

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

**FINANCIAL STATEMENTS
December 31, 2015 and 2014**

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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**

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 Harrison County Water Association, Inc. (the Association), as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the Association's basic financial statements, and have issued our report thereon dated May 12, 2016.

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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Harrison County Water Association, Inc., as of December 31, 2015 and 2014, 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 Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 12, 2016, 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.

RFH

RFH, PLLC
May 12, 2016

HARRISON COUNTY WATER ASSOCIATION, INC.
STATEMENTS OF FINANCIAL POSITION
December 31,

| | 2015 | 2014 |
|---|----------------------|----------------------|
| ASSETS | | |
| Current assets | | |
| Cash | \$ 214,232 | \$ 328,113 |
| Cash - construction | 12,829 | 202,727 |
| Accounts receivable customers | 170,128 | 175,592 |
| Accrued interest receivable | 3,699 | 15,221 |
| Prepaid expenses | 15,383 | 16,222 |
| Inventory | <u>37,394</u> | <u>18,598</u> |
| Total current assets | <u>453,665</u> | <u>756,473</u> |
| Other assets | | |
| Cash-debt service reserves | 2,700 | 1,874 |
| Certificates of deposit-debt service reserves | <u>1,519,083</u> | <u>1,515,804</u> |
| Total other assets | <u>1,521,783</u> | <u>1,517,678</u> |
| Capital assets | | |
| Property and equipment | 21,298,790 | 20,871,941 |
| Less accumulated depreciation | (11,366,967) | (10,902,998) |
| Construction in progress | <u>264,366</u> | <u>82,172</u> |
| Total capital assets | <u>10,196,189</u> | <u>10,051,115</u> |
| Total assets | <u>\$ 12,171,637</u> | <u>\$ 12,325,266</u> |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities | | |
| Accounts payable | \$ 123,331 | \$ 106,823 |
| Taxes payable | 8,653 | 8,326 |
| Customer deposits payable | 126,558 | 121,479 |
| Accrued interest payable | 19,198 | 19,812 |
| Accrued sick pay | 11,075 | 6,803 |
| Current portion of loans payable | <u>36,098</u> | <u>34,694</u> |
| Total current liabilities | <u>324,913</u> | <u>297,937</u> |
| Long-term debt | | |
| Loans payable | <u>1,498,114</u> | <u>1,534,212</u> |
| Net assets | | |
| Unrestricted | | |
| Customer contributions | 2,564,785 | 2,518,745 |
| Grants in aid of construction | 9,042,455 | 8,920,378 |
| Debt service reserves | 1,521,783 | 1,517,678 |
| Appropriated | 491,033 | 420,480 |
| Unappropriated (deficit) | <u>(3,271,446)</u> | <u>(2,884,164)</u> |
| Total net assets | <u>10,348,610</u> | <u>10,493,117</u> |
| Total liabilities and net assets | <u>\$ 12,171,637</u> | <u>\$ 12,325,266</u> |

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

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

| | 2015 | 2014 |
|--------------------------------------|-----------------------|-----------------------|
| OPERATING INCOME | | |
| Water sales | \$ 2,319,556 | \$ 2,231,628 |
| Late charges | 43,825 | 44,834 |
| Other service | 12,862 | 6,900 |
| Other revenue | <u>8,514</u> | <u>23,580</u> |
| Total operating income | <u>2,384,757</u> | <u>2,306,942</u> |
| OPERATING EXPENSES | | |
| Purchased water | 1,171,361 | 1,109,568 |
| Salaries | 393,220 | 373,568 |
| Payroll taxes | 32,008 | 32,671 |
| Employee benefits | 198,070 | 159,889 |
| Utilities | 81,007 | 84,010 |
| Material & supplies | 55,276 | 38,534 |
| Office supplies | 41,194 | 41,318 |
| Transportation | 35,865 | 48,519 |
| Repairs | 45,613 | 31,643 |
| Insurance | 30,514 | 31,606 |
| Billing | 30,073 | 29,863 |
| Accounting | 17,500 | 17,400 |
| Legal | 2,798 | 2,804 |
| Other contractual services | 25,904 | 60,945 |
| Bad debt expense | 7,382 | 18,559 |
| Telephone | 8,518 | 7,329 |
| Miscellaneous | 38 | 53 |
| Regulatory assessment fee | <u>4,386</u> | <u>4,303</u> |
| Total operating expense | <u>2,180,727</u> | <u>2,092,582</u> |
| Operating income before depreciation | 204,030 | 214,360 |
| Depreciation expense | <u>(463,969)</u> | <u>(466,323)</u> |
| OPERATING (LOSS) | (259,939) | (251,963) |
| Non-operating income (expenses) | | |
| Interest income | 7,213 | 18,268 |
| Interest expense | <u>(59,895)</u> | <u>(60,252)</u> |
| NET (LOSS) | (312,621) | (293,947) |
| Net assets (deficit), beginning | (2,884,164) | (2,560,489) |
| Transfer (to) reserves | <u>(74,661)</u> | <u>(29,728)</u> |
| NET ASSETS (DEFICIT), ENDING | <u>\$ (3,271,446)</u> | <u>\$ (2,884,164)</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,

| | 2015 | 2014 |
|--|-------------------|-------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from customers | \$ 2,401,743 | \$ 2,276,405 |
| Payments to suppliers | (1,553,799) | (1,476,736) |
| Payments for employee services and benefits | <u>(618,699)</u> | <u>(616,589)</u> |
| Net cash provided by operating activities | <u>229,245</u> | <u>183,080</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Retirement of note principal | (34,694) | (45,189) |
| Interest paid | (60,509) | (61,930) |
| Construction in progress | (182,193) | (54,170) |
| Purchase of equipment | (426,850) | (292,381) |
| Customer contributions | 46,040 | 52,840 |
| Proceeds from grants | <u>122,077</u> | <u>-</u> |
| Net cash (used in) capital and related financing activities | <u>(536,129)</u> | <u>(400,830)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of certificates of deposit | (3,282) | (174) |
| Interest income | <u>7,213</u> | <u>18,268</u> |
| Net cash provided by investing activities | <u>3,931</u> | <u>18,094</u> |
| NET DECREASE IN CASH | (302,953) | (199,656) |
| Cash, beginning of year | <u>532,714</u> | <u>732,370</u> |
| CASH, END OF YEAR | <u>\$ 229,761</u> | <u>\$ 532,714</u> |
| Reconciliation of operating income (loss) to net cash provided by (used in) operating activities: | | |
| Operating (loss) | \$ (259,939) | \$ (251,963) |
| Non-cash items included in operating income | | |
| Depreciation | 463,969 | 466,323 |
| Changes in assets and liabilities | | |
| (Increase) decrease in accounts receivables | 5,464 | (18,204) |
| (Increase) decrease in interest receivable | 11,522 | (12,333) |
| (Increase) decrease in inventory | (18,796) | 28,062 |
| (Increase) decrease in prepaid expenses | 839 | (839) |
| Increase (decrease) in accounts payable | 16,508 | 19,553 |
| Increase (decrease) in other payables | 4,599 | (50,461) |
| Increase (decrease) in customer deposits | <u>5,079</u> | <u>2,942</u> |
| Net cash provided by operating activities | <u>\$ 229,245</u> | <u>\$ 183,080</u> |

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

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2015 and 2014

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.

The Association files an income tax return in the U.S. federal jurisdiction and the state of Kentucky. The Association is generally no longer subject to income tax examinations by tax authorities for years before 2011. Association believes there are no tax positions that meet the more likely than not threshold for disclosure in these financial statements.

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.

Interest income and interest expense are considered non-operating. Generally, all other income and expense is considered operating.

Basis of Presentation

The Association is required to report information regarding its financial position and activities according to the three classes of net assets; unrestricted, temporarily restricted, and permanently restricted.

Unrestricted - These assets generally result from revenues from providing services, receiving unrestricted contributions and receiving dividends and interest from income-producing assets, less expense incurred in providing services, raising contributions and performing administrative functions. The only limits on unrestricted net assets are the board limits resulting from the nature of the Organization, the environment in which it operates and the purposes specified in its articles of incorporation.

Temporarily restricted - These assets result from receiving contributions that may be expended only for specific purposes or in specific future periods. There were no temporarily restricted net assets for the years ended December 31, 2015 or 2014.

Permanently restricted - These assets represent funds that are permanently restricted by the donor with income and appreciation available to support the general operations of the Association. There were no permanently restricted net assets for the years ended December 31, 2015 or 2014.

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.

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2015 and 2014

1. ORGANIZATION AND ACCOUNTING POLICIES (CONTINUED)

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 an 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 May 12, 2016, 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, 2015, have not been evaluated by the Association.

2. CASH AND INVESTMENTS

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Association will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. In order to anticipate market changes and provide a level of security for all funds, the collateralization level shall be one hundred percent of the market value of the principal, plus accrued interest.

The Association's deposits and investments at December 31, 2015 and 2014, were substantially covered by Federal Depository Insurance or by collateral held by the custodial banks in the Association's name. At December 31, 2015 and 2014, the bank balances of the Association's deposits totaled \$1,816,302 and \$2,100,472 respectively. At December 31, 2015, cash balances were covered by the following:

| | |
|--|----------------------------|
| FDIC Insurance | \$ 1,717,600 |
| Collateralized by securities held by the pledging financial institution | 97,088 |
| Uninsured and uncollateralized | <u>1,614</u> |
| Total | <u>\$ 1,816,302</u> |

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

| | 2015 | 2014 |
|---------------------|--------------------------|--------------------------|
| Cash | \$ 214,232 | \$ 328,113 |
| Cash - construction | 12,829 | 202,727 |
| Cash - restricted | <u>2,700</u> | <u>1,874</u> |
| Total | <u>\$ 229,761</u> | <u>\$ 532,714</u> |

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2015 and 2014

3. CAPITAL ASSETS

| | Balance 12/31/2014 | Additions | Disposals | Balance 12/31/2015 |
|-----------------------------------|-------------------------------|-------------------|------------------|-------------------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 32,635 | \$ 74 | \$ - | \$ 32,709 |
| Construction in progress | <u>82,172</u> | <u>182,194</u> | <u>-</u> | <u>264,366</u> |
| Total assets not depreciated | <u>114,807</u> | <u>182,268</u> | <u>-</u> | <u>297,075</u> |
| Capital assets being depreciated: | | | | |
| Property and equipment | 20,839,306 | 426,775 | - | 21,266,081 |
| Less: accumulated depreciation | <u>(10,902,998)</u> | <u>(463,969)</u> | <u>-</u> | <u>(11,366,967)</u> |
| Net depreciable assets | <u>9,936,308</u> | <u>(37,194)</u> | <u>-</u> | <u>9,899,114</u> |
| Total capital assets, net | <u>\$ 10,051,115</u> | <u>\$ 145,074</u> | <u>\$ -</u> | <u>\$ 10,196,189</u> |

4. CONSTRUCTION IN PROGRESS

Construction in progress totaled \$264,366 at December 31, 2015. \$247,944 of the total relates to the construction in progress for the Russell Cave Road waterline connection project and the remaining \$16,422 relates to the construction in progress for the Kelat tank construction project.

5. LONG-TERM DEBT

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

| Loans - U.S. Department of Agriculture | 2015 | 2014 |
|---|---------------------|--------------------|
| Loan - \$656,000 | | |
| Date 9/21/95 in annual installments of \$37,609 through 2041 Interest at 4.75% | \$ 441,045 | \$ 456,949 |
| Loan - \$300,000 | | |
| Date 11/25/03 in annual installments of \$16,912 through 2043 Interest at 4.625% | 247,790 | 253,001 |
| Loan - \$885,000 | | |
| Date 12/02/2010 in annual installments of \$39,348 starting in 2014 through 2051 Interest at 3% | <u>845,377</u> | <u>858,956</u> |
| | 1,534,212 | 1,568,906 |
| Less: current portion | <u>(36,098)</u> | <u>(34,694)</u> |
| Long-term portion of loans payable | <u>\$ 1,498,114</u> | <u>\$1,534,212</u> |

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2015 and 2014

5. LONG-TERM DEBT (CONTINUED)

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

| | December 31, 2014 | Additions | Retirements | December 31, 2015 | Due Within One Year |
|---------------|----------------------|-------------|--------------------|----------------------|---------------------------|
| Loans payable | <u>\$ 1,568,906</u> | <u>\$ -</u> | <u>\$ (34,694)</u> | <u>\$ 1,534,212</u> | <u>\$ 36,098</u> |

The annual requirements to amortize all loans outstanding as of December 31, 2015 are as follows:

| Year Ending December 31, | Principle | Interest | Total |
|-----------------------------|---------------------|-------------------|---------------------|
| 2016 | \$ 36,098 | \$ 57,771 | \$ 93,869 |
| 2017 | 37,561 | 56,308 | 93,869 |
| 2018 | 39,086 | 54,783 | 93,869 |
| 2019 | 40,675 | 53,194 | 93,869 |
| 2020 | 42,332 | 51,537 | 93,869 |
| 2021-2025 | 239,084 | 230,261 | 469,345 |
| 2026-2030 | 292,471 | 176,874 | 469,345 |
| 2031-2035 | 262,853 | 114,437 | 377,290 |
| 2036-2040 | 207,970 | 73,330 | 281,300 |
| 2041-2045 | 156,131 | 41,292 | 197,423 |
| 2046-2050 | <u>179,951</u> | <u>16,498</u> | <u>196,449</u> |
| | <u>\$ 1,534,212</u> | <u>\$ 926,285</u> | <u>\$ 2,460,497</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, 2015 totaled \$34,694. The balance of investments as of December 31, 2015 and 2014, totaled \$106,217 and \$104,487, respectively.

Depreciation reserve – This account is required to maintain a reserve for unusual repairs. The required balance at December 31, 2015 totaled \$67,220. The balance of investments as of December 31, 2015 and 2014, totaled \$95,000 for each year.

7. DEFINED CONTRIBUTION 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 \$3,250 per employee and the Association matches these contributions. For the years ended December 31, 2015 and 2014, employee contributions totaled \$27,500, for both years and employer contributions totaled \$27,500, for both years.

HARRISON COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2015 and 2014

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.

9. DEFICIT RETAINED EARNINGS

The Association carried a deficit in unappropriated net assets at December 31, 2015 and 2014 of \$3,271,446 and \$2,884,164, respectively. The deficit is primarily a result of user charges insufficient to provide for depreciation on contributed assets. Accumulated depreciation on contributed assets totaled \$6,406,010 and \$6,162,566 at December 31, 2015 and 2014, respectively.



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 Harrison County Water Association, Inc. (the Association) as of and for the years ended December 31, 2015 and 2014, 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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.

The logo consists of the letters 'RFH' in a bold, stylized, handwritten-style font.

RFH, PLLC
May 12, 2016