

NORTH MERCER WATER DISTRICT
AUDIT OF FINANCIAL STATEMENTS

DECEMBER 31, 2014

CRAIG A. BUTLER
CERTIFIED PUBLIC ACCOUNTANT
DANVILLE, KENTUCKY

CONTENTS

| | <u>PAGE</u> |
|---|-------------|
| Independent Auditor's Report | 1-2 |
| Management's Discussion & Analysis | 3-6 |
| Financial Statements: | |
| Statement of Net Position | 7-8 |
| Statement of Revenues, Expenses and Changes in Net Position | 9 |
| Statement of Changes in Net Position | 10 |
| Statement of Operating Expenses | 11 |
| Statement of Cash Flows | 12-13 |
| Notes to Financial Statements | 14-20 |
| Compliance Section: | |
| Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed In Accordance With <u>Government Auditing Standards</u> | 21-22 |

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INDEPENDENT AUDITOR'S REPORT

Chairman and Commissioners
North Mercer Water District
Salvisa, KY 40372

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of the North Mercer Water District as of and for the years ended December 31, 2014 and 2013, 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

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the comptroller general of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit 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, I 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.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Mercer Water District, as of December 31, 2014 and 2013, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated March 12, 2015, on my consideration of the District's internal control over financial reporting and my tests of compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* in considering the North Mercer Water District's internal control over financial reporting and compliance.

Craig A. Butler, CPA

Craig A. Butler
Certified Public Accountant

Danville, Kentucky
March 12, 2015

North Mercer Water District
Management Discussion and Analysis
For the Year Ended December 31, 2014

The management of the North Mercer Water District presents this narrative to help our readers review the accompanying annual financial statements for the year ended December 31, 2014. We have prepared this overview and analysis of the District's financial activities to add additional information to the financial schedules and the note disclosures. Our analysis will examine the financial highlights for this fiscal year and help explain the format for our readers.

Financial Highlights

- As of December 31, 2014, the District's assets (page 8) exceeded liabilities by \$5,242,629. This amount includes \$4,042,781 of resources that are invested in capital assets, net of related debt. \$1,199,848 of these resources are unrestricted and are available to fund the District's outstanding obligations and future programs.
- Unrestricted cash and cash equivalents (page 7) as of December 31, 2014, were \$544,294 and current liabilities payable from unrestricted resources (i.e. excluding principal and interest on long term debt) were \$145,833.
- Net position (equity) decreased by \$200,127 (page 9). However, it should be noted that this decrease includes depreciation expense of \$450,729, a non-cash expense. The water loss percentage for the year was 12.98% which represents an increase of 1% compared to the previous year
- The District's total debt decreased \$121,000 for the year ended December 31, 2014 equal to the scheduled payments for the year.

Overview of the Financial Statements

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

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

Notes to the Financial Statements

Notes provide additional information that is essential to a full understanding of the information included in the financial schedules. Notes provide additional details about the balances and transactions in the District's financial statements and are presented on pages 14 through 20.

Government-wide Financial Analysis

Net position (equity) may serve over time as a useful indicator of a government's financial position. 77% of the District's net position reflects its investment in capital assets (e.g. distribution system, equipment, etc), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to its customers; consequently these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. 23% of the District's net position is unrestricted.

North Mercer Water District
Management Discussion and Analysis
For the Year Ended December 31, 2014

The first statement in the government-wide statements is the Statement of Net Position. The following table summarizes the Statement of Net Position (pages 7-8).

| | 2014 | 2013 |
|---|---------------------|---------------------|
| Current and other assets | \$ 1,472,280 | \$ 1,522,924 |
| Capital assets | 11,065,781 | 11,308,266 |
| Total assets | 12,538,061 | 12,831,190 |
| Long-term debt outstanding | 7,023,000 | 7,144,000 |
| Other liabilities | 272,432 | 244,434 |
| Total liabilities | 7,295,432 | 7,388,434 |
| Net position: | | |
| Invested in capital assets, net of related debt | 4,042,781 | 4,164,266 |
| Restricted | - | 100,272 |
| Unrestricted (deficit) | 1,199,848 | 1,178,218 |
| Total Net Position | \$ 5,242,629 | \$ 5,442,756 |

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

| | 2014 | 2013 |
|--|---------------------|-------------------|
| Revenues: | | |
| Charges for services | \$ 2,063,537 | \$ 2,072,786 |
| Grants and contributions | 14,300 | 306,813 |
| Rental income | 2,682 | 2,507 |
| Interest earnings | 8,051 | 6,840 |
| Gain on sale of assets | - | 3,588 |
| Total Revenues | 2,088,570 | 2,392,534 |
| Expenses: | | |
| Operating expenses, excluding depreciation | 1,567,723 | 1,492,866 |
| Depreciation | 450,729 | 458,685 |
| Interest and amortization | 270,245 | 281,332 |
| Total Expenses | 2,288,697 | 2,232,883 |
| Increase (decrease) in net position | \$ (200,127) | \$ 159,651 |

North Mercer Water District
Management Discussion and Analysis
For the Year Ended December 31, 2014

For the years ended December 31, 2010, and 2011, the District had water losses in excess of 25% of the gallons purchased. For the years ended December 31, 2012, 2013 and 2014, the District's water loss percentages improved dramatically and were less than 12% for the years ended December 31, 2012 and 2013, and slightly less than 13% for the year ended December 31, 2014.

Capital Asset and Debt Administration

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

Capital Assets

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

| | 2014 | 2013 |
|--|---------------|---------------|
| Land | \$ 48,802 | \$ 48,802 |
| Buildings, structures & improvements | 64,316 | 68,319 |
| Equipment, vehicles, furniture, & fixtures | 289,508 | 320,029 |
| Transmission system | 8,052,095 | 8,151,580 |
| Distribution system | 1,125,519 | 1,169,454 |
| Water meters | 1,459,870 | 1,522,528 |
| Hydrants | 7,631 | 8,171 |
| Pump station equipment | 18,040 | 19,383 |
| Total, net of depreciation | \$ 11,065,781 | \$ 11,308,266 |

Long Term Debt

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

| | 2014 | 2013 |
|--------------------------------|--------------|--------------|
| Water revenue refunding bonds | \$ 1,470,000 | \$ 1,470,000 |
| Water revenue bonds | 5,325,500 | 5,404,000 |
| Notes due to State of Kentucky | 227,500 | 270,000 |
| Total Outstanding Debt | \$ 7,023,000 | \$ 7,144,000 |

The District's outstanding debt decreased \$121,000 for the year equal to the amount of the scheduled payments.

North Mercer Water District
Management Discussion and Analysis
For the Year Ended December 31, 2014

Economic Factors for Next Year

As stated previously, the District has made tremendous progress during the fiscal years ended December 31, 2012, 2013, and 2014 in getting its water losses under control. Going forward, the District will continue to monitor its water losses and take the necessary action to keep them at an acceptable level.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office, P.O. Box 79, Salvisa, KY 40372, telephone number (859) 865-2292.

NORTH MERCER WATER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2014
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2013)

| | 2014 | 2013 |
|--|---------------|---------------|
| <u>ASSETS</u> | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 544,294 | \$ 711,489 |
| Cash and cash equivalents - restricted | 411,228 | 277,962 |
| Accounts receivable (net of allowance) | 251,842 | 282,568 |
| Inventory | 62,722 | 74,743 |
| Prepaid expenses | 56,468 | 27,621 |
| Total Current Assets | 1,326,554 | 1,374,383 |
| Non-current Assets: | | |
| Unamortized bond issuance costs | 50,686 | 53,501 |
| Investments | 95,040 | 95,040 |
| Property and Equipment: | | |
| Plant and equipment in service | 17,811,140 | 17,602,896 |
| Less: Accumulated Depreciation | (6,745,359) | (6,294,630) |
| Net Property and Equipment | 11,065,781 | 11,308,266 |
| Total Non-current Assets | 11,211,507 | 11,456,807 |
| Total Assets | \$ 12,538,061 | \$ 12,831,190 |

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

NORTH MERCER WATER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2014
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2013)

| | 2014 | 2013 |
|---|---------------|---------------|
| <u>LIABILITIES</u> | | |
| Current Liabilities: | | |
| Accounts payable | \$ 38,253 | \$ 43,237 |
| Accrued liabilities | 23,393 | 23,924 |
| Customer deposits | 84,187 | 72,568 |
| Accrued interest payable | 116,641 | 95,805 |
| Current portion of long-term liabilities | 223,000 | 216,000 |
| Total current liabilities | 485,474 | 451,534 |
| Non-Current Liabilities: | | |
| Accrued compensated absences | 9,958 | 8,900 |
| Water revenue bonds | 6,617,500 | 6,700,500 |
| Notes due to State of Kentucky | 182,500 | 227,500 |
| Total non-current liabilities | 6,809,958 | 6,936,900 |
| Total Liabilities | 7,295,432 | 7,388,434 |
| <u>NET POSITION</u> | | |
| Invested in capital assets, net of related debt | 4,042,781 | 4,164,266 |
| Restricted: | | |
| Capital projects | - | 100,272 |
| Unrestricted | 1,199,848 | 1,178,218 |
| Total Net Position | 5,242,629 | 5,442,756 |
| Total Liabilities and Net Position | \$ 12,538,061 | \$ 12,831,190 |

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

NORTH MERCER WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2014
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2013)

| | <u>2014</u> | <u>2013</u> |
|---|---------------------|---------------------|
| Operating Revenue: | | |
| Water sales | \$ 2,003,293 | \$ 2,004,469 |
| Miscellaneous | <u>60,244</u> | <u>68,317</u> |
| Total Operating Revenue | 2,063,537 | 2,072,786 |
| Operating Expenses: | | |
| Source of supply | 673,596 | 692,217 |
| Transmission and distribution | 480,812 | 405,943 |
| Customer accounts | 176,629 | 170,431 |
| General and administrative | <u>201,427</u> | <u>190,430</u> |
| Total Operating Expenses Before | | |
| Taxes and Depreciation | 1,532,464 | 1,459,021 |
| Taxes | 35,259 | 33,845 |
| Depreciation | <u>450,729</u> | <u>458,685</u> |
| Total Operating Expenses | <u>2,018,452</u> | <u>1,951,551</u> |
| Operating Income | <u>45,085</u> | <u>121,235</u> |
| Non-Operating Revenue (Expenses): | | |
| Rent | 2,682 | 2,507 |
| Interest income | 8,051 | 6,840 |
| Interest expense | (267,430) | (278,517) |
| Gain on sale of capital assets | - | 3,588 |
| Amortization of bond discount | <u>(2,815)</u> | <u>(2,815)</u> |
| Total Non-Operating Revenue (Expenses) | <u>(259,512)</u> | <u>(268,397)</u> |
| Change in Net Position Before Capital Contributions | (214,427) | (147,162) |
| Capital contributions | <u>14,300</u> | <u>306,813</u> |
| Change in Net Position | (200,127) | 159,651 |
| Net Position - Beginning of Year | <u>5,442,756</u> | <u>5,283,105</u> |
| Net Position - End of Year | <u>\$ 5,242,629</u> | <u>\$ 5,442,756</u> |

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

NORTH MERCER WATER DISTRICT
STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

| | <u>Tap Fees</u> | <u>Contributions In Aid Of Construction</u> | <u>Retained Deficit</u> | <u>Total</u> |
|---|---------------------|---|-----------------------------|---------------------|
| Balance at January 1, 2013 | \$ 2,081,896 | \$ 4,542,040 | \$(1,340,831) | \$ 5,283,105 |
| 2013 capital contributions-government | - | 292,295 | - | 292,295 |
| Tap fees | 14,518 | - | - | 14,518 |
| 2013 change in net position before capital contributions | <u>-</u> | <u>-</u> | <u>(147,162)</u> | <u>(147,162)</u> |
| Balance at December 31, 2013 | 2,096,414 | 4,834,335 | (1,487,993) | 5,442,756 |
| 2014 capital contributions-government | - | - | - | - |
| Tap fees | 14,300 | - | - | 14,300 |
| 2014 change in net position before capital contributions | <u>-</u> | <u>-</u> | <u>(214,427)</u> | <u>(214,427)</u> |
| Balance at December 31, 2014 | <u>\$ 2,110,714</u> | <u>\$ 4,834,335</u> | <u>\$(1,702,420)</u> | <u>\$ 5,242,629</u> |

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

NORTH MERCER WATER DISTRICT
STATEMENT OF OPERATING EXPENSES (BEFORE TAXES & DEPRECIATION)
FOR THE YEAR ENDED DECEMBER 31, 2014
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2013)

| | Source of Supply | Transmission & Distribution- | | Transmission & Distribution- | | Customer Accounts | Administrative & General | Totals | |
|------------------------------------|---------------------|---------------------------------|-------------------|---------------------------------|-------------------|----------------------|-----------------------------|--------|------|
| | | Operating | Maintenance | Operating | Maintenance | | | 2014 | 2013 |
| Salaries & Wages-Employees | \$ - | 27,816 | \$ 211,533 | \$ 106,437 | \$ 66,658 | \$ 412,444 | \$ 384,085 | | |
| Salaries & Wages-Directors | - | - | - | - | 14,400 | 14,400 | 14,400 | | |
| Employee Pension & Benefits | - | 11,320 | 86,087 | 43,316 | 27,127 | 167,850 | 152,159 | | |
| Purchased Water | 673,596 | - | - | - | - | 673,596 | 692,217 | | |
| Purchased Power | - | 19,825 | - | - | 4,341 | 24,166 | 21,135 | | |
| Materials & Supplies | - | 38,218 | 2,821 | 17,679 | 10,227 | 68,945 | 59,015 | | |
| Contractual Services-Accounting | - | - | - | - | 6,900 | 6,900 | 7,865 | | |
| Contractual Services-Legal | - | - | - | - | 4,800 | 4,800 | 5,550 | | |
| Contractual Services-Engineering | - | 3,600 | - | - | - | 3,600 | - | | |
| Contractual Services-Water Testing | - | 9,700 | - | - | - | 9,700 | 5,104 | | |
| Contractual Services-Other | - | - | 26,316 | - | - | 32,647 | 10,991 | | |
| Transportation Expenses | - | 30,720 | - | - | 3,795 | 34,515 | 34,992 | | |
| Insurance-General Liability | - | - | - | - | 24,531 | 24,531 | 20,976 | | |
| Insurance-Worker's Compensation | - | 624 | 4,743 | 2,386 | 1,494 | 9,247 | 8,432 | | |
| Insurance-Other | - | - | - | - | 2,008 | 2,008 | 2,110 | | |
| Bad Debts | - | - | - | 6,811 | - | 6,811 | 10,786 | | |
| Miscellaneous Expenses | - | - | 7,489 | - | 28,814 | 36,303 | 29,204 | | |
| Total Operating Expenses* | \$ 673,596 | \$ 141,823 | \$ 338,989 | \$ 176,629 | \$ 201,427 | \$ 1,532,464 | \$ 1,459,021 | | |

*Before taxes and depreciation

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

NORTH MERCER WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2014
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2013)

| | <u>2014</u> | <u>2013</u> |
|---|-------------------|-------------------|
| Cash Flows From Operating Activities: | | |
| Receipts from customers | \$ 2,105,882 | \$ 2,056,108 |
| Payments to suppliers | (963,626) | (932,215) |
| Payments for employee services & related benefits | <u>(625,380)</u> | <u>(577,852)</u> |
| Net Cash Provided by (Used in) Operating Activities | <u>516,876</u> | <u>546,041</u> |
| Cash Flows From Non-Capital Financing Activities: | | |
| Interest paid on customer deposits | <u>(598)</u> | <u>(468)</u> |
| Net Cash Provided by (Used in) Non-Capital Financing Activities | <u>(598)</u> | <u>(468)</u> |
| Cash Flows From Capital and Related Financing Activities: | | |
| Proceeds from tapping fees | 14,300 | 14,518 |
| Proceeds from federal grant | - | 292,295 |
| Acquisition of capital assets | (208,244) | (372,633) |
| Proceeds from sale of capital assets | - | 3,588 |
| Rent | 2,682 | 2,507 |
| Principal paid on bonded debt | (78,500) | (128,000) |
| Principal paid on KIA debt | (42,500) | (40,000) |
| Interest paid on debt | <u>(245,996)</u> | <u>(278,959)</u> |
| Net Cash Used in Financing Activities | <u>(558,258)</u> | <u>(506,684)</u> |
| Cash Flows From Investing Activities: | | |
| Interest income | <u>8,051</u> | <u>6,840</u> |
| Net Cash Provided by (Used in) Investing Activities | <u>8,051</u> | <u>6,840</u> |
| Net Increase (Decrease) in Cash & Cash Equivalents | (33,929) | 45,729 |
| Cash & Cash Equivalents - Beginning of Year | <u>989,451</u> | <u>943,722</u> |
| Cash & Cash Equivalents - End of Year | <u>\$ 955,522</u> | <u>\$ 989,451</u> |

Continued

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

NORTH MERCER WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2014
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2013)
Continued

| | 2014 | 2013 |
|--|-------------------|-------------------|
| Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities: | | |
| Operating Income (Loss) | \$ 45,085 | \$ 121,235 |
| Depreciation | 450,729 | 458,685 |
| Decrease (Increase) in Accounts Receivable | 30,726 | (27,119) |
| Decrease (Increase) in Inventory | 12,021 | (10,472) |
| Decrease (Increase) in Prepaid Expenses | (28,847) | (11,571) |
| Increase (Decrease) in Accounts Payable | (4,984) | (1,795) |
| Increase (Decrease) in Customer Deposits | 11,619 | 10,441 |
| Increase (Decrease) in Accrued Compensated Absences | 1,058 | (474) |
| Increase (Decrease) in Other Current Liabilities | <u>(531)</u> | <u>7,111</u> |
| Net Cash Provided by (Used in) Operating Activities | <u>\$ 516,876</u> | <u>\$ 546,041</u> |
| Schedule of cash and cash equivalents: | | |
| Beginning of period: | | |
| Unrestricted cash and cash equivalents | \$ 711,489 | \$ 586,667 |
| Restricted cash and cash equivalents | <u>277,962</u> | <u>357,055</u> |
| Total cash and cash equivalents | <u>989,451</u> | <u>943,722</u> |
| End of period: | | |
| Unrestricted cash and cash equivalents | \$ 544,294 | \$ 711,489 |
| Restricted cash and cash equivalents | <u>411,228</u> | <u>277,962</u> |
| Total cash and cash equivalents | <u>955,522</u> | <u>989,451</u> |
| Non-Cash Financing and Investing Activities: | | |
| Amortization of debt discount | 2,815 | 2,815 |

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The North Mercer Water District (District) was established in 1959 under KRS 74.010 to provide water service for public health, convenience, fire protection, and comfort to the residents of northern Mercer County, Kentucky. Several expansions of the system have taken place in Mercer, Anderson, Boyle, and Washington Counties since the creation of the District. The Board of Commissioners consists of three members, all residents of Mercer County, appointed by the county judge.

North Mercer Water District has been appointed by the Mercer County Fiscal Court as an independent unit. The District selects management, staff, sets user charges, establishes budgets and controls all aspects of its daily activities.

The commissioners appoint the Chair(person) from existing members. The Chair responsibilities are to preside at all meetings; be the chief officer of the District; perform all duties commonly incident to the position of presiding officer of a board, commission or business organization and exercise supervision over the business of the District, its officers and employees.

The accompanying statements of the District have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The financial statements include all organizations, activities, and functions that comprise the District. Component units are legally separate entities for which the District (the primary entity) is financially accountable. Financial accountability is defined as the ability to appoint a voting majority of the organization's governing body and either (1) the District's ability to impose its will over the organization or (2) the potential that the organization will provide a financial benefit to, or impose a financial burden on, the District. Using these criteria, the District has no component units.

Basis of Presentation

The District's fund is an enterprise fund. Enterprise funds are proprietary funds used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus applied.

The proprietary funds utilize and "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net position.

All proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District's enterprise fund are charges to customers for sales and service. 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.

North Mercer Water District
Notes to Financial Statements
December 31, 2014

Assets, Liabilities, and Net Position

Cash and Investments

For purposes of the statement of cash flows, the District considers all highly liquid investments, including restricted assets, with a maturity of three months or less when purchased, to be cash equivalents.

Restricted Assets

Restricted assets represent cash and cash equivalents whose use is limited by legal requirements.

Inventory

Inventory consists of materials and supplies on hand at the end of the year and is stated at the lower of cost (average cost method) or market.

Utility Plant

Utility plant is recorded at cost for items purchased or constructed and at estimated fair market value on the date donated for contributed items. The capitalization threshold for utility plant is \$500. Depreciation is computed by the straight-line method based on the estimated useful lives of related asset classifications. It is the District's policy to depreciate assets one-half year in the year of acquisition and one-half year in the year of disposal or retirement.

Construction in Progress

Construction work in progress represents costs accumulated for the replacement of sections of the District's transmission and distribution systems, plant expansions and rehabilitations, and other projects that were not completed at year end.

Compensated Absences

It is the District's policy to permit employees to accumulate earned but unused vacation benefits. Employees may, depending on level and length of service, be paid for various amounts of their total accrued leave upon termination or retirement. The District accrues a liability for leave hours that meet the criteria for payment at the eligible employees' current rates of pay plus retirement benefits and employment taxes. The accrual for compensated absences at December 31, 2014 was \$9,958.

Long-Term Obligations

Long-term debt and other long-term obligations are reported as liabilities on the District's statement of net position.

Bond Issuance Costs

The Government Accounting Standards Board (GASB) issued GASB Statement #65, effective for fiscal years beginning after December 15, 2012. GASB Statement #65 changed the method of accounting for debt issuance costs. Prior to the issuance of GASB Statement #65, debt issuance costs were recognized in a systematic manner over the life of the related debt. However, GASB Statement #65 states that debt issuance costs (with the exception of prepaid insurance costs) should be recognized in the year they are incurred. Furthermore, regulated utilities are allowed to apply certain criteria outlined in GASB Statement #62 to determine if they can continue to amortize debt issuance costs. If the criteria are met, then debt issuance costs would continue to be amortized over the life of the related debt. The District has reviewed the criteria contained in GASB Statement #62 and has determined that it remains appropriate to amortize its bond issuance costs consistent with how it has treated them in prior years.

Net Position

Net position represents the differences between assets and liabilities in the statement of net position.

1. Net position invested in capital assets is reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets.
2. Net position is reported as restricted when there are legal limitations imposed on their use by District legislation or external restrictions by creditors, grantors, laws or regulations of other governmental entities.

North Mercer Water District
Notes to Financial Statements
December 31, 2014

Budget

In accordance with the District's enabling legislation, the Commission holds public hearings and subsequently adopts an annual budget for operating expenses and capital outlays. The budget is adopted on a basis consistent with generally accepted accounting principles. It is monitored at various levels of classification detail within the enterprise fund.

Use of 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 amounts reported in the financial statements and the accompanying notes. Actual results may differ from those estimates.

NOTE 2. DEPOSITS AND INVESTMENTS

The following information classifies deposits and investments by categories of risk as defined in GASB Statement 3, *"Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements"*.

Deposits

At year-end, the carrying amount of the District's deposits was \$955,522 and the bank balance was \$958,663. The bank balance covered by federal depository insurance was \$749,547. The remaining deposits were classified as Category 2, collateralized, as defined by GASB (securities are pledged with the financial institution's trust department or agent in the District's name).

Investments

| | |
|------------|--|
| Category 1 | Insured or registered, with securities held by the District or its agent in the District's name. |
| Category 2 | Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the District's name. |
| Category 3 | Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the District's name. |

The District has investments of \$95,040 in bank certificates of deposit. The certificates of deposit are covered by federal depository insurance.

NOTE 3. RESTRICTED ASSETS

Under the District's bond agreements, the District is required to transfer to the Debt Service Account on or before the last day of each month the following amounts:

- Interest-deposit the sum together with the balance in this account an amount equal to the interest on all outstanding bonds accrued and unpaid and to accrue to the end of the then current calendar month.
- Principal-deposit the sum together with the balance in this account an amount equal to (a) the principal amount of all outstanding bonds other than term bonds due and unpaid, (b) that portion of the principal amount of the bonds next due which would have accrued on such bonds other than term bonds next due during the current calendar month if such principal amount thereof were deemed to accrue monthly in equal installments from a date one year preceding the due date of such bonds next due and (c) the portion of the principal amount of the bonds next due which shall have accrued on such basis in prior months.
- Depreciation-deposit a monthly sum until the depreciation account reaches the balance required by bond agreements.

NOTE 4. LONG-TERM DEBT

Kentucky Infrastructure Loan of 1993 (KIA)

The Kentucky Infrastructure has first pledge of gross income and revenues derived from the operation of the system to pay for the District's portion of the debt service requirements of the Kentucky Infrastructure Authority Revenue Bonds, Series 1993E dated April 7, 1993, which redeemed and retired KIA Bonds series 1988A and 1988B.

Waterworks Revenue Bonds. Series 1994

The District authorized the issuance of \$439,000 in "Waterworks Revenue Bonds" by resolution on June 21, 1994 to finance the cost of construction of extensions, additions and improvements to the system. On February 7, 1995, the U.S. Department of Agriculture Farmers Home Administration purchased the entire issue at 4.5% interest rate. The bonds are payable from and secured by a second pledge of revenues derived from the operation of the System, subject to the priority of a prior obligation to the Kentucky Infrastructure Authority of first pledge revenues.

Waterworks Revenue Bonds. Series 2011A

The District authorized the issuance of \$1,547,000 in "Waterworks Revenue Bonds" by resolution to finance the construction of additions and improvements to the system. On January 19, 2012, the U.S. Department of Agriculture Rural Development purchased the entire issue at 3.75% interest rate. The bonds are payable and secured by a second pledge of revenues derived from the operation of the system, subject to the priority of a prior obligation to the Kentucky Infrastructure Authority of first pledge revenues.

Waterworks Revenue Bonds. Series 2011

The District authorized the issuance of \$1,874,000 in "Waterworks Revenue Bonds" by resolution to finance the construction of additions and improvements to the system. On January 19, 2012, the U.S. Department of Agriculture Rural Development purchased the entire issue at 3.75% interest rate. The bonds are payable and secured by a second pledge of revenues derived from the operation of the system, subject to the priority of a prior obligation to the Kentucky Infrastructure Authority of first pledge revenues.

Waterworks Refunding Revenue Loan, Series 2010C

On June 10, 2010, the District issued Waterworks Refunding Revenue Loan, Series 2010C in the amount of \$1,790,000 with an interest rate of 2.2%-4.325% for the purpose of refunding and retiring the outstanding Waterworks Revenue Bonds of 1992 and the Waterworks Refunding Revenue Bonds Series 1996, with interest rates of 5.375%-5.5%. The Waterworks Refunding Revenue Loan, Series 2010C were issued at a par amount of \$1,790,000 and, after paying issuance cost and discount of \$63,590, the net proceeds were \$1,726,410. The refunding met the requirements of an in-substance debt defeasance and the Revenue Bonds were removed from the District's long-term debt.

As a result of the refunding, the District reduced its total debt service requirements by \$488,774, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debt) of \$327,270.

Waterworks Revenue Bonds. Series 1996

On May 7, 1996 the District entered into a loan agreement with the Kentucky Rural Water Finance Corporation, a non-profit corporation, to provide interim financing in the amount of \$433,000 in anticipation of delivery of the Waterworks Revenue Bonds, Series 1996. Permanent financing was obtained from RECD on January 9, 1997, with the issuance of the bonds and draws in the amount of \$368,000 which was repaid from bond proceeds. The bonds sold were in the amount of 443,000 and carry an interest rate of 5.50%.

Waterworks Revenue Bonds. Services 2003

On March 11, 2003, the District entered into a loan agreement with the Kentucky Rural Water Finance Corporation to provide revenue bond anticipation notes in the amount of \$1,450,000 at an interest rate of 3.4% in anticipation of delivery of the Waterworks Revenue Bonds, Series 2004. Permanent financing was obtained from

North Mercer Water District
Notes to Financial Statements
December 31, 2014

Rural Development in 2004, with the issuance of the bonds and draws in the amount of \$1,059,400 which was repaid from the bond proceeds. The bonds sold were in the amount of \$1,450,000 and carry an interest rate of 4.375%.

Long-term liability activity for the year ended December 31, 2014 was as follows:

| | Beginning Balance | Increases | Reductions | Ending Balance | Due Within One Year |
|--|----------------------|-------------|---------------------|---------------------|------------------------|
| Waterworks refunding loan series 2010C | \$ 1,470,000 | \$ - | \$ - | \$ 1,470,000 | \$ 95,000 |
| Water revenue bonds series 1994 | 332,000 | - | (9,000) | 323,000 | 10,000 |
| Water revenue bonds series 1996 | 345,500 | - | (8,500) | 337,000 | 9,000 |
| Water revenue bonds series 2003 | 1,305,500 | - | (22,000) | 1,283,500 | 23,000 |
| Water revenue bonds series 2011 | 1,874,000 | - | (19,500) | 1,854,500 | 20,500 |
| Water revenue bonds series 2011A | 1,547,000 | - | (19,500) | 1,527,500 | 20,500 |
| Bonds payable total | 6,874,000 | - | (78,500) | 6,795,500 | 178,000 |
| Note due to state of Kentucky | 270,000 | - | (42,500) | 227,500 | 45,000 |
| Long-term debt total | <u>\$ 7,144,000</u> | <u>\$ -</u> | <u>\$ (121,000)</u> | <u>\$ 7,023,000</u> | <u>\$ 223,000</u> |

The future maturity amounts and related interest costs for all long-term debt are as follows:

| Year Ending December 31, | Bonds | | KIA Loan | | Total | |
|-----------------------------|---------------------|---------------------|-------------------|------------------|---------------------|---------------------|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2015 | \$ 178,000 | \$ 254,591 | \$ 45,000 | \$ 10,006 | \$ 223,000 | \$ 264,597 |
| 2016 | 186,000 | 248,508 | 45,000 | 8,178 | 231,000 | 256,686 |
| 2017 | 190,500 | 241,771 | 80,000 | 6,069 | 270,500 | 247,840 |
| 2018 | 199,000 | 234,720 | 57,500 | 2,444 | 256,500 | 237,164 |
| 2019 | 208,500 | 227,053 | - | - | 208,500 | 227,053 |
| 2020-24 | 1,077,500 | 1,008,353 | - | - | 1,077,500 | 1,008,353 |
| 2025-29 | 955,000 | 815,253 | - | - | 955,000 | 815,253 |
| 2030-34 | 1,065,500 | 600,366 | - | - | 1,065,500 | 600,366 |
| 2035-39 | 785,000 | 423,814 | - | - | 785,000 | 423,814 |
| 2040-44 | 883,000 | 261,186 | - | - | 883,000 | 261,186 |
| 2045-49 | 735,000 | 122,025 | - | - | 735,000 | 122,025 |
| 2050-51 | 332,500 | 11,434 | - | - | 332,500 | 11,434 |
| Total | <u>\$ 6,795,500</u> | <u>\$ 4,449,074</u> | <u>\$ 227,500</u> | <u>\$ 26,697</u> | <u>\$ 7,023,000</u> | <u>\$ 4,475,771</u> |

NOTE 5. WATER RATES

The overall water rate is \$16.59 per thousand gallons for the first 1,000 gallons of water consumed and various amounts per thousand gallons for water in excess of 1,000 gallons. The minimum water bill, which includes 1,000 gallons of water consumption, is \$16.59 per month.

The number of customer accounts billed during December 2014 was 4,688.

North Mercer Water District
Notes to Financial Statements
December 31, 2014

NOTE 6. OTHER OPERATING REVENUES

Other miscellaneous operating revenues consisted of the following for the year ended December 31, 2014:

| | |
|-----------------|------------------|
| Penalty Charges | \$ 28,944 |
| Service Charges | 24,198 |
| Miscellaneous | 7,102 |
| Total | <u>\$ 60,244</u> |

NOTE 7. RISK RETENTION

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance for risks of loss. There were not significant reductions in insurance coverage in 2014 from coverage in the prior year. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years. There were no presented claim liabilities at December 31, 2014.

NOTE 8. RETIREMENT

The District contributes to the Kentucky Retirement System, a cost-sharing multiple-employer public retirement system administered by the State of Kentucky to provide retirement, disability, or death benefits for covered employees. Kentucky statutes establish eligibility and vesting requirements and benefit provisions. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Retirement System, 1260 Louisville Road, Frankfort Kentucky 40601.

The retirement coverage is employee contributory. Employees contribute 5-6% of gross pay and the District contributes 17.67% of gross wages.

NOTE 9. DEFERRED COMPENSATION PLAN

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. In prior years, the Internal Revenue Code specified that the plan's assets were the property of the District until paid or made available to participants, subject only on an equal basis to the claims of the Authority's creditors. A 1996 federal law now requires all assets and income of Internal Revenue Code Section 457 deferred compensation plans to be held in trust, custodial accounts, or annuity contracts for the exclusive benefit of the participants and their beneficiaries.

Assets of the District's plan are administered by Kentucky Deferred Compensation under contract with the District. The administrator amended the plan as of January 1, 1998, to comply with the new federal law. Consequently, the plan's assets and liabilities are not reflected in the District's financial statements.

NOTE 10. CONTINGENCIES

As of December 31, 2014, the District did not have any pending litigation or potential non-disclosed liabilities.

The North Mercer Water District participates in federal loan programs, which are governed by various rules of the grantor agency. Costs charged to the program are subject to audit and adjustment by the grantor agency; therefore, to the extent that the District has not complied with the rules and regulations governing these programs, refunds of any money received may be required. In the opinion of the District, there are no significant contingent liabilities relating to the compliance with the rules and regulations governing the respective programs.

North Mercer Water District
Notes to Financial Statements
December 31, 2014

NOTE 11. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2014 was as follows:

| | <u>Beginning Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending Balance</u> |
|--|------------------------------|--------------------|---------------------|---------------------------|
| Capital assets, not being depreciated: | | | | |
| Land and Land Rights | \$ 48,802 | \$ - | \$ - | \$ 48,802 |
| Total capital assets not being depreciated | <u>48,802</u> | <u>-</u> | <u>-</u> | <u>48,802</u> |
| Capital assets, being depreciated: | | | | |
| Structures and improvements | 200,041 | - | - | 200,041 |
| Other plant | 645,524 | - | - | 645,524 |
| Equipment | 258,289 | 749 | - | 259,038 |
| Water system | 16,450,240 | 207,495 | - | 16,657,735 |
| Construction in Process | - | 207,495 | (207,495) | - |
| Total capital assets being depreciated | <u>17,554,094</u> | <u>415,739</u> | <u>(207,495)</u> | <u>17,762,338</u> |
| Less accumulated depreciation for: | | | | |
| Structures and improvements | (131,721) | (4,003) | - | (135,724) |
| Other plant | (378,634) | (16,044) | - | (394,678) |
| Equipment | (205,148) | (15,226) | - | (220,374) |
| Water system | (5,579,127) | (415,456) | - | (5,994,583) |
| Total accumulated depreciation | <u>(6,294,630)</u> | <u>(450,729)</u> | <u>-</u> | <u>(6,745,359)</u> |
| Capital Assets, Net | <u>\$ 11,308,266</u> | <u>\$ (34,990)</u> | <u>\$ (207,495)</u> | <u>\$ 11,065,781</u> |

COMPLIANCE SECTION

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

Chairman and Commissioners
North Mercer Water District
Salvisa, KY 40372

I 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 the North Mercer Water District as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the North Mercer Water District's basic financial statements and have issued my report thereon dated March 12, 2015.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is 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.

My consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of my 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.

Craig A. Butler, CPA

Craig A. Butler
Certified Public Accountant

Danville, Kentucky
March 12, 2015