

**HARRISON COUNTY WATER
ASSOCIATION, INC.
Cynthiana, Kentucky**

**FINANCIAL STATEMENTS
December 31, 2013 and 2012**

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Harrison County Water Association, Inc.
Cynthiana, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Harrison County Water Association, Inc. (the Association) as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Association'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.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Harrison County Water Association, Inc., as of December 31, 2013 and 2012, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters***Required Supplementary Information***

Management has omitted the Management Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with ***Government Auditing Standards***, we have also issued our report dated March 26, 2014, on our consideration of the Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with ***Government Auditing Standards*** in considering the Association's internal control over financial reporting and compliance.

Ray, Foley, Hensley & Company

Ray, Foley, Hensley & Company, PLLC

March 26, 2014

HARRISON COUNTY WATER ASSOCIATION, INC.
BALANCE SHEETS
December 31,

	2013	2012
ASSETS		
Current Assets		
Cash	\$ 515,755	\$ 379,462
Cash - construction	202,194	201,491
Accounts receivable customers	157,388	166,513
Accrued interest receivable	2,888	4,027
Prepaid expenses	15,383	13,570
Inventory	46,660	19,831
Total current assets	<u>940,268</u>	<u>784,894</u>
Restricted Assets		
Cash	14,421	38,369
Certificates of deposit	1,515,630	1,506,570
Total restricted assets	<u>1,530,051</u>	<u>1,544,939</u>
Capital Assets		
Property and equipment	20,579,560	20,380,107
Less accumulated depreciation	(10,436,675)	(9,975,673)
Construction in progress	28,002	11,554
Total capital assets	<u>10,170,887</u>	<u>10,415,988</u>
Total assets	<u><u>\$ 12,641,206</u></u>	<u><u>\$ 12,745,821</u></u>
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	\$ 87,270	\$ 88,488
Taxes payable	9,688	14,569
Customer deposits payable	118,537	114,267
Construction payable	-	4,896
Accrued interest payable	21,490	16,631
Accrued sick pay	10,902	12,443
Retirement payable	45,000	-
Current portion of loans payable	32,992	31,863
Total current liabilities	<u>325,879</u>	<u>283,157</u>
Long-term Debt		
Loans payable	<u>1,581,103</u>	<u>1,606,124</u>
Equity		
Contributed capital		
Customer contributions	2,465,905	2,429,835
Grants in aid of construction	8,920,378	8,920,319
Retained earnings-appropriated	378,379	318,577
Retained earnings-unappropriated (deficit)	<u>(1,030,438)</u>	<u>(812,191)</u>
Total equity	<u>10,734,224</u>	<u>10,856,540</u>
Total liabilities and equity	<u><u>\$ 12,641,206</u></u>	<u><u>\$ 12,745,821</u></u>

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

HARRISON COUNTY WATER ASSOCIATION, INC.
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
for the years ended December 31,

	2013	2012
OPERATING INCOME		
Water sales	\$ 2,139,292	\$ 2,256,478
Late charges	40,715	39,419
Other service	8,465	8,700
Other revenue	<u>15,784</u>	<u>26,391</u>
Total operating income	<u>2,204,256</u>	<u>2,330,988</u>
OPERATING EXPENSES		
Purchased water	1,008,338	1,056,165
Salaries	369,184	365,074
Payroll taxes	31,568	30,493
Employee benefits	141,080	123,177
Utilities	74,110	74,047
Material & supplies	32,562	21,193
Office supplies	35,851	38,942
Transportation	44,203	47,373
Repairs	18,196	24,894
Insurance	29,763	26,793
Billing	29,929	29,837
Accounting	16,900	16,100
Legal	2,545	3,318
Other contractual services	11,324	8,969
Bad debt expense	11,144	13,580
Telephone	6,282	6,638
Miscellaneous	60	41
Regulatory assessment fee	<u>4,161</u>	<u>3,873</u>
Total operating expense	<u>1,867,200</u>	<u>1,890,507</u>
Operating income before depreciation	337,056	440,481
Depreciation expense	<u>(461,002)</u>	<u>(472,688)</u>
OPERATING (LOSS)	(123,946)	(32,207)
Non-operating income (expenses)		
Interest income	23,826	17,963
Interest expense	<u>(58,325)</u>	<u>(76,677)</u>
NET (LOSS)	(158,445)	(90,921)
Retained earnings (deficit), beginning	(812,191)	(640,897)
Transfer (to) reserves	<u>(59,802)</u>	<u>(80,373)</u>
RETAINED EARNINGS (DEFICIT), ENDING	<u>\$ (1,030,438)</u>	<u>\$ (812,191)</u>

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

HARRISON COUNTY WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
for the years ended December 31,

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 2,213,381	\$ 2,450,636
Payments to suppliers	(1,354,041)	(1,514,468)
Payments for employee services and benefits	<u>(503,254)</u>	<u>(514,861)</u>
Net cash provided by operating activities	<u>356,086</u>	<u>421,307</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Retirement of note principal	(23,892)	(498,610)
Interest paid	(55,279)	(88,757)
Construction in progress	(16,448)	(136,334)
Purchase of equipment	(199,453)	(194,239)
Customer contributions	36,070	28,200
Proceeds from grants	<u>59</u>	<u>188,455</u>
Net cash (used in) capital and related financing activities	<u>(258,943)</u>	<u>(701,285)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
(Purchase of) proceeds from certificates of deposit	(9,060)	461,790
Interest income	<u>24,965</u>	<u>25,537</u>
Net cash provided by investing activities	<u>15,905</u>	<u>487,327</u>
NET INCREASE IN CASH	113,048	207,349
Cash, beginning of year	<u>619,322</u>	<u>411,973</u>
CASH, END OF YEAR	<u><u>\$ 732,370</u></u>	<u><u>\$ 619,322</u></u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating (loss)	\$ (123,946)	\$ (32,207)
Noncash items included in operating income		
Depreciation	461,002	472,688
Changes in assets and liabilities		
(Increase) decrease in accounts receivables	9,125	(10,920)
(Increase) decrease in other receivables	-	130,568
(Increase) decrease in inventory	(26,829)	(4,576)
Increase (decrease) in accounts payable	(6,114)	(141,309)
Increase (decrease) in other payables	38,578	3,883
Increase (decrease) in customer deposits	<u>4,270</u>	<u>3,180</u>
Net cash provided by operating activities	<u><u>\$ 356,086</u></u>	<u><u>\$ 421,307</u></u>

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

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

1. ORGANIZATION AND ACCOUNTING POLICIES

The Harrison County Water Association, Inc. (the Association) distributes and sells water to approximately 5,600 members. The Association serves primarily Harrison County outside the City of Cynthiana and parts of the adjacent counties. Its suppliers of water are the City of Cynthiana, Kentucky American Water, the City of Paris, and the Nicholas County Water District.

Reporting Entity

The Harrison County Water Association, Inc. was created and organized as a non-profit association under Section 501(c)12 of the Internal Revenue Code. No income tax is applicable due to the Association's tax exempt status.

Basis of Accounting

The Association maintains its accounting records on the cash basis during the year. Adjustments are made to the accrual basis from memorandum records at year end.

The Board makes a determination whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted funds are available.

Cash and Cash Equivalents

The Association considers all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents. Cash and cash equivalents for purposes of the statement of cash flows include restricted and unrestricted accounts.

Accounts Receivable

The Association charges all uncollected accounts directly against current earnings.

Inventory

The Association's inventory is stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment

Fixed assets are recorded at cost. Depreciation has been provided using the straight-line method over the estimated useful life of the asset, which ranges from 5 to 35 years. Land is not subject to depreciation. Interest costs during construction of fixed assets are capitalized as a part of the cost.

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 period. Actual results could differ from those estimates.

Management's Review of Subsequent Events

The Association has evaluated and considered the need to recognize or disclose subsequent events through March 26, 2014, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the year ended December 31, 2013, have not been evaluated by the Association.

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

2. CASH AND INVESTMENTS

The Association's deposits and investments at December 31, 2013 and 2012 were substantially covered by Federal Depository Insurance or by collateral held by the custodial banks in the Association's name. At December 31, 2013 and 2012, the bank balances of the Association's deposits were \$2,260,065 and \$2,179,466 respectively. At December 31, 2013, cash balances were covered by the following:

FDIC Insurance	\$ 1,729,232
Collateral by securities held by the pledging financial institution	<u>530,833</u>
Total	<u>\$ 2,260,065</u>

For purposes of the statement of cash flows, the Association includes cash and cash equivalents with the following restrictions:

	2013	2012
Cash	\$ 515,755	\$ 379,462
Cash - construction	202,194	201,491
Cash - restricted	<u>14,421</u>	<u>38,369</u>
Total	<u>\$ 732,370</u>	<u>\$ 619,322</u>

3. CAPITAL ASSETS

	Balance 12/31/2012	Additions	Disposals	Balance 12/31/2013
Capital assets not depreciated:				
Land	\$ 28,035	\$ 612	\$ -	\$ 28,647
Construction in progress	<u>11,554</u>	<u>16,448</u>	<u>-</u>	<u>28,002</u>
Totals	<u>39,589</u>	<u>17,060</u>	<u>-</u>	<u>56,649</u>
Capital assets being depreciated:				
Property and equipment	20,352,072	198,841	-	20,550,913
Less: accumulated depreciation	<u>9,975,673</u>	<u>461,002</u>	<u>-</u>	<u>10,436,675</u>
Net depreciable assets	<u>10,376,399</u>	<u>(262,161)</u>	<u>-</u>	<u>10,114,238</u>
Total capital assets, net	<u>\$ 10,415,988</u>	<u>\$ (245,101)</u>	<u>\$ -</u>	<u>\$ 10,170,887</u>

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

4. CONSTRUCTION IN PROGRESS

Construction in progress totaled \$28,002 at December 31, 2013. \$2,632 of the total relates to the construction in progress for the Lafferty Pike waterline relocation project and the remaining \$25,370 relates to the construction in progress for the Russell Cave Road waterline connection project.

5. LONG-TERM DEBT

The following is a summary of the loans outstanding for the association for the years ended December 31,

Notes - U.S. Department of Agriculture	2013	2012
Loan - \$656,000		
Date 9/21/95 in annual installments		
of \$37,609 through 2041		
Interest at 4.75%	\$ 472,132	\$ 491,264
Loan - \$300,000		
Date 11/25/03 in annual installments		
of \$16,912 through 2043		
Interest at 4.625%	257,981	262,741
Loan - \$885,000		
Date 12/02/2010 in annual installments		
of \$39,348 starting in 2014 through 2051		
Interest at 3%	<u>883,982</u>	<u>883,982</u>
	1,614,095	1,637,987
Less: current portion	<u>(32,992)</u>	<u>(31,863)</u>
Long-term portion of loans payable	<u>\$ 1,581,103</u>	<u>\$1,606,124</u>

The following is a summary of changes in long-term debt:

	December 31, 2012	Additions	Retirements	December 31, 2013	Due Within One Year
Loans payable	<u>\$ 1,637,987</u>	<u>\$ -</u>	<u>\$ (23,892)</u>	<u>\$ 1,614,095</u>	<u>\$ 32,992</u>

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

5. LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize all loans outstanding as of December 31, 2013 are as follows:

Year Ending December 31,	Principle	Interest	Total
2014	\$ 32,992	\$ 60,877	\$ 93,869
2015	34,328	59,541	93,869
2016	35,721	58,148	93,869
2017	37,173	56,696	93,869
2018	38,686	55,183	93,869
2019-2023	218,476	250,869	469,345
2024-2028	267,232	202,113	469,345
2029-2033	310,536	141,971	452,507
2034-2038	190,480	90,820	281,300
2039-2043	174,814	56,432	231,246
2044-2048	165,317	31,423	196,740
2049-2051	<u>108,340</u>	<u>6,469</u>	<u>114,809</u>
	<u>\$ 1,614,095</u>	<u>\$ 1,070,542</u>	<u>\$ 2,684,637</u>

6. COMPLIANCE WITH LOAN AGREEMENT

The loan agreement between Rural Development (U.S. Department of Agriculture) concerning the various loans requires certain reserves be created and maintained as follows:

Principal and interest reserve – This account is required to accumulate a balance sufficient to retire the next installment payment on the loans. The required balance at December 31, 2013 totaled \$34,305. The balance of appropriated investments as of December 31, 2013 and 2012 totaled \$117,687 and \$140,329, respectively.

Depreciation reserve – This account is required to maintain a reserve for unusual repairs. The required balance at December 31, 2013 totaled \$61,540. The balance of appropriated investments as of December 31, 2013 and 2012 totaled \$95,000 for each year.

7. PENSION PLAN

The Association has contributed to the employees' IRA account, a defined contribution plan, annually for all full-time employees. The plan is funded by contributions from employees of up to \$2,500 per employee and the Association matches these contributions. For the years ended December 31, 2013 and 2012, employee contributions totaled \$22,500 and \$22,500, respectively and employer contributions totaled \$22,500 and \$22,500, respectively.

8. RISK MANAGEMENT

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

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

9. DEFICIT RETAINED EARNINGS

The Association carried a deficit in retained earnings at December 31, 2013 and 2012 of \$1,030,438 and \$812,191, respectively. The deficit is primarily a result of user charges insufficient to provide for depreciation on contributed assets. Accumulated depreciation on contributed assets totaled \$5,917,888 and \$5,676,002 at December 31, 2013 and 2012, respectively.

10. RECLASSIFICATIONS

Certain items in the statements of cash flows have been reclassified in the prior year to match the current year presentation. The reclassification does not have any effect on previously reported change in cash.



Certified Public Accountants and Consultants

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

To the Board of Directors
Harrison County Water Association, Inc.
Cynthiana, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in **Government Auditing Standards** issued by the Comptroller General of the United States, the financial statements of the Harrison County Water Association, Inc. (the Association), as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Association's basic financial statements, and have issued our report thereon dated March 26, 2014.

Internal Control Over Financial Reporting

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

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

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 to those charged with governance.

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS
(CONTINUED)**

Compliance and Other Matters

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

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.

Ray, Foley, Hensley & Company

Ray, Foley, Hensley & Company, PLLC
March 26, 2014