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David L. Armstrong
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James W. Gardner
Vice Chairman

Linda Brethitt
Commissioner

January 24, 2013

Mr. James Green, Chairman
Cawood Water District
P.O. Box 429
Cawood, Kentucky 40815

RECEIVED

AUG 12 2013

PUBLIC SERVICE
COMMISSION

RE: PSC Case No. 2009-00499

Dear Mr. Green:

The ordering paragraphs of the final order in PSC Case No. 2009-00499 dated January 13, 2010 state the following:

Three years from the date of this Order, CWD shall file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rates approved herein are sufficient to meet its operating expenses and annual debt service requirements.

This letter is a reminder that this information is now past due. Please submit the information and reference the above case number so that it can be added to the case file. Your attention to this matter is greatly appreciated.

Sincerely,

A handwritten signature in cursive script that reads "Linda Faulkner".

Linda Faulkner
Filings Director

RECEIVED

AUG 12 2013

PUBLIC SERVICE
COMMISSION

CAWOOD WATER DISTRICT
Cawood, Kentucky

AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Years Ended December 31, 2012 and 2011

CAWOOD WATER DISTRICT
Cawood, Kentucky
AUDITED FINANCIAL STATEMENTS
Years Ended December 31, 2012 and 2011

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FORTNER SMALLEY, PLLC

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Cawood Water District
Cawood, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Cawood Water District (the "District") as of and for the years ended December 31, 2012 and 2011, 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.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cawood Water District as of December 31, 2012 and 2011, and the 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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 30, 2013, on our consideration of Cawood Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Fortner Smalley, PLLC
Certified Public Accountants
Kingsport, Tennessee

May 30, 2013

CAWOOD WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2012

This section presents management's analysis of the Water District's financial condition and activities for the fiscal year. This information should be read in conjunction with the financial statements.

Financial Highlights

Management believes that the District's financial has improved due to the acquisition of funding for capital asset for the purpose of improvement and the expansion of water distribution lines. Total operating revenue increased 3.6% primarily due to the addition of residential services. The expansion of water distribution lines into areas where residents primarily rely upon pumps and/or wells for water provides for growth opportunities that extend beyond the current year. As residents experience problems with their pumps and/or wells, many will have the option of connecting to the District's water system, an option that was not previously available.

Operating expenses, not including depreciation or interest expense, increased by 5.0% from the previous year. Management believes this increase to largely due to increased water loss. The Kentucky Public Service Commission has set a benchmark for anticipated water loss to be 15%, though management believes the terrain in Harlan County makes that goal unobtainable. Nevertheless, water loss is an important non-financial metric for any water district. The District's current priority is to reduce water loss, which was 41.5% and 34.6% in 2012 and 2011, respectively.

Accordingly, the District's priorities in the use of grant funds have been focused upon expansion of its water distribution lines and the reduction of water loss. The following projects of the District have had the greatest impact upon 2012 operations and are expected to impact future operations as well:

- Smith Hwy. 987 Expansion – This expansion was completed in the Fall of 2011 and potentially provided access to an additional 238 new customers. As of the end of 2012, only 128 meters were set while more are expected as households experience trouble with their pump/well systems.
- Grays Knob Expansion – This expansion was completed in the Summer of 2012, potentially providing access to 8 additional households, with 5 meters set as of the end of 2012.
- Bob's Creek Expansion – This expansion was completed near the end of 2011, potentially providing access to 14 new customers of which 6 meters were set for a planned future development.
- During 2012, engineering plans were developed to install approximately 10,420 feet of ductile pipe along the Hwy. 421 Bypass, where the District has experienced significant water losses. This is expected to be bid upon in early 2013 and will be funded by remaining funds from existing grants.
- A new telemetry system was bid upon near the end of 2012 and expected to be completed in 2013. This system is expected to reduce costs drastically. Currently, District employees are required to physically observe each tank throughout the distribution system to obtain information concerning water volume. The system will notify the District of sudden or increased water loss due to leaks and prevent tank overflows.

CAWOOD WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2012

- Harlan County at their own expense installed water lines to a new commercial operation, the state military operation of the Appalachian Challenge Academy. This site has the potential for serving 150 students plus numerous workers.
- A state grant has been obtained to employ the Kenvirons Engineering firm to complete a thorough water loss analysis and survey. The work is expected to begin in 2013.
- In 2012, the District updated its billing software, which has been implemented as of January 1, 2013. With the added capabilities of the new system, the financial officer is currently in negotiations with the City of Harlan Sewage System to provide their billing services, creating additional revenue streams with minimal additional cost since the updated billing system was designed to be used in this capacity.

Overview of Annual Financial Report

Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements and supplementary information. The MD&A represents management's examination and analysis of the District's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the District's planning, budget, and other management tools were used for this analysis.

The financial statements report information about the Water District using full accrual accounting methods as utilized by similar business activities in the private sector.

Financial statements include a statement of net position; a statement of revenues, expenses, and changes in net position; a statement of cash flows; and notes to the financial statements. The statement of net position presents the financial position of the District on a full accrual historical basis as of the last day of the fiscal year. It provides balances for all assets, liabilities, and net assets of the District as of December 31, 2012.

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the statement of revenues, expenses, and changes in net position presents the results of the business activities over the course of the specified period and information as to how the net position changed during that specified period. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the District's recovery of its costs.

The statement of cash flows presents changes in cash and cash equivalents, resulting from operations, financing, and investing activities. This statement presents cash receipts and cash disbursements information without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The notes to the financial statements provide required disclosures and other information that is essential to fully understanding the material data provided in the statements. The notes present information about the District's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies, and subsequent events, if any.

CAWOOD WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2012

The financial statements were prepared by the District from the detailed books and records of the District. The financial statements were audited and adjusted, if material, during the independent external audit process.

Summary of Organization and Business

Cawood Water District was created on January 27, 1965 by the Harlan County Court under the provisions of Chapter 74 of the Kentucky Revised Statutes (KRS) and is subject to the regulatory authority of the Kentucky Public Service Commission (PSC) pursuant to KRS 278.040.

The District's funding is provided by water sales to residential and commercial customers in Harlan Co., Kentucky, grants from the Commonwealth of Kentucky, and loans for U.S. Department of Rural Development.

Financial Condition

The District's financial condition is strong at period end with current ratio of 2.7. The current financial condition, staff capabilities, and operating expansion plans to meet anticipated customer needs are well balanced and under control. The following information summarizes the District's statement of net position as of December 31, 2012:

Total assets increased by \$150,310. Total liabilities decreased by \$53,418, primarily due to the payment of long term debt. Net assets increased by \$203,728, attributable entirely to the capital contributions.

Results of Operations

Operating Revenues: Current revenues from operations fall into three general categories of residential and commercial water sales, with other income generated primarily to billing services provided to the City of Harlan. Total operating revenues increased by \$27,692 (3.6%) from last year, which can be attributed mainly to a increase in residential water sales.

Expenses: Operating expenses (before depreciation of \$223,602) of the District increased by \$30,758 (5.0%) from last year, which is due in large part to an increase in water losses. However, management has continued to closely monitor and review all operating expenses and activities, striving to minimize operating costs while continuing to provide quality service to customers.

Final Comments

The District continues to strive to provide adequate and efficient water service to its customers, increase revenue streams, and decrease water loss percentages.

Lana Pace, Financial Officer



CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF NET POSITION
December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|--------------|--------------|
| <u>LIABILITIES AND NET POSITION</u> | | |
| CURRENT LIABILITIES: | | |
| Accounts Payable | 48,100 | 47,570 |
| Customer Deposits and Tap Fees | 18,700 | 34,744 |
| Accrued Interest Payable | 34,374 | 35,157 |
| Accrued Wages | 4,274 | 4,846 |
| Current Portion of Long-Term Debt | 38,300 | 36,700 |
| Other Current Liabilities | 3,438 | 3,287 |
| Total Current Liabilities | 147,186 | 162,304 |
| LONG-TERM DEBT: | | |
| Long-Term Debt, Net of Current Portion | 1,596,000 | 1,634,300 |
| Total Long-Term Debt | 1,596,000 | 1,634,300 |
| NET POSITION: | | |
| Invested in Capital Assets, Net of Related Debt | 7,171,490 | 7,210,940 |
| Restricted for: | | |
| Depreciation Reserve | 109,421 | 104,014 |
| Debt Service | 82,697 | 73,924 |
| Unrestricted | 290,031 | 61,033 |
| Total Net Position | 7,653,639 | 7,449,911 |
| TOTAL LIABILITIES AND NET POSITION | \$ 9,396,825 | \$ 9,246,515 |

See accompanying notes and independent accountants' audit report.

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET POSITION
For the Year Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|
| OPERATING REVENUE: | | |
| Water Sales - Residential | \$ 703,002 | \$ 670,357 |
| Water Sales - Commercial | 29,211 | 37,075 |
| Other Operating Revenue | 59,205 | 56,294 |
| Total Operating Revenue | 791,418 | 763,726 |
| | | |
| OPERATING EXPENSES: | | |
| Salaries and Wages | 242,436 | 246,015 |
| Payroll Taxes | 20,474 | 20,521 |
| Employee Benefits | 87,631 | 89,517 |
| Chemicals | 51,512 | 47,111 |
| Materials and Supplies | 36,847 | 17,293 |
| Contractual Services | 12,155 | 13,160 |
| Insurance | 21,065 | 20,478 |
| Office Expense | 22,970 | 19,637 |
| Utilities | 51,240 | 64,281 |
| Repairs and Maintenance | 41,984 | 35,618 |
| Purchased Water for Distribution | 24,000 | 14,566 |
| Bad Debt Expense | 8,860 | - |
| Depreciation Expense | 223,602 | 180,118 |
| Other Operating Expenses | 18,746 | 20,965 |
| Total Operating Expenses | 863,522 | 789,280 |
| | | |
| NET OPERATING (LOSS) | (72,104) | (25,554) |
| | | |
| NONOPERATING REVENUE (EXPENSE): | | |
| Interest Income | 228 | 1,698 |
| Interest Expense | (67,800) | (69,846) |
| Total Nonoperating Revenue (Expenses) | (67,572) | (68,148) |
| | | |
| INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS | (139,676) | (93,702) |

See accompanying notes and independent accountants' audit report.

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET POSITION
For the Year Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--------------------------------|--------------|--------------|
| CAPITAL CONTRIBUTIONS: | | |
| Grants | 309,110 | 1,770,224 |
| Tap Fees | 34,294 | 12,730 |
| Total Capital Contributions | 343,404 | 1,782,954 |
| CHANGE IN NET ASSETS | 203,728 | 1,689,252 |
| NET ASSETS - BEGINNING OF YEAR | 7,449,911 | 5,760,659 |
| NET ASSETS - END OF YEAR | \$ 7,653,639 | \$ 7,449,911 |

See accompanying notes and independent accountants' audit report.

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|--------------------------|--------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Receipts from Customers | \$ 789,980 | \$ 737,850 |
| Payments to Suppliers | (405,656) | (343,855) |
| Payments to Employees | (241,864) | (245,864) |
| Net Cash Provided by Operating Activities | <u>142,460</u> | <u>148,131</u> |
| CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES: | | |
| Deposits into Restricted Accounts | (14,180) | (566) |
| Principal Payments on Long-Term Debt | (36,700) | (29,600) |
| Interest Paid on Long-Term Debt | (68,583) | (68,265) |
| Net Cash (Used) by Capital Financing Activities | <u>(119,463)</u> | <u>(98,431)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from Grants and Tap Fees | 343,404 | 1,782,953 |
| Purchases of Capital Assets | (304,436) | (1,776,485) |
| Interest Received | 228 | 1,698 |
| Net Cash Provided by Investing Activities | <u>39,196</u> | <u>8,166</u> |
| NET INCREASE IN CASH | <u>62,193</u> | <u>57,866</u> |
| CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR | <u>235,060</u> | <u>177,194</u> |
| CASH AND CASH EQUIVALENTS - END OF YEAR | <u><u>\$ 297,253</u></u> | <u><u>\$ 235,060</u></u> |

See accompanying notes and independent accountants' audit report.

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|-------------|-------------|
| RECONCILIATION OF OPERATING LOSS TO CASH FLOWS | | |
| PROVIDED BY OPERATING ACTIVITIES: | | |
| Net (Loss) from Operations | \$ (72,104) | \$ (25,554) |
| Adjustments to reconcile net (loss) from operations to net cash provided by operating activities: | | |
| Depreciation Expense | 223,602 | 180,118 |
| Bad Debt Expense | 8,860 | - |
| Changes in Assets and Liabilities: | | |
| Customer Accounts Receivable | (1,438) | 1,454 |
| Prepaid Expenses | (524) | 2,925 |
| Accounts Payable | 530 | (8,648) |
| Customer Deposits and Tap Fees | (16,044) | 150 |
| Accrued Wages | (572) | 151 |
| Other Current Liabilities | 150 | (2,465) |
| Net Cash Provided by Operating Activities | \$ 142,460 | \$ 148,131 |

See accompanying notes and independent accountants' audit report.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

NATURE OF ORGANIZATION AND OPERATIONS – Cawood Water District is a water utility which provides service to residential and commercial customers in Harlan County, Kentucky. The district was created on January 27, 1965, by the Harlan County Court under the provisions of Chapter 74 of the Kentucky Revised Statutes (KRS). The District is subject to the regulatory authority of the Kentucky Public Service Commission (PSC) pursuant to KRS 278.040.

BASIS OF ACCOUNTING – The District’s financial statements are prepared in conformity with accounting principles generally accepted in the United States as set forth by the Governmental Accounting Standards Board (GASB) for proprietary funds. Private sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the proprietary fund financial statements to the extent they do not conflict with or contradict guidance of the GASB. Governments also have the option of following subsequent private sector guidance for their business type activities and enterprise funds. The District has elected not to follow subsequent private sector guidance.

CASH AND CASH EQUIVALENTS – For purposes of presenting the statement of cash flows, the District considers all unrestricted cash, certificates of deposits, and short-term investments to be cash and cash equivalents.

ACCOUNTS RECEIVABLE – Customer accounts receivable consists of fees for services for water charges due from individuals, businesses, and other governments. Customer accounts receivable are presented on the statement of net assets net of an allowance for expected uncollectible accounts, which is based on historical performance and projected future collections. The allowance for uncollectible accounts as of December 31, 2012 and 2011 was \$32,899 and \$24,039, respectively.

Garbage fees receivable consists of amounts due from customers for garbage fees billed by the District on behalf of Harlan County. These fees are collected by the District and remitted to Harlan County, less a collection fee of 6.5% of billed garbage fees, which is earned when collected. Since the District simply acts as a billing and collection agent for Harlan County, the net receivables are reduced by the corresponding payable as of December 31, 2012 as follows:

| | |
|---|------------------|
| Total Accounts Receivable | \$ 254,889 |
| Less: Garbage Fees Payable | (138,319) |
| Less: Allowance of Uncollectible Accounts | <u>(32,899)</u> |
| Customer Accounts Receivable, Net | <u>\$ 83,671</u> |

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

PREPAID EXPENSES – Prepaid expenses consists of amounts paid in advance for insurance premiums, water treatment chemicals, and PSC assessments and dues.

CAPITAL ASSETS – Capital assets are stated at original cost. The cost of repairs and maintenance that does not result in an extension of the life of an asset is charged to the proper expense account as incurred. Property replacements with a cost of \$1,500 or greater are capitalized. When assets are retired or otherwise disposed of, the related asset and accumulated depreciation is written off and any related gains or losses are recorded.

DEPRECIATION – Depreciation is applied on the straight-line method over the estimated useful life of the asset and is recognized in accordance with ASC 958-360-35 (formerly known as Statement of Financial Accounting Standards No. 93, “*Recognition of Depreciation by Not-for-Profit Organization.*”). Class lives range from five to sixty years.

BAD DEBTS - The District uses the allowance method for recording bad debts. The District’s bad debt expense amounted to \$8,860 and \$0 for the years ended December 31, 2012 and 2011, respectively.

CUSTOMER DEPOSITS – The District collects deposits, which are required to secure active water accounts, from customers for current and proposed water service areas. Interest payable as of December 31, 2012 and 2011 on the deposit balances of \$18,700 and \$18,350 was approximately \$494 and \$481, respectively. The interest rate as of December 31, 2012 was three percent.

INCOME RECOGNITION – Income from sales of water to residential and commercial customers is recognized in the month the services are provided and is based on actual and/or estimated water meter readings. All customers are billed on a monthly basis.

OPERATING REVENUE AND EXPENSES – The District distinguishes *operating* revenue and expenses from *non-operating* items. Operating revenue consists of charges for water services and other related fees and charges. Operating expenses consist of costs related to providing water services to customers as well as administrative expenses and depreciation of capital assets. All revenue and expenses not meeting these definitions are reported as non-operating revenue and expenses or capital contributions.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

INCOME TAX STATUS – The District was formed as a nonprofit organization and, as such, is exempt from federal and state income taxes. Accordingly, the financial statements include no provision for income taxes.

ESTIMATES – The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

FINANCIAL INSTRUMENTS – CONCENTRATION OF CREDIT RISK – Financial instruments which potentially subject the District to significant concentrations of credit risk consist primarily of cash and accounts receivable.

As of December 31, 2012 and 2011, Cawood Water District had total cash on deposit with a financial institution that exceeded the FDIC insured limits by \$142,986 and \$63,290, respectively. However, the Bank of Harlan has pledged securities in the form of Federal Home Loan Bank Bonds to Cawood Water District in the amount of \$500,000 to cover this risk.

ACCOUNTING FOR IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS – The District evaluates events or changes in circumstances for indications that the carrying amount of an asset may not be recoverable and makes adjustments accordingly. There were no such adjustments for the years ended December 31, 2012 and 2011.

NOTE B – CAPITAL ASSETS:

Capital asset activity for the year ended December 31, 2012 was as follows:

| | Balance | | | Balance |
|----------------------------------|------------------------|------------------|------------------|--------------------------|
| | January 1, 2011 | Additions | Disposals | December 31, 2012 |
| Land and Land Rights | \$ 28,750 | \$ - 0 - | \$ - 0 - | \$ 28,750 |
| Water Plant & Treatment | 1,176,258 | 8,459 | - 0 - | 1,184,717 |
| Trans and Distribution Equipment | 8,953,794 | 252,760 | - 0 - | 9,206,554 |
| Meters and Hydrants | 642,795 | 11,550 | - 0 - | 654,345 |
| Office Equipment | 29,583 | 14,995 | - 0 - | 44,578 |
| Equipment | 122,645 | 16,672 | - 0 - | 139,317 |
| Vehicles | <u>121,820</u> | <u>- 0 -</u> | <u>- 0 -</u> | <u>121,821</u> |
| Total Capital Assets | 11,075,645 | 304,436 | - 0 - | 11,380,081 |
| Less: Accumulated Depreciation | <u>(2,350,689)</u> | <u>(223,602)</u> | <u>- 0 -</u> | <u>(2,574,291)</u> |
| Net Capital Assets | <u>\$ 8,724,956</u> | <u>\$ 80,833</u> | <u>\$ - 0 -</u> | <u>\$ 8,805,790</u> |

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE B – CAPITAL ASSETS (Continued):

Depreciation expense for the year ended December 31, 2012 and 2011 was \$223,602 and \$180,118, respectively. Depreciation allocated to new meter installations was \$4,410.

NOTE C – LONG-TERM DEBT/BONDS:

The District currently has outstanding revenue bonds from four (4) separate issuances. A summary of each series is as follows:

- In 1990, the District issued Farmers Home Administration (FmHA) Water Revenue Bonds, Series 1989 A and B, in the aggregate principal amounts of \$383,000 and \$191,000, respectively. Both issues carry an annual interest rate of 5.00%, with interest payable each January and July 1st, and maturing principal amounts payable on January 1st of each year through 2028 and 2027, respectively. The principal balance on these bonds was \$302,000 and \$123,000, respectively, as of December 31, 2012.
- In 1996, the District issued U.S. Department of Agriculture (USDA) Rural Development (RD) Water Revenue Bonds, Series 1995 A and B, in the aggregate principal amounts of \$343,000 and \$343,000, respectively. Both issues carry an annual interest rate of 4.50%, with interest payable each January and July 1st, and maturing principal amounts payable on January 1st of each year through 2034. The principal balance on these bonds was \$268,900 and \$268,900, respectively, as of December 31, 2012.
- In 2004, the District issued USDA RD Water Revenue Bonds, Series 2004, in the aggregate principal amount of \$350,000. This bond issue carries an annual interest rate of 4.50%, with interest payable each January and July 1st, and maturing principal amounts payable on January 1st of each year through 2043. The principal balance on these bonds was \$320,000 as of and December 31, 2012.
- In 2010, the District issued USDA RD Water Revenue Bonds, Series 2010, in the aggregate principal amount of \$357,000. This bond issue carries an annual interest rate of 2.25%, with interest payable each January and July 1st, and maturing principal amounts payable on January 1st of each year through 2050. The principal balance on these bonds was \$351,500 as of December 31, 2012.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE C – LONG-TERM DEBT/BONDS (Continued):

Bond principal amounts to be retired and the total interest due for the next five (5) years and thereafter in five (5) year increments until maturity are as follows:

| <u>Year(s)</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|----------------|--------------------|-------------------|--------------------|
| 2013 | \$ 39,900 | \$ 66,090 | \$ 105,990 |
| 2014 | 43,000 | 64,343 | 107,343 |
| 2015 | 44,800 | 62,458 | 107,258 |
| 2016 | 47,400 | 60,492 | 107,892 |
| 2017 | 49,700 | 58,399 | 108,099 |
| 2018-2022 | 295,900 | 256,310 | 552,210 |
| 2023-2027 | 380,900 | 181,953 | 562,853 |
| 2028-2032 | 262,300 | 105,240 | 367,540 |
| 2033-2037 | 191,600 | 53,545 | 245,145 |
| 2038-2042 | 141,500 | 25,605 | 167,105 |
| 2043-2047 | 72,500 | 6,739 | 79,239 |
| 2048-2049 | <u>16,500</u> | <u>371</u> | <u>16,871</u> |
| Totals | <u>\$1,586,000</u> | <u>\$ 941,545</u> | <u>\$2,527,545</u> |

NOTE D – BOND FUNDING REQUIREMENTS:

The District’s bond resolutions require the creation and maintenance of a Revenue Fund, a Sinking Fund, a Depreciation Reserve Fund, and an Operation and Maintenance Fund.

REVENUE FUND – The District deposits all collections into the Revenue Fund account in accordance with its bond resolutions and funds all other fund accounts from this account in the order of priorities specified in the bond resolutions.

SINKING FUND – Monthly deposits to the Sinking Fund (identified with the name “Debt Service Account”) are to be made on or before the 20th day of each month as required by bond resolutions, for payment of interest and principal on the outstanding bonds. The monthly amount shall equal the total of 1) 1/6th of the next succeeding six-month interest payment to become due on the bonds, plus 2) 1/12th of the principal of any bonds maturing on the next succeeding January 1st. Based on the preceding formula, monthly deposits for the upcoming year are required to total \$8,838.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE D – BOND FUNDING REQUIREMENTS (Continued):

At December 31, 2012, the balance of the Sinking Fund was \$82,697. A summary of the yearly activity is presented below:

| <u>Bond Sinking Fund</u> | |
|--------------------------------------|------------------|
| Beginning balance on January 1, 2012 | \$ 73,924 |
| Deposits made during 2012 | 114,000 |
| Interest income earned | 29 |
| Disbursements made during 2012 | <u>(105,256)</u> |
| Ending Balance on December 31, 2012 | \$ <u>82,697</u> |

DEPRECIATION RESERVE FUND – Monthly deposits to the Depreciation Reserve Fund are to be made until the current outstanding bonds are paid in full. The current monthly deposit amount per USDA Rural Development for the year ended December 31, 2012 was \$295 with a required reserve account balance of \$89,220. Monies in the Depreciation Reserve Fund are restricted in their withdrawal and use by the prior and current bond resolutions. At December 31, 2012, the balance of the Depreciation Reserve Fund was \$109,421, resulting in a surplus of \$20,201.

NOTE E – COMMITMENTS:

The bond issues of 1990 and 1996, referred to in Note C above, are secured by a statutory mortgage lien against the District's system. The bond issues of 2004 and 2010 have been secured by a revenue pledge, payable on a first lien basis out of the gross revenues of the District, on parity with the prior bonds, and by a lien on all contracts of the District.

NOTE F – NET POSITION:

GASB requires the classification of net position into three classifications defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. As of December 31, 2012 and 2011, the District had invested in capital assets of \$7,171,490 and \$7,210,940, respectively.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE F – NET POSITION (Continued):

- Restricted – This component of net position consists of amounts which have external constraints placed on its use imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. As of December 31, 2012 and 2011, the District had restricted net position of \$192,118 and \$177,938, respectively.
- Unrestricted – This component consists of net assets that do not meet the definition of “invested in capital assets, net of related debt” or “restricted”. As of December 31, 2012 and 2011, the District had unrestricted net position of \$290,031 and \$61,033, respectively.

NOTE G – GASB STATEMENT NO. 34:

In June 1999, the Government Accounting Standards Board (GASB) approved Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments* (Statement). Governments with less than \$10 million in total annual revenues are to apply the provisions of GASB Statement No. 34 for periods beginning after June 15, 2004. As such, Cawood Water District was required to implement the general provisions of Statement No. 34 with the reporting period ended December 31, 2006 and present the following as required supplementary information (RSI):

- Management’s discussion and analysis. (This analysis will supply users with the information they need to help them assess whether the government’s financial position has improved or deteriorated as a result of the year’s operations.)
- Budgetary comparison schedules (unless the government elects to include the required information in a budgetary comparison statement as part of the basic financial statements, rather than RSI).
- Infrastructure condition data (only if the government elects not to depreciate such assets).

Management has not presented the budgetary comparison schedules for the period ended December 31, 2012.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE H – RECLASSIFICATIONS:

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements.

NOTE I – SUBSEQUENT EVENTS:

Cawood Water District has evaluated all events that have occurred since the balance sheet date of December 31, 2012 through May 30, 2013, the date when the financial statements were available to be issued. No events have occurred requiring disclosure that affect the period ended December 31, 2012.

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 Commissioners
Cawood Water District
Cawood, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United State 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 Cawood Water District (the "District") as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Cawood Water District's basic financial statements and have issued our report thereon dated May 30, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Cawood Water District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

accompanying schedule of findings and questioned costs that we consider to be significant deficiencies. These deficiencies are presented as items 2012-1 through 2012-3 in the accompanying schedule of findings and questioned costs

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Cawood Water District's financial statements are free of 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*.

Cawood Water District's Response to Findings

Cawood Water District's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The District's response was subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Fortner Smalley PLLC
Certified Public Accountants
Kingsport, Tennessee
May 30, 2013

CAWOOD WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended December 31, 2012

A. SUMMARY OF AUDITORS' RESULTS

1. The independent auditors' report expresses an unqualified opinion on the financial statements of Cawood Water District (the District).
2. Three (3) significant deficiencies in internal control over financial reporting were identified and are presented in section B below.
3. No instances of noncompliance material to the basic financial statements of the District were disclosed during the audit.

B. FINDINGS – FINANCIAL STATEMENT AUDIT

2012-1 Inadequate separation and incompatibility of duties.

- Management is of the opinion that an adequate segregation of duties is impractical due to the limited number of employees available. Further, they have stated that correcting the condition would exceed the economic benefit derived. Management will, however, continue to strive for the greatest separation of duties possible with the limited number of personnel that are available.

2012-2 The accounting software used for accounts receivable does not provide aging reports that are essential for effective management of customers' account balances and to ensure timely follow up and collection of past due accounts.

- Management has plans to implement new accounting software in 2013.

2012-3 Controls over Financial Reporting

- Statement on Auditing Standard No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (SAS 112), applies to audits ending on or after December 15, 2006. The standard provides guidance in that if an entity is unable to draft its own financial

statements, there may be a material weakness or significant deficiency. External auditors cannot be a part of the District's internal control, including controls over the preparation of the financial statements, and are prohibited from auditing their own work, as doing so impairs their independence. The District should have the capacity to prepare full disclosure financial statements in accordance with generally accepted accounting principles. The effect of this new standard is that the District is required to take full responsibility for the adequacy of its financial statements in accordance with generally accepted accounting principles.

To carry out this responsibility, the District is required to have in place proper internal controls over financial reporting. Proper internal controls over financial reporting include staffing to allow competent individuals to exercise financial reporting and related oversight. The accounting staff prepares monthly financial statements without footnote disclosures or a statement of cash flows.

- In order to provide oversight of the financial statement preparation at an appropriate level, effective Review Policies and Procedures should be established to include performance of the following functions:
 - A. Reconcile general ledger amounts to the draft financial statements utilizing grouping schedules provided by us, the auditors.
 - B. Review the adequacy of financial statement disclosures by completing a disclosure checklist or reviewing and approving the completed disclosure checklist we will provide to you.
 - C. Review and approve schedules and calculations supporting amounts included in the notes to financial statements.
 - D. Review and approve the cash flow worksheet used in preparing the statement of cash flows.
 - E. Perform other procedures as considered necessary by management.