518	20,518
2023	12,000	9,023	21,023
2024	12,000	8,483	20,483
2025	13,000	7,943	20,943
2026	13,500	7,358	20,858
2027	14,000	6,750	20,750
2028	14,500	6,120	20,620
2029	15,500	5,468	20,968
2030	16,000	4,770	20,770
2031	16,500	4,050	20,550
2032	17,500	3,308	20,808
2033	18,000	2,520	20,520
2034	19,000	1,710	20,710
2035	19,000	855	19,855
	<u>\$ 293,500</u>	<u>\$ 183,088</u>	<u>\$ 476,588</u>

WATER REVENUE BOND - SERIES 1999

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 1,300	\$ 2,885	\$ 4,185
2014	1,300	2,826	4,126
2015	1,400	2,768	4,168

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND - SERIES 1999 (CONTINUED)

2016	1,400	2,705	4,105
2017	1,500	2,642	4,142
2018	1,600	2,574	4,174
2019	1,600	2,502	4,102
2020	1,800	2,430	4,230
2021	1,800	2,349	4,149
2022	1,900	2,268	4,168
2023	2,000	2,183	4,183
2024	2,000	2,093	4,093
2025	2,200	2,003	4,203
2026	2,200	1,904	4,104
2027	2,400	1,805	4,205
2028	2,400	1,697	4,097
2029	2,600	1,589	4,189
2030	2,700	1,472	4,172
2031	2,800	1,350	4,150
2032	2,900	1,224	4,124
2033	3,100	1,094	4,194
2034	3,200	954	4,154
2035	3,300	810	4,110
2036	3,500	662	4,162
2037	3,600	504	4,104
2038	3,800	342	4,142
2039	3,800	171	3,971
	<u>\$ 64,100</u>	<u>\$ 47,806</u>	<u>\$ 111,906</u>

WATER REVENUE BOND - SERIES 2001

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 6,500	\$ 9,084	\$ 15,584
2014	6,500	8,873	15,373
2015	6,500	8,661	15,161
2016	7,000	8,450	15,450

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND – SERIES 2001 (CONTINUED)

2017	7,000	8,223	15,223
2018	7,500	7,995	15,495
2019	7,500	7,751	15,251
2020	8,000	7,508	15,508
2021	8,000	7,248	15,248
2022	8,500	6,988	15,488
2023	8,500	6,711	15,211
2024	9,000	6,435	15,435
2025	9,000	6,143	15,143
2026	9,500	5,850	15,350
2027	10,000	5,541	15,541
2028	10,000	5,216	15,216
2029	10,500	4,891	15,391
2030	11,000	4,550	15,550
2031	11,000	4,193	15,193
2032	11,500	3,835	15,335
2033	12,000	3,461	15,461
2034	12,000	3,071	15,071
2035	13,000	2,681	15,681
2036	13,000	2,259	15,259
2037	13,500	1,836	15,336
2038	14,000	1,398	15,398
2039	14,500	943	15,443
2040	14,500	471	14,971
	<u>\$ 279,500</u>	<u>\$ 150,266</u>	<u>\$ 429,766</u>

WATER REVENUE BOND - SERIES 2002

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 4,500	\$ 12,182	\$ 16,682
2014	4,600	11,979	16,579
2015	4,900	11,772	16,672
2016	5,000	11,552	16,552

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND – SERIES 2002 (CONTINUED)

2017	5,300	11,327	16,627
2018	5,500	11,088	16,588
2019	5,800	10,841	16,641
2020	6,000	10,580	16,580
2021	6,300	10,310	16,610
2022	6,600	10,026	16,626
2023	6,900	9,729	16,629
2024	7,200	9,419	16,619
2025	7,500	9,095	16,595
2026	7,900	8,757	16,657
2027	8,200	8,402	16,602
2028	8,600	8,033	16,633
2029	9,000	7,646	16,646
2030	9,400	7,241	16,641
2031	9,800	6,818	16,618
2032	10,200	6,377	16,577
2033	10,700	5,918	16,618
2034	11,200	5,436	16,636
2035	11,700	4,932	16,632
2036	12,200	4,406	16,606
2037	12,800	3,857	16,657
2038	13,300	3,281	16,581
2039	14,000	2,682	16,682
2040	14,500	2,052	16,552
2041	15,300	1,400	16,700
2042	15,800	711	16,511
	<hr/>	<hr/>	<hr/>
	\$ 270,700	\$ 227,849	\$ 498,549
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND - SERIES 2003

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 8,000	\$ 24,063	\$ 32,063
2014	9,000	23,713	32,713
2015	9,000	23,319	32,319
2016	10,000	22,925	32,925
2017	10,000	22,488	32,488
2018	11,000	22,050	33,050
2019	11,000	21,569	32,569
2020	12,000	21,088	33,088
2021	12,000	20,563	32,563
2022	13,000	20,038	33,038
2023	13,000	19,469	32,469
2024	14,000	18,900	32,900
2025	14,000	18,288	32,288
2026	15,000	17,675	32,675
2027	16,000	17,019	33,019
2028	16,000	16,319	32,319
2029	17,000	15,619	32,619
2030	18,000	14,875	32,875
2031	19,000	14,088	33,088
2032	20,000	13,256	33,256
2033	21,000	12,381	33,381
2034	21,000	11,463	32,463
2035	22,000	10,544	32,544
2036	23,000	9,581	32,581
2037	24,000	8,575	32,575
2038	26,000	7,525	33,525
2039	27,000	6,388	33,388
2040	28,000	5,206	33,206
2041	29,000	3,981	32,981
2042	30,000	2,713	32,713
2043	32,000	1,400	33,400
	\$ 550,000	\$ 467,081	\$ 1,017,081

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND - SERIES 2006

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 14,000	\$ 38,734	\$ 52,734
2014	14,000	38,156	52,156
2015	15,000	37,579	52,579
2016	16,000	36,960	52,960
2017	16,000	36,300	52,300
2018	17,000	35,640	52,640
2019	18,000	34,939	52,939
2020	18,000	34,196	52,196
2021	19,000	33,454	52,454
2022	20,000	32,670	52,670
2023	21,000	31,845	52,845
2024	22,000	30,979	52,979
2025	22,000	30,071	52,071
2026	23,000	29,164	52,164
2027	24,000	28,215	52,215
2028	25,000	27,225	52,225
2029	26,000	26,194	52,194
2030	27,000	25,121	52,121
2031	29,000	24,008	53,008
2032	30,000	22,811	52,811
2033	31,000	21,574	52,574
2034	32,000	20,295	52,295
2035	34,000	18,975	52,975
2036	35,000	17,573	52,573
2037	36,000	16,129	52,129
2038	38,000	14,644	52,644
2039	39,000	13,076	52,076
2040	41,000	11,468	52,468
2041	43,000	9,776	52,776
2042	45,000	8,003	53,003
2043	46,000	6,146	52,146
2044	48,000	4,249	52,249
2045	55,000	2,269	57,269
	<u>\$ 939,000</u>	<u>\$ 798,438</u>	<u>\$ 1,737,438</u>

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND - SERIES 2008

YEAR	PRINCIPAL	INTEREST	TOTAL
2013	\$ 17,750	\$ 58,269	\$ 76,019
2014	18,480	57,537	76,017
2015	19,240	56,775	76,015
2016	20,030	55,981	76,011
2017	20,860	55,155	76,015
2018	21,720	54,294	76,014
2019	22,620	53,399	76,019
2020	23,550	52,465	76,015
2021	24,520	51,494	76,014
2022	25,530	50,483	76,013
2023	26,590	49,429	76,019
2024	27,680	48,333	76,013
2025	28,820	47,191	76,011
2026	30,010	46,002	76,012
2027	31,250	44,764	76,014
2028	32,540	43,475	76,015
2029	33,880	42,133	76,013
2030	35,280	40,735	76,015
2031	36,740	39,280	76,020
2032	38,250	37,764	76,014
2033	39,830	36,187	76,017
2034	41,470	34,544	76,014
2035	43,180	32,833	76,013
2036	44,960	31,052	76,012
2037	46,820	29,197	76,017
2038	48,750	27,266	76,016
2039	50,760	25,255	76,015
2040	52,850	23,161	76,011
2041	55,030	20,981	76,011
2042	57,300	18,711	76,011
2043	59,670	16,347	76,017
2044	62,130	13,886	76,016
2045	64,690	11,323	76,013

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE E - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND – SERIES 2008 (CONTINUED)

2046	67,360	8,655	76,015
2047	70,140	5,876	76,016
2048	72,310	2,983	75,293
	<u>\$ 1,412,590</u>	<u>\$ 1,323,215</u>	<u>\$ 2,735,805</u>

BONDS PAYABLE IN THE AGGREGATE

<u>Year Ended December 31</u>	<u>Scheduled Principal</u>	<u>Scheduled Interest</u>
2013	\$ 66,910	\$ 170,372
2014	69,260	167,533
2015	71,440	164,594
2016	76,850	161,563
2017	78,100	158,299
2018-2022	447,380	738,441
2023-2027	547,610	634,912
2028-2032	672,240	508,442
2033-2037	707,050	358,719
2038-2042	734,190	211,605
2043-2047	504,990	70,151
2048	72,310	2,983
Totals	<u>\$ 4,048,330</u>	<u>\$ 3,347,614</u>

NOTE F – CAPITAL LEASES

The District has entered into two lease agreements as lessee with the Morgan County Fiscal Court for the use of 2,500 square feet of office space at 1009 Hwy 172, West Liberty, Kentucky 41472 and 2,500 square feet of office and storage space at 150 County Garage Road, West Liberty, Kentucky 41472. The lease agreements qualify as capital leases for accounting purposes (the terms of the leases are equal to seventy-five percent or more of the estimated economic life of the leased properties). The terms of the leases are ninety-nine years. During 2012, the District prepaid \$423,364 in full payment of all future lease payments. Amortization expense for the fiscal year ended December 31, 2012 was \$4,276.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE G - RETIREMENT

The District has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement System. This is a cost-sharing multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute.

Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008 are required to contribute 6 percent of their salary to be allocated as follows: 5% will go to the member's account and 1% will go to the KRS insurance fund. The District's contribution rate for nonhazardous employees was 16.93 percent for the first six months of 2012 and 18.96 percent for the last six months of 2012.

The District's contribution for calendar year 2010 was \$23,251, calendar year 2011 was \$26,698 and calendar year 2012 was \$28,767.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

CERS also provides post retirement health care coverage as follows:

For member participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>	<u>% Paid by Member through Payroll Deduction</u>
20 or more	100%	0%
15-19	75%	25%
10-14	50%	50%
4-9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE G – RETIREMENT (CONTINUED)

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

401K

In January 2001, the district began a non-matching 401K deferred compensation plan. The employees may contribute twenty-five percent (25%) of their compensation, not to exceed \$10,500 annually. Participation is optional. Benefits are available upon separation of service or attainment of age fifty-nine and one-half (59.5) years. Benefits must commence by the later of: April 1 of the calendar year in which employment ends, or the calendar year in which the employee reaches age seventy and one-half (70.5) years of age.

NOTE H - INSURANCE COVERAGE

For the fiscal year ended December 31, 2012, the District was a member of the Kentucky Association of Counties All Lines Insurance Fund (KALF). KALF is a self- insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

NOTE I – COMPENSATED ABSENCES

Upon termination of employment from the District, an employee who has been an employee of the District for a total of twelve months shall be compensated for a maximum of fifteen days of accrued annual leave. Employees accumulate 3.69 hours of annual leave per pay period. Employees employed less than six months upon termination will not be compensated for accrued annual leave, unless approved by the Water District Manager. Annual leave accrued as of December 31, 2011 is \$8,611 and as of December 31, 2012 is \$10,953.

NOTE J – EXTRAORDINARY ITEM

On March 2, 2012, the District's office building sustained a direct hit from an F-3 Tornado. The District's office was completely destroyed as well as the contents of the office building. KACO All Lines Fund (the District's insurance provider) paid the District \$553,562 for these losses. As a result, as of December 31, 2012, \$414,318 of net insurance recoveries were recorded as an extraordinary item on the Statement of Revenues, Expenses, and Changes in Fund Net Position.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011**

NOTE K – SUBSEQUENT EVENTS

Subsequent events have been evaluated through March 19, 2013, which is the date the financial statements were available to be issued.

NOTE L – PRIOR PERIOD ADJUSTMENT

The District has recorded a prior period adjustment for accrued compensated absences not recorded in prior years that reduced net position by \$8,611.

Morgan-Franklin, LLC
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Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

Board of Directors
Morgan County Water District
West Liberty, Kentucky

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 financial statements of the business-type activities of Morgan County Water District as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Morgan County Water District's basic financial statements, and have issued our report thereon dated March 19, 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. Accordingly, we do not express an opinion on the effectiveness of Morgan County Water 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 a 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.

Independent Auditors' 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*

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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. We did identify a certain deficiency in internal control, described in the accompanying comments and recommendations as item 2012-1, that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Morgan County Water District's financial statements are free from 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 those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying comments and recommendations as item 2012-2.

Morgan County Water District's Response to Findings

Morgan County Water District's responses to the findings identified in our audit are described in the accompanying comments and recommendations. The District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 result 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.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky
March 19, 2013

MORGAN COUNTY WATER DISTRICT
Comments and Recommendations
December 31, 2012

SIGNIFICANT DEFICIENCY

2012-1 The District Should Have Adequate Controls Over The Preparation Of The Financial Statements Being Audited

Condition: The District should have adequate controls over the preparation of the financial statements being audited

Criteria: SAS 112 states that an entity must have sufficient controls in place to prepare a full set of GAAP financial statements, including full disclosures.

Effect: Management may not be able to identify deficiencies in reporting.

Cause: Lack of controls over the preparation of the financial statements.

Recommendation: We recommend that The District's management develop adequate controls over the preparation of the financial statements.

Management may engage a qualified individual with suitable skills to review the draft audit in order to advise management sufficiently for them to be able to take responsibility for the financial statements.

Or management could implement the following controls.

1. Review draft financial statements by comparing to year-end QuickBooks reports that were prepared by management.
2. Read footnotes accompanying the financial statement to ensure no discrepancies between footnotes and financial statements.
3. Review a disclosure checklist and compare to the footnotes for omitted or inaccurate disclosures.

These controls could be documented by initialing and dating the draft financial statement and disclosure checklist.

Response: *No response.*

MORGAN COUNTY WATER DISTRICT
Comments and Recommendations
December 31, 2012

NONCOMPLIANCE

2012-2 The Treasurer Should Have Maintained A Proper Record Of The Receipts and Disbursements Of The Water District

Condition: The Morgan County Water District was issued seven checks from their insurance company for damages incurred during the March 2, 2012 tornado that destroyed their office building. Two of these checks were endorsed by the treasurer and given to the Morgan County Fiscal Court in return for the lease of office space. The checks were not deposited into the Morgan County Water District's bank accounts. Furthermore, the treasurer failed to receive District approval to endorse and remit one of the checks in the amount of \$22,833 to the Morgan County Fiscal Court. The receipts or related disbursements were not recorded on the District's accounting records.

Criteria: Pursuant to KRS 74.050, the treasurer of the commission shall be the lawful custodian of the funds of the water district and shall cause the funds to be disbursed according to procedures adopted by the commission. The procedures shall include a requirement for approval of disbursements by a commissioner in addition to the treasurer. The treasurer shall cause to be maintained a proper record of the receipts and disbursements of the water district in accordance with the Uniform System of Accounts for utilities. Pursuant to KRS 74.240, the commission shall keep an account of each item of expense incurred in connection with any water district, and shall charge such account to the District for which the expense was incurred. Furthermore, the District requires that all disbursements be approved by the Board.

Good accounting practices dictate that all transactions be recorded on the District's accounting records regardless of how the physical receipts and disbursements are handled.

Effect: Insurance proceeds of \$423,364 were not recorded on the District's accounting records. A material misstatement could have occurred and not been detected in a timely manner.

Cause: Failure to follow established procedures.

Recommendation: We recommend that all receipts be deposited into the District's bank accounts and that all disbursements be made by check. We further recommend that all receipts and disbursements be recorded on the accounting records of the District in a timely manner. We recommend that checks not be endorsed to other entities under any circumstance.

Response: *The Morgan County Water District will comply in the future*