

Cline, Jeff D (PSC)

From: Eddie Campbell
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Subject: Knott County Water & Sewer District 2012 Audit
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Turner Campbell, CFO
Knott County Water & Sewer District
7777 Big Branch Road
Vicco, KY 41773

606-642-3582
606-889-1504

KNOTT COUNTY WATER AND SEWER DISTRICT

REPORT OF AUDITED FINANCIAL STATEMENTS

For The Year Ended December 31, 2012

KNOTT COUNTY WATER AND SEWER DISTRICT

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Chris Gooch
Certified Public Accountant
P.O. Box 1536
Hazard, Kentucky 41702
(606) 436-5700 FAX: (606) 436-5701
chrisgooch@chrisgoochcpa.com

INDEPENDENT AUDITOR'S REPORT

To Members of the Board
Knott County Water and Sewer District
7777 Big Branch Road
Vicco, Kentucky 41773

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Knott County Water and Sewer District, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Knott County Water and Sewer District's basic financial statements required by accounting principles generally accepted in the United States of America.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Qualified Opinion

Management did not provide verification through third party receipts and other supporting documentation for various expenditures paid by the District indicating reasonable and/or allowable disbursements totaling \$80,122.02 for which we requested as part of our audit procedures.

Qualified Opinion

In our opinion, except for the possible effects of the matters discussed in the "Basis for Qualified Opinion" paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Knott County Water and Sewer District, as of December 31, 2012, and the changes in financial position and cash flows for the year 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 a management's discussion and analysis be presented to supplement the basic financial statements. Management did not prepare or provide us with a management's discussion and analysis for the year ended December 31, 2012. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Certain limited procedures to the required supplementary information would be applied in accordance with auditing standards generally accepted in the United States of America, which would consist 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 would not express an opinion or provide any assurance on the information because the limited procedures that would have been performed do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knott County Water and Sewer District's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 6, 2013, on our consideration of the Knott County Water and Sewer District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Knott County Water and Sewer District's internal control over financial reporting and compliance.



Chris Gooch
Certified Public Accountant

Hazard, Kentucky

December 6, 2013

KNOTT COUNTY WATER AND SEWER DISTRICT

STATEMENT OF NET POSITION

At December 31, 2012

ASSETS:

- Current Assets -	
Cash in Banks - Unrestricted	72,592
Accounts Receivable, net of allowance for doubtful accounts	310,233
Other Current Assets	<u>59,798</u>
<u>Total Current Assets</u>	<u>442,623</u>
- Fixed Assets -	
Land, Structure & Equipment, net of depreciation	29,443,666
Construction in Progress	<u>5,580,635</u>
<u>Total Fixed Assets</u>	<u>35,024,301</u>
- Other Assets -	
Cash - Restricted	<u>197,860</u>
<u>Total Assets</u>	<u><u>35,664,784</u></u>
<u>LIABILITIES AND NET POSITION:</u>	
- Current Liabilities -	
Accounts Payable	49,865
Payroll Liabilities Payable	16,322
Accrued Compensation	13,332
Interest Payable	31,420
Other Current Liabilities	83,238
Current Portion of Long-Term Debt	<u>48,135</u>
<u>Total Current Liabilities</u>	<u>242,312</u>
- Long Term Liabilities -	
Bonds/Notes Payable	770,526
Less: Current Portion	<u>(48,135)</u>
<u>Total Long-Term Liabilities</u>	<u>722,391</u>
<u>Total Liabilities</u>	<u>964,703</u>
- Net Position -	
Unrestricted (deficit)	279,866
Restricted Assets	197,860
Invested in Fixed Assets, net of related debt	<u>34,222,355</u>
<u>Total Net Position</u>	<u>34,700,081</u>
<u>Total Liabilities and Net Position</u>	<u><u>35,664,784</u></u>

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

KNOTT COUNTY WATER AND SEWER DISTRICT

STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET POSITION

For The Year Ended December 31, 2012

<u>Revenue</u>	
Water and Sewer Operations	<u>1,691,343</u>
<u>Operating Expense</u>	
Salaries and Fringe Benefits	444,714
Commissioner Fee	60,600
Office Expense	19,123
Water Consumption	73,827
Electric	242,071
Telephone	14,517
Travel and Training	1,341
Advertisement	1,216
Legal and Accounting	23,465
Contractual Fees	95,637
Uniforms	10,829
Vehicle Expense	44,069
Operating Supplies and Maintenance	142,390
Licenses, Permits and Fees	18,894
Insurance and Bonds	20,486
Depreciation Expense	<u>1,305,843</u>
<u>Total Operating Expense</u>	<u>2,519,022</u>
Excess (Deficiency) of Operating Revenue	
<u>Over Operating Expense</u>	<u>(827,679)</u>
<u>Other Income (Expense)</u>	
Interest Income	806
Interest Expense	<u>(32,984)</u>
<u>Total Other Income (Expense)</u>	<u>(32,178)</u>
Net Income (Loss)	(859,857)
Net Position, Beginning of Year	1,611,577
Add: Capital Contributions	<u>33,948,361</u>
Net Position, End of Year	<u><u>34,700,081</u></u>

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

KNOTT COUNTY WATER AND SEWER DISTRICT

STATEMENT OF CASH FLOWS

For The Year Ended December 31, 2012

<u>Cash Flows from Operating Activities:</u>	
Receipts from customers and users	1,482,302
Payments to personnel	(492,868)
Payments to suppliers	(532,670)
Payments to contractors	(132,330)
Other operating payments	<u>(84,643)</u>
<u>Net Cash Provided (Used) by Operating Activities</u>	<u>239,791</u>
<u>Cash Flows From Capital and Related Financing Activities:</u>	
Increase in infrastructure assets - net	(5,612,963)
Tap fees	49,106
Principal paid on bonds	(46,374)
Interest paid on bonds and notes	(32,984)
Disposal of equipment	14,468
Capital grants and contributions received	<u>4,898,422</u>
<u>Net Cash Provided (Used) for Capital and Related Financing Activities</u>	<u>(730,325)</u>
<u>Cash Flows from Investing Activities</u>	
Interest revenue	<u>806</u>
Net Increase (Decrease) in Cash	(489,728)
Cash and restricted cash, January 1	<u>760,180</u>
Cash and restricted cash, December 31	<u><u>270,452</u></u>
Reconciliation of Operating Income (Loss) to	
<u>Net Cash Provided by Operating Activities:</u>	
Operating loss	(827,679)
Adjustments to reconcile operating net cash provided by operating activities:	
Depreciation	1,305,843
Changes in assets and liabilities	
(Increase) decrease in accounts receivable	(152,758)
(Increase) decrease in other current assets	(56,283)
Increase (decrease) in accounts payable	(49,036)
Increase (decrease) in payroll tax payable	(739)
Increase (decrease) in accrued compensation	13,185
Increase (decrease) in other current liabilities	<u>7,258</u>
<u>Net Cash Provided (Used) by Operations</u>	<u><u>239,791</u></u>

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

KNOTT COUNTY WATER AND SEWER DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

At December 31, 2012

1. Reporting Entity

Knott County Water and Sewer District was created by Knott County Fiscal Court to be governed and operated under the rules and procedures established under KRS Chapter 74, relating to water districts and KRS Chapter 220 relating to sanitation districts. The entity's plans are to expand its operating activities into parts of Knott County not presently served with water and sewer utility services.

2. Accounting Policies and Procedures

a. Cash

For purposes of the cash flow statement, cash consists of interest bearing checking accounts, restricted and unrestricted.

b. Fixed Assets and Depreciation

Property, plant and equipment are stated at historical or estimable cost. Fixed assets are recorded and depreciated using the straight-line method of accounting over the respective assets useful lives as follows:

Equipment	5 – 7 years
Transmission Lines	20 – 40 years
Water Wells, Structures and Improvements	15 – 40 years

c. Allowance for Doubtful Accounts

Knott County Water and Sewer District's financial statements reflect an allowance account for its customer accounts receivable based on management's estimate of probable losses. An allowance expense in the amount of \$25,154 was recognized in the financial statements for the year ended December 31, 2012.

d. Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

KNOTT COUNTY WATER AND SEWER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

e. Basis of Presentation

GASB 34 creates basic financial statements for reporting on the governmental financial activities. Financial statements include government-wide financial statements prepared on an accrual basis of accounting and fund financial statements which present information for individual major funds rather than by fund type. Knott County Water and Sewer District is considered a special purpose government engaged in a business-type activity. No governmental type funds are recognized.

The accounting and reporting treatment applied to a fund is determined by its measurement focus. Proprietary funds are reported using the economic resources measurement focus. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary activities.

The District has the following fund:

Proprietary Funds (Enterprise Funds)

The Water and Sewer Revenue Funds accounts for revenues and expenses related to customer utility services.

f. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. For its water and sewer enterprise operations the District uses the full-accrual basis of accounting where revenues are recorded when earned and expenses are recognized when incurred.

Revenues – Exchange and Non-exchange Transactions – Revenues resulting from exchange transactions, in which each party receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenues are recorded in the fiscal year in which the resources are measurable and available.

Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current fiscal year. For the District, available means expected to be received within sixty days of the fiscal year-end.

Nonexchange transactions, in which the District receives value without directly giving equal value in return, include grants, entitlements and donations. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the

KNOTT COUNTY WATER AND SEWER DISTRICTNOTES TO THE FINANCIAL STATEMENTS (CONTINUED)At December 31, 2012

f. Basis of Accounting (Continued)

resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the District must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. On a modified accrual basis, revenues from nonexchange transactions must also be available before it can be recognized.

Deferred Revenue – Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied. Grants and entitlements received before the eligibility requirements are met are recorded as deferred revenue.

Expenses/Expenditures – On the accrual basis of accounting, expenses are recognized at the time they are incurred.

g. Net Position

GASB 63, implemented for the current fiscal year, has changed the presentation of the District's financial statements to incorporate the concepts of net position, deferred outflows of resources and deferred inflows of resources. Net position represents the difference between assets and deferred outflows and liabilities and deferred inflows. The net position component "investment in capital assets", consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for acquisition, construction or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt also should be included in this component of net position. Net position is reported as restricted when there are limitations on its use either through enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

h. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the District, those revenues are primarily charges for utility services provided.

i. Materials and Supplies

Inventory is currently charged to expense as incurred. Supplies are acquired on an as needed basis.

3. Cash and Cash Equivalents

The carrying amount of cash was \$270,452 and the bank balance of cash was \$315,676 at December 31, 2012. The bank balance of cash at December 31, 2012 was adequately covered by FDIC. Cash at December 31, 2012 was comprised of the following:

KNOTT COUNTY WATER AND SEWER DISTRICT

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

3. Cash and Cash Equivalents (Continued)

	<u>Bank</u> <u>Balance</u>	<u>Book</u> <u>Balance</u>	<u>Interest</u> <u>Rate</u>	<u>Financial</u> <u>Institution</u>
Operating Account	117,816	72,592	0.25%	Whitaker Bank
Funded Depreciation Reserve Account	145,023	145,023	0.25%	Whitaker Bank
RD/ARC Fund	1,489	1,489	0.25%	Whitaker Bank
Carr Creek Water Line Extension	49,992	49,992	0.25%	Whitaker Bank
Red Oak	34	34	0.00%	Whitaker Bank
Debt Retirement Fund - RD	25	25	0.00%	Whitaker Bank
Coal Severance Fund	15	15	0.00%	Whitaker Bank
Coal Removal Escrow Fund	34	34	0.00%	Whitaker Bank
Interim Financing Construction Account	49	49	0.00%	Whitaker Bank
AML Clear Creek	271	271	0.00%	Whitaker Bank
AML Irishman Creek	552	552	0.00%	Whitaker Bank
Pippa Passess Tanks	374	374	0.00%	Whitaker Bank
AML Red Fox	<u>2</u>	<u>2</u>	2.00%	Whitaker Bank
	<u>315,676</u>	<u>270,452</u>		

Custodial credit risk is the risk that in event of bank failure the deposits may not be returned or that Knott County Water and Sewer District may not recover collateral securities. The organization's deposits at December 31, 2012 exceeded the amount of the Federal Deposit Insurance Corporation Insurance (FDIC). Knott County Water and Sewer District has a collateral agreement that covers any amounts not insured by FDIC. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. Knott County Water and Sewer District does not have any investments other than its interest bearing checking accounts. Concentrations of credit risk are the risk of loss attributed to the magnitude of the District's investment in a single issuer. Over ninety-eight percent of the Organization's cash at December 31, 2012 is held at Whitaker Bank.

Foreign currency risk is the risk of changes in exchange rates effecting foreign investments. The District does not hold any foreign investments.

4. Other Current Assets

Other current assets consisted of the following at December 31, 2012:

Prepaid insurance	14,111
Due from employees	<u>45,687</u>
	<u>59,798</u>

KNOTT COUNTY WATER AND SEWER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

5. Other Current Liabilities

Other current liabilities consisted of the following at December 31, 2012:

Customer deposits payable	66,920
Utility tax payable	<u>16,318</u>
	<u>83,238</u>

6. Changes in Fixed Assets

Following are changes in fixed assets for Knott County Water and Sewer District at December 31, 2012:

	1/1/2012 <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	12/31/2012 <u>Balance</u>
<u>Fixed Assets - Water operations</u>				
Land and land rights	117,294	-	-	117,294
Sewer plant and transmission lines	34,131,393	5,580,635	-	39,712,028
Vehicles	202,418	-	(15,439)	186,979
Operating equipment	391,092	23,250	-	414,342
Office furniture and equipment	<u>118,291</u>	<u>9,078</u>	-	<u>127,369</u>
Subtotal	<u>34,960,488</u>	<u>5,612,963</u>	<u>(15,439)</u>	<u>40,558,012</u>
<u>Accumulated Depreciation - Water operations</u>				
Water plant and transmission lines	3,986,157	1,215,893	-	5,202,050
Vehicles	49,321	36,471	(971)	84,821
Operating equipment	185,810	32,288	-	218,098
Office furniture and equipment	<u>25,338</u>	<u>16,724</u>	-	<u>42,062</u>
Subtotal	<u>4,246,626</u>	<u>1,301,376</u>	<u>(971)</u>	<u>5,547,031</u>
<u>Total</u>	<u>30,713,862</u>	<u>4,311,587</u>	<u>(14,468)</u>	<u>35,010,981</u>
<u>Fixed Assets - Sewer operations</u>				
Land and land rights	2,791	-	-	2,791
Sewer plant and transmission lines	260,673	-	-	260,673
Operating equipment	<u>76,367</u>	-	(18,263)	<u>58,104</u>
Subtotal	<u>339,831</u>	-	<u>(18,263)</u>	<u>321,568</u>
<u>Accumulated Depreciation - Sewer operations</u>				
Sewer plant and transmission lines	252,882	1,498	-	254,380
Operating equipment	<u>69,162</u>	<u>2,969</u>	(18,263)	<u>53,868</u>
Subtotal	<u>322,044</u>	<u>4,467</u>	<u>(18,263)</u>	<u>308,248</u>
<u>Total</u>	<u>17,787</u>	<u>(4,467)</u>	-	<u>13,320</u>

KNOTT COUNTY WATER AND SEWER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

6. Changes in Fixed Assets (Continued)

Total depreciation expense for the year ended December 31, 2012 is allocated as follows:

	<u>Depreciation</u>
Water operations	1,301,376
Sewer operations	4,467
<u>Total</u>	<u>1,305,843</u>

7. Long Term Debt

A Rural Utilities Service bond, dated December 19, 2003 was issued to pay off prior debt of Knott County Water and Sewer District. The bond issue has an annual interest rate of 4.5%. The total amount of the loan was \$185,000. The bond calls for 40 annual interest and principal payments. The bond agreement also establishes a funded depreciation reserve calling for annual payments of \$1,080, beginning with the first month of the first full fiscal year after the facility becomes operational. The District balance in this reserve account was \$145,023 at December 31, 2012.

Following is the RUS debt service schedule for this issue:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Balance</u>
				169,500
2013	2,500	7,628	10,128	167,000
2014	2,500	7,515	10,015	164,500
2015	3,000	7,403	10,403	161,500
2016	3,000	7,268	10,268	158,500
2017	3,000	7,133	10,133	155,500
2018-2022	18,000	33,414	51,414	137,500
2023-2027	22,000	29,072	51,072	115,500
2028-2032	28,000	23,582	51,582	87,500
2033-2037	34,500	16,697	51,197	53,000
2038-2042	43,000	8,236	51,236	10,000
2043	10,000	450	10,450	-
<u>Total</u>	<u>169,500</u>	<u>148,398</u>	<u>317,898</u>	

Knott County Water and Sewer District entered into an assistance agreement with the Kentucky Infrastructure Authority for KIA Fund C03-3 loan assistance dated January 1, 2004 having a maturity date of June 1, 2022 for expenditures related to the Highway 899/Mallie waterworks improvement project. The original principal balance was \$547,000. The interest rate is 4.05%. The District entered into an agreement to pay past due interest and fees of \$65,047.95 beginning with the March 1, 2011 due date.

KNOTT COUNTY WATER AND SEWER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

7. Long Term Debt (Continued)

Following is a debt service schedule:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Servicing Fees</u>	<u>Past Due Interest</u>	<u>Total</u>	<u>Balance</u>
						504,326
2013	44,435	19,606	968	6,410	71,419	459,891
2014	46,268	17,773	878	6,410	71,329	413,623
2015	48,177	15,864	783	6,410	71,234	365,446
2016	50,165	13,876	685	6,410	71,136	315,281
2017	52,235	11,806	583	-	64,624	263,046
2018-2022	<u>263,046</u>	<u>25,140</u>	<u>12,141</u>	<u>-</u>	<u>300,327</u>	-
<u>Total</u>	<u>504,326</u>	<u>104,065</u>	<u>16,038</u>	<u>25,640</u>	<u>650,069</u>	

A Rural Utilities Service bond, dated January 26, 2007 was issued to finance a portion of the Water Treatment Plant project. The bond issue has an annual interest rate of 4.125%. The total amount of the loan was \$100,000. The bond calls for 40 annual interest and principal payments.

Following is a debt service schedule:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Balance</u>
				96,700
2013	1,200	4,356	5,556	95,500
2014	1,200	4,302	5,502	94,300
2015	1,300	4,248	5,548	93,000
2016	1,400	4,190	5,590	91,600
2017	1,400	4,127	5,527	90,200
2018-2022	8,100	19,626	27,726	82,100
2023-2027	10,000	17,641	27,641	72,100
2028-2032	12,500	15,166	27,666	59,600
2033-2037	15,700	12,079	27,779	43,900
2038-2042	19,500	8,218	27,718	24,400
2043-2045	<u>24,400</u>	<u>3,440</u>	<u>27,840</u>	-
<u>Total</u>	<u>96,700</u>	<u>97,393</u>	<u>194,093</u>	

KNOTT COUNTY WATER AND SEWER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

7. Long Term Debt (Continued)

Changes in long-term debt for the District are as follows:

	<u>1/1/2012</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/2012</u> <u>Balance</u>	<u>Current</u> <u>Portion</u>
US Rural Development 91-11	97,900	-	1,200	96,700	1,200
Kentucky Infrastructure Authority - C03-03	547,000	-	42,674	504,326	44,435
US Rural Development 93-05	<u>172,000</u>	<u>-</u>	<u>2,500</u>	<u>169,500</u>	<u>2,500</u>
Total	<u>816,900</u>	<u>-</u>	<u>46,374</u>	<u>770,526</u>	<u>48,135</u>

8. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; injuries to employees; and natural disasters. The District carries commercial insurance for risk of loss. The District manages and finances these risks by purchasing commercial insurance for their worker's compensation and employer's liability.

The District did not have settled claims that exceeded the District's commercial insurance coverage in any of the past three years.

9. Contingencies

The District receives funding from local, state, and federal government agencies. These funds are to be used for designated purposes only. For government agency grants, if the grantor's review indicates that the funds have not been used for the intended purpose, the grantors may request a refund of monies advanced or refuse to reimburse the District for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the District's grant programs is predicated upon the grantor's satisfaction that the funds provided are being spent as intended and the grantors' intent to continue their programs.

10. Subsequent Events

Knott County Water and Sewer District has evaluated subsequent events through December 6, 2013, the date financial statements were available to be issued.

The District entered into an agreement after December 31, 2012 with Troublesome Creek Environmental Authority to provide billing services for its sanitation customers and charge an administrative fee. Negotiations were also underway allowing the District to acquire the facility and related debt and provide plant operations and maintenance.

KNOTT COUNTY WATER AND SEWER DISTRICT

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

11. Pension Plans

The Knott County Water and Sewer District is a participating employer of the County Employees' Retirement System (CERS) which is a cost-sharing multi-employer defined benefit plan that covers substantially all regular full-time employees of each county, school board, municipal and other local agencies electing to participate. The plan provides for retirement, disability, and death benefits to plan members. Upon election to participate in the CERS, each employee is given the option to participate, however, all subsequent employees must participate and the employer is required to continue participation.

The Knott County Water and Sewer had a total of 2 non-hazardous employees covered by the CERS. The employees non-hazardous contribute 5.0%. The employer contributes 19.55% except for new hires after September 1, 2008 with payroll withholdings of 6.0%. The District's contribution for the year ended December 31, 2012 was \$25,548 and the employees contributed \$6,446.

Following summarizes employer contributions to the CERS plan:

<u>Year Ended</u>	<u>Employer Amount</u>
2012	25,548
2011	26,894
2010	26,870

The District's total payroll for the year was \$296,300 and the payroll for employees reported under CERS was \$132,912.

Benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the plan documents.

The "pension benefits obligation" is a standardized disclosure measure of the present value of pension benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the pensions' funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among the plans and employers.

CERS does not make separate measurement of assets and pension benefit obligations for individual employers. The following table presents certain information regarding the plans' status as a whole, derived from actuarial valuations performed as of the dates indicated:

KNOTT COUNTY WATER AND SEWER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At December 31, 2012

11. Pension Plans (Continued)

	<u>CERS</u> <u>as of June 30, 2012</u>
Actuarial Accrued Liability	12,149,560
Actuarial Value of Assets	<u>7,294,615</u>
Unfunded (Overfunded) Actuarial Accrued Liability	<u><u>4,854,945</u></u>
Funded Ratio	<u><u>60.0</u></u>
Covered Payroll	<u><u>2,700,775</u></u>
UAAL as a % of Covered Payroll	<u><u>179.8</u></u>

Historical trend information showing CERS's progress in accumulating sufficient assets to pay benefits when due is presented in their June 30, 2012 comprehensive annual financial reports.

As the District is only one of several employers participating in the plan, it is not practicable to determine the District's portion of the unfunded past service cost or the vested benefits of the District's portion of the plan.

KNOTT COUNTY WATER AND SEWER DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For The Year Ended December 31, 2012

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Grantors Number</u>	<u>Program Expenditures</u>
US Department of Interior			
Passed through Kentucky Natural Resources and Environmental Protection Cabinet			
Abandoned Mines Land - Arnold Fork Water Project	15.252	n/a	152,073
Abandoned Mines Land - Clear Creek Water Project	15.252	n/a	966,193
Abandoned Mines Land - Highway 582 Water Project	15.252	n/a	2,434,807
Abandoned Mines Land - Highway 582 Water Study	15.252	n/a	125,280
Abandoned Mines Land - Dry Creek Water Project	15.252	n/a	<u>127,067</u>
<u>Total Federal Awards Expenditures</u>			<u><u>3,805,420</u></u>

NOTE A

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Knott County Water and Sewer District and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in preparation of, the basic financial statements.

Chris Gooch
Certified Public Accountant
P.O. Box 1536
Hazard, Kentucky 41702
(606) 436-5700 FAX: (606) 436-5701
chrisgooch@chrisgoochcpa.com

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

To the Members of the Board
Knott County Water and Sewer District
7777 Big Branch Road
Vicco, Kentucky 41773

Report on Compliance for Each Major Federal Program

We have audited Knott County Water and Sewer District's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Knott County Water and Sewer District's major federal programs for the year ended December 31, 2012. Knott County Water and Sewer District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Knott County Water and Sewer District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Knott County Water and Sewer District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Knott County Water and Sewer District's compliance.

Opinion on Each Major Federal Program

In our opinion, Knott County Water and Sewer District, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

Report on Internal Control Over Compliance

Management of Knott County Water and Sewer District, is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Knott County Water and Sewer District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Knott County Water and Sewer District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.



Chris Gooch
Certified Public Accountant

Hazard, Kentucky

December 6, 2013

Chris Gooch

Certified Public Accountant
P.O. Box 1536
Hazard, Kentucky 41702
(606) 436-5700 FAX: (606) 436-5701
chrisgooch@chrisgoochcpa.com

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

To the Members of the Board
Knott County Water and Sewer District
7777 Big Branch Road
Vicco, Kentucky 41773

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Knott County Water and Sewer District, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Knott County Water and Sewer District's basic financial statements and have issued our report thereon dated December 6, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Knott County Water and Sewer 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses: 2012-1, 2012-2, 2012-7 and 2012-10.

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. We consider the deficiencies described in the accompany schedule of findings and questioned costs to be significant deficiencies: 2012-3, 2012-5, 2012-6 and 2012-9.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Knott County Water and Sewer District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs: 2012-3, 2012-4 and 2012-8.

Knott County Water and Sewer District's Response to Findings

The District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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



Chris Gooch
Certified Public Accountant

Hazard, Kentucky

December 6, 2013

KNOTT COUNTY WATER AND SEWER DISTRICT
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
For The Year Ended December 31, 2012

The previous financial statements audited were for the year ended December 31, 2008.

KNOTT COUNTY WATER AND SEWER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For The Year Ended December 31, 2012

-SUMMARY OF AUDIT RESULTS-

1. We have issued a modified opinion on the financial statements.
2. Material weaknesses and significant deficiencies not identified as material weaknesses were disclosed by the audit of the financial statements.
3. Material noncompliance was disclosed in our audit of the financial statements.
4. No material weakness or significant deficiency not identified as a material weakness was disclosed by the audit in internal control over major programs.
5. We have issued an unmodified opinion on compliance for major programs.
6. The audit did not disclose any audit findings which we are required to report under Section .510(a) of A-133.
7. Knott County Water and Sewer District had the following major program:
 - US Department of Interior
 - Passed through Kentucky Natural Resources and
 - Environmental Protection Cabinet
 - Abandoned Mine Land (AMLR) Reclamation Programs – CFDA #15.252
 - Arnold Fork Water Project
 - Clear Creek Water Project
 - Highway 582 Water Study and Project
 - Dry Creek Water Project
8. The dollar threshold used to distinguish between major and non-major programs was \$300,000.
9. The auditee did not qualify as a low-risk auditee under Section .530 of A-133.

KNOTT COUNTY WATER AND SEWER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For The Year Ended December 31, 2012

-FINDINGS RELATED TO THE FINANCIAL STATEMENTS-

2012-1:

Condition:

A request for additional supporting documentation regarding thirty-six Visa line item payments occurred during the audit period. A copy of the original statement having a closing date of April 11, 2012 was retained by the auditor. Management later provided the auditor with a faxed copy of the above-referenced statement and some receipts. The faxed copy had been altered reflecting different vendors in eighteen of the thirty-six items listed. The total vendor purchases modified from the original vendor amounted to \$1,741.92. This matter was referred to the Kentucky State Attorney General's office for further action.

Criteria:

Management should readily provide evidence of costs supporting its allowable purpose to the District's operations. All costs charged and paid by the District should be for allowable purposes.

Cause:

The District did not have procedures to adequately monitor controls over Visa transactions.

Effect:

Funds of the District appear to be misappropriated and used for unallowable purposes.

Recommendation:

The District should establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses should be provided. The District should seek restitution where applicable.

Management's Response:

The District will establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses will be provided. The District will seek restitution where applicable.

2012-2:

Condition:

As part of our audit procedures, management failed to provide requested additional supporting documentation not readily available for various disbursements totaling \$78,380.10 in addition to finding 2012-1.

KNOTT COUNTY WATER AND SEWER DISTRICT

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)

For The Year Ended December 31, 2012

2012-2 (Continued):

Criteria:

Management should readily provide evidence of costs supporting its allowable purpose to the District's operations. All costs charged and paid by the District should be for allowable purposes.

Cause:

The District did not provide documentation requested.

Effect:

Funds of the District may be misappropriated and used for unallowable purposes.

Recommendation:

The District should establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses should be provided. The District should seek restitution where applicable.

Management's Response:

The District will establish procedures mitigating the risk of financial statement material misstatement and fraud by having dual controls over its disbursement procedures. Evidence for pre-authorization of materials, supplies or other operating expenses will be provided. The District will seek restitution where applicable.

2012-3:

Condition:

Payments were made to Water District Commissioner's during the year without adequate supporting perpetual subsidiary schedules indicating the periods each payment should be applied. Therefore, we were not able to determine the actual amount owed, if any, by the District to the Commissioners and no accrual was made at December 31, 2012. According to management, in previous years' funds were inadequate to pay Commissioner's the statutory compensation as provided by KRS 74.020 and therefore, some payments made in 2012 were for previous years. Furthermore, we noted some payments were increased due to completion of water district management training. We did not receive evidence of the district management training. In addition, the Chairman was paid \$40,000 in 2012 for back commissioner pay owed. We noted a 1099-MISC form had not been prepared and submitted to the Internal Revenue Service for this transaction.

Criteria:

Management is not accounting for commissioner pay on a perpetual basis. Management has not provided evidence increases in commissioner pay were valid. Management has made payments without adequate supporting documentation.

Cause:

The District is not maintaining adequate subsidiary schedules to account for Commissioner compensation accrued and paid. The District is not retaining evidence of training.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2012**2012-3 (Continued):**

Effect:

Payments made to Commissioners may not be for an accurate or allowable amount without detail underlying supporting documentation.

Recommendation:

The District should maintain a perpetual subsidiary schedule accruing compensation and related payments for its Commissioners. The District should retain evidence of continuing education.

Management's Response:

The District will maintain a perpetual subsidiary schedule accruing compensation and related payments for its Commissioners. The District will retain evidence of continuing education.

2012-4:

Condition:

Management has not adjusted gross wages as reported to the County Employee Retirement System since the District was required to report its activity on-line. Therefore since this period, any raises or increases in pay or overtime appears to not have been properly reported. In addition, we noted recent hires were not included on monthly reports although they meet criteria for participation in the retirement system. An amount has not been accrued for any underpayment and potential penalties or interest potentially owed by the District.

Criteria:

Management should understand clearly applicable participation, reporting and remittance requirements related to the District's participation in the County Employee Retirement System.

Cause:

Management has not properly applied gross wages and related remittances to the County Employee Retirement System.

Effect:

Active participants are not properly remitted and applied. Other potential participants have been excluded. The District may have a substantial liability to County Employee Retirement System for underreporting.

Recommendation:

District management should clearly understand applicable participation, reporting and remittance requirements related to the District's participation in the County Employee Retirement System.

Management's Response:

District management will obtain continuing education to clearly understand applicable participation, reporting and remittance requirements related to the District's participation in the County Employee Retirement System.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2012**2012-5:**

Condition:

We did not find evidence the District's annual budget was assessed, prepared or reviewed for 2013. In addition, no evidence was retained reflecting the most recent annual Public Service Commission annual financial report (2011) was presented to the Commission for review, discussion and authorization.

Criteria:

The Commission should authorize annual operating budgets. The Commission should authorize annual reports submitted to the Public Service Commission.

Cause:

Management did not retain evidence annual budgets or reports were authorized by the Commission.

Effect:

Objectives and criteria may be executed without official consent of the Commission.

Recommendation:

Management should retain evidence annual budgets or reports were authorized by the Commission.

Management's Response:

Management will retain evidence annual budgets or reports were authorized by the Commission.

2012-6:

Condition:

Documentation for personnel overtime pay was not maintained in a manner readily identifying the purpose for overtime or indicating written authorization.

Criteria:

Overtime pay should be maintained in a manner allowing charges to be allocated to specific projects, areas, divisions or accounts. In addition, all overtime pay should reflect written authorization.

Cause:

Management did not retain evidence specifying projects, areas, divisions or accounts or was written authorization reflected prior to remitting personnel pay with overtime.

Effect:

Overtime paid may be for unallowable purposes without adequate supporting and authorizing documentation.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2012**2012-6 (Continued):**

Recommendation:

Overtime pay should be maintained in a manner allowing charges to be allocated to specific projects, areas, divisions or accounts. In addition, all overtime pay should reflect written authorization.

Management's Response:

Overtime pay will be maintained in a manner allowing charges to be allocated to specific projects, areas, divisions or accounts. In addition, all overtime pay will reflect written authorization.

2012-7:

Condition:

No evidence is retained by the District indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

Criteria:

Evidence of daily or periodic reconciliations of utility collections to system customer accounts and to deposits and bank statements reduces risks of errors or misappropriation of assets occurring.

Cause:

Management did not retain evidence indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

Effect:

The risk is higher misappropriation of assets or errors in reporting of cash collections are occurring.

Recommendation:

Management should retain evidence indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

Management's Response:

Management will retain evidence indicating the utility customer cash receipts drawer is reconciled to the customer utility billing system cash collections report, bank deposit and bank statement on a periodic basis.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2012**2012-8:**

Condition:

The District Water office manager is paid \$558.00 per month, the approximate amount of her tax free health insurance plan if participating in the District's plan. The monthly payment does not appear to meet the Internal Revenue Code definition of non-taxable fringe benefits paid by employers and should be included in the employee's gross payroll subject to applicable withholdings.

Criteria:

Any benefit plan offered by the District should be on an equitable basis for all participating employees. All benefits provided should meet applicable compliance requirements.

Cause:

The District has made payments in the form of benefits to an employee appearing not to qualify as tax-free benefits and should be subject to tax withholding.

Effect:

The District may have a receivable due from personnel for benefits paid not meeting applicable fringe benefit criteria. The District may need to amend prior years' W-2/W-3 and tax reporting forms to reflect a reclassification.

Recommendation:

Management should determine if personnel owe the District for fringe benefits not meeting specific criteria and if amended reports should be filed with regulatory authorities.

Management's Response:

Management will determine if personnel owe the District for fringe benefits not meeting specific criteria and if amended reports should be filed with regulatory authorities.

2012-9:

Condition:

The District purchases its diesel and other fuel in bulk and stores on premises at the 7777 Big Branch location. A perpetual log is not maintained indicating the District's purchase and dispensing of fuel and diesel usage. Fuel used by Commissioners should indicate purpose and destination.

Criteria:

A fuel log indicating beginning balance, purchases, gallons used and ending balances should be retained and evidence of reconciliation to actual fuel inventory on hand should be periodically performed.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2012**2012-9 (Continued):**

Cause:

The fuel log maintained is not accounted for in a manner allowing for individual gallons used and reconciliation to fuel inventory on hand,

Effect:

Management does not retain fuel usage or reconciliation in a manner indicating fuel usage is for allowable purposes. Without periodic and timely reconciliations, the risk is greater fuel may be used for unallowable purposes.

Recommendation:

Management should enhance its accounting and reconciliation procedures for purchased fuel and related inventory.

Management's Response:

Management will enhance its accounting and reconciliation procedures for purchased fuel and related inventory.

2012-10:

Condition:

When assessing control over the District's utility revenue billing process we noted the following:

- Meter readings are adjusted without supervisory authorization.
- Customer account maintenance or closeouts are occurring without supervisory consent.
- Manual adjustments to customer account balances are occurring without supervisory authorization.
- No written indication outgoing monthly customer billings are compared to system reports.
- No separate function for personnel opening mail, posting to customer deposits, making deposits and adjusting customer accounts.

Criteria:

Segregation of responsibilities in the billing process mitigates the risk fraud, misappropriation of assets or errors are occurring.

Cause:

The District has not adopted or implemented policies and procedures related to utility billings segregating responsibilities.

Effect:

Without segregation of duties and evidence of authorization in this area, the risk is higher fraud or errors are occurring.

KNOTT COUNTY WATER AND SEWER DISTRICTSCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)For The Year Ended December 31, 2012**2012-10 (Continued):**

Recommendation:

Management should develop and implement policies and procedures providing evidence of authorization and segregation of responsibilities for the above-referenced areas.

Management's Response:

Management will develop and implement policies and procedures providing evidence of authorization and segregation of responsibilities for the above-referenced areas.

-FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS-

-NONE