

CAWOOD WATER DISTRICT
Cawood, Kentucky

AUDITED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Years Ended December 31, 2014 and 2013

CAWOOD WATER DISTRICT
Cawood, Kentucky
AUDITED FINANCIAL STATEMENTS
Years Ended December 31, 2014 and 2013

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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 year ended December 31, 2014 and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents. Also, we were engaged to audit the accompanying financial statements of Cawood Water District (the "District") as of and for the year ended December 31, 2013 and the related notes to the financial statements, which collectively comprise the District's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of the 2014 financial statements 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 on the 2014 financial statements. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 2013 financial statements.

Opinion on the 2014 Financial Statements

In our opinion, the 2014 financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Cawood Water District as of December 31, 2014 and the changes in financial position and cash flows thereof for the year ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Disclaimer of Opinion on 2013 Financial Statements

We were unable to substantiate a large number of journal entries due to lack of supporting documentation and subsequent period postings dates in the 2013 financial statements. We were unable to obtain sufficient appropriate audit evidence about the completeness of the 2013 financial statements by other auditing procedures.

Disclaimer of Opinion on 2013 Financial Statements

Because of the significance of the matter discussed in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 2013 financial statements. Accordingly, we do not express an opinion on the 2013 financial statements referred to in the first paragraph.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be

To the Board of Commissioners
Cawood Water District
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an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2016, 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* in considering Cawood Water District's internal control over financial reporting and compliance.



Fortner Smalley, PLLC
Certified Public Accountants
Kingsport, Tennessee

January 7, 2016

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF NET POSITION
December 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|--|-------------------------|-------------------------|
| <u>ASSETS</u> | | |
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | \$ 348,447 | \$ 321,327 |
| Customer Accounts Receivable, Net | 83,747 | 82,017 |
| Prepaid Expenses | 27,011 | 33,299 |
| Total Current Assets | <u>459,205</u> | <u>436,643</u> |
| CAPITAL ASSETS: | | |
| Utility Plant, Equipment, and Vehicles | 11,967,581 | 11,555,777 |
| Less Accumulated Depreciation | <u>(3,026,650)</u> | <u>(2,813,158)</u> |
| | 8,940,931 | 8,742,619 |
| Construction in Progress | 144,549 | 21,500 |
| Net Value of Capital Assets | <u>9,085,480</u> | <u>8,764,119</u> |
| RESTRICTED ASSETS: | | |
| Depreciation Reserve Account | 119,885 | 114,427 |
| Debt Service Account | 99,008 | 91,487 |
| Total Restricted Assets | <u>218,893</u> | <u>205,914</u> |
| TOTAL ASSETS | <u>\$ 9,763,578</u> | <u>\$ 9,406,676</u> |

See accompanying notes

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF NET POSITION
December 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|--|---------------------|---------------------|
| <u>LIABILITIES AND NET POSITION</u> | | |
| CURRENT LIABILITIES: | | |
| Accounts Payable | \$ 66,181 | \$ 54,665 |
| Customer Deposits | 20,750 | 19,850 |
| Accrued Interest Payable | 32,193 | 33,046 |
| Accrued Wages | 2,759 | 6,774 |
| Current Portion of Long-Term Debt | 43,000 | 39,900 |
| Other Current Liabilities | 9,441 | 8,888 |
| Total Current Liabilities | <u>174,324</u> | <u>163,123</u> |
| LONG-TERM DEBT: | | |
| Long-Term Debt, Net of Current Portion | <u>1,513,100</u> | <u>1,556,100</u> |
| Total Long-Term Debt | <u>1,513,100</u> | <u>1,556,100</u> |
| NET POSITION: | | |
| Net Investment in Capital Assets | 7,529,380 | 7,168,119 |
| Restricted for: | | |
| Depreciation Reserve | 119,885 | 114,427 |
| Debt Service | 99,008 | 91,487 |
| Unrestricted | <u>327,881</u> | <u>313,420</u> |
| Total Net Position | <u>8,076,154</u> | <u>7,687,453</u> |
| TOTAL LIABILITIES AND NET POSITION | <u>\$ 9,763,578</u> | <u>\$ 9,406,676</u> |

See accompanying notes

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
For the Year Ended December 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|--|------------------|------------------|
| OPERATING REVENUES: | | |
| Water Sales - Residential | \$ 685,974 | \$ 676,128 |
| Water Sales - Commercial | 29,193 | 46,301 |
| Other Operating Revenue | <u>61,029</u> | <u>67,891</u> |
| Total Operating Revenues | <u>776,196</u> | <u>790,320</u> |
| OPERATING EXPENSES: | | |
| Salaries and Wages | 246,447 | 241,869 |
| Payroll Taxes | 17,671 | 21,350 |
| Employee Benefits | 79,258 | 88,539 |
| Chemicals | 33,548 | 43,090 |
| Materials and Supplies | 19,169 | 34,301 |
| Contractual Services | 12,951 | 13,117 |
| Insurance | 32,311 | 26,938 |
| Office Expense | 13,198 | 13,382 |
| Utilities | 65,286 | 54,348 |
| Repairs and Maintenance | 51,887 | 59,018 |
| Purchased Water for Distribution | 28,168 | 21,588 |
| Bad Debt Expense | 6,426 | 7,081 |
| Depreciation Expense | 213,491 | 238,867 |
| Other Operating Expenses | <u>38,283</u> | <u>24,886</u> |
| Total Operating Expenses | <u>858,094</u> | <u>888,374</u> |
| NET OPERATING INCOME (LOSS) | <u>(81,898)</u> | <u>(98,054)</u> |
| NONOPERATING REVENUES (EXPENSES): | | |
| Interest Income | 231 | 186 |
| Interest Expense | <u>(64,395)</u> | <u>(66,134)</u> |
| Total Nonoperating Revenues (Expenses) | <u>(64,164)</u> | <u>(65,948)</u> |
| INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS | <u>(146,062)</u> | <u>(164,002)</u> |

See accompanying notes

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
For the Year Ended December 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|----------------------------------|----------------------------|----------------------------|
| CAPITAL CONTRIBUTIONS: | | |
| Grants | 526,513 | 190,666 |
| Tap Fees | <u>8,250</u> | <u>7,150</u> |
| Total Capital Contributions | <u>534,763</u> | <u>197,816</u> |
| CHANGE IN NET POSITION | 388,701 | 33,814 |
| NET POSITION - BEGINNING OF YEAR | <u>7,687,453</u> | <u>7,653,639</u> |
| NET POSITION - END OF YEAR | <u><u>\$ 8,076,154</u></u> | <u><u>\$ 7,687,453</u></u> |

See accompanying notes

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF CASH FLOWS
For the Year Ended December 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|---|--------------------------|--------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Receipts from Customers | \$ 768,941 | \$ 840,713 |
| Payments to Suppliers | (373,373) | (458,528) |
| Payments to Employees | <u>(250,462)</u> | <u>(239,369)</u> |
| Net Cash Provided by Operating Activities | <u>145,106</u> | <u>142,816</u> |
| CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES: | | |
| Net Deposits into Restricted Accounts | (12,979) | (13,796) |
| Proceeds from Grants and Tap Fees | 8,250 | 37,000 |
| Principal Payments on Long-Term Debt | (39,900) | (38,300) |
| Interest Paid on Long-Term Debt | <u>(65,248)</u> | <u>(67,462)</u> |
| Net Cash (Used) by Capital Financing Activities | <u>(109,877)</u> | <u>(82,558)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of Capital Assets | (8,340) | (36,299) |
| Interest Received | <u>231</u> | <u>115</u> |
| Net Cash (Used) by Investing Activities | <u>(8,109)</u> | <u>(36,184)</u> |
| NET INCREASE IN CASH | <u>27,120</u> | <u>24,074</u> |
| CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR | <u>321,327</u> | <u>297,253</u> |
| CASH AND CASH EQUIVALENTS - END OF YEAR | <u><u>\$ 348,447</u></u> | <u><u>\$ 321,327</u></u> |

See accompanying notes

CAWOOD WATER DISTRICT
Cawood, Kentucky
STATEMENTS OF CASH FLOWS
For the Year Ended December 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|---|-------------------|-------------------|
| RECONCILIATION OF OPERATING LOSS TO CASH FLOWS | | |
| PROVIDED BY OPERATING ACTIVITIES: | | |
| Net (Loss) from Operations | \$ (81,898) | \$ (98,054) |
| Adjustments to reconcile net (loss) from operations to net cash provided by operating activities: | | |
| Depreciation Expense | 213,491 | 238,867 |
| Bad Debt Expense | 6,426 | 7,081 |
| Changes in Assets and Liabilities: | | |
| Customer Accounts Receivable | (8,155) | (5,427) |
| Prepaid Expenses | 6,288 | (15,316) |
| Accounts Payable | 11,516 | 6,565 |
| Customer Deposits | 900 | 1,150 |
| Accrued Wages | (4,015) | 2,500 |
| Other Current Liabilities | 553 | 5,450 |
| Net Cash Provided by Operating Activities | <u>\$ 145,106</u> | <u>\$ 142,816</u> |

SUPPLEMENTAL DISCLOSURES:

Schedule of Noncash Investing Transactions

| | | |
|----------------------------------|-------------------|-------------------|
| Purchases of Capital Assets from | | |
| Capital Grant Contributions | <u>\$ 526,513</u> | <u>\$ 160,897</u> |

See accompanying notes

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE A – REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY – 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 consist of fees for services for water charges due from individuals, businesses, and other governments. Customer accounts receivable are presented on the statement of net position 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, 2014 and 2013 was \$46,405 and \$39,980, respectively.

The District bills and collects garbage fees and sewer fees on behalf of Harlan County and the City of Harlan, respectively. These fees are collected by the District and remitted to the appropriate utility, less a collection fee of 6.5% of fees, which is earned when collected. Since the District simply acts as a billing and collection agent for Harlan County and the City of Harlan, the net receivables are reduced by the corresponding payables, as follows:

| | <u>12/31/14</u> | <u>12/31/13</u> |
|---|------------------|------------------|
| Total Accounts Receivable | \$ 285,507 | \$ 253,664 |
| Less: Garbage Fees Payable | (146,191) | (124,869) |
| Less: Sewer Fees Payable | (9,164) | (6,798) |
| Less: Allowance of Uncollectible Accounts | <u>(46,405)</u> | <u>(39,980)</u> |
| Customer Accounts Receivable, Net | <u>\$ 83,747</u> | <u>\$ 82,017</u> |

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE A – REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

PREPAID EXPENSES – Prepaid expenses consist 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 gain or loss is recorded.

DEPRECIATION – Depreciation is applied using 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 \$6,426 and \$7,081 for the years ended December 31, 2014 and 2013, 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, 2014 and 2013 on the respective deposit balances of \$20,750 and \$19,850 was approximately \$22 and \$531, respectively. The interest rates as of December 31, 2014 and 2013 were 3% and 0.1%, respectively.

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 REVENUES AND EXPENSES – The District distinguishes *operating* revenues and expenses from *non-operating* items. Operating revenues consist 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 revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses or capital contributions.

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.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE A – REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2014 and 2013, Cawood Water District had total cash on deposit with a financial institution that exceeded the FDIC insured limits by \$187,934 and \$145,527, 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, 2014 and 2013.

NOTE B – CAPITAL ASSETS

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

| | Balance January 1, 2014 | Additions | Disposals | Balance December 31, 2014 |
|----------------------------------|----------------------------|-------------------|-----------------|------------------------------|
| Land and Land Rights | \$ 28,750 | \$ - 0 - | \$ - 0 - | \$ 28,750 |
| Water Plant & Treatment | 1,184,717 | - 0 - | - 0 - | 1,184,717 |
| Trans and Distribution Equipment | 9,226,054 | 403,464 | - 0 - | 9,629,518 |
| Meters and Hydrants | 660,125 | 8,340 | - 0 - | 668,465 |
| Office Equipment | 44,578 | - 0 - | - 0 - | 44,578 |
| Equipment | 289,733 | - 0 - | - 0 - | 289,733 |
| Vehicles | <u>121,820</u> | <u>- 0 -</u> | <u>- 0 -</u> | <u>121,820</u> |
| Total Capital Assets | 11,555,777 | 411,804 | - 0 - | 11,967,581 |
| Less: Accumulated Depreciation | <u>(2,813,158)</u> | <u>(213,492)</u> | <u>- 0 -</u> | <u>(3,026,650)</u> |
| Net Depreciable Assets | 8,742,619 | 198,312 | - 0 - | 8,940,931 |
| Construction in Progress | <u>21,500</u> | <u>123,049</u> | <u>- 0 -</u> | <u>144,549</u> |
| Net Value of Capital Assets | <u>\$ 8,764,119</u> | <u>\$ 321,361</u> | <u>\$ - 0 -</u> | <u>\$ 9,085,480</u> |

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE B – CAPITAL ASSETS (Continued)

Depreciation expense for the year ended December 31, 2014 and 2013 was \$213,491 and \$238,867, respectively.

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 issuances 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 bond issuances was \$284,000 and \$112,000, respectively, as of December 31, 2014, with \$11,000 and \$6,000 principal due next year, respectively.
- 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 issuances 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 bond issuances was \$254,800 and \$254,800, respectively, as of December 31, 2014, with \$7,500 principal due on each next year.
- In 2004, the District issued USDA RD Water Revenue Bonds, Series 2004, in the aggregate principal amount of \$350,000. This bond issuance 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 this bond issuance was \$310,000 as of December 31, 2014, with \$5,000 principal due next year.
- 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 this bond issuance was \$340,500 as of December 31, 2014, with \$6,000 principal due next year.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

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

Long-term debt activity for the year ended December 31, 2014 is as follows:

| <u>Debt Issuance</u> | <u>Balance</u> <u>1/1/14</u> | <u>Principal</u> <u>Payments</u> | <u>Balance</u> <u>12/31/14</u> |
|----------------------|---------------------------------|-------------------------------------|-----------------------------------|
| Series 1989 A | \$ 293,000 | \$ (9,000) | \$ 284,000 |
| Series 1989 B | 118,000 | (6,000) | 112,000 |
| Series 1995 A | 262,000 | (7,200) | 254,800 |
| Series 1995 B | 262,000 | (7,200) | 254,800 |
| Series 2004 | 315,000 | (5,000) | 310,000 |
| Series 2010 | <u>346,000</u> | <u>(5,500)</u> | <u>340,500</u> |
| Totals | <u>\$1,596,000</u> | <u>\$ (39,900)</u> | <u>\$1,556,100</u> |

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> |
|----------------|--------------------|-------------------|--------------------|
| 2015 | \$ 43,000 | \$ 64,343 | \$ 107,343 |
| 2016 | 44,800 | 62,458 | 107,258 |
| 2017 | 47,400 | 60,492 | 107,892 |
| 2018 | 49,700 | 58,400 | 108,100 |
| 2019 | 52,500 | 56,209 | 108,709 |
| 2020-2024 | 313,300 | 243,131 | 556,431 |
| 2025-2029 | 377,500 | 164,327 | 541,827 |
| 2030-2034 | 262,600 | 94,410 | 357,010 |
| 2035-2039 | 162,300 | 46,094 | 208,394 |
| 2040-2044 | 131,000 | 20,576 | 151,576 |
| 2045-2049 | <u>72,000</u> | <u>5,017</u> | <u>77,017</u> |
| Totals | <u>\$1,556,100</u> | <u>\$ 875,457</u> | <u>\$2,431,557</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.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE D – BOND FUNDING REQUIREMENTS (Continued)

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 \$8,938.

At December 31, 2014, the balance of the Sinking Fund was \$99,008. A summary of the yearly activity is presented below:

Bond Sinking Fund

| | |
|--------------------------------------|------------------|
| Beginning balance on January 1, 2014 | \$ 91,487 |
| Deposits made during 2014 | 114,500 |
| Interest income earned in 2014 | 17 |
| Disbursements made during 2014 | <u>(106,996)</u> |
| Ending balance on December 31, 2014 | \$ <u>99,008</u> |

DEPRECIATION RESERVE FUND – Deposits of all proceeds from connection fees in excess of related costs are to be made to the Depreciation Reserve Fund until the current outstanding bonds are paid in full. The voluntary monthly deposit amount to this account for the year ended December 31, 2014 was \$450, with a required reserve account balance of \$92,700. Monies in the Depreciation Reserve Fund are restricted in their withdrawal and use by the prior and current bond resolutions. At December 31, 2014, the balance of the Depreciation Reserve Fund was \$119,885, resulting in a surplus of \$27,185.

NOTE E – COMMITMENTS

The bond issuances 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 – RECLASSIFICATION

Certain prior period financial statement amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on the reported results of operations.

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE G – NET POSITION

GASB Statement No. 63 requires the classification of net position into three categories, defined as follows:

- Net Investment in Capital Assets – This component of net position 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, 2014 and 2013, the District's net investment in capital assets was \$7,529,380 and \$7,168,119, respectively.
- Restricted – This component of net position consists of net asset amounts which have external constraints placed on their 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, 2014 and 2013, the District had restricted net position of \$218,893 and \$205,914, respectively.
- Unrestricted – This component of net position consists of net asset amounts that do not meet the definition of "net investment in capital assets" or "restricted". As of December 31, 2014 and 2013, the District had unrestricted net position of \$327,881 and \$313,420, respectively.

NOTE H – 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).

CAWOOD WATER DISTRICT
Cawood, Kentucky
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

NOTE H – GASB STATEMENT NO. 34 (Continued)

- Infrastructure condition data (only if the government elects not to depreciate such assets).

As a special purpose government conducting only business-like activities, the District does not contain a general fund subject to the budgetary comparison requirement and depreciates all assets. Accordingly, management has not presented the budgetary comparison schedules and infrastructure condition data for the periods ended December 31, 2014 and 2013. Management has also elected not to present the management's discussion and analysis (MD&A) as required supplementary information for the year ended December 31, 2014.

NOTE I – GRANTS

The District expended grant funds in the amount of \$526,513 and \$190,666 for the years ended December 31, 2014 and 2013, respectively. The purpose of the grants was for capital improvements and the expended funds have been presented as capital contributions on the statements of revenue, expenses, and changes in net position. Grants received and expended for the year ended December 31, 2014 are as follows:

- The District received and expended \$403,464 in grant funds in 2014 from the Commonwealth of Kentucky, Office of Governor, Governor's Office for Local Development, made available through House Bill 380 and administered through the Harlan County Fiscal Court, Kentucky. The purpose of the grant is to construct an extension to the water distribution system. Funds totaling \$51,784 remain available under this grant for future expenditures.
- The District received and expended \$123,049 in grant funds in 2014 from the Harlan County Fiscal Court to construct an interconnection between Cawood Water District and Harlan Water Works. Funds totaling \$1,000 remain available under this grant for future expenditures.

NOTE J – SUBSEQUENT EVENTS

Cawood Water District has evaluated all events that have occurred since the balance sheet date of December 31, 2014 through January 7, 2016, the date when the financial statements were available to be issued. No events have occurred requiring disclosure that affect the period ended December 31, 2014.



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

To the Board of Commissioners
Cawood Water District
Cawood, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Cawood Water District (the "District") as of and for the year ended December 31, 2014, 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 January 7, 2016.

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.

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 responses, 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 responses to be material weaknesses: 2014-1, 2014-2, 2014-3, 2014-4, and 2014-5.

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 accompanying schedule of findings and responses to be significant deficiencies: 2014-6, 2014-7 and 2014-8.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Cawood Water 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 responses as item 2014-8.

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 responses. Cawood Water District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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

To the Board of Commissioners
Cawood Water District
Page 3

considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in cursive script that reads "Fortner Smalley PLLC".

Fortner Smalley PLLC
Certified Public Accountants
Kingsport, Tennessee

January 7, 2016

CAWOOD WATER DISTRICT
SCHEDULE OF DISPOSITION OF PRIOR YEAR FINDINGS
Year Ended December 31, 2014

ITEM 2013-1: Lack of significant influence over the internal control environment and financial reporting by those charged with governance.

Disposition: This finding was not corrected by the Board and has been included in the accompanying Schedule of Findings and Responses as part of Item 2014-7.

ITEM 2013-2: Transactions are not being posted and key accounts are not being reconciled on a timely basis.

Disposition: This finding was not corrected by the Board or management and has been included in the accompanying Schedule of Findings and Responses as Item 2014-1.

ITEM 2013-3: Journal entries are not properly documented.

Disposition: This finding was not corrected by the Board or management and has been included in the accompanying Schedule of Findings and Responses as Item 2014-2.

ITEM 2013-4: Inadequate separation of incompatible duties in the cash receipts process.

Disposition: This finding was corrected by management during 2014 by separating the duties of receiving cash from customers and preparing and making the daily deposit.

ITEM 2013-5: The District does not maintain proper records and procedures necessary to accurately report the financial affairs of the District.

Disposition: This finding was not corrected by the Board or management and has been included in the accompanying Schedule of Findings and Responses as Item 2014-3.

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

MATERIAL WEAKNESSES

ITEM 2014-1

CONDITION: Transactions are not being posted to the general ledger and key accounts are not being reconciled on a timely basis. Many transactions are not being recorded until well after year end, thus making accurate and timely financial reporting virtually impossible.

CRITERIA: Internal controls must be designed and implemented to allow management and/or employees, in the normal course of performing their assigned functions, may prevent, or detect and correct, misstatements on a timely basis. This process includes posting financial transactions to the general ledger and reconciling key account balances in a timely manner.

CAUSE OF CONDITION: Internal controls related to key transaction classes are not designed properly and/or operating effectively enough to provide assurance that the information contained in the financial statements is relevant, timely, and free of material misstatements.

POTENTIAL EFFECT OF CONDITION: Material misstatements could occur without being detected and corrected in a timely manner.

RECOMMENDATION: We recommend that procedures be implemented and formally documented to provide assurance that transactions are being posted to the general ledger and key accounts are being reconciled on a timely basis. These procedures should minimally address the following:

- a) All sales and customer receipts should be posted regularly and reviewed for accuracy; general ledger software features other than general journal entries should be utilized, if available;
- b) Accounts receivable should be reconciled to customer sub-ledgers on a monthly basis;
- c) All bank accounts should be reconciled monthly;
- d) Fixed asset additions and grant revenue should be posted timely;
- e) Depreciation expense should be recorded on a monthly basis;
- f) Pass-through billings and collections should be recorded regularly;

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

ITEM 2014-1 (Continued)

- g) Customer accounts should be reviewed regularly for collectability;
- h) Insurance expense should be posted regularly;
- i) Customer security deposit transactions should be posted in a timely manner and the general ledger balances should be reconciled to the related schedule.

DISTRICT'S RESPONSE: The Board of Commissioners has authorized the finance officer to contract with an outside CPA to take over the tasks of doing the general ledger entries, reconciling the sub-ledgers, and preparing financial statements for the Board on a monthly basis. This will allow the internal staff more time to gain better control over invoice processing, disbursements, payroll processing, and other daily financial activities.

ITEM 2014-2

CONDITION: Journal entries are not made on a timely basis and are often not supported by proper documentation.

CRITERIA: All entries to general ledger accounts should be made in a timely manner, should correspond to the underlying transactions, and should be supported by proper documentation. Proper documentation includes the nature of the underlying transaction and appropriate documentation to support the adjustment.

CAUSE OF CONDITION: Appropriate controls are not in place to require timely posting of journal entries to the general ledger and to require that all journal entries be supported by proper documentation to ensure that the entries are posted correctly (e.g., to the correct period, in the correct amount, to the correct general ledger accounts, etc).

POTENTIAL EFFECT OF CONDITION: Financial reports may be misstated due to untimely posting of journal entries and appropriate, sufficient evidence may not exist to support general ledger balances.

RECOMMENDATION: We recommend that appropriate procedures be implemented and documented requiring proper review of all journal entries for evidence of correct and timely posting and appropriate documentation. We recommend that this include the Treasurer's approval of all journal entries. The evidence of general ledger posting and supporting documentation should be attached and filed appropriately.

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

ITEM 2014-2 (Continued)

DISTRICT'S RESPONSE: As referenced in the District's response to Item 2014-1, the District plans to contract with an outside CPA who will be responsible for making all general journal entries, with each entry being accompanied by sufficient supporting documentation.

ITEM 2014-3

CONDITION: The District does not maintain proper accounting records and procedures necessary for proper financial reporting to external parties of interest.

CRITERIA: Article 5, Section 502 of the USDA – Rural Development bond agreement states that the “District shall maintain proper records and accounts relating to the operation of the System and the District’s financial affairs...”. In addition, KRS 74.050 states that the Treasurer “shall cause to be maintained a proper record of the receipts and disbursements of the water district...”.

CAUSE OF CONDITION: Lack of onsite accountant/bookkeeper prevents the Organization from being able to post transactions and make adjusting journal entries in a timely manner, resulting in a lack of proper accounting records and the inability to produce accurate and timely financial reports.

POTENTIAL EFFECT OF CONDITION: The District is non-compliant with USDA bond agreements and state regulatory authority requirements. Non-compliance with these provisions could result in sanctions or additional actions being taken by governing authorities and/or the USDA.

RECOMMENDATION: We recommend that the District employ a full-time onsite accountant/bookkeeper to be responsible for maintaining proper accounting records and for providing timely financial reporting to management and the Board, thus ensuring compliance with USDA bond agreements and state regulatory authority requirements.

DISTRICT'S RESPONSE: As referenced in the District's response to Item 2014-1, the District plans to contract with an outside CPA who will be responsible for providing adequate accounting support such that the current internal accounting personnel will have the time necessary to better manage the bookkeeping function. The District also plans to fill the open clerical position within the next 60 days, thereby improving the performance of daily office activities and, hopefully, resulting in improved recordkeeping.

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

ITEM 2014-4

CONDITION: Numerous cash disbursements are not supported by proper documentation. Check requests lack information regarding the business purpose of the transaction and the general ledger account(s) to which the transaction should be posted. In many cases, no invoice nor check stub is attached to the check request.

CRITERIA: All cash disbursements should be supported by proper and sufficient documentation to ensure that transactions have a legitimate business purpose and are recorded accurately in the general ledger.

CAUSE OF CONDITION: Appropriate controls are not in place requiring sufficient documentation to be assembled for all cash disbursements before being approved for payment by the Board.

POTENTIAL EFFECT OF CONDITION: Possibility of fraudulent cash disbursements being approved and processed for payment without being detected. Risk of material misstatement of financial records due to fraudulent transactions and/or misclassification of transactions in the general ledger.

RECOMMENDATION: We recommend that proper internal controls be designed and implemented to ensure that, before a cash disbursement is approved for payment by the Board, all supporting documentation has been assembled to include an original invoice and a properly completed check request, with the related check stub to be attached to the signed check request and supporting documentation after the check has been processed for payment.

DISTRICT'S RESPONSE: The securing of the additional accounting support and clerical personnel referred to in the responses to previous findings will allow for improvement in the financial processes of the District, which should result in the development and implementation of much improved controls over disbursement processing and documentation, as well as other financial-related areas.

**CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014**

ITEM 2014-5

CONDITION: Payroll tax payments are not supported by sufficient documentation to ensure accurate recording in the general ledger and are not being made in a timely manner.

CRITERIA: Payroll tax payments should be supported by documentation sufficient enough to allow verification of the specific payroll that the tax payment applies to, that the amount being paid is correct, that the payment is being made in a timely manner, and that the amount matches the amount of the ACH debit to the bank account.

CAUSE OF CONDITION: Lack of management oversight regarding payroll tax disbursements and lack of controls being in place requiring proper documentation for payroll tax payments and payment of payroll tax deposits within the required time frame.

POTENTIAL EFFECT OF CONDITION: Possibility of material misstatement of payroll tax expense and/or accrued payroll taxes due to inability to determine what tax payments have been made, when they were made, etc., resulting in possible non-payment or duplicate payment of payroll taxes. Non-payment or late payment of payroll taxes can result in penalties being assessed against the District by the taxing authority.

RECOMMENDATION: We recommend that proper internal controls be designed and implemented to ensure that all payroll tax payments are supported by sufficient documentation, such as a payroll register, reflecting the pay period for which the taxes are being paid and the amount of payroll taxes being paid for that period. Each payment should be made within three (3) days of the pay date and should be traced to the bank account to verify that the ACH payment is timely and that the amount is correct.

DISTRICT'S RESPONSE: Management will make sure that the recommended additional documentation will be attached to all future payroll tax payments in an effort to better account for and track these payments. Improved controls in this area will help mitigate the risk of payroll tax deposits not being made in a timely manner, possibly resulting in late payment penalties being levied against the District by the taxing authority.

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

SIGNIFICANT DEFICIENCIES

ITEM 2014-6

CONDITION: Lack of controls over check stock resulting in checks being used out of sequence. Numerous canceled checks were found to have one pre-printed check number and a different check number printed on the check by the computer system (however, all cleared the bank according to the pre-printed number). Numerous check numbers were used multiple times in the check register.

CRITERIA: Internal controls must be designed and implemented to ensure that check stock is secure and only accessible by authorized personnel. Computer controls should be designed and implemented to ensure that check numbers are not allowed to be printed on checks that already contain pre-printed check numbers and that check numbers are not allowed to be entered more than one time in the accounting system.

CAUSE OF CONDITION: Lack of controls being in place to prevent the use of checks out of sequence, to prevent check numbers from being printed by the computer system on pre-numbered checks, and to prevent check numbers from being entered into the accounting system more than one time.

POTENTIAL EFFECT OF CONDITION: Check stock could be used in a fraudulent manner without being detected and financial statements could be materially misstated due to incorrect postings or omitted transactions as a result of the ability to override check numbers in the accounting system.

RECOMMENDATION: We recommend that internal controls be designed and implemented to ensure that only authorized personnel have access to check stock and that checks are used in order of pre-printed numbers. Accounting software should be modified or replaced to ensure that check numbers can only be entered in the accounting system one time to reduce the risk of fraud and misstatement of financial records.

DISTRICT'S RESPONSE: Printer problems related to this condition have been fixed and the accounting department is now paying special attention to the process by which checks are loaded for printing and by which check numbers are entered into the accounting system.

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

ITEM 2014-7

CONDITION: Accrual basis financial reports, including actual-to-budget revenue and expense comparisons, are not provided to the Board on a monthly basis.

CRITERIA: The Board should receive, on a monthly basis, accrual basis financial reports and actual-to-budget revenue and expense comparisons in order to allow the members to satisfactorily perform their duties of financial and operational oversight of the District.

CAUSE OF CONDITION: Lack of proper and timely monthly financial reporting due mainly to the lack of onsite accounting personnel capable of preparing accurate accrual basis financial reports and actual-to-budget revenue and expense comparisons. The prior year's audit reported deficiencies in internal control related to financial reporting but these deficiencies were not corrected or improved upon by the Board or management.

POTENTIAL EFFECT OF CONDITION: The monthly reports currently being provided to the Board are strictly cash basis in nature. Since the profitability of the operations of the District are partially determined by non-cash factors, the Board has no reliable gauge by which to determine the profitability or the efficiency of the Organization's operations. In addition, KRS 65A.080 prohibits the expending of any moneys except as provided in the originally adopted or subsequently amended budget. Accordingly, without an actual-to-budget comparison of revenues and expenses, the Board has no means by which to monitor the District's compliance with this requirement. Overall, material misstatements in the financial statements, whether due to error or fraud, and material non-compliance with regulatory requirements may exist without the Board's awareness.

RECOMMENDATION: Due to the size and funding limitations of the water district, we acknowledge limitations in implementing revisions to the financial reporting procedures. However, we recommend that the Board take immediate action to obtain and review accrual basis reports and actual-to-budget comparisons on a monthly basis. As financial reporting procedures are refined, we would suggest that the Board establish a goal date to begin receiving and reviewing internally prepared financial statements on a quarterly basis. In addition, we recommend that the Board formally implement policies describing how the Board will assess risks, monitor compliance and financial reporting, oversee other internal control related matters, and promote a sound control environment.

**CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014**

ITEM 2014-7 (Continued)

DISTRICT'S RESPONSE: One of the duties of the outside CPA referred to previously will be to prepare monthly financial reports for submission to the Board, which will be prepared on the accrual basis of accounting and will include actual-to-budget comparisons.

ITEM 2014-8

CONDITION: Several issues of material noncompliance exist regarding USDA loan covenants resulting from the lack of proper management and Board oversight, which could possibly result in penalties, fines, etc. being levied against the District. The noncompliance issues are detailed as follows:

1. Transfers required to be made to the Sinking Fund (Debt Service Fund) by the 20th of each month are only being made in a timely manner approximately half the time.
2. Proper records and accounts relating to the operation of the System and the District's financial affairs are not being adequately maintained.
3. Audit reports are not being submitted to the USDA-RD within the required 90-day period following the close of each fiscal year.
4. Proposed annual budget of operating expenses for the next fiscal year is not being prepared within the required 60-day period preceding the end of the current fiscal year.
5. Estimate of next year's gross revenues is not being made within the required 60-day period preceding the current fiscal year end in order to revise rates and charges to sufficiently provide funds needed for the following year's O&M, debt service, and other funding requirements.
6. The annual budget for the next fiscal year is not being adopted before the first day of that year.

CRITERIA: USDA loan covenants must be complied with in order to remain in good standing regarding all outstanding debt with the USDA. Management and/or Board oversight must be sufficient to ensure that the District is constantly in compliance with all loan covenants.

CAUSE OF CONDITION: Lack of management and/or Board oversight regarding the District's compliance with all loan covenants, regardless of the source of the debt.

CAWOOD WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND RESPONSES
Year Ended December 31, 2014

ITEM 2014-8 (Continued)

POTENTIAL EFFECT OF CONDITION: Noncompliance with USDA loan covenants could result in the District being held in default regarding the outstanding USDA debt, possibly resulting in penalties, fines, etc. being levied against the District.

RECOMMENDATION: We recommend that controls be designed and implemented to ensure that all loan covenants, whether from the USDA or other sources, are being strictly complied with in order to prevent the possibility of punitive actions being taken against the District.

DISTRICT'S RESPONSE: The addition of a new clerk and an outside CPA to perform the monthly financial reporting function will allow the staff to perform their duties within the required time frame and should also result in more efficient and effective reports being provided to the Board. This should give the Board a better understanding regarding the activities of the District and give them sufficient information to use in discharging their duty to oversee the financial matters of the District. The timeliness of audits, budgets, and other required reports will be greatly improved as the outside CPA will be submitting these reports to the Board at the second meeting following the close of each month (e.g.: January financial reports will be submitted to the Board at the March meeting). This process should improve the quality and timeliness of year-end information being provided to the auditing firm so that the annual audit and reports to the regulatory authorities will be submitted within the required time frame.