

CAWOOD WATER DISTRICT
Cawood, Kentucky

Financial Statements and Supplemental Information
For the Year Ended December 31, 2015

CAWOOD WATER DISTRICT

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CAWOOD WATER DISTRICT

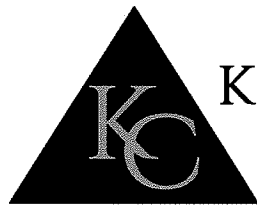
**District Commission Members and Management
December 31, 2015**

District Commission Members

Donnie Britton	Chairperson
Harold Sellers	Treasurer
Timothy Engle	Secretary
Sheila Middleton	Commissioner
Howard Farmer, Jr.	Commissioner

Management

Lana Pace	Finance Officer
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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Cawood Water District
Cawood, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of Cawood Water District (the "District"), as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my 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 I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I 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.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of Cawood Water District as of December 31, 2015, and the changes in financial position and cash flows thereof 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 the Management's Discussion and Analysis on pages 4-6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's response to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Cawood Water District's basic financial statements. The introductory section is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, I do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated February 8, 2017, on my consideration of Cawood Water District's internal control over financial reporting and on my 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 my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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.

Kingsport CPA, PC

Kingsport, Tennessee

February 8, 2017

CAWOOD WATER DISTRICT

Management's Discussion and Analysis For Year Ended December 31, 2015

As financial management of the Cawood Water District (the "District"), we offer readers of these financial statements this narrative overview and analysis of the financial activities of the District for the year ended December 31, 2015. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the financial statements taken as a whole.

Financial Highlights

The District recognized an operating loss of \$122,845 for 2015 compared to operating loss of \$81,898 for 2014. Although operating revenue increased to \$794,751 in 2015, up 2% from 2014 operating revenue of \$776,196, total operating expenses increased \$59,502, up 7% from the prior year. The increased operating loss is primarily due to aging plant equipment and distribution lines. Deteriorating plant equipment caused water production to be less efficient, resulting in increased operating costs. However, extensive upgrades were performed in 2016 to increase the operating efficiency of water production. Similarly, breaks in distribution lines and undetected water losses have been major concerns of the District, requiring additional resources to repair. Preventing, detecting, and repairing line breaks continue to be the area of greatest concern and opportunity for improvement. Capital contributions were received in the form of tap fees and state grants primarily for ongoing capital expansion projects in the amounts of \$18,584 and \$534,763 for the years 2015 and 2014, respectively. Net losses and capital contributions produced a decrease in net position of \$166,535 in 2015 compared to an increase in net position of \$388,701 in 2014. The difference between the two years is primarily due to the significant grant funds received in 2014. The term "net position" refers to the difference between assets and liabilities. As of December 31, 2015, the District had net position of \$7,909,619, a decrease of 2% from \$8,076,154 at the close of 2014.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's financial statements, which are comprised of the basic financial statements and the notes to the financial statements. Since the District consists of a single enterprise fund, no fund level financial statements are shown. In addition, the District has no infrastructure assets and is therefore exempt from required infrastructure disclosures.

Basic financial statements: The basic financial statements are designed to provide readers with a broad overview of the District's finances in a manner similar to a private-sector business.

The statement of net position presents information on all of the District's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the District is improving or deteriorating. Net position increases when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities results in increased net position which indicates an improved financial position.

The statement of revenue, expenses, and changes in net position presents information showing how the District's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The statement of cash flows present cash flows broken down into four categories: cash flows from operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The statement of cash flows relates these amounts to changes in cash balances from the beginning of the year to the end of the year.

Notes to the financial statements: The notes provide additional information that is essential to a full understanding of the information provided in the basic financial statements.

CAWOOD WATER DISTRICT

**Management's Discussion and Analysis (continued)
For Year Ended December 31, 2015**

Financial Analysis

Net position may serve, over time, as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by \$7,909,619 as of December 31, 2015. This represents a decrease of \$166,535 (2%) from the prior year. The unrestricted net position was \$328,043.

The largest portion of the District's net position has historically been its capital assets including significant construction in progress.

The District's net position was as follows as of December 31, 2015 and 2014:

	2015	2014
Current assets	\$ 434,438	\$ 459,205
Capital assets	8,887,944	9,085,480
Restricted assets	237,961	218,893
Total assets	9,560,343	9,763,578
Current liabilities	182,424	174,324
Long-term liabilities	1,468,300	1,513,100
Total liabilities	1,650,724	1,687,424
Net position:		
Net investment in capital assets	7,343,615	7,529,380
Restricted	237,961	218,893
Unrestricted	328,043	327,881
Total net position	\$ 7,909,619	\$ 8,076,154

The District's changes in net position were as follows for the years ended December 31, 2015 and 2014:

	2015	2014
Operating revenues	\$ 794,941	\$ 776,196
Operating expenses	917,596	858,094
Income (loss) from operations	(122,845)	(81,898)
Non-operating revenues (expenses):		
Interest income	184	231
Interest (expense)	(62,458)	(64,395)
Capital Contributions	18,584	534,763
Total non-operating revenues (expenses)	(43,690)	470,599
Increase (decrease) in net position	(166,535)	388,701
Net position, beginning of year	8,076,154	7,687,453
Net position, end of year	\$ 7,909,619	\$ 8,076,154

CAWOOD WATER DISTRICT

Schedule of Findings and Responses (continued) For the Year Ended December 31, 2015

Significant Events

The District has outsourced some of its financial reporting to a local accounting firm. It is expected that this move will provide more timely reporting and additional analysis, allowing the Commissioners to make more informed decisions based upon more current information.

Cash Flows

Net cash provided by operating activities for the year ended December 31, 2015 was \$104,672, a decrease of \$40,434 from 2014 operating cash flows. There was no net cash from noncapital financing activities during the year ended December 31, 2015. Net cash from capital and related financing activities resulted in cash outlays of \$137,320 for the 2015, an increase of \$27,443 from the prior year. Interest earned on savings account in the amount of \$184 provided net cash from investing activities.

Capital Assets and Debt Administration

Capital Assets: The District's investment in capital assets amounted to \$8,887,944 as of December 31, 2015, a decrease of \$197,536 due to depreciation. Capital assets include the water plant, distribution line, meters and hydrants, along with related office and operating equipment.

Long-term Debt: The District had long-term debt in the amount of \$1,513,100 as of December 31, 2015, a decrease of \$43,000 from the prior year.

Summary of Organization and Business

Cawood Water District was created on January 27, 1965 by the Harlan County Fiscal Court under the provisions of Chapter 74 of the Kentucky Revised Statutes and is subject to the regulatory authority of the Kentucky Public Service Commission. The governing board is comprised of five commissioners appointed by the Harlan County Fiscal Court.

The District provides water to the businesses and residents of southern Harlan County, which generates virtually all of the District's operating revenue. Major capital projects are usually funded by state grants.

Final Comments

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

Requests for Information

This financial report is designed to provide a general overview of the District's finances for all interested parties. Questions concerning this report or requests for additional information should be directed to Finance Officer, Cawood Water District, P.O. Box 429, Cawood, Kentucky, 40815.

CAWOOD WATER DISTRICT
Statement of Net Position
December 31, 2015

ASSETS

Current Assets:

Cash and cash equivalents	\$ 315,983
Customer accounts receivable, net	87,088
Prepaid expenses	31,367
Total Current Assets	<u>434,438</u>

Capital Assets:

Utility plant, equipment, and vehicles	11,986,309
Construction in progress	156,255
Accumulated depreciation	(3,254,620)
Total Capital Assets	<u>8,887,944</u>

Restricted Assets:

Depreciation reserve accounts	125,333
Debt service account	112,628
Total Restricted Assets	<u>237,961</u>

TOTAL ASSETS \$ 9,560,343

CAWOOD WATER DISTRICT
Statement of Net Position
December 31, 2015

LIABILITIES AND NET POSITION

Current Liabilities:	
Accounts payable	\$ 84,371
Customer deposits	15,150
Accrued interest payable	31,229
Accrued wages	3,229
Other current liabilities	3,645
Current portion of long-term debt	44,800
Total Current Liabilities	<u>182,424</u>
Long-Term Debt:	
Long-term debt, net of current portion	<u>1,468,300</u>
Total Long-Term Debt	<u>1,468,300</u>
Net Position:	
Net investment in capital assets	7,343,615
Restricted for:	
Depreciation reserve	125,333
Debt service	112,628
Unrestricted	328,043
Total Net Position	<u>7,909,619</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 9,560,343</u>

See accompanying notes

CAWOOD WATER DISTRICT
Statement of Revenue, Expenses, and Changes in Net Position
For the Year Ended December 31, 2015

Operating Revenue:	
Water sales - residential	\$ 675,941
Water sales - commercial	36,195
Other operating revenue	82,615
Total Operating Revenue	794,751
Operating Expenses	
Salaries & wages	238,252
Payroll taxes	19,064
Employee benefits	71,018
Chemicals	30,638
Materials and supplies	19,957
Contractual services	16,978
Insurance	29,900
Office expense	24,051
Utilities	63,397
Repairs and maintenance	65,084
Professional fees	28,750
Purchased water for distribution	35,306
Bad debt expense	16,356
Depreciation expense	227,970
Other operating expenses	30,875
Total Operating Expenses	917,596
Net Operating Income (Loss)	(122,845)
Other Income (Expenses)	
Interest income	184
Interest expense	(62,458)
Total Other Income (Expenses)	(62,274)
Capital Contributions:	
Grants	9,784
Tap fees	8,800
Total Capital Contributions	18,584
Change in Net Position	(166,535)
Net Position - beginning of year	8,076,154
Net Position - end of year	\$ 7,909,619

See accompanying notes

CAWOOD WATER DISTRICT
Statement of Cash Flows
For the Year Ended December 31, 2015

Cash Flows from Operating Activities	
Cash received from customers	\$ 769,454
Cash paid for goods and services	(427,000)
Cash paid to employees	<u>(237,782)</u>
Net Cash Provided by Operating Activities	<u>104,672</u>
Cash Flows from Capital and Related Financing Activities	
Net deposits into restricted accounts	(19,068)
Principal paid on notes payable	(43,000)
Interest paid on debt service	(63,401)
Proceeds from grants and tap fees	8,800
Construction of capital assets in progress	(1,922)
Purchase of capital assets	<u>(18,729)</u>
Net Cash Used by Capital and Related Financing Activities	<u>(137,320)</u>
Cash Flows from Investing Activities	
Interest income	<u>184</u>
Net Cash Provided by Investing Activities	<u>184</u>
Net (Decrease) in Cash	(32,464)
Cash - beginning of year	<u>348,447</u>
Cash - end of year	<u><u>\$ 315,983</u></u>

See accompanying notes

CAWOOD WATER DISTRICT
Statement of Cash Flows
For the Year Ended December 31, 2015

Reconciliation of Operating Income to Net Cash Provided by Operating Activities:

Operating (loss)	\$ (122,845)
Adjustments to reconcile net (loss) from operations to net cash provided by operating activities:	
Depreciation expense	227,970
Bad debt expense	16,356
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	(19,697)
(Increase) decrease in prepaid expenses	(4,356)
Increase (decrease) in accounts payable	18,190
Increase (decrease) in customer deposits	(5,600)
Increase (decrease) in accrued wages	470
Increase (decrease) in other current liabilities	<u>(5,816)</u>
Net Cash Provided by Operating Activities	<u>\$ 104,672</u>

Supplemental Disclosures:

Schedule of Noncash Capital and Related Financing Transactions

Purchase of capital assets from capital grant contributions	<u>\$ 9,784</u>
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See accompanying notes

CAWOOD WATER DISTRICT

Notes to the Financial Statements
For Year Ended December 31, 2015

Note 1 – Reporting Entity and Summary of Significant Accounting Policies

Reporting Entity

Cawood Water District is a water utility which provides services 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) and is subject to the regulatory authority of the Kentucky Public Service Commission (PSC) pursuant to KRS 278.040.

Basis of Presentation

As a special purpose government, 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). The operations of the District are accounted for in a proprietary fund. Proprietary funds are reported using a flow of economic resources measurement focus and the accrual basis of accounting. This is the same measurement focus and basis of accounting used by private business enterprises

Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe how transactions are recorded with the financial statements. Basis of accounting refer to when transactions are recorded regardless of the measurement focus applied.

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Accordingly, all assets, deferred outflows of resources, liabilities, and deferred inflows of resources (whether current or noncurrent) are included in the statement of net position. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

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, 2015 was \$62,761.

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

	<u>December 31, 2015</u>
Total Accounts Receivable	\$ 273,970
Less: Garbage Fees Payable	(113,982)
Less: Sewer Fees Payable	(10,139)
Less: Allowance for Uncollectible Accounts	<u>(62,761)</u>
Customer Accounts Receivable, Net	<u>\$ 87,088</u>

CAWOOD WATER DISTRICT

Notes to the Financial Statements For Year Ended December 31, 2015

Note 1 – 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. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets, ranging from five to sixty years. 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 recorded.

Bad Debts

The District uses the allowance method for recording bad debts. The District's bad debt expense amounted to \$16,356 for the year ended December 31, 2015.

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 water district organized and existing pursuant to the provisions of Kentucky Revised Statutes Chapter 74, which is exempt from federal income taxes pursuant to 26 USC 115 relating to the income of states, municipalities, etc.

Net Position

Net position comprises the various net earnings from operating and nonoperating revenues, expenses, and contributions of capital. Net position is classified in the following three components as applicable: investment in capital assets, restricted net position, and unrestricted net position. Investment in capital assets consists of all capital assets, net of accumulated depreciation, and, if applicable, deferred outflows of resources, reduced by any outstanding debt attributable to the acquisition, construction, and improvement of those assets. Debt or deferred inflow of resources attributable to unspent proceeds or other restricted cash and investments are excluded from the determination. Restricted net position consists of net positions for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations, and enabling legislation, including self-imposed legal mandates. The unrestricted component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position.

Net Position Flow Assumption

Sometimes the District will fund outlays for a particular purpose from both restricted and unrestricted resources. In order to calculate the amounts to report as restricted net position and unrestricted net position in the financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. When both restricted and unrestricted resources are available for use, it is the District's policy to consider restricted net position to have been depleted before unrestricted net position is applied.

CAWOOD WATER DISTRICT

**Notes to the Financial Statements
For Year Ended December 31, 2015**

Note 1 – 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 require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual notes could differ from these 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, 2015, Cawood Water District had total cash on deposit with a financial institution that exceeded the FDIC insured limits by \$171,038. 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 year ended December 31, 2015.

Date of Management's Review

The District's management has evaluated events and transactions occurring after the statement of net position date for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date of the report which is the date these financial statements were available to be issued.

CAWOOD WATER DISTRICT

**Notes to the Financial Statements
For Year Ended December 31, 2015**

Note 2 – Capital Assets

Capital asset activity for the year ended December 31, 2015 was as follows:

	Balance 1/1/15	Additions	Retirements/ Transfers	Balance 12/31/15
Capital assets not being depreciated:				
Land	\$ 28,750	\$ -	\$ -	\$ 28,750
Construction in progress	144,549	11,706	-	156,255
Total capital assets not being depreciated	173,299	11,706	-	185,005
Capital assets being depreciated:				
Water Plant	1,184,717	6,354	-	1,191,071
Distribution Lines	9,629,518	-	-	9,629,518
Meters & Hydrants	668,465	12,374	-	680,839
Office Equipment	44,578	-	-	44,578
Plant Equipment	289,733	-	-	289,733
Vehicles	121,820	-	-	121,820
Total capital assets being depreciated	11,938,831	18,728	-	11,957,559
Accumulated depreciation:				
Water Plant	(474,748)	(23,747)	-	(498,495)
Distribution Lines	(1,820,345)	(162,225)	-	(1,982,570)
Meters & Hydrants	(435,364)	(19,445)	-	(454,809)
Office Equipment	(36,609)	(4,540)	-	(41,149)
Plant Equipment	(138,342)	(17,435)	-	(155,777)
Vehicles	(121,242)	(578)	-	(121,820)
Total accumulated depreciation	(3,026,650)	(227,970)	-	(3,254,620)
Net capital assets being depreciated	8,912,181	(209,242)	-	8,702,939
Capital assets, net	\$ 9,085,480	\$ (197,536)	\$ -	\$ 8,887,944

Depreciation expense for the year ended December 31, 2015 was \$227,970.

CAWOOD WATER DISTRICT

**Notes to the Financial Statements
For Year Ended December 31, 2015**

Note 3 – Long-Term Debts/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 \$273,000 and \$106,000, respectively, as of December 31, 2015, 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 \$247,300 and \$247,300, respectively as of December 31, 2015, with \$7,900 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 4.5%, with interest payable each January and July 1st, and maturing principal amounts payable on January 1st of each year through 2043. The principal balance on these bond issuances was \$305,000 as of December 31, 2015, with \$6,000 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 on 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 \$334,500 as of December 31, 2015, with \$6,000 principal due next year.

Long-term debt activity for the year ended December 31, 2015 is as follows:

<u>Debt Issuance</u>	<u>Balance, 1/1/2015</u>	<u>Principal Payments</u>	<u>Balance, 12/31/2015</u>
Series 1989 A	\$ 284,000	\$ 11,000	\$ 273,000
Series 1989 B	112,000	6,000	106,000
Series 1995 A	254,800	7,500	247,300
Series 1995 B	254,800	7,500	247,300
Series 2004	310,000	5,000	305,000
Series 2010	<u>340,500</u>	<u>6,000</u>	<u>334,500</u>
Totals	<u>\$ 1,556,100</u>	<u>\$ 43,000</u>	<u>\$ 1,513,100</u>

CAWOOD WATER DISTRICT

**Notes to the Financial Statements
For Year Ended December 31, 2015**

Note 3 – Long-Term Debts/Bonds (continued)

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

<u>Year(s)</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 44,800	\$ 60,492	\$ 105,292
2017	47,400	58,399	105,799
2018	49,700	56,209	105,909
2019	52,500	53,883	106,383
2020	55,300	51,426	106,726
2021-2025	330,900	214,327	545,227
2026-2030	352,800	131,860	484,660
2031-2035	274,200	72,392	346,592
2036-2040	130,000	35,381	165,381
2041-2045	117,000	12,206	129,206
2046-2049	<u>58,500</u>	<u>2,081</u>	<u>60,581</u>
Totals	<u>\$ 1,513,100</u>	<u>\$ 748,656</u>	<u>\$ 2,261,756</u>

Note 4—Bond Funding Requirement

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 in to the Revenue Fund account in accordance with its bond resolutions and funds all other fund accounts from this account in order of priorities in the bond resolutions.

Sinking Fund

Monthly deposits to the Sinking Fund (identified with the name “Debt Service Account”) are to be make 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 of \$8,774 are required for the upcoming year.

At December 31, 2015, the balance of the Sinking Fund was \$112,628. A summary of the yearly activity is presented below:

Bond Sinking Fund

Beginning balance on January 1, 2015	\$ 99,008
Deposits made during the year	120,000
Interest income earned	20
Principal and interest payments	<u>(106,400)</u>
Ending balance on December 31, 2015	<u>\$ 112,628</u>

CAWOOD WATER DISTRICT

Notes to the Financial Statements For Year Ended December 31, 2015

Note 4—Bond Funding Requirement (continued)

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, 2015 was \$450, with a required reserve account balance of \$106,920. Monies in the Depreciation Reserve Fund are restricted in their withdrawal and use by the prior and current bond resolutions. At December 31, 2015, the balance of the Depreciation Reserve Fund was \$125,333, resulting in a surplus of \$18,413.

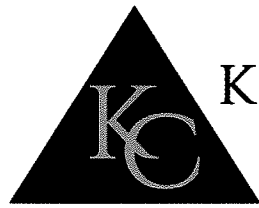
Note 5 – Commitments

The bond issuances of 1990 and 1996, referred to in Note 3 above, are secured by a statutory mortgage lien against the District's system. The bond issues in 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 6—Grants

The District has received grants from various state agencies primarily to be used for capital improvements. All receipts of grant funds are presented as capital contributions on the statements of revenue, expenses, and changes in net position. Grants received and available for the year ended December 31, 2015 are as follows:

- The District received a grant of \$2,000,000 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. The District received no disbursements and recognized no revenue under this grant for the year ended December 31, 2015. As of December 31, 2015, funds totaling \$51,784 remain available under this grant for future expenditures.
- The District received a reimbursement grant up to \$57,930 from the Commonwealth of Kentucky, Transportation Cabinet, executed December 18, 2015, for the purpose of relocating utility lines related to a bridge replacement. For the year ended December 31, 2015, the District recognized revenue of \$9,784. As of December 31, 2015, grant funds in the amount of \$48,146 remain available for future expenditures



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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 Board of Commissioners
Cawood Water District
Cawood, Kentucky

I 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 Cawood Water District (the "District") as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued my report thereon dated February 8, 2017.

Internal Control over Financial Reporting

In planning and performing my audit of the financial statements, we considered the 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 my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, I do not express an opinion on the effectiveness of the District's internal control.

My 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. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. 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: 2015-001.

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: 2015-002, 2015-003

Compliance and Other Matters

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

Cawood Water District's Response to Findings

Cawood Water District's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Cawood Water District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, I 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, the communication is not suitable for any other purpose.

Kingsport CPA, PC

Kingsport, Tennessee

February 8, 2017

CAWOOD WATER DISTRICT

**Schedule of Prior Year Findings
For the Year Ended December 31, 2015**

Finding Number	Finding Title	Status
2014-1	Account reconciliations (original finding # 2013-2)	Partially corrected; repeated
2014-2	Journal entry documentation (original finding # 2013-3)	Corrected
2014-3	Proper accounting records (original finding # 2013-5)	Partially corrected; repeated
2014-4	Documentation of cash disbursements	Repeated
2014-5	Payroll tax payments	Corrected
2014-6	Controls over check stock	Corrected
2014-7	Financial reports for Board	Partially corrected; repeated
2014-8	Noncompliance with loan covenants	Corrected

CAWOOD WATER DISTRICT

**Schedule of Findings and Responses
For the Year Ended December 31, 2015**

ITEM 2015-001: Proper accounting records / reconciliations (repeated; original # 2013-2, 2013-5)

CONDITION: Not all transactions are being posted to the general ledger in a manner or in sufficient detail to allow accurate and timely financial reporting to internal and external users of the information.

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

CAUSE OF CONDITION: The District uses a custom software package for all accounts receivable related functions, including billing, customer adjustments, write-offs, and security deposits. This accounts receivable software does not interface with the District's general ledger accounting software. Increases and decreases to customer balances are summarized and posted to the general ledger as an adjusting journal entry. However, the summary does not provide sufficient detail to determine the source of the increase or decrease and no standard reports are available within the system to reconcile the various balances. Furthermore, no person is charged with reconciling the two systems or maintaining subsidiary journals for the underlying balances and transactions.

POTENTIAL EFFECT OF CONDITION: Accounts receivable and related accounts can be materially misstated without being detected and corrected. The limited information which is available also limits the ability of management and commissioners to make well-informed decisions.

RECOMMENDATION: It is recommended that internal controls be designed and implemented, including updates to the accounts receivable software, to allow for sufficient detail of general ledger and appropriate reporting to maintain subsidiary ledgers. This should also include procedures to train personnel involved in the accounts receivable to maintain appropriate documentation of adjustments, write-offs, and security deposit transactions.

DISTRICT'S RESPONSE: Management concurs with this finding. Management will communicate with the software developer to design more standard reports to effectively address the issues and attempt to revise current procedures.

CAWOOD WATER DISTRICT

**Schedule of Findings and Responses (continued)
For the Year Ended December 31, 2015**

ITEM 2015-002: Documentation of cash disbursements (partially corrected, repeated, original #2014-4)

CONDITION: Not all cash disbursements are supported by proper documentation, such as invoice and general ledger posting account.

CRITERIA: All cash disbursement 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 for the physical flow of documentation and reports through the accounting function.

POTENTIAL EFFECT OF CONDITION: This could result in material misstatement of financial information due to duplicate payments, unrecorded liabilities, and misclassification of expense items.

RECOMMENDATION: It is recommended that the current purchase order system be revised to appropriately record purchases, documenting the related budget-line item and/or general ledger account on the face of the purchase order.

DISTRICT'S RESPONSE: Management concurs with this finding and will continue developing procedures to implement auditor's recommendation.

CAWOOD WATER DISTRICT

**Schedule of Findings and Responses (continued)
For the Year Ended December 31, 2015**

ITEM 2015-003: Financial reporting to Board (partially corrected, repeated, original #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 commissioners to satisfactorily perform their duties of financial and operational oversight of the District.

CAUSE OF CONDITION: Since cash flow is a primary concern for management and commissioners, most management reports have been historically prepared on the cash basis and focused upon immediate cash needs.

POTENTIAL EFFECT OF CONDITION: In many cases, if the information received is on the cash basis, the Board may inadvertently be distracted from addressing non-cash factors that impact the financial performance of the District and has no reliable gauge by which to determine the profitability or efficiency of District's operations. Furthermore, 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, both monthly and year-to-date, the Board has no means by which to monitor the District's compliance with this requirement.

RECOMMENDATION: It is recommended that the Board formally implement a system of internal control to address the "tone at the top", which will permeate the entire Organization. This system of internal control should address five components: 1) the control environment, 2) risk assessment, 3) control activities, 4) information and communication, and 5) monitoring. It will not only address the current issue of financial reporting to the Board, but will also allow the Board to focus on areas which will make the biggest difference.

DISTRICT'S RESPONSE: Management concurs with this finding and has been developing reports to improve communication and financial monitoring.