

**SOUTH 641 WATER DISTRICT
HAZEL, KENTUCKY**

**FINANCIAL STATEMENTS
with Independent Auditor's Report**

FOR THE YEAR ENDED DECEMBER 31, 2015

Revised on May 16, 2016 and approved by David M. Anderson, CPA

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
South 641 Water District
207 Main Street
P.O. Box 126
Hazel, KY 42049

Report on the Financial Statements

We have audited the accompanying financial statements of South 641 Water District, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our 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 South 641 Water District, as of December 31, 2015, 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 State of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 3-5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2016, on our consideration of the South 641 Water 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 South 641 Water District's internal control over financial reporting and compliance.



David M. Anderson, CPA
Ledbetter, Kentucky
March 28, 2016

**SOUTH 641 WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2015**

The South 641 Water District ("District") offers Management's Discussion and Analysis to provide an overview and analysis of the District's financial activities for the year ended December 31, 2015. To fully understand the entire scope of the District's financial activities, this information should be read in conjunction with the financial statements provided in this document.

FINANCIAL HIGHLIGHTS

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's financial statements. The District is authorized under Kentucky Revised Statutes (KRS) and constitutes a governmental subdivision of the Commonwealth of Kentucky. The District's financial report includes only the activities of the South 641 Water District. The South 641 Water District's financial statements are provided for the Water, Sewer and the combined review of the entire District.

The District's financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles promulgated by the Governmental Accounting Standards Board (GASB).

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The District's basic financial statements include a statement of net position, a statement of revenues, expenses and changes in net position, a statement of cash flows and notes to the financial statements.

Statement of Net Position – The statement of net position presents the financial position of the District. It presents information on the District's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the District is improving or deteriorating. The statement of net position can be found on page 6.

Statement of Revenues, Expenses and Changes in Net Position – The statement of revenues, expenses and changes in net position presents information showing how the District's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues are recognized when they are earned, not when they are received. Expenses are recognized when incurred, not when they are paid. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future periods. The statement of revenues, expenses and changes in net position is on page 7 of this report.

Statement of Cash Flows – The statement of cash flows presents changes in cash and cash equivalents, resulting from operating, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration for when revenues were earned or when the obligation (expense) occurred. The statement of cash flows is found on page 8 of this report.

Notes to the Financial Statements – The notes provide additional information that is essential to a full understanding of the data provided in the fund financial statements. The notes to the financial statements can be found on pages 9-13 of this report.

OVERVIEW OF THE DISTRICT'S FINANCIAL POSITION AND RESULTS OF OPERATIONS

As noted earlier, net position may serve overtime as a useful indicator of the District's financial position. The District's assets exceeded liabilities for Water by \$195,150.37, Sewer by \$828,494.70 with the combined District's assets exceeding liabilities by \$1,023,645.07.

During 2015, the District's net capital assets decreased in water by \$21,448.90, sewer \$31,289.76, and combined district total decrease in net capital assets by \$52,738.66. These changes were accompanied by decrease in unrestricted net position of \$9,505.62. The District's overall financial position and results of operations for the past two years are summarized as follows, based on the information included in the financial statements.

	<u>Business-Type Activities</u>					
	<u>2015</u>			<u>2014</u>		
	<u>Water</u>	<u>Sewer</u>	<u>Combined</u>	<u>Water</u>	<u>Sewer</u>	<u>Combined</u>
Assets:						
Current Assets	\$ 34,355.77	\$ 25,051.53	\$ 59,407.30	\$ 43,295.23	\$ 29,838.58	\$ 73,133.81
Capital Assets	217,566.94	848,125.19	1,065,692.13	239,015.84	879,414.95	1,118,430.79
Restricted Assets	<u>46,511.66</u>	<u>26,760.94</u>	<u>73,272.60</u>	<u>44,087.04</u>	<u>25,952.51</u>	<u>70,039.55</u>
Total Assets	<u>298,434.37</u>	<u>899,937.66</u>	<u>1,198,372.03</u>	<u>326,398.11</u>	<u>935,206.04</u>	<u>1,261,604.15</u>
Liabilities:						
Long-term Liabilities	66,550.00	54,450.00	121,000.00	78,100.00	63,900.00	142,000.00
Other Liabilities	<u>36,734.00</u>	<u>16,992.96</u>	<u>53,726.96</u>	<u>38,075.56</u>	<u>18,092.58</u>	<u>56,168.14</u>
Total Liabilities	<u>103,284.00</u>	<u>71,442.96</u>	<u>174,726.96</u>	<u>116,175.56</u>	<u>81,992.58</u>	<u>198,168.14</u>
Net Position:						
Net Inv. in Cap Assets	139,466.94	784,225.19	923,692.13	149,915.84	806,514.95	956,430.79
Restricted	28,658.07	23,447.50	52,105.57	27,308.73	22,343.50	49,652.23
Unrestricted	<u>27,025.36</u>	<u>20,822.01</u>	<u>47,847.37</u>	<u>32,997.98</u>	<u>24,355.01</u>	<u>57,352.99</u>
Total Net Position	<u>195,150.37</u>	<u>828,494.70</u>	<u>1,023,645.07</u>	<u>210,222.55</u>	<u>853,213.46</u>	<u>1,063,436.01</u>
Operating Income	145,299.02	47,156.53	192,455.55	138,366.09	43,294.49	181,660.58
Operating Expenses	<u>(112,397.17)</u>	<u>(113,254.49)</u>	<u>(225,651.66)</u>	<u>(111,029.61)</u>	<u>(111,507.96)</u>	<u>(222,537.57)</u>
Operating Income	<u>32,901.85</u>	<u>(66,097.96)</u>	<u>(33,196.11)</u>	<u>27,336.48</u>	<u>(68,213.47)</u>	<u>(40,876.99)</u>
Interest Revenue	277.66	227.51	505.17	338.86	277.23	616.09
Interest Expense	<u>(3,905.00)</u>	<u>(3,195.00)</u>	<u>(7,100.00)</u>	<u>(4,445.00)</u>	<u>(3,655.00)</u>	<u>(8,100.00)</u>
Non-operating Exp	<u>(3,627.34)</u>	<u>(2,967.49)</u>	<u>(6,594.83)</u>	<u>(4,106.14)</u>	<u>(3,377.77)</u>	<u>(7,483.91)</u>
Income (Loss) before Transfers	29,274.51	(69,065.45)	(39,790.94)	23,230.34	(71,591.24)	(48,360.90)
Transfers In (Out)	(44,346.69)	44,346.69	0.00	(31,422.96)	31,422.96	0.00
Net Position—Jan 1	<u>210,222.55</u>	<u>853,213.46</u>	<u>1,063,436.01</u>	<u>218,415.17</u>	<u>893,381.74</u>	<u>1,111,796.91</u>
Net Position – Dec 31	<u>195,150.37</u>	<u>828,494.70</u>	<u>1,023,645.07</u>	<u>210,222.55</u>	<u>853,213.46</u>	<u>1,063,436.01</u>

A portion of the District's net position \$923,692.13, reflects its investment in net plant, such as water tanks, buildings, equipment, and distribution systems, oxidation lagoons, less any related outstanding debt used to acquire those assets. The District uses these assets to provide services to its customers; consequently, these assets are not available for future spending. Resources needed to repay the outstanding debt shown on the statement of net position must come from other sources such as operations, since the assets themselves cannot be used to liquidate these long-term liabilities.

CAPITAL ASSETS

The District's investment in capital assets as of December 31, 2015 was \$217,566.94 for water, \$848,125.19 for sewer, for a combined total of \$1,065,692.13 in capital assets. During the year ended December 31, 2015, the District capitalized new meters, 4 water tap-ons with additional charges to the District and office furniture for water. During the year ended December 31, 2015, the District capitalized an exhaust fan in the sewer pumping station, one sewer tap-on with additional charges, a hydro-matic pump, an injector pump, and a gate valve at the oxidation lagoon for sewer.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the South 641 Water District's finances for all those with an interest in the government's finances. Questions or requests for additional information may be addressed to Amy Fadden, Administrator, South 641 Water District, P.O. Box 126, Hazel, KY 42049.

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SOUTH 641 WATER DISTRICT			
STATEMENT OF NET POSITION - PROPRIETARY FUND			
DECEMBER 31, 2015			
ASSETS			
Current Assets	WATER	SEWER	COMBINED
Unrestricted			
Cash in Bank (Rev. and O&M)	\$ 22,276.23	\$ 18,226.01	\$ 40,502.24
Petty Cash	<u>22.91</u>	<u>0.00</u>	<u>22.91</u>
Total Unrestricted Cash	<u>22,299.14</u>	<u>18,226.01</u>	<u>40,525.15</u>
Restricted			
Cash for Debt Service	14,730.74	12,052.42	26,783.16
USDA Reserve Depreciation Account-CD	15,879.83	12,992.58	28,872.41
Cash in Customer Deposit Account	<u>15,901.09</u>	<u>1,715.94</u>	<u>17,617.03</u>
Total Restricted Cash	<u>46,511.66</u>	<u>26,760.94</u>	<u>73,272.60</u>
Receivables			
Accounts Receivables (net allow for uncollect.)	1,931.67	759.98	2,691.65
Unbilled Receivables (net allow. For uncollect.)	<u>10,124.96</u>	<u>6,065.54</u>	<u>16,190.50</u>
Total Receivables	<u>12,056.63</u>	<u>6,825.52</u>	<u>18,882.15</u>
Total Current Assets	<u>80,867.43</u>	<u>51,812.47</u>	<u>132,679.90</u>
Noncurrent/Capital Assets			
Land (Nondepreciable)	20,000.00	0.00	20,000.00
Assets in Service	1,400,105.13	1,298,709.89	2,698,815.02
Accumulated Depreciation	<u>(1,202,538.19)</u>	<u>(450,584.70)</u>	<u>(1,653,122.89)</u>
Total Noncurrent/Capital Assets	<u>217,566.94</u>	<u>848,125.19</u>	<u>1,065,692.13</u>
TOTAL ASSETS	<u>298,434.37</u>	<u>899,937.66</u>	<u>1,198,372.03</u>
LIABILITIES			
Current Liabilities			
Accounts Payable	5,523.90	3,056.98	8,580.88
Taxes Withheld	616.31	504.25	1,120.56
State Taxes (S&U and School)	373.41	0.00	373.41
Accrued Payroll Taxes	218.39	178.69	397.08
Customer Advanced Payments	598.40	489.60	1,088.00
Customer Deposits	15,901.09	1,715.94	17,617.03
Accrued Interest	1,952.50	1,597.50	3,550.00
Current Portion of Long Term Debt - Bonds Payable	<u>11,550.00</u>	<u>9,450.00</u>	<u>21,000.00</u>
Total Current Liabilities	<u>36,734.00</u>	<u>16,992.96</u>	<u>53,726.96</u>
Noncurrent Liabilities			
Bonds Payable (net of current portion)	<u>66,550.00</u>	<u>54,450.00</u>	<u>121,000.00</u>
Total Noncurrent Liabilities	<u>66,550.00</u>	<u>54,450.00</u>	<u>121,000.00</u>
TOTAL LIABILITIES	<u>103,284.00</u>	<u>71,442.96</u>	<u>174,726.96</u>
NET POSITION			
Net Investment in Capital Assets	139,466.94	784,225.19	923,692.13
Restricted	28,658.07	23,447.50	52,105.57
Unrestricted	<u>27,025.36</u>	<u>20,822.01</u>	<u>47,847.37</u>
TOTAL NET POSITION	<u>\$ 195,150.37</u>	<u>\$ 828,494.70</u>	<u>\$ 1,023,645.07</u>

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

SOUTH 641 WATER DISTRICT			
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION			
PROPRIETARY FUNDS			
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2015			
OPERATING REVENUES	WATER	SEWER	COMBINED
Charges for Service			
Residential	\$ 100,085.68	\$ 42,057.13	\$ 142,142.81
Commercial	24,967.35	0.00	24,967.35
Non-Profit	2,831.38	0.00	2,831.38
Unmetered	227.70	0.00	227.70
TN Customers	4,809.37	1,919.20	6,728.57
Tap-On Fees	<u>3,000.00</u>	<u>1,200.00</u>	<u>4,200.00</u>
Total Service Revenue	<u>135,921.48</u>	<u>45,176.33</u>	<u>181,097.81</u>
Other Income			
Returned Check Fee	55.00	45.00	100.00
Sales Tax Collected	4,894.69	0.00	4,894.69
Service	807.74	660.88	1,468.62
Penalties	<u>3,620.11</u>	<u>1,274.32</u>	<u>4,894.43</u>
Total Other Income	<u>9,377.54</u>	<u>1,980.20</u>	<u>11,357.74</u>
TOTAL OPERATING REVENUE	<u>145,299.02</u>	<u>47,156.53</u>	<u>192,455.55</u>
OPERATING EXPENSES			
Salaries	27,066.03	22,144.08	49,210.11
Transportation	3,953.72	3,158.28	7,112.00
Purchased Water	31,135.88	0.00	31,135.88
Testing & Chemicals	765.75	21,029.21	21,794.96
Fuel & Power	1,290.78	4,280.01	5,570.79
Taxes	7,274.22	1,581.51	8,855.73
Maintenance/Repair & Materials	3,508.16	9,225.48	12,733.64
Insurances	3,696.97	3,024.79	6,721.76
General/Misc. Operating	<u>7,036.76</u>	<u>5,514.87</u>	<u>12,551.63</u>
<i>Expenses before Depreciation</i>	85,728.27	69,958.23	155,686.50
Depreciation	<u>26,668.90</u>	<u>43,296.26</u>	<u>69,965.16</u>
TOTAL OPERATING EXPENSES	<u>112,397.17</u>	<u>113,254.49</u>	<u>225,651.66</u>
OPERATING INCOME (LOSS)	<u>32,901.85</u>	<u>(66,097.96)</u>	<u>(33,196.11)</u>
NONOPERATING REVENUE (EXPENSES)			
Interest Revenue	277.66	227.51	505.17
Interest Expense	<u>(3,905.00)</u>	<u>(3,195.00)</u>	<u>(7,100.00)</u>
TOTAL NONOPERATING EXPENSES	<u>(3,627.34)</u>	<u>(2,967.49)</u>	<u>(6,594.83)</u>
INCOME (LOSS) BEFORE TRANSFERS	29,274.51	(69,065.45)	(39,790.94)
TRANSFERS IN (OUT)	<u>(44,346.69)</u>	<u>44,346.69</u>	<u>0.00</u>
CHANGE IN NET POSITION	<u>(15,072.18)</u>	<u>(24,718.76)</u>	<u>(39,790.94)</u>
NET POSITION BEGINNING OF YEAR	<u>210,222.55</u>	<u>853,213.46</u>	<u>1,063,436.01</u>
NET POSITION END OF THE YEAR	<u>\$ 195,150.37</u>	<u>\$ 828,494.70</u>	<u>\$ 1,023,645.07</u>

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

SOUTH 641 WATER DISTRICT				
PROPRIETARY FUND STATEMENT OF CASH FLOWS				
YEAR ENDED DECEMBER 31, 2015				
		<u>WATER</u>	<u>SEWER</u>	<u>COMBINED</u>
Cash Flows from operating activities:				
Cash received from customers		\$ 144,414.92	\$ 43,952.44	\$ 188,367.36
Cash payments to suppliers for goods and services		(60,553.80)	(49,363.77)	(109,917.57)
Cash payments to employees for services		(27,066.03)	(22,144.08)	(49,210.11)
Net cash provided (used) by operating activities		<u>56,795.09</u>	<u>(27,555.41)</u>	<u>29,239.68</u>
Cash Flows from non- capital financing activities:				
Transfer from (to) other funds		(44,346.69)	44,346.69	0.00
Net cash provided (used) by non-capital financing activities		<u>(44,346.69)</u>	<u>44,346.69</u>	<u>0.00</u>
Cash Flows from capital and related financing activities:				
Acquisition and construction of property, plant and equipment		(5,220.00)	(12,006.50)	(17,226.50)
Principal payments on long term-debt		(11,000.00)	(9,000.00)	(20,000.00)
Interest paid on long-term debt		(3,905.00)	(3,195.00)	(7,100.00)
Net cash provided (used) by capital and related financing activities		<u>(20,125.00)</u>	<u>(24,201.50)</u>	<u>(44,326.50)</u>
Cash flows from investing activities:				
Interest Income		277.66	227.51	505.17
Net cash provided (used) by investing activities		<u>277.66</u>	<u>227.51</u>	<u>505.17</u>
Net increase (decrease) in cash		<u>(7,398.94)</u>	<u>(7,182.71)</u>	<u>(14,581.65)</u>
Cash and cash equivalents, beginning of year		<u>76,209.74</u>	<u>52,169.66</u>	<u>128,379.40</u>
Cash and cash equivalents, end of year		<u>\$68,810.80</u>	<u>\$44,986.95</u>	<u>\$113,797.75</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:				
Operating (loss) income		\$ 32,901.85	\$ (66,097.96)	\$ (33,196.11)
Adjustments - Operating Activities:				
Depreciation		26,668.90	43,296.26	69,965.16
(Increase) Decrease in:				
Accounts Receivable		(1,257.00)	(510.06)	(1,767.06)
Unbilled Receivables		372.90	(2,694.03)	(2,321.13)
Increase (Decrease) in:				
Accounts Payable		(2,938.36)	(1,220.16)	(4,158.52)
Taxes Withheld		118.80	97.19	215.99
State Taxes		12.94	0.00	12.94
Accrued Payroll Taxes		35.84	29.33	65.17
Customer Advanced Payments		(196.06)	(160.41)	(356.47)
Customer's Deposits		1,350.28	(70.57)	1,279.71
Accrued Interest		(275.00)	(225.00)	(500.00)
Net cash provided (used) by operating activities		<u>\$ 56,795.09</u>	<u>\$(27,555.41)</u>	<u>\$ 29,239.68</u>

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

SOUTH 641 WATER DISTRICT

Notes to the Financial Statements

1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Activities – The South 641 Water District is a county water district supported by funds derived from the sale of water and sewer distribution and is operated by a District Board. The District is authorized under Kentucky Revised Statutes and constitutes a Special Purpose Government Entity, subdivision of the Department of Local Government, of the Commonwealth of Kentucky. The District is located in Hazel, KY and serves the city of Hazel and the southern portion of Calloway County area.

Principles determining scope of reporting entity – The District’s financial report includes only the funds of the District. The District has no oversight responsibility for any other governmental entity and is not included in any other governmental “reporting entity” as defined by the Governmental Accounting Standards Board pronouncement. The District’s Board members are appointed equally by the County Judge Executive of Calloway County, and they have decision making authority, the authority to set rates, the power to designate management, the ability to significantly influence operations and primary accountability for fiscal matters.

Basis of accounting – The District is presented as a proprietary enterprise fund. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Grants and similar items are recognized as soon as all eligibility requirements imposed by the provider have been met.

The District follows all pronouncements of the Government Accounting Standards Board. Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise fund’s principal ongoing operations. The principal operating revenues of the District are charges to customers for water distribution and waste water treatment. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenue and expenses.

As dictated by the Kentucky Public Service Commission (PSC), any undetermined revenues and expenses for water and sewer are to be allocated 55% water and 45% sewer.

Budget – Business-type activities use budgets for internal planning and control, but the budgets generally do not have the legal status or political nature of governmental activity budgets. For instance, usually they are not subject to public comment and are not formally adopted by the governing body. South 641 Water District has no legally adopted budget.

Accounts Receivable – Receivables result from unpaid billings for water service to customers and from unpaid billings related to work performed for or materials sold to certain entities. All receivables are shown net of an allowance for uncollectible accounts. The allowance for uncollectible customer accounts recorded by the District is based on past history of uncollectible accounts and management’s analysis of current accounts.

Unbilled Receivables – The district bills one month in arrears of usage, therefore January 2016 billing is actually for December 2015 usage. Unbilled receivables are for usage that has occurred that the District still needs to prepare billing for and send to customers. The PSC has authorized the District (Case No. 2015-00278) to raise the sewer rates by 88.83% for the December 2015 usage (January 2016 billing).

Utility Plant – The utility plant is carried at cost. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant betterments are capitalized. Contributions from customers for the purpose of purchasing service connections to the utility plant are recorded as contributions when they are received. Depreciation on contributed assets is recorded as an expense in the statement of revenues and expenses. Capital assets are depreciated over the following estimated useful lives:

Organization Costs, Collection Sewers, Transmission & distribution lines & water tanks:	40 years
Engineering costs, Receiving Wells & Pump Pits:	35 years
Hydrants, Fittings and valves:	30 years
Oxidation Lagoons:	25 years
Regional Plans, Structures & Improvements, Hoists, some office equipment, water pumps:	20 years
Meters and Tap-Ons, Air conditioners/heaters, and meter testers:	15 years
Sewer Pumps:	7 years
Some office equipment & Automatic samplers:	5 years

Expenses – On May 28, 2015 the City of Murray notified the District of their intent to increase its wholesale rate of water to the District. This increase began July 1, 2015 and continue to increase semi-annually until July 1, 2018. The PSC has allowed the District (TFS 2015-00341) to increase its monthly water rate by \$0.20 per 1,000 gallons. This “Purchase Water Adjustment” and the expenses of this increase will be off-set by a water rate increase.

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

Use of Restricted/Unrestricted Net Position – when an expense is incurred for purposes for which both restricted and unrestricted assets are available, the District’s policy is to consider unrestricted net position to have been depleted before restricted net position is applied.

Cash and Cash Equivalents – For purposes of the statement of cash flows, the District considers all highly liquid investments with original maturity of three months or less when purchased to be cash equivalents.

2 - RESTRICTED CASH AND INVESTMENTS

Depreciation Reserve – The bond ordinances with the U.S Department of Agriculture (USDA/FHA – formally Rural Development RD) require South 641 Water District to maintain an account in the amount of \$28,000. A Certificate of Deposit was opened on 10/29/2013 for a term of 60 months. At December 31, 2015 the balance of the Certificate of Deposit held at The Murray Bank was \$28,872.41. The interest for this account is 1.5400% with an annual percentage yield of 1.55%. Interest is compounded semi-annually.

Customer Deposits – South 641 Water District sets aside in an independent checking account held at The Murray Bank for all customers’ deposits. This is a non-interest bearing account. The balance of this account at December 31, 2015 was \$17,617.03.

Cash for Long-Term Debt – The District holds an account with The Murray Bank in which the District transfers monies monthly to accumulate cash for semi-annual withdrawals for principal and interest on the District’s Bond payable to The USDA/FHA. This account is interest bearing at 0.05% and at December 31, 2015 held a balance of \$26,783.16. Although this account is accessible to the District management, it selects to deem this account as restricted to ensure funds availability for semi-annual payments of interest and annual payment of principal.

3 DEPOSITS – The District’s cash in bank demand deposits at December 31, 2015 does not exceed the FDIC insured amount. If the District exceeds FDIC insurance amounts this excess would represent a potential loss in the event the financial institution failed to perform on its obligations.

4 – CAPITAL ASSETS

Capital Assets Note Illustration

CAPITAL ASSETS

Business-type Activities

	<u>Beginning</u>				
<u>WATER FUND</u>	<u>Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	
Land & Land Rights	\$ 20,000.00	\$0.00	\$0.00	\$ 20,000.00	
Organization Costs	184,700.00	0.00	0.00	184,700.00	
Structures & Improvements	282,285.00	0.00	0.00	282,285.00	
Pumping Equipment	39,672.00	0.00	0.00	39,672.00	
Water Towers	302,000.00	0.00	0.00	302,000.00	
Transmission & Distribution	390,450.00	0.00	0.00	390,450.00	
Meter & Tap-ons	147,207.13	5,130.00	0.00	152,337.13	
Hydrants	27,750.00	0.00	0.00	27,750.00	
Regional Plan	9,900.00	0.00	0.00	9,900.00	
Office & Equipment	10,731.00	90.00	0.00	10,821.00	
Meter Tester	190.00	0.00	0.00	190.00	
<u>Water Capital Assets, Net</u>	<u>\$ 1,414,885.13</u>	<u>\$ 5,220.00</u>	<u>\$0.00</u>	<u>\$ 1,420,105.13</u>	
<u>SEWER FUND</u>					
Organization Costs	\$ 46,500.00	\$0.00	\$0.00	\$ 46,500.00	
Misc. Intangible	176,598.00	0.00	0.00	176,598.00	
Structures and Improvements	40,000.00	2,805.00	0.00	42,805.00	
Collection Sewers & Lines	263,298.00	0.00	0.00	263,298.00	
Other Collection Plant	11,900.00	0.00	0.00	11,900.00	
Services/Tap-Ons	12,747.00	2,500.00	0.00	15,247.00	
Automatic Samplers	7,911.69	0.00	0.00	7,911.69	
Rec Wells & Pump Pits	170,638.32	0.00	0.00	170,638.32	
Pumping Equipment	15,129.07	4,470.00	0.00	19,599.07	
Oxidation Lagoon	502,033.28	2,231.50	0.00	504,264.78	
Office & Equipment	7,199.03	0.00	0.00	7,199.03	
Generator for Pumps	32,749.00	0.00	0.00	32,749.00	
<u>Sewer Capital Assets, Net</u>	<u>\$ 1,286,703.39</u>	<u>\$ 12,006.50</u>	<u>\$0.00</u>	<u>\$ 1,298,709.89</u>	

Depreciation expense was charged to functions as follows:

Water: \$26,668.90

Sewer: \$43,296.26

Total Business-type activities depreciation expense: \$69,965.16

5 – LONG TERM DEBT – The District’s revenue bonds were issued in 1981 in the original amount of \$472,000.00 payable to the U.S. Department of Agriculture at 5.00% per annum. Interest is payable semi-annually on January 1 and July 1 of each year, beginning in 1984, and ending with a final payment, on January 1, 2021. Principal payments are made on January 1 each year, beginning in 1984 and with a final payment on January 1, 2021. Bond Payment schedule is as follows:

USDA/RURAL DEVELOPMENT BOND PAYMENT SCHEDULE						ACCUM
DATE	INTEREST	PRINCIPAL	TOTAL PAYMENT	BALANCE	INTREST PAID	INT PD
1/1/2016	3,550.00	21,000.00	24,550.00	121,000.00	3,550.00	560,900.00
7/1/2016	3,025.00		3,025.00		3,025.00	563,925.00
1/1/2017	3,025.00	22,000.00	25,025.00	99,000.00	3,025.00	566,950.00
7/1/2017	2,475.00		2,475.00		2,475.00	569,425.00
1/1/2018	2,475.00	23,000.00	25,475.00	76,000.00	2,475.00	571,900.00
7/1/2018	1,900.00		1,900.00		1,900.00	573,800.00
1/1/2019	1,900.00	24,000.00	25,900.00	52,000.00	1,900.00	575,700.00
7/1/2019	1,300.00		1,300.00		1,300.00	577,000.00
1/1/2020	1,300.00	25,000.00	26,300.00	27,000.00	1,300.00	578,300.00
7/1/2020	675.00		675.00		675.00	578,975.00
1/1/2021	675.00	27,000.00	27,675.00	0.00	675.00	579,650.00

6 – COMMERCIAL INSURANCE – It is the policy of the District to purchase commercial insurance for the risks of losses to which it is exposed. These risks include general liability and fidelity bond coverage. Settled claims have not exceeded the commercial coverage in any of the past three fiscal years.

7 – INTEREST EXPENSE – The District incurred interest costs in 2015 of \$7,100.00. The entire amount has been recognized as a current operating expense.

8 – SUBSEQUENT EVENTS

Water Rate increase TFS 2016-0055 PWA On May 28, 2015 the City of Murray notified the District of their intent to increase its wholesale rate of water to the District. This increase began July 1, 2015 and continues to increase semi-annually until July 1, 2018. The PSC has allowed the District (TFS 2015-00341) to increase its monthly water rate, a.k.a. “Purchase Water Adjustment”, (PWA) and the expenses of this increase will be off-set by a water rate increase. There was an increase effective January 1, 2016 and another on July 1, 2016. These increases in wholesale water rates will increase the cost, expense, of purchased water, and also an equal increase to water revenue.

Sewer Rate Increase – PSC Case No. 2015-00278. The South 641 Water District will see an 88.83% increase in sewer revenue (with usage assumed equal) for the 2016 fiscal year. This is Phase 1 of the approved sewer rate increase by the PSC. Phase 2 (of 2) of this increase will be 47.04% increase of current Sewer rates will go into effect for the December 2016 usage (January 2017 billing). This increase will affect the Unbilled Receivables for the 2016 financial statements.

Public Service Commission Case No. 2015-00278 – The South 641 Water District applied for a rate adjustment to the PSC in 2015. Upon the review of the District and its financial records, the PSC made several recommendations besides authorizing the increase of the District’s sewer rates. The District will abide by their recommendations, and they are as follows:

Lives of Capital Assets – As recommended by the PSC, the District will change the depreciable lives assigned to certain sewer assets. These changes will be applied to 2016 fiscal year. The assets lives (in years) affected are the following:

	<u>2015 & Before</u>	<u>2016</u>
Administrative & Engineering Costs	20	35
Pumps, Impellers	5	7
Oxidation Lagoons	31.5-40	25

Water and Sewer Expense Allocation - Any unspecified expense for water and sewer have previously been allocated 55% to water and 45% to sewer. The following changes will be applied to the 2016 financial records:

62.2% to water & 37.8% to sewer for:

- Employee Wages
- Dental Insurance
- Telephone
- Office Supplies
- Postage
- Mileage Reimbursement
- Workers Comp Insurance
- Payroll Taxes
- PSC Fees
- Interest Revenue
- Fees Revenue (Turn-on and returned check)

75.33% to water & 24.67% to sewer for:

- Uncollectible Accounts
- General Liability Insurance
- Long-Term Debt
- Interest Expense

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Member of
American Institute of CPA's

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 Board of Commissioners
South 641 Water District
207 Main Street
P.O. Box 126
Hazel, Kentucky 42049

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 South 941 Water District, Hazel, Kentucky as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the South 641 Water District's basic financial statements and have issued our report thereon dated March 28, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered South 641 Water 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 South 641 Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of South 641 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.

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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether South 641 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs (pages 16-17) as Condition 1 and Condition 2.

South 641 Water District's Response to Findings

South 641 Water District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. South 641 Water 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.



David M. Anderson, CPA
Ledbetter, Kentucky
March 28, 2016

SOUTH 641 WATER DISTRICT

HAZEL, KENTUCKY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

December 31, 2015

SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: unqualified

Internal control over financial reporting:

Material weakness(es) identified? yes X no

Significant deficiency(ies) identified? yes X none reported

Noncompliance material to financial statements noted? X yes no

FINANCIAL STATEMENT FINDINGS

FINDINGS

Condition 1: South 641 Water District's Water and Sewer Revenue Bond Resolution of 1981 states that an annual audit shall be made by a Certified Public Accountant licensed in Kentucky. The District has been having an audit only every fourth year, as required by KRS 65A.030 for special purpose government entities.

Effect: Annual audits would help the district maintain their compliance responsibilities, internal controls and accurate financial statements making material misstatements less likely.

Recommendation: The District should have annual audits in accordance with the bond resolution.

Management's Response: South 641 Water District has a letter from the United States Department of Agriculture which states the criteria they should follow to determine which type of annual financial statement they are required to submit. One of the criteria states that if they have an outstanding Rural Utilities Service loan balance of less than \$1,000,000 they may, with Rural Development's approval, submit a management report in lieu of an audit report.

Condition 2: South 641 Water District's Water and Sewer Revenue Bond Resolution of 1981 states that the District will adopt an annual budget. The District has no adopted budget resolution.

Effect: Annual budgets help management monitor revenues and control expenditures. Budgets are tools used to help prevent material misstatement of financial information.

Recommendation: The District should adopt an annual budget in accordance with the bond resolution.

Management's Response: The commissioners of South 641 Water plan to adopt an annual budget in accordance with the bond resolution and will have this action line-itemed in their minutes to reaffirm this action.

PRIOR YEAR AUDIT FINDINGS

None