

KNOTT COUNTY WATER AND SEWER DISTRICT

REPORT OF AUDITED FINANCIAL STATEMENTS

For The Year Ended December 31, 2013

KNOTT COUNTY WATER AND SEWER DISTRICT

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INDEPENDENT AUDITOR'S REPORT

To Members of the Board
Knott County Water and Sewer District
7777 Big Branch Road
Vicco, Kentucky 41773

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Knott County Water and Sewer District, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Knott County Water and Sewer 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 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 judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Knott County Water and Sewer District, as of December 31, 2013, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Subsequent to the year end and prior to report date, after a previous audit found possible forged financial documents, a Kentucky Attorney General's investigation provided sufficient evidence indicting the former manager of the District on a theft charge who allegedly allowed approximately \$85,000 in questionable charges to be made on a credit card issued to her over a period from 2009 through 2013.

Gross Customer Billing Accounts Receivable prior to allowances for bad debts total \$414,174 at December 31, 2013. \$112,108 and \$169,148 of this balance was attributable to water purchases by the City of Vicco and City of Hindman, and the delinquent portions were \$93,586 and \$157,322, respectively.

Subsequent to year end and prior to report date, the Knott County Fiscal Court voted unanimously to remove Board Chair, Alice G. Ritchie. The action was later upheld by Knott County Circuit Court.

Other Matters***Required Supplementary Information***

Management has omitted the management's discussion and analysis 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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knott County Water and Sewer District's basic financial statements. The 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 not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 19, 2014, on our consideration of the Knott County Water and Sewer 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 Knott County Water and Sewer District's internal control over financial reporting and compliance.

A handwritten signature in black ink, appearing to read 'CG', with a horizontal line extending to the right.

Chris Gooch
Certified Public Accountant

Hazard, Kentucky

September 19, 2014

KNOTT COUNTY WATER AND SEWER DISTRICTSTATEMENT OF NET POSITIONAt December 31, 2013**ASSETS:**

- Current Assets -		
Cash in Banks - Unrestricted	\$	117,594
Accounts Receivable, net of allowance for doubtful accounts		315,182
Other Current Assets		<u>94,896</u>
<u>Total Current Assets</u>		<u>527,672</u>
- Fixed Assets -		
Land, Structure & Equipment, net of depreciation		34,002,232
Construction in Progress		<u>3,778,567</u>
<u>Total Fixed Assets</u>		<u>37,780,799</u>
- Other Assets -		
Cash - Restricted		<u>187,311</u>
<u>Total Assets</u>		<u><u>38,495,782</u></u>
<u>LIABILITIES AND NET POSITION:</u>		
- Current Liabilities -		
Accounts Payable		94,894
Payroll Liabilities Payable		38,165
Accrued Compensation		29,550
Other Current Liabilities		317,985
Current Portion of Long-Term Debt		<u>46,268</u>
<u>Total Current Liabilities</u>		<u>526,862</u>
- Long Term Liabilities -		
Bonds/Notes Payable		718,590
Less: Current Portion		<u>(46,268)</u>
<u>Total Long-Term Liabilities</u>		<u>672,322</u>
<u>Total Liabilities</u>		<u>1,199,184</u>
- Net Position -		
Unrestricted (deficit)		47,078
Restricted Assets		187,311
Net Investment in Capital Assets		<u>37,062,209</u>
<u>Total Net Position</u>		<u>37,296,598</u>
<u>Total Liabilities and Net Position</u>	\$	<u><u>38,495,782</u></u>

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

KNOTT COUNTY WATER AND SEWER DISTRICTSTATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET POSITIONFor The Year Ended December 31, 2013

<u>Revenue</u>	
Water and Sewer Operations	\$ <u>1,720,203</u>
<u>Operating Expense</u>	
Salaries and Fringe Benefits	599,476
Commissioner Fee	37,900
Office Expense	17,839
Water Consumption	80,323
Electric	271,058
Telephone	16,233
Travel and Training	1,248
Advertisement	8,310
Rents and Leases	8,473
Contractual Fees	139,267
Uniforms	8,979
Vehicle Expense	44,523
Operating Supplies and Maintenance	326,680
Licenses, Permits, Dues and Fees	13,731
Insurance and Bonds	29,950
Depreciation Expense	<u>1,387,145</u>
<u>Total Operating Expense</u>	<u>2,991,135</u>
Excess (Deficiency) of Operating Revenue <u>Over Operating Expense</u>	<u>(1,270,932)</u>
<u>Other Income (Expense)</u>	
Interest Income	541
Interest Expense	(49,965)
Miscellaneous Income	<u>22,188</u>
<u>Total Other Income (Expense)</u>	<u>(27,236)</u>
Net Income (Loss)	(1,298,168)
Net Position, Beginning of Year, Restated	34,614,995
Add: Capital Contributions	<u>3,979,771</u>
Net Position, End of Year	<u>\$ 37,296,598</u>

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

KNOTT COUNTY WATER AND SEWER DISTRICTSTATEMENT OF CASH FLOWSFor The Year Ended December 31, 2013

<u>Cash Flows from Operating Activities:</u>	
Receipts from customers and users	\$ 1,680,156
Payments to personnel	(684,401)
Payments to suppliers	(549,244)
Payments to contractors	(74,890)
Other operating payments	<u>(94,124)</u>
<u>Net Cash Provided (Used) by Operating Activities</u>	<u>277,497</u>
<u>Cash Flows From Capital and Related Financing Activities:</u>	
Increase in infrastructure assets - net	(4,143,643)
Principal paid on bonds	(51,936)
Interest paid on bonds and notes	(49,965)
Miscellaneous income	22,188
Capital grants and contributions received	<u>3,979,771</u>
<u>Net Cash Provided (Used) for Capital and Related Financing Activities</u>	<u>(243,585)</u>
<u>Cash Flows from Investing Activities</u>	
Interest revenue	<u>541</u>
Net Increase (Decrease) in Cash	34,453
Cash and restricted cash, January 1	<u>270,452</u>
Cash and restricted cash, December 31	<u><u>304,905</u></u>
Reconciliation of Operating Income (Loss) to	
<u>Net Cash Provided by Operating Activities:</u>	
Operating loss	(1,270,932)
Adjustments to reconcile operating net cash provided by operating activities:	
Depreciation	1,387,145
Restatement of net position	(85,086)
Changes in assets and liabilities	
(Increase) decrease in accounts receivable	(4,949)
(Increase) decrease in other current assets	(35,098)
Increase (decrease) in accounts payable	45,029
Increase (decrease) in payroll tax payable	21,843
Increase (decrease) in accrued compensation	16,218
Increase (decrease) in other current liabilities	<u>203,327</u>
<u>Net Cash Provided (Used) by Operations</u>	<u>\$ 277,497</u>

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

KNOTT COUNTY WATER AND SEWER DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

At December 31, 2013

1. Reporting Entity

Knott County Water and Sewer District was created by Knott County Fiscal Court to be governed and operated under the rules and procedures established under KRS Chapter 74, relating to water districts and KRS Chapter 220 relating to sanitation districts. The entity's plans are to expand its operating activities into parts of Knott County not presently served with water and sewer utility services.

2. Accounting Policies and Procedures

a. Cash

For purposes of the cash flow statement, cash consists of interest bearing checking accounts, restricted and unrestricted.

b. Fixed Assets and Depreciation

Property, plant and equipment are stated at historical or estimable cost. Fixed assets costing over \$1,500 are recorded and depreciated using the straight-line method of accounting over the respective assets useful lives as follows:

Equipment	5 – 7 years
Transmission Lines	20 – 40 years
Water Wells, Structures and Improvements	15 – 40 years

c. Allowance for Doubtful Accounts

Knott County Water and Sewer District's financial statements reflect an allowance account for its customer accounts receivable based on management's estimate of probable losses. An allowance expense in the amount of \$99,531 was recognized in the financial statements for the year ended December 31, 2013.

d. Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 2013

e. Basis of Presentation

GASB 34 creates basic financial statements for reporting on the governmental financial activities. Financial statements include government-wide financial statements prepared on an accrual basis of accounting and fund financial statements which present information for individual major funds rather than by fund type. Knott County Water and Sewer District is considered a special purpose government engaged in a business-type activity. No governmental type funds are recognized.

The accounting and reporting treatment applied to a fund is determined by its measurement focus. Proprietary funds are reported using the economic resources measurement focus. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary activities.

The District has the following fund:

Proprietary Funds (Enterprise Funds)

The Water and Sewer Revenue Funds accounts for revenues and expenses related to customer utility services.

f. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. For its water and sewer enterprise operations the District uses the full-accrual basis of accounting where revenues are recorded when earned and expenses are recognized when incurred.

Revenues – Exchange and Non-exchange Transactions – Revenues resulting from exchange transactions, in which each party receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenues are recorded in the fiscal year in which the resources are measurable and available.

Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current fiscal year. For the District, available means expected to be received within sixty days of the fiscal year-end.

Nonexchange transactions, in which the District receives value without directly giving equal value in return, include grants, entitlements and donations. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 2013

f. Basis of Accounting (Continued)

resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the District must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. On a modified accrual basis, revenues from nonexchange transactions must also be available before it can be recognized.

Deferred Revenue – Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied. Grants and entitlements received before the eligibility requirements are met are recorded as deferred revenue.

Expenses/Expenditures – On the accrual basis of accounting, expenses are recognized at the time they are incurred.

g. Net Position

GASB 63, implemented for the year ended December 31, 2012, has changed the presentation of the District's financial statements to incorporate the concepts of net position, deferred outflows of resources and deferred inflows of resources. Net position represents the difference between assets and deferred outflows and liabilities and deferred inflows. The net position component "net investment in capital assets", consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for acquisition, construction or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt also should be included in this component of net position. Net position is reported as restricted when there are limitations on its use either through enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

h. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the District, those revenues are primarily charges for utility services provided.

i. Materials and Supplies

Inventory is currently charged to expense as incurred. Supplies are acquired on an as needed basis.

3. Cash and Cash Equivalents

The carrying amount of cash was \$304,905 and the bank balance of cash was \$910,667 at December 31, 2013. Cash at December 31, 2013 was comprised of the following:

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 20133. Cash and Cash Equivalents (Continued)

	<u>Bank Balance</u>	<u>Book Balance</u>	<u>Interest Rate</u>
Revenue Account	\$ 108,453	\$ 108,453	0.12%
O&M Account	53,305	15	0.07%
Payroll Account	8,626	8,626	0.07%
Meter Deposit Account	74,549	74,549	0.12%
Debt Service Account	70	70	0.07%
Carr Creek Water Line Extension	513,473	1,229	0.12%
Pippa Passes WW Rehab Project	5,163	375	0.11%
WTP Upgrade Project	35,932	(8)	0.07%
Funded Depreciation Account	109,605	109,605	0.12%
RD/ARC Funds	1,491	1,491	0.12%
Cash on hand	<u>N/a</u>	<u>500</u>	N/a
	<u>\$ 910,667</u>	<u>\$ 304,905</u>	

Custodial credit risk is the risk that in event of bank failure the deposits may not be returned or that Knott County Water and Sewer District may not recover collateral securities. The organization's deposits at December 31, 2013 exceeded the amount of the Federal Deposit Insurance Corporation insurance (FDIC). At report date, a current collateral agreement covers any amounts not insured by FDIC. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. Knott County Water and Sewer District does not have any investments other than its interest bearing checking accounts. Concentrations of credit risk are the risk of loss attributed to the magnitude of the District's investment in a single issuer. All of the Organization's cash, excluding cash on hand, at December 31, 2013 is held at Whitaker Bank.

Foreign currency risk is the risk of changes in exchange rates effecting foreign investments. The District does not hold any foreign investments.

4. Other Current Assets

Other current assets consisted of the following at December 31, 2013:

Prepaid insurance	\$ 17,863
Prepaid maintenance agreement	1,202
Deposits trade and other	981
Due from employees	<u>74,850</u>
	<u>\$ 94,896</u>

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2013

5. Other Current Liabilities

Other current liabilities consisted of the following at December 31, 2013:

Customer deposits payable	\$ 84,390
Board member arrears	109,400
USACE payable	31,232
Contractor retainage	47,814
Interest payable	43,122
Utility tax payable	<u>2,027</u>
	<u>\$ 317,985</u>

6. Changes in Fixed Assets

Following are changes in fixed assets for Knott County Water and Sewer District at December 31, 2013:

	1/1/2013 <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	12/31/2013 <u>Balance</u>
<u>Fixed Assets - Water operations</u>				
Land and land rights	\$ 117,294	\$ -	\$ -	\$ 117,294
Construction in progress	5,580,635	-	(1,802,068)	3,778,567
Water plant and transmission lines	34,134,044	5,945,711	-	40,079,755
Vehicles	346,099	-	-	346,099
Operating equipment	172,495	-	-	172,495
Office furniture and equipment	146,808	-	-	146,808
Subtotal	<u>40,497,375</u>	<u>5,945,711</u>	<u>(1,802,068)</u>	<u>44,641,018</u>
<u>Accumulated Depreciation - Water operations</u>				
Water plant and transmission lines	5,203,548	1,295,293	-	6,498,841
Vehicles	160,108	54,039	-	214,147
Operating equipment	106,415	9,494	-	115,909
Office furniture and equipment	61,450	17,305	-	78,755
Subtotal	<u>5,531,521</u>	<u>1,376,131</u>	<u>-</u>	<u>6,907,652</u>
Total	<u>34,965,854</u>	<u>4,569,580</u>	<u>(1,802,068)</u>	<u>37,733,366</u>
<u>Fixed Assets - Sewer operations</u>				
Land and land rights	2,790	-	-	2,790
WWTPs & Collection System	310,604	-	-	310,604
Operating equipment	68,811	-	-	68,811
Subtotal	<u>382,205</u>	<u>-</u>	<u>-</u>	<u>382,205</u>
<u>Accumulated Depreciation - Sewer operations</u>				
WWTPs & Collection System	301,737	3,555	-	305,292
Operating equipment	22,021	7,459	-	29,480
Subtotal	<u>323,758</u>	<u>11,014</u>	<u>-</u>	<u>334,772</u>
Total	<u>\$ 58,447</u>	<u>\$ (11,014)</u>	<u>\$ -</u>	<u>\$ 47,433</u>

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 20136. Changes in Fixed Assets (Continued)

Total depreciation expense for the year ended December 31, 2013 is allocated as follows:

	<u>Depreciation</u>
Water operations	\$ 1,376,131
Sewer operations	<u>11,014</u>
Total	<u>\$ 1,387,145</u>

7. Long Term Debt

A Rural Utilities Service bond, dated December 19, 2003 was issued to pay off prior debt of Knott County Water and Sewer District. The bond issue has an annual interest rate of 4.5%. The total amount of the loan was \$185,000. The bond calls for 40 annual interest and principal payments.

Following is the RUS debt service schedule for this issue:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Balance</u>
				\$ 164,500
2014	\$ -	\$ 3,757	\$ 3,757	164,500
2015	3,000	7,403	10,403	161,500
2016	3,000	7,268	10,268	158,500
2017	3,000	7,133	10,133	155,500
2018	3,500	6,998	10,498	152,000
2019-2023	18,500	32,604	51,104	133,500
2024-2028	23,000	28,082	51,082	110,500
2029-2033	29,500	22,322	51,822	81,000
2034-2038	36,000	15,144	51,144	45,000
2039-2043	<u>45,000</u>	<u>6,301</u>	<u>51,301</u>	-
Total	<u>\$ 164,500</u>	<u>\$ 137,012</u>	<u>\$ 301,512</u>	

Knott County Water and Sewer District entered into an assistance agreement with the Kentucky Infrastructure Authority for KIA Fund C03-3 loan assistance dated January 1, 2004 having a maturity date of June 1, 2022 for expenditures related to the Highway 899/Mallie waterworks improvement project. The original principal balance was \$547,000. The interest rate is 4.05%. The District entered into an agreement to pay past due interest and fees of \$65,047.95 beginning with the March 1, 2011 due date.

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2013

7. Long Term Debt (Continued)

Following is a debt service schedule:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Servicing Fees</u>	<u>Past Due Interest</u>	<u>Total</u>	<u>Balance</u>
						\$ 459,890
2014	\$ 46,268	\$ 17,773	\$ 878	\$ 6,410	\$ 71,329	413,622
2015	48,177	15,864	783	6,410	71,234	365,445
2016	50,165	13,876	685	6,410	71,136	315,280
2017	52,235	11,806	583	-	64,624	263,045
2018	54,390	9,651	477	-	64,518	208,655
2019-2022	<u>208,655</u>	<u>15,489</u>	<u>765</u>	<u>-</u>	<u>224,909</u>	-
<u>Total</u>	<u>\$ 459,890</u>	<u>\$ 84,459</u>	<u>\$ 4,171</u>	<u>\$ 19,230</u>	<u>\$ 567,750</u>	

A Rural Utilities Service bond, dated January 26, 2007 was issued to finance a portion of the Water Treatment Plant project. The bond issue has an annual interest rate of 4.125%. The total amount of the loan was \$100,000. The bond calls for 40 annual interest and principal payments.

Following is a debt service schedule:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Balance</u>
				\$ 94,200
2014	\$ -	\$ 2,362	\$ 2,362	94,200
2015	1,300	4,248	5,548	92,900
2016	1,400	4,190	5,590	91,500
2017	1,400	4,127	5,527	90,100
2018	1,500	4,064	5,564	88,600
2019-2023	8,400	19,261	27,661	80,200
2024-2028	10,500	17,191	27,691	69,700
2029-2033	13,100	14,604	27,704	56,600
2034-2038	16,400	11,372	27,772	40,200
2039-2043	20,300	7,341	27,641	19,900
2044-2047	<u>19,900</u>	<u>2,337</u>	<u>22,237</u>	-
<u>Total</u>	<u>\$ 94,200</u>	<u>\$ 91,097</u>	<u>\$ 185,297</u>	

The Rural Utilities Service bonds and the Kentucky Infrastructure Authority loan requires Knott County Water and Sewer District to establish a reserve account funded annually based on the original loan amount. At December 31, 2013, the required balance of \$39,950 has been restricted.

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 20137. Long Term Debt (Continued)

Changes in long-term debt for the District are as follows:

	<u>1/1/2013</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/2013</u> <u>Balance</u>	<u>Current</u> <u>Portion</u>
US Rural Development 91-11	\$ 96,700	\$ -	\$ (2,500)	\$ 94,200	\$ -
Kentucky Infrastructure Authority - C03-03	504,326	-	(44,436)	459,890	46,268
US Rural Development 93-05	<u>169,500</u>	<u>-</u>	<u>(5,000)</u>	<u>164,500</u>	<u>-</u>
Total	<u>\$ 770,526</u>	<u>\$ -</u>	<u>\$ (51,936)</u>	<u>\$ 718,590</u>	<u>\$ 46,268</u>

8. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; injuries to employees; and natural disasters. The District carries commercial insurance for risk of loss. The District manages and finances these risks by purchasing commercial insurance for their worker's compensation and employer's liability.

The District did not have settled claims that exceeded the District's commercial insurance coverage in any of the past three years.

9. Contingencies

The District receives funding from local, state, and federal government agencies. These funds are to be used for designated purposes only. For government agency grants, if the grantor's review indicates that the funds have not been used for the intended purpose, the grantors may request a refund of monies advanced or refuse to reimburse the District for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the District's grant programs is predicated upon the grantor's satisfaction that the funds provided are being spent as intended and the grantors' intent to continue their programs.

10. Subsequent Events

Knott County Water and Sewer District has evaluated subsequent events through September 19, 2014, the date financial statements were available to be issued.

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 201311. Pension Plans

The Knott County Water and Sewer District is a participating employer of the County Employees' Retirement System (CERS) which is a cost-sharing multi-employer defined benefit plan that covers substantially all regular full-time employees of each county, school board, municipal and other local agencies electing to participate. The plan provides for retirement, disability, and death benefits to plan members. Upon election to participate in the CERS, each employee is given the option to participate, however, all subsequent employees must participate and the employer is required to continue participation.

The Knott County Water and Sewer had a total of 11 non-hazardous employees covered by the CERS. The employees contribute 5.0%, except for new hires after September 1, 2008 who contribute 6.0%. The employer contributed 19.55% from January 2013 through June 2013 and 18.89% from July 2013 through December 2013. The District's contribution for the year ended December 31, 2013 was \$46,609 and the employees contributed \$11,503.

Following summarizes employer contributions to the CERS plan:

<u>Year Ended</u>	<u>Employer Amount</u>
2013	\$ 46,609
2012	25,548
2011	26,894

The District's total payroll for the year was \$348,903 and the payroll for employees reported under CERS was \$233,202.

Benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the plan documents.

The "pension benefits obligation" is a standardized disclosure measure of the present value of pension benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the pensions' funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among the plans and employers.

CERS does not make separate measurement of assets and pension benefit obligations for individual employers. The following table presents certain information regarding the plans' status as a whole, derived from actuarial valuations performed as of the dates indicated:

KNOTT COUNTY WATER AND SEWER DISTRICT

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2013

11. Pension Plans (Continued)

	CERS	
	<u>as of June 30, 2013</u>	
Actuarial Accrued Liability	\$	9,378,876
Actuarial Value of Assets		<u>5,637,094</u>
Unfunded (Overfunded) Actuarial Accrued Liability	\$	<u>3,741,782</u>
Funded Ratio		<u>60.1</u>
Covered Payroll	\$	<u>2,236,277</u>
UAAL as a % of Covered Payroll		<u>167.3</u>

Historical trend information showing CERS's progress in accumulating sufficient assets to pay benefits when due is presented in their June 30, 2013 comprehensive annual financial reports.

As the District is only one of several employers participating in the plan, it is not practicable to determine the District's portion of the unfunded past service cost or the vested benefits of the District's portion of the plan.

12. Restatement of Net Position

Beginning net position was adjusted for the following items:

	Net Position	
	<u>Increase (Decrease)</u>	
Record payable to board commissioners for prior years services	\$	(109,400)
Record payable for retirement contributions not remitted in prior year		(5,877)
Adjust receivable from former employee		<u>30,191</u>
	\$	<u>(85,086)</u>

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF EXPENDITURES OF FEDERAL AWARDSFor The Year Ended December 31, 2013

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Grantors Number</u>	<u>Program Expenditures</u>
US Department of Interior			
Passed through Kentucky Natural Resources and Environmental Protection Cabinet			
Abandoned Mines Land - Highway 582 Water Project	15.252	N/a	\$ 193,372
Abandoned Mines Land - Multi-Site Water Project	15.252	N/a	1,419,465
Abandoned Mines Land - WTP Upgrade Project	15.252	N/a	<u>196,105</u>
<u>Total US Department of Interior</u>			<u>1,808,942</u>
US Department of Agriculture			
-Direct-			
Water and Waste Disposal Systems for Rural Communities	10.760	N/a	<u>10,506</u>
US Department of Defense			
-Direct-			
ARRA - Southern and Eastern KY Environmental Infrastructure	12.127	N/a	<u>27,094</u>
<u>Total Federal Awards Expenditures</u>			<u>\$ 1,846,542</u>

NOTE A

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Knott County Water and Sewer District and is presented on the modified accrual basis of accounting. 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*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in preparation of, the basic financial statements.

Chris Gooch

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

To the Members of the Board
Knott County Water and Sewer District
7777 Big Branch Road
Vicco, Kentucky 41773

Report on Compliance for Each Major Federal Program

We have audited Knott County Water and Sewer District's compliance 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 Knott County Water and Sewer District's major federal programs for the year ended December 31, 2013. Knott County Water and Sewer 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 on compliance for each of Knott County Water and Sewer 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 Knott County Water and Sewer 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 Knott County Water and Sewer District's compliance.

Opinion on Each Major Federal Program

In our opinion, Knott County Water and Sewer 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, 2013.

Report on Internal Control over Compliance

Management of Knott County Water and Sewer 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 Knott County Water and Sewer 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 an opinion on compliance for 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 Knott County Water and Sewer 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. However, material weaknesses may exist that have not been identified.

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.



Chris Gooch
Certified Public Accountant

Hazard, Kentucky

September 19, 2014

Chris Gooch

Certified Public Accountant
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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*

To the Members of the Board
Knott County Water and Sewer District
7777 Big Branch Road
Vicco, Kentucky 41773

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 Knott County Water and Sewer District, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise Knott County Water and Sewer District's basic financial statements, and have issued our report thereon dated September 19, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Knott County Water and Sewer 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 Knott County Water and Sewer District's internal control. Accordingly, we do not express an opinion on the effectiveness of Knott County Water and Sewer 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.

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 certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies: 2013-1, 2013-2, 2013-3 and 2013-4

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Knott County Water and Sewer 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

District's Response to Findings

Knott County Water and Sewer District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Knott County Water and Sewer District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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.



Chris Gooch
Certified Public Accountant

Hazard, Kentucky

September 19, 2014

KNOTT COUNTY WATER AND SEWER DISTRICT
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For The Year Ended December 31, 2013

-FINDINGS RELATED TO THE FINANCIAL STATEMENTS-

2012-1:

Condition:

A request for additional supporting documentation regarding thirty-six Visa line item payments occurred during the audit period. A copy of the original statement having a closing date of April 11, 2012 was retained by the auditor. Management later provided the auditor with a faxed copy of the above-referenced statement and some receipts. The faxed copy had been altered reflecting different vendors in eighteen of the thirty-six items listed. The total vendor purchases modified from the original vendor amounted to \$1,741.92. This matter was referred to the Kentucky State Attorney General's office for further action.

Criteria:

Management should readily provide evidence of costs supporting its allowable purpose to the District's operations. All costs charged and paid by the District should be for allowable purposes.

Cause:

The District did not have procedures to adequately monitor controls over Visa transactions.

Effect:

Funds of the District appear to be misappropriated and used for unallowable purposes.

Recommendation:

The District should establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses should be provided. The District should seek restitution where applicable.

Management's Response:

The District will establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses will be provided. The District will seek restitution where applicable.

2012-2:

Condition:

As part of our audit procedures, management failed to provide requested additional supporting documentation not readily available for various disbursements totaling \$78,380.10 in addition to finding 2012-1.

KNOTT COUNTY WATER AND SEWER DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)

For The Year Ended December 31, 2013

2012-2 (Continued):

Criteria:

Management should readily provide evidence of costs supporting its allowable purpose to the District's operations. All costs charged and paid by the District should be for allowable purposes.

Cause:

The District did not provide documentation requested.

Effect:

Funds of the District may be misappropriated and used for unallowable purposes.

Recommendation:

The District should establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses should be provided. The District should seek restitution where applicable.

Management's Response:

The District will establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses will be provided. The District will seek restitution where applicable.

2012-3:

Condition:

Payments were made to Water District Commissioner's during the year without adequate supporting perpetual subsidiary schedules indicating the periods each payment should be applied. Therefore, we were not able to determine the actual amount owed, if any, by the District to the Commissioners and no accrual was made at December 31, 2012. According to management, in previous years' funds were inadequate to pay Commissioner's the statutory compensation as provided by KRS 74.020 and therefore, some payments made in 2012 were for previous years. Furthermore, we noted some payments were increased due to completion of water district management training. We did not receive evidence of the district management training. In addition, the Chairman was paid \$40,000 in 2012 for back commissioner pay owed. We noted a 1099-MISC form had not been prepared and submitted to the Internal Revenue Service for this transaction.

Criteria:

Management is not accounting for commissioner pay on a perpetual basis. Management has not provided evidence increases in commissioner pay were valid. Management has made payments without adequate supporting documentation.

Cause:

The District is not maintaining adequate subsidiary schedules to account for Commissioner compensation accrued and paid. The District is not retaining evidence of training.

KNOTT COUNTY WATER AND SEWER DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)

For The Year Ended December 31, 2013

2012-3 (Continued):

Effect:

Payments made to Commissioners may not be for an accurate or allowable amount without detail underlying supporting documentation.

Recommendation:

The District should maintain a perpetual subsidiary schedule accruing compensation and related payments for its Commissioners. The District should retain evidence of continuing education.

Management's Response:

The District will maintain a perpetual subsidiary schedule accruing compensation and related payments for its Commissioners. The District will retain evidence of continuing education.

2012-4:

Condition:

Management has not adjusted gross wages as reported to the County Employee Retirement System since the District was required to report its activity on-line. Therefore since this period, any raises or increases in pay or overtime appears to not have been properly reported. In addition, we noted recent hires were not included on monthly reports although they meet criteria for participation in the retirement system. An amount has not been accrued for any underpayment and potential penalties or interest potentially owed by the District.

Criteria:

Management should understand clearly applicable participation, reporting and remittance requirements related to the District's participation in the County Employee Retirement System.

Cause:

Management has not properly applied gross wages and related remittances to the County Employee Retirement System.

Effect:

Active participants are not properly remitted and applied. Other potential participants have been excluded. The District may have a substantial liability to County Employee Retirement System for underreporting.

Recommendation:

District management should clearly understand applicable participation, reporting and remittance requirements related to the District's participation in the County Employee Retirement System.

Management's Response:

District management will obtain continuing education to clearly understand applicable participation, reporting and remittance requirements related to the District's participation in the County Employee Retirement System.

KNOTT COUNTY WATER AND SEWER DISTRICTSUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)For The Year Ended December 31, 2013**2012-5:**

Condition:

We did not find evidence the District's annual budget was assessed, prepared or reviewed for 2013. In addition, no evidence was retained reflecting the most recent annual Public Service Commission annual financial report (2011) was presented to the Commission for review, discussion and authorization.

Criteria:

The Commission should authorize annual operating budgets. The Commission should authorize annual reports submitted to the Public Service Commission.

Cause:

Management did not retain evidence annual budgets or reports were authorized by the Commission.

Effect:

Objectives and criteria may be executed without official consent of the Commission.

Recommendation:

Management should retain evidence annual budgets or reports were authorized by the Commission.

Management's Response:

Management will retain evidence annual budgets or reports were authorized by the Commission.

2012-6:

Condition:

Documentation for personnel overtime pay was not maintained in a manner readily identifying the purpose for overtime or indicating written authorization.

Criteria:

Overtime pay should be maintained in a manner allowing charges to be allocated to specific projects, areas, divisions or accounts. In addition, all overtime pay should reflect written authorization.

Cause:

Management did not retain evidence specifying projects, areas, divisions or accounts or was written authorization reflected prior to remitting personnel pay with overtime.

Effect:

Overtime paid may be for unallowable purposes without adequate supporting and authorizing documentation.

KNOTT COUNTY WATER AND SEWER DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)

For The Year Ended December 31, 2013

2012-6 (Continued):

Recommendation:

Overtime pay should be maintained in a manner allowing charges to be allocated to specific projects, areas, divisions or accounts. In addition, all overtime pay should reflect written authorization.

Management's Response:

Overtime pay will be maintained in a manner allowing charges to be allocated to specific projects, areas, divisions or accounts. In addition, all overtime pay will reflect written authorization.

2012-7:

Condition:

No evidence is retained by the District indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

Criteria:

Evidence of daily or periodic reconciliations of utility collections to system customer accounts and to deposits and bank statements reduces risks of errors or misappropriation of assets occurring.

Cause:

Management did not retain evidence indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

Effect:

The risk is higher misappropriation of assets or errors in reporting of cash collections are occurring.

Recommendation:

Management should retain evidence indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

Management's Response:

Management will retain evidence indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

KNOTT COUNTY WATER AND SEWER DISTRICTSUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)For The Year Ended December 31, 2013**2012-8:**

Condition:

The District Water office manager is paid \$558.00 per month, the approximate amount of her tax free health insurance plan if participating in the District's plan. The monthly payment does not appear to meet the Internal Revenue Code definition of non-taxable fringe benefits paid by employers and should be included in the employee's gross payroll subject to applicable withholdings.

Criteria:

Any benefit plan offered by the District should be on an equitable basis for all participating employees. All benefits provided should meet applicable compliance requirements.

Cause:

The District has made payments in the form of benefits to an employee appearing not to qualify as tax-free benefits and should be subject to tax withholding.

Effect:

The District may have a receivable due from personnel for benefits paid not meeting applicable fringe benefit criteria. The District may need to amend prior years' W-2/W-3 and tax reporting forms to reflect a reclassification.

Recommendation:

Management should determine if personnel owe the District for fringe benefits not meeting specific criteria and if amended reports should be filed with regulatory authorities.

Management's Response:

Management will determine if personnel owe the District for fringe benefits not meeting specific criteria and if amended reports should be filed with regulatory authorities.

2012-9:

Condition:

The District purchases its diesel and other fuel in bulk and stores on premises at the 7777 Big Branch location. A perpetual log is not maintained indicating the District's purchase and dispensing of fuel and diesel usage. Fuel used by Commissioners should indicate purpose and destination.

Criteria:

A fuel log indicating beginning balance, purchases, gallons used and ending balances should be retained and evidence of reconciliation to actual fuel inventory on hand should be periodically performed.

KNOTT COUNTY WATER AND SEWER DISTRICTSUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)For The Year Ended December 31, 2013**2012-9 (Continued):****Cause:**

The fuel log maintained is not accounted for in a manner allowing for individual gallons used and reconciliation to fuel inventory on hand,

Effect:

Management does not retain fuel usage or reconciliation in a manner indicating fuel usage is for allowable purposes. Without periodic and timely reconciliations, the risk is greater fuel may be used for unallowable purposes.

Recommendation:

Management should enhance its accounting and reconciliation procedures for purchased fuel and related inventory.

Management's Response:

Management will enhance its accounting and reconciliation procedures for purchased fuel and related inventory.

2012-10:**Condition:**

When assessing control over the District's utility revenue billing process we noted the following:

- Meter readings are adjusted without supervisory authorization.
- Customer account maintenance or closeouts are occurring without supervisory consent.
- Manual adjustments to customer account balances are occurring without supervisory authorization.
- No written indication outgoing monthly customer billings are compared to system reports.
- No separate function for personnel opening mail, posting to customer deposits, making deposits and adjusting customer accounts.

Criteria:

Segregation of responsibilities in the billing process mitigates the risk fraud, misappropriation of assets or errors are occurring.

Cause:

The District has not adopted or implemented policies and procedures related to utility billings segregating responsibilities.

Effect:

Without segregation of duties and evidence of authorization in this area, the risk is higher fraud or errors are occurring.

KNOTT COUNTY WATER AND SEWER DISTRICTSUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Continued)For The Year Ended December 31, 2013**2012-10 (Continued):**

Recommendation:

Management should develop and implement policies and procedures providing evidence of authorization and segregation of responsibilities for the above-referenced areas.

Management's Response:

Management will develop and implement policies and procedures providing evidence of authorization and segregation of responsibilities for the above-referenced areas.

-FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS-

-NONE

KNOTT COUNTY WATER AND SEWER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For The Year Ended December 31, 2013

-SUMMARY OF AUDIT RESULTS-

1. We have issued an unmodified opinion on the financial statements.
2. No material weakness was disclosed by the audit of the financial statements; however, significant deficiencies not identified as material weaknesses were disclosed by the audit of the financial statements.
3. No material noncompliance was disclosed in our audit of the financial statements.
4. No material weakness or significant deficiency not identified as a material weakness was disclosed by the audit in internal control over major programs.
5. We have issued an unmodified opinion on compliance for major programs.
6. The audit did not disclose any audit findings which we are required to report under Section .510(a) of A-133.
7. Knott County Water and Sewer District had the following major program:
 - US Department of Interior
 - Passed through Kentucky Natural Resources and Environmental Protection Cabinet
 - Abandoned Mine Land (AMLR) Reclamation Programs – CFDA #15.252
 - Multi-Site Water Project
 - WTP Upgrade Project
 - Highway 582 Water Project
8. The dollar threshold used to distinguish between major and non-major programs was \$300,000.
9. The auditee did not qualify as a low-risk auditee under Section .530 of A-133.

KNOTT COUNTY WATER AND SEWER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For The Year Ended December 31, 2013

-FINDINGS RELATED TO THE FINANCIAL STATEMENTS-

2013-1:

Condition:

Cash drawer reconciliation forms were developed to include two signatures as a control measure. When sampling, only the clerk's signature was noted. Also, dual signature of deposit documentation is not denoted. No reconciliation forms were noted between September 27, 2013 and January 9, 2014.

Criteria:

Reconciliations of cash drawers should include indication of dual review.

Cause:

District created procedures to adequately monitor controls over cash receipts were not being followed.

Effect:

Funds of the District are more susceptible to fraud or misappropriation.

Recommendation:

The District should implement and periodically monitor controls over cash receipts collections.

Management's Response:

The District will implement and periodically monitor controls over cash receipts collections.

2013-2:

Condition:

No formal contract for services provided by Joseph Campbell, 1099MISC \$9,620 and William H Campbell, 1099MISC, \$2,000 in 2013 indicating type of services performed and how it related to District operations were noted during our audit.

Criteria:

Contracts or other supporting documentation should support district expenditures for services provided.

Cause:

The District could not provide the documentation or agreement requested. Management did not have an explanation for services provided as referenced.

KNOTT COUNTY WATER AND SEWER DISTRICT

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)

For The Year Ended December 31, 2013

2013-2 (Continued):

Effect:

Funds of the District may be misappropriated and used for unallowable purposes.

Recommendation:

The District should establish procedures mitigating the risk of financial statement material misstatement and fraud by monitoring its disbursement procedures. Evidence for pre-authorization of contracts for services should be at the Commissioner level meeting certain dollar thresholds.

Management's Response:

The District will establish procedures mitigating the risk of financial statement material misstatement and fraud by monitoring its disbursement procedures. Evidence for pre-authorization of contracts for services should be at the Commissioner level meeting certain dollar thresholds.

2013-3:

Condition:

Fuel logs presented for audit began July 23, 2013. Management indicated logs prior to this date could not be located.

Criteria:

Disbursements for fuel purchased for its on-site tanks should be readily reconciled to fuel consumption inventory documentation.

Cause:

The District was not maintaining adequate supporting documentation to track the use of fuel consumed for District operations.

Effect:

Fuel purchased and intended for District operations could be used for fraudulent purposes without adequate underlying controls to monitor fuel purchases and consumption.

Recommendation:

The District should maintain underlying reconciliation forms to adequately monitor its purchases and use of fuel for operations.

Management's Response:

The District should maintain underlying reconciliation forms to adequately monitor its purchases and use of fuel for operations.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2013**2013-4:**

Condition:

When test sampling disbursements underlying documentation for some transactions were not located for the following:

- P Mullins, \$5,545.29
- PSC, \$2,590.58
- Fleet One, \$669.50 and \$484.24

Criteria:

Management should assure adequate supporting documentation is on file for all District disbursements allowing a review of its intended operational or administrative purpose.

Cause:

Management could not locate support documentation for all transactions selected for testing.

Effect:

Disbursements could be made through the District's funds that are unallowable or fraudulent without evidence of supporting documentation.

Recommendation:

Management should assure adequate supporting documentation is on file for all District disbursements allowing a review of its intended operational or administrative purpose.

Management's Response:

Management should assure adequate supporting documentation is on file for all District disbursements allowing a review of its intended operational or administrative purpose.