

MOUNTAIN WATER DISTRICT

REPORT OF AUDIT

DECEMBER 31, 2013

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Mountain Water District
Pikeville, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of Mountain Water District, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Mountain Water District's basic financial statement 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 opinions 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. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statement are free from material misstatement.

An audit involves performing procedure to obtain audit evidence about the amounts and disclosures in the financial statements. The procedure 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 presentations 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 evidence I obtained is sufficient and appropriate to provide a basis for my audit opinions.

Opinions

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Mountain Water District, as of December 31, 2013, and the respective changes in financial position and where applicable, cash flows thereof for the year ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and budgetary comparison information on pages 3-5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of 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 methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge 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 assurance.

Other Reporting Required by Governmental Auditing Standards

In accordance with Governmental Auditing Standards, I have also issued my report dated August 30, 2014, on my consideration of Mountain Water District's internal control over financial reporting and on 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 Governmental Auditing Standards in considering Mountain Water District's internal control over financial reporting and compliance.

The financial statements for the year ended December 31, 2012 are being presented for comparison purposes only. They were audited by Griffith Delaney, Hillman & Company dated September 25, 2013 in which and Unmodified Opinion was expressed.

Richard F. Paulmann CPA, LLC

Richard F. Paulmann CPA-MBA

Crestwood, KY
September 4, 2014

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2013

Our discussion and analysis of the Mountain Water District's financial performance provides an overview of the District's financial activities for the fiscal year ended December 31, 2013. Please read it in conjunction with the accompanying basic financial statements. It is our intent that this discussion provide all parties interested in the District's financial condition, especially the users of the facilities, a better understanding of the District's operations and financial status.

The District reports its financial statements in a required model format issued by the Governmental Accounting Standards Board.

Financial Highlights

- Net assets decreased this year by \$2,465,242 from operating activities and before capital contributions.
- The District's total long-term debt decreased by \$728,878 with additional loan proceeds of \$181,572 and payment on the outstanding principal of \$802,049, plus \$108,401 of debt cancelled per the agreement with the management service company.
- The District acquired several vehicles through financing.
- The District was able to make the following purchases:
 1. Significant water and sewer line extensions to the outlying areas of Pike County.
 2. Assorted new equipment for treatment plant and distribution system to facilitate daily operations.

Overview of the Financial Statements

The District's basic financial statements include: (1) fund financial statements, and (2) notes to the financial statements. These financial statements present information about business-type activities, which consists principally of the fees the District charges its users to cover all or most of the cost of the services it provides.

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2013
(CONTINUED)

Fund Financial Statements

The fund financial statements provide detailed information about the proprietary fund. When the District charges customers for services it provides, these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the District's enterprise funds (a component of proprietary funds) are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows for proprietary funds.

Notes to the financial statements

The accompanying notes to the financial statements provide information essential to a full understanding of the fund financial statements. The notes to the financial statements begin immediately following the basic financial statements.

Reporting on the District as a Whole

One of the most important questions asked about the District's finances is, "Is the District as a whole better off or worse off as a result of this year's activities?" The statements of Fund Net Assets and the Statement of Revenue, Expenses and Changes in Fund Net Assets report information about the District as a whole and about its activities in a way that helps answer this question.

Our discussion begins with an analysis of overall revenues and expenses and their treatment. An overwhelming majority of the District's revenue is received from charges for services.

The District's total revenues increased from a year ago by \$92,244 (1.0%). The increase was the result of an incline in residential usage, while total cost of all programs and services (including depreciation) increased by \$55,242 (0.5%). Interest expense decreased by \$99,767 due in large part to the refinancing of bonds in 2012, at lower interest rates. This trend is expected to remain approximately the same through the next fiscal year end.

Financial Analysis of the District's Proprietary Fund

At year-end, the District's proprietary fund reported total net assets of \$74,743,148, which is an increase of \$2,686,561 or (3.7%) from last year.

Capital Assets

As noted above, the District was able to

make several capital asset purchases without additional debt.

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2013
(CONTINUED)

Debt/Advances in Construction

At year-end, the District had various bond/notes payables to various lenders with a combined remaining balance of \$13,779,446 to be paid from utility revenues.

As of December 31, 2013, the District had received advances for construction towards projects not completed in the amount of \$5,401,265. During 2012, various construction projects were completed allowing the advances for construction from the prior year in the amount of \$5,000,431 to be transferred to capital contributions from government grants.

Contacting the District's Financial Management

This financial report is designed to provide our customers, creditors, and other users with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Treasurer, at the Mountain Water District, P. O. Box 3157, Pikeville, KY 41502, telephone number (606) 631-9162.

STATEMENT OF FINANCIAL POSITION
,December 31, 2013
(with prior year data for comparison purposes only)

| | 2013 | 2012 |
|---|----------------------|----------------------|
| ASSETS | | |
| <u>CURRENT ASSETS</u> | | |
| Cash and Cash Equivalents | \$ 204,752 | \$ 275,671 |
| Accounts Receivable (Net of Allowance for Delinquencies of \$49,000 in 2013 and \$52,000 in 2012) | 970,349 | 1,006,435 |
| TOTAL CURENT ASSETS | \$ 1,175,101 | \$ 1,282,106 |
| <u>NONCURRENT ASSETS</u> | | |
| Restricted Assets | | |
| Cash-Depreciation Reserve | 575,742 | 456,678 |
| Cash-Construction | 687,233 | 670,973 |
| Cash-Customer Deposits | 380,296 | 361,731 |
| Cash-Recycling Account | 1,262 | 3,629 |
| Cash-Operation and Maintenance Reserve | 16,534 | 16,517 |
| Cash-Wastewater Operation and Maintenance Reserve | 565,514 | 428,941 |
| Cash-Sinking Fune | 439,048 | 321,513 |
| TOTAL RESTRICTED CASH | 2,665,629 | 2,259,982 |
| Capital Assets | | |
| Supply & Pumping | 3,372,662 | 3,368,712 |
| Water Treatment Equipment | 9,231,954 | 9,231,954 |
| Transmission & Distributiion | 84,751,581 | 82,774,724 |
| General Plant | 4,321,613 | 4,298,594 |
| Land and Land Rights | 534,875 | 534,875 |
| Sewer Utility Plant | 27,597,671 | 24,402,155 |
| Sewer General Plant | 582,125 | 445,891 |
| Total Capital Assets | 130,392,481 | 125,056,905 |
| Less: Accumulated Depreciation | (44,368,333) | (40,759,599) |
| Net Capital Assets | 86,024,148 | 84,297,306 |
| Construction in Progress | 5,008,870 | 8,063,672 |
| OTHER ASSETS | | |
| Deposit on Leased Vehicles | 625 | 625 |
| Bond refinancing Cost- Net of Amortization | 88,002 | 91,442 |
| TOTAL OTHER ASSETS | 88,627 | 92,067 |
| <u>TOTAL NONCURRENT ASSETS</u> | 93,787,274 | 94,713,027 |
| <u>TOTAL ASSETS</u> | \$ 94,962,375 | \$ 95,995,133 |

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF FINANCIAL POSITION
,December 31, 2013
(with prior year data for comparison purposes only)

| | <u>2013</u> | <u>2012</u> |
|--|----------------------|----------------------|
| <u>LIABILITIES</u> | | |
| <u>CURRENT LIABILITIES</u> | | |
| Accounts Payable | \$ 526,713 | \$ 576,066 |
| Other Accrued Liabilities | 27,112 | 29,370 |
| Accrued Interest | 172,606 | 162,579 |
| Customer Deposits | 312,035 | 291,742 |
| Bonds Payable, Current | 43,266 | 51,000 |
| Notes Payable and Capital Leases, Current | <u>904,227</u> | <u>928,895</u> |
| TOTAL CURRENT LIABILITIES | 1,985,959 | 2,039,652 |
| <u>LONG-TERM LIABILITIES</u> | | |
| Bonds Payable, long-Term | 3,870,234 | 3,914,154 |
| Notes Payable and Capital Leases, Long-Term | 8,961,769 | 9,614,325 |
| Advances For Construction | <u>5,401,265</u> | <u>8,373,415</u> |
| TOTAL LONG-TERM LIABILITIES | 18,233,268 | 21,901,894 |
| <u>TOTAL LIABILITIES</u> | <u>20,219,227</u> | <u>23,941,546</u> |
| <u>NET ASSETS</u> | | |
| Invested in Capital Assets, Net of Related Debt | 71,852,257 | 69,479,189 |
| Restricted for: | | |
| Construction | 687,233 | 670,973 |
| Depreciation, Maintenance and Replacement | 1,311,730 | 1,056,073 |
| Customer Deposits | 68,262 | 69,988 |
| Unrestricted | <u>823,666</u> | <u>780,364</u> |
| <u>TOTAL NET ASSETS</u> | <u>74,743,148</u> | <u>72,056,587</u> |
| <u>TOTAL LIABILITIES AND NET ASSETS</u> | <u>\$ 94,962,375</u> | <u>\$ 95,998,133</u> |

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND ASSETS
 FOR THE YEAR ENDED DECEMBER 31, 2013
 (With prior year data for comparison purposes only)

| | <u>2013</u> | <u>2012</u> |
|--|-------------|-------------|
| <u>OPERATING REVENUE</u> | | |
| Metered Sales-Residential | \$6,565,930 | \$6,403,370 |
| Metered Sales-Commercial | 705,969 | 701,329 |
| Sewage Revenue | 917,414 | 936,239 |
| Metered Sales-Multi-Family | 260,990 | 256,103 |
| Metered Sales-Public Authorities | 268,995 | 284,208 |
| Customer Late Payment Charges | 192,896 | 209,655 |
| Other Water Service Revenue | 129,633 | 216,486 |
| Service Connection Fees | 165,658 | 91,916 |
| Metered Sales-Industrial | 41,469 | 57,404 |
| Fire Protection Revenue | 1,200 | 1,200 |
| | <hr/> | <hr/> |
| TOTAL OPERATING REVENUE | 9,250,154 | 9,157,910 |
| <u>OPERATING EXPENSES</u> | | |
| Contract Service-Management | 7,258,888 | 7,138,394 |
| Depreciation | 3,608,734 | 3,451,970 |
| Material and Supplies | 43,097 | 240,463 |
| Wages | 153,080 | 141,600 |
| Contract Service-Accounting | 70,901 | 70,462 |
| Education, Dues and Meetings | 39,100 | 39,748 |
| Contract Service-Legal | 47,225 | 35,928 |
| Rate Study | - | 17,698 |
| Taxes & Licenses | - | 15,964 |
| Payroll Taxes | 8,625 | 15,735 |
| Retirement Expense | 19,513 | 14,639 |
| Auto and Transport Expense | 5,956 | 12,017 |
| Settlement Fees | 510 | 8,429 |
| Advertising | 7,464 | 4,370 |
| Bad Debt | - | 3,000 |
| Amortization Expense | 3,440 | 874 |
| | <hr/> | <hr/> |
| TOTAL OPERATING EXPENSE | 11,266,533 | 11,211,291 |
| | <hr/> | <hr/> |
| OPERATING LOSS | (2,016,379) | (2,053,381) |
| <u>NON-OPERATING REVENUE (EXPENSES)</u> | | |
| Gain On Sale of Assets | 2,800 | 3,500 |
| Interest Income | 2,886 | 2,838 |
| Interest Expense | (454,549) | (554,316) |
| | <hr/> | <hr/> |
| TOTAL NON-OPERATING REVENUE (EXPENSES) | (448,863) | (547,978) |
| | <hr/> | <hr/> |
| LOSS BEFORE CAPITAL CONTRIBUTIONS AND OTHER CHANGES IN NET ASSETS | (2,465,242) | (2,601,359) |

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND ASSETS
 FOR THE YEAR ENDED DECEMBER 31, 2013
 (With prior year data for comparison purposes only)

| | <u>2013</u> | <u>2012</u> |
|---|----------------------|----------------------|
| <u>CAPITAL CONTRIBUTIONS AND OTHER CHANGES</u> | | |
| <u>IN NET ASSETS</u> | | |
| Capital Contributions from: | | |
| Government Grants | 5,000,430 | 5,681,812 |
| Customers through Tap-on Fees | <u>151,373</u> | <u>195,725</u> |
| <u>TOTAL CAPITAL CONTRIBUTIONS AND</u> | | |
| <u>OTHER CHANGES IN NET ASSETS</u> | <u>5,151,803</u> | <u>5,877,537</u> |
| <u>CHANGE IN NET ASSETS</u> | <u>2,686,561</u> | <u>3,276,178</u> |
| <u>NET ASSETS, BEGINNING OF YEAR</u> | <u>72,056,587</u> | <u>68,780,409</u> |
| <u>NET ASSETS, END OF YEAR</u> | <u>\$ 74,743,148</u> | <u>\$ 72,056,587</u> |

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013
(with prior year data for comparison purposes only)

| | <u>2013</u> | <u>2012</u> |
|---|--------------------|--------------------|
| <u>CASH FLOWS FROM OPERATING ACTIVITIES</u> | | |
| Receipts from Customers | \$9,286,240 | \$9,123,616 |
| Payment to Suppliers | (7,552,890) | (7,254,147) |
| Payment to Employees | (153,080) | (141,600) |
| | <u>1,580,270</u> | <u>1,727,869</u> |
| <u>NET CASH PROVIDED BY OPERATING ACTIVITIES</u> | | |
| <u>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</u> | | |
| Increase (Decrease) In Customer Deposits | <u>18,565</u> | <u>6,378</u> |
| <u>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</u> | | |
| Proceeds From Tap-On Fees | 151,373 | 195,725 |
| Construction in Aid of Construction | 5,000,430 | 5,681,812 |
| (Decrease) Increase in Advances for Construction | (2,972,150) | (4,302,648) |
| Purchases of Plant & Equipment | (5,336,534) | (218,922) |
| Increase in Construction in Progress | 3,054,802 | (1,330,269) |
| Principal Payments | (910,450) | (1,288,134) |
| Interest Payments | (438,836) | (633,485) |
| Proceeds of Bank Loan | 181,572 | 425,963 |
| Debt Issuance Costs | | (92,316) |
| Proceeds from Sale of Vehicles | <u>2,800</u> | <u>3,500</u> |
| | <u>(1,266,993)</u> | <u>(1,558,774)</u> |
| <u>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</u> | | |
| <u>CASH FLOWS FROM INVESTING ACTIVITIES</u> | | |
| Interest Income | <u>2,886</u> | <u>2,838</u> |
| | <u>334,728</u> | <u>178,311</u> |
| <u>NET INCREASE IN CASH</u> | | |
| | 2,535,653 | 2,357,342 |
| <u>CASH, BEGINNING OF YEAR</u> | | |
| | \$ 2,870,381 | \$ 2,535,653 |
| <u>CASH, END OF YEAR</u> | | |

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012
(with prior year date for comparison purposes only)

"Continued"

| | 2013 | 2012 |
|--|---------------------|---------------------|
| <u>RECONCILIATION OF OPERATING LOSS</u> | | |
| <u>TO NET CASH PROVIDED BY</u> | | |
| <u>OPERATING ACTIVITIES</u> | | |
| Operating Loss | \$ (2,016,379) | \$ (2,053,381) |
| Adjustments to Reconcile operating Loss to Net Cash Provided by Operating Activities | | |
| Depreciation | 3,608,734 | 3,451,970 |
| Amortization | 3,440 | 874 |
| Cancellation of Debt Payments | | (103,126) |
| (Decrease) Increase in Provision for Uncollectible Accounts | 3,000 | (3,000) |
| Decrease (Increase) In: | | |
| Customer Accounts Receivable | (22,058) | (20,650) |
| Other Accounts Receivable | 55,144 | 57,943 |
| Prepaid Expenses | - | - |
| Increase (Decrease) In: | | |
| Accounts Payable: | | |
| Trade | (49,353) | 395,900 |
| Construction in progress | - | (551) |
| Other Accrued Liabilities | (2,258) | 1,890 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 1,580,270 | \$ 1,727,869 |
| NON-CASH CAPITAL AND RELATED FINANCINGS ACTIVITIES | | |
| During the period the Company purchased Vehicles in exchange for long term debt. | \$ 20,039 | \$ 124,087 |
| During the period the Company Completed Certain construction projects that were transferred to capital assets. | \$ 5,044,706 | \$ 6,874,838 |
| Refinance of Bonds | \$ - | \$ 6,270,000 |
| Gain on Sale of Assets | \$ (2,800) | \$ (3,500) |

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Mountain Water District ("the District") conform to generally accepted accounting principles as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The following is a summary of the more significant policies:

A. Organization

Mountain Water District is a political subdivision of the Pike County Fiscal Court, organized under chapter 74 of the Kentucky Revised Statutes. It was formed from a merger of four existing water districts-Marrowbone Water District, Shelby Valley Water District, Pond Creek Water District, and John's Creek Water District- on June 30, 1986 and at that time assumed all assets and liabilities of the existing water districts.

The territorial limits of Mountain Water District, set by the Pike County Judge/Executive on January 20, 1987, are all of Pike County except; (1) the territory of that portion of the Sandy Valley Water District located in Pike County (2) the water services area of the City of Pikeville, and (3) special financing relationships.

B. Reporting Entity

The District is the basic level of government which has financial accountability and control over all activities related to the District. The District is not included in any other governmental "reporting entity" as defined by GASB pronouncement. The Board of Commissioners have decision making authority, the power to designate management, the ability to influence operations, and the primary accountability for fiscal matters. There are no component units as defined in GASB Statement 14 which included in the District's reporting entity.

C. Basis of Presentation-Fund Accounting

The accounts of the District are organized on the basis of funds each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures, or expenses, as appropriate.

Proprietary Funds/Enterprises Funds

Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises-where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for accountability, capital maintenance, public policy, management control, or other purposes.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Basis of Accounting

All proprietary funds are accounted for using the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when obligations are incurred.

E. Encumbrance Accounting

The District does not use encumbrance accounting. Since effective budgetary control and accountability and cash planning and control can be facilitated without encumbrance accounting, this is not considered departure from generally accepted accounting principles. There were no unperformed contracts in process at year end which otherwise might have resulted in the need to encumber estimated expenditures.

F. Customer Accounts Receivable

Customer accounts receivable are stated at face value, less allowance for uncollectible accounts. Changes in the allowance are charged to operating expenses.

G. Capital Assets

Capital Assets, which included property, plant and equipment, are reported in the fund financial statements at historical cost.

Depreciation is recorded as an allocated expense in the Statement of Revenues, Expenses and Changes in Fund Net Assets with accumulated depreciation reflected in the Statement of Fund Net Assets. Depreciation is computed using straight-line method over the estimated useful lives of the related assets. Estimated useful lives range from 3 to 40 years.

Capital additions improvements and major renewals are capitalized, whereas maintenance, repairs and minor renewals are charged to expenses when they are incurred. In the case of disposals, the assets and related reserves are removed from the accounts and the net amount less any proceeds from disposals, is charged or credited to revenues.

H. Cash and Cash Equivalents

For purpose of the statement of cash flows, the District considered all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

As of December 31, 2013, cash consisted of the following:

| | |
|-------------------|----------------------------|
| Petty Cash | \$ 320 |
| Cash in Bank | 204,432 |
| Restricted Cash | <u>2,665,629</u> |
| Total Cash | <u>\$ 2,870,381</u> |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

I. Bad Debts

Bad debts are recognized using the reserve method of accounting for uncollectible accounts.

J. Inventory

Inventory is valued at lower of cost or market on a First-In, First-Out Basis. The management service company took over ownership of the inventory and its maintenance until the contract with them is completed.

K. Investment Policy

The District's policy is to invest available funds in the following:

1. Obligations of the U.S. and its agencies and Instrumentalities.
2. Obligations and contract for future delivery of purchases of obligations backed by the full faith and credit of the U.S. or a U.S. Government agency, including but not limited to"
 - a) United States Treasury
 - b) Export-Import Bank of the United States.
 - c) USDA-Rural Development
 - d) Government National Mortgage Corporation, and
 - e) Merchant Marine Bonds
3. Obligations of any corporation of the U.S. Government.
4. Certificate of Deposit issued by other interest bearing accounts of any bank or savings and loan institutions which are issued by the Federal Deposit Insurance Corporation or similar entity of which are collateralized, to the extent uninsured, by any obligation permitted by section 41.240(4) of the Kentucky revised statutes.
5. Uncollateralized certificates of deposits issued by any bank or savings and loans institution rated in one of the three highest categories by a national recognized rating agency.
6. Bankers' Acceptance for banks rated in one of three highest categories by a nationally recognized rating agency.
7. Commercial paper rated in the highest categories by a nationally recognized rated agency.
8. Bonds or certified of indebtedness of the Commonwealth of Kentucky and of its agencies or instrumentalities.
9. Securities issued by a state or local government, or any instrumentality or agency thereof, in the U.S. , and rated in one the three highest categories by a nationally recognized rating agency.
10. Shares of mutual funds, which contain certain characteristics.

Limits on investments transactions are limited in amount in one category to 20% of the total funds invested and no investment shall be purchased on a margin basis.

The District is currently invested only in interest bearing accounts of local federal insured financial institutions, including interest bearing checking accounts and certificates.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

L. Leave Policy-Vacation/Leave Policy-Sick Leave

The District allows full-time employees to accrue vacation leave as follows: (a) ten (10) days during the first year of employment. Employees can accrue vacation time up to a maximum of twice the annual entitlement. If an accrual of twice the annual vacation entitlement is attained, additional vacation days do not accrue. Upon termination of employment, an employee shall be paid for all accrued vacation leave.

Employees shall accrue sick leave at the rate of ten (10) days per year. Employees can accrue sick leave up to a maximum of 160 hours, after the maximum is obtained no additional sick leave is accrued. Upon termination, resignation, retirement or voluntary leave, the employee shall not be reimbursed for the accrued leave hours.

As of December 31, 2013 and December 31, 2012, the accrued liability for vacation leave was -0- and -0-, respectively.

M. Advertising

The company expenses advertising costs as incurred. Total advertising costs charged to expense for the years ended December 31, 2013 and 2012 are \$7,464 and \$4,370, respectively.

N. Equity Classifications

In the fund financial statements, equity classified as net assets and displayed in three components.

- Invested in capital assets, net of related debt-Consist of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowing that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted net assets-Consist of net assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- Unrestricted net assets-All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

2. EMPLOYEE RETIREMENT SYSTEMS

The District has elected to participate in the County Employee Retirement System (CERS) pursuant to KRS 78.530, administered by the Board of Trustees of the Kentucky Retirement System. This is a multiple employer public retirement system which covers all eligible full-time-employees. Benefit contributions and provisions are established by statute. Non-hazardous covered employees are required to contribute 5 percent of their salary to the Plan. The District's contribution rate for non-hazardous employees was 18.96 percent.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

2. EMPLOYEE RETIREMENT SYSTEMS (Continued)

Benefits fully vest on reaching five years of service for non-hazardous employees. Aspects of benefits for non-hazardous employees included retirement after 27 years of service or age 65.

The District's payroll for the year ended December 31, 2013 was \$153,080. The payroll for employees covered under CERS was \$113,577. The contributions required for CERS for the year was \$27,504 which consisted of \$21,829 of District contributions and \$5,675 of employee contributions.

The District's payroll for the year ended December 31, 2012 was \$141,600. The payroll for employees covered under CERS was \$111,600. The contributions required for CERS for the year was \$14,639 which consisted of \$9,059 of District contributions and \$5,580 of employee contributions.

3. FIXED ASSETS

The following is a summary of changes in fixed asset:

| Description | Balance January 1 <u>2013</u> | <u>Additions</u> | <u>Dispositions</u> | Balance December 31 <u>2013</u> |
|-----------------------------|-------------------------------------|--------------------|---------------------|---------------------------------------|
| Supply & Pumping | \$3,368,712 | \$ 3,950 | \$ -0- | \$3,372,662 |
| Water Treatment Equipment | 9,231,954 | -0- | -0- | 9,231,954 |
| Transmission & Distribution | 82,774,724 | 1,976,857 | -0- | 84,751,581 |
| General Plant | 4,298,594 | 23,019 | -0- | 4,321,613 |
| Land and Land Rights | 534,875 | -0- | -0- | 534,875 |
| Sewer Utility Plant | 24,402,155 | 3,195,516 | -0- | 27,597,671 |
| Sewer General Plant | <u>445,891</u> | <u>136,234</u> | <u>-0-</u> | <u>582,125</u> |
| Totals | 125,056,905 | 5,335,576 | -0- | 130,392,481 |
| Accumulated Depreciation | <u>(40,759,999)</u> | <u>(3,608,734)</u> | <u>- 0-</u> | <u>(44,368,333)</u> |
| Net Utility Plant | <u>\$84,297,306</u> | <u>\$1,726,842</u> | <u>\$(-0-)</u> | <u>\$86,024,148</u> |

| Description | January 1 <u>2012</u> | <u>Additions</u> | <u>Dispositions</u> | December 31 <u>2012</u> |
|-----------------------------|--------------------------|--------------------|---------------------|----------------------------|
| Supply & Pumping | \$3,358,362 | \$ 10,350 | \$ -0- | \$3,368,712 |
| Water Treatment Equipment | 6,380,590 | 2,581,364 | -0- | 9,231,954 |
| Transmission & Distribution | 80,434,366 | 2,340,358 | -0- | 82,774,724 |
| General Plant | 4,243,436 | 124,087 | (68,929) | 4,298,594 |
| Land and Land Rights | 534,875 | -0- | -0- | 534,875 |
| Sewer Utility Plant | 22,663,261 | 1,738,894 | -0- | 24,402,155 |
| Sewer General Plant | <u>383,095</u> | <u>62,796</u> | <u>-0-</u> | <u>445,891</u> |
| Totals | 117,997,985 | 7,127,849 | (68,929) | 125,056,905 |
| Accumulated Depreciation | <u>(37,376,558)</u> | <u>(3,451,970)</u> | <u>68,929</u> | <u>(40,759,905)</u> |
| Net Utility Plant | <u>\$80,621,427</u> | <u>\$3,675,879</u> | <u>\$(-0-)</u> | <u>\$84,297,306</u> |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

3. FIXED ASSETS (Continued)

Depreciation expense was \$3,608,734 and \$3,451,970 for the years ended December 31, 2013 and 2012, respectively.

4. CONSTRUCTION IN PROGRESS

Mountain Water District has overseen several construction projects. As of December 31, 2013, the following projects were in progress.

Water Projects

| | |
|-------------------------------|------------|
| Tank Rehab Southern Corrosion | \$ 675,433 |
| Jonican | 584,807 |
| Bad Fork | 231,397 |
| Russell Fork Treatment Plant | 266,631 |
| Majesterial District 2 | 5,801 |
| Various In House Projects | 642,958 |

Sewer Projects

| | |
|---------------------------|------------------|
| Phelps/Buskirk | 168,513 |
| Henry Clay | 138,708 |
| Belfry Pond Sewer | 281,707 |
| Douglas | 55,174 |
| Sewer Rehabilitation | 71,361 |
| Sandy Valley 201 | 49,900 |
| Various In-House Projects | <u>1,836,480</u> |

Total Construction in Progress **\$ 5,008,870**

5. CUSTOMER DEPOSIT FUND

Deposits required from customers when they sign up for the water service are deposited into the customer deposit escrow account. When services are terminated or a customer has paid in a timely fashion, a refund of the deposit plus interest is given after a year of water service. Customer deposits as of December 31, 2013 and December 31, 2012 were \$312,035 and \$291,742, respectively, and are currently held in escrow.

6. COMMITMENTS AND CONTINGENCIES

The District has been committed to several construction projects that have not been either started or completed as of the date of this report.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

7. CONSTRUCTION FUNDS

Mountain Water District has several construction accounts used for the water projects. These are as follows:

| | <u>2013</u> | <u>2012</u> |
|--|--------------------------|--------------------------|
| Big Creek Sewer Coal Settlement | \$ 24,134 | \$ 24,135 |
| District Wide Tap Fees | 258,501 | 268,765 |
| Misc. Line Extensions | 7,970 | 7,949 |
| MWD Special Projects | 1,405 | 1,538 |
| Phelps/Buskirk Waste Water | 14,632 | 14,545 |
| Shelby Waste Water | 61,117 | 60,934 |
| Penny Road Water and Sewer | 44,868 | 44,868 |
| Cowpen Waste Water Project | 1,860 | 1,860 |
| Elk Creek Project | 2,372 | 2,374 |
| Water Treatment Plant Upgrade | 1 | (20) |
| Water Treatment Raw Water Intake | 25 | 25 |
| LMI Service Contract | 656 | 104 |
| Various Short Line Extensions | 175 | 162 |
| Telemetry Project | 100 | 100 |
| Watson Hill Water Line | 85 | 85 |
| Long Fork Virgie Sewer Project | 100 | 100 |
| Belfry Pond Sewer Project | 100 | 100 |
| Smith Fork Waste Water Phase II | 100 | 100 |
| Pike County Fiscal Court Projects | 226,173 | 228,077 |
| Repair and Maintenance Reimbursement | 991 | 30 |
| MWD Rehabilitation Project | 23,550 | 110 |
| Sewer Customer Deposit | <u>18,318</u> | <u>15,032</u> |
| <u>Total Construction Funds</u> | <u>\$ 687,233</u> | <u>\$ 670,973</u> |

8. SUBSEQUENT EVENTS

In Preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through September 4, 2014 the date the financial statements were available to be issued.

9. RECLASSIFICATIONS

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

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

10. DEPOSITS WITH FINANCIAL INSTITUTIONS

At December 31, 2013, the carrying amount of the District's deposits with financial institutions was \$2,870,381 and the bank balance, per statements was \$2,994,132. The Bank balance is categorized as follows:

| | |
|--|----------------------------|
| Amount insured by FDIC | \$ 750,000 |
| Amount collateralized by securities held by third party trust company in the District's name | <u>2,256,385</u> |
| <u>Total Bank Balance</u> | <u>\$ 3,006,385</u> |

Pledged collateral was obtained for amounts up to \$1,693,665 for money on deposit at Community Trust Bank in the name of Mountain Water District.

Pledged Collateral was obtained for accounts up to \$562,720 for money on deposit with BB&T and Community Trust Bank in the name of Mountain Water District.

11. RESTRICTED ASSETS AND RESERVE NET ASSETS

Each of the proprietary funds has a portion of its net assets restricted in connection with assets restricted in uses, such as bond interest and redemption, depreciation, and customer deposits. Restricted net assets includes excess of restricted cash over liabilities payable from restricted cash.

As of December 31, 2013 and 2012 restricted cash were as follows:

| | <u>2013</u> | <u>2012</u> |
|-------------------------------------|---------------------------|---------------------------|
| Depreciation Reserve | \$ 575,742 | \$ 456,678 |
| Sinking Fund | 439,048 | 321,513 |
| Customer Deposit Escrow Account | 380,296 | 361,731 |
| Operation & Maintenance reserve | 16,534 | 16,517 |
| Waste Water O & M Reserve | 565,514 | 428,941 |
| Recycling Account | 1,262 | 3,629 |
| Construction Account (Note 7) | <u>687,233</u> | <u>670,973</u> |
| <u>Total Restricted Cash</u> | <u>\$2,665,629</u> | <u>\$2,259,982</u> |

The District is required by debt covenants to pay into and maintain a Depreciation Reserve Fund, a Repair and Maintenance Fund and Operation and Maintenance Fund. These Amounts may be used for extraordinary maintenance expenses related to the project or for costs of replacing worn obsolete portions or the project. If Amounts are withdrawn from said funds, the District must make required periodic deposits until the required balance is reinstated.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

11 RESTRICTED ASSETS AND RESERVE NET ASSETS (Continued)

| | Maximum Required Balance | Required Balance at <u>12/31/13</u> | Actual Balance At <u>12/31/13</u> |
|-------------------------------|---|--|--|
| Depreciation Reserve Funds | \$851,400 | \$ 700,425 | \$ 575,742 |
| Repairs and Maintenance Funds | 866,168 | <u>848,043</u> | <u>582,048</u> |
| Total | | <u>\$1,548,468</u> | <u>\$1,157,790</u> |

The Repair and Maintenance Funds required by Kentucky Infrastructure Authority (KIA) loan agreements are underfunded by \$265,995. This deficiency resulted from not making scheduled deposits to the reserve and from transfers to the operating account to make loan payments on several debt obligations. Such disbursements do not meet the criteria for appropriate withdrawals indicated by the KIA loan agreements.

The Depreciation Reserve Funds Required by USDA-Rural Development (RD) loan requirements are underfunded by \$124,683. This deficiency resulted from not making scheduled deposits to the reserve and from transfers to the operating account to make loan payments on several debt obligations. Such disbursements do not meet the criteria for appropriate withdrawals indicated by the RD loan agreements.

Mountain Waters management stated during the field work that there is verbal agreement to transfer \$11,000 to Kentucky Infrastructure Authority reserves and \$9,000 monthly to Rural Development Reserves until the deficit is made up. These payments were transferred during 2013.

The USDA-Rural Development (RD) loan agreements also include a requirement for an Operation and Maintenance Fund. The funding of this reserve is secondary to the Depreciation Reserve Funds.

12. BONDS PAYABLE

| | <u>2013</u> | <u>2012</u> |
|---|-------------|-------------|
| Shelby Waste Water Project Fund | | |
| The 4.125% sewer system revenue bonds issued July 22, 2005 in the original amount of \$740,000 are payable to USDA-Rural Development to the year 2045. The bonds are secured by a statutory Mortgage lien on the utility plant service and a pledge of all water revenues from the system | \$678,500 | \$688,500 |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

12 BONDS PAYABLE (Continued)

| | <u>2013</u> | <u>2012</u> |
|---|---------------------------|---------------------------|
| Phelps Waste Water Project Bond The 4.5% sewer system revenue bonds issued October 23, 2003 in the original amount of \$426,000 are payable to USDA-Rural Development to the year 2043. The bonds are secured by a statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system. | \$ 384,000 | \$390,000 |
| Feds creek Project The 3.5% revenue bonds issued July 2002 in the original amount of \$800,000 are payable to USDA-Rural Development to the year 2035. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system. | \$688,000 | \$702,000 |
| Johns Creek The 4.125% revenue bonds issued November 2005 in the original amount of \$1,650,000 are payable to USDA-Rural Development to the year 2027. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system. | \$1,534,000 | \$1,555,654 |
| Russell Fork Water Plant Project The 4.5% revenue bonds issued April 2009 in the original amount of \$650,000 are payable to USDA-Rural Development to the year 2047. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and pledge of all water revenue from the system. | <u>\$ 629,000</u> | <u>\$ 629,000</u> |
| Total bonds | <u>\$3,913,500</u> | <u>\$ 3,965,154</u> |
| Less current portion | <u>(43,266)</u> | <u>(51,000)</u> |
| Long Term Bonds Payable | <u><u>\$3,870,234</u></u> | <u><u>\$3,915,154</u></u> |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

12 BONDS PAYABLE (Continued)

Maturities of these long-term bonds are as follows:

| | Principal | Interest |
|-----------|--------------------|--------------------|
| 2014 | 62,000 | 158,151 |
| 2015 | 63,500 | 155,911 |
| 2016 | 66,500 | 153,040 |
| 2017 | 70,000 | 150,328 |
| 2018 | 73,000 | 147,462 |
| 2019-2023 | 410,500 | 690,218 |
| 2024-2028 | 506,000 | 598,603 |
| 2029-2033 | 621,500 | 485,815 |
| 2034-2038 | 766,500 | 346,395 |
| 2039-2043 | 905,500 | 175,877 |
| 2044-2048 | <u>368,500</u> | <u>30,487</u> |
| | <u>\$3,913,500</u> | <u>\$3,092,287</u> |

13. NOTES PAYABLE AND CAPITAL LEASES

| | <u>2013</u> | <u>2012</u> |
|---|--------------|--------------|
| Kentucky Rural Water Finance Corporation The 3.14% note issued August 2012 120 the original amount of \$6,270,000, payable in monthly installments, with payments through August 2039, secured by water revenues from the system. | \$ 6,100,000 | \$ 6,270,000 |
| Kentucky Infrastructure Authority-Multi-Area The 2.9% note issued June 1994 in the original Amount of \$5,165,093, payable in semi-annual Installments of \$129,479, with payments through the year 2023, secured by water revenues from the system. | 2,233,980 | 2,424,010 |
| Kentucky Infrastructure Authority-Indian Creek The 3% note issued June 1994 in the original amount of \$377,760, payable in semi-annual installments of \$8,577, with payments though the year 2023, secured by water revenue from the system. | 147,254 | 159,709 |
| Kentucky Infrastructure Authority-F01-07 The 1.8% note issued January 2002 in the original amount of \$1,197,072 payable in semi-annual of \$35,769, with payments through the year 20024 secured by water revenues from the system. | 681,655 | 740,123 |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENT
DECEMBER 31, 2013 AND 2012

13 NOTES PAYABLE AND CAPITAL LEASES (Continued)

| | <u>2013</u> | <u>2012</u> |
|---|-------------|-------------|
| Kentucky Infrastructure Authority A03-06 The 1% note issued June 2004 in the original Amount of \$226,776, payable in semi-annual Installments of \$6,846 with payments through the year 2023, secured by water revenues from the system. | 106,123 | 115,206 |
| Kentucky Infrastructure Authority A209-32 The 1% note issued January 2010 in the original amount of \$750,000 with \$390,750 in principle forgiveness, payable in semi-annual installments of \$5,212, with payments through the year 2031, secured by water revenues from the system. | 325,186 | 342,109 |
| <u>Community Trust Bank</u> A purchase agreement, original balance \$22,588 at 5.08% interest; secured by a vehicle; payments are \$678 for 36 months, maturing September 2014. | 5,960 | 13,644 |
| <u>Community Trust Bank</u> A purchase agreement, original balance \$20,710 at 3.36% interest, secured by vehicle; payments are \$462 for 48 months, maturing November 2015 | 10,301 | 15,462 |
| <u>Community Trust Bank</u> A purchase agreement, original balance \$30,105 at 4.75% interest; secured by vehicle; payments are \$690 for 45 months maturing July 2015. | 11,905 | 19,482 |
| <u>Community Trust Bank</u> A purchase agreement, original balance \$30,105 at 4.75% interest; secured by vehicle; payments are \$690 for 48 months maturing July 2015 | 11,909 | 19,478 |
| <u>Community Trust Bank</u> The District has a line of credit providing for a maximum borrowing of \$400,000. Interest and principle on this note is payable monthly at the rate of 6%. The line of credit is secured by assets of the District. | -0- | 39,898 |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

13 NOTES PAYABLE AND CAPITAL LEASES (Continued)

| | <u>2013</u> | <u>2012</u> |
|--|-------------|-------------|
| <u>Community Trust Bank</u> | | |
| The District has a line of credit providing for maximum borrowing of \$275,000. Interest on this note is payable monthly at the rate of 4.5%. The lone of credit is secured by assets of the District. | 90,953 | 113,367 |
| <u>Utility Management Group</u> | | |
| A note payable, original balance of \$500,000 at 5% interest; secured by assets of the District; Payments are \$9,436 for 60 months, maturing April 2014. | 37,353 | 145,754 |
| <u>Community Trust Bank</u> | | |
| A lease purchase agreement, original balance \$34,251; at 5.22% interest; secured by a vehicle; Payments are \$792 for 48 months, maturing October 2013. | -0- | 6,926 |
| <u>Community Trust Bank</u> | | |
| A lease purchase agreement, original balance \$34,625; at 3.99% interest; secured by a vehicle; Payments are \$638 for 23 months and a final Balloon payment of \$22,246, maturing April 2014. | 23,838 | 30,400 |
| <u>Community Trust Bank</u> | | |
| A lease purchase agreement, original balance \$34,625; at 3.99% interest; secured by a vehicle; Payments are \$638 for 23 months and a final Balloon payment of \$22,246, maturing April 2014. | 23,633 | 30,400 |
| <u>Chrysler Financial</u> | | |
| A lease-purchase agreement, original balance \$37,580 at 0% interest; secured by a vehicle; Payments are \$792 for 48 months, maturing October 2013. | -0- | 6,926 |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

13 NOTES PAYABLE AND CAPITAL LEASES (Continued)

Community Trust Bank

A lease purchase agreement, original balance \$27,580; at 3.99% interest; secured by a vehicle; payments are \$623 for 23 months with a final balloon payment of \$14,970, maturing September 2014.

19,413 25,961

Community Trust Bank

A lease purchase agreement, original balance \$27,256; at 3.99% interest; secured by vehicle; payments are \$503 for 23 months with a final balloon payment of \$17,511, maturing May 2014.

19,216 24,355

Community Trust Bank

A lease purchase agreement, original balance \$20,039; at 3.99% interest; secured by a vehicle; Payments are \$453 for 23 months with a final balloon payment of \$13,294, maturing May 2015.

17,317 -0-

Total Notes Payable

9,865,996 10,543,220

Less current portion

(904,227) (928,859)

Total Line term Debt

\$8,961,769 \$9,614,325

Maturity of the long term debt and capital leases are as follows:

| | Principal | Interest |
|-----------|--------------------|---------------------|
| 2014 | \$ 976,412 | \$ 259,152 |
| 2015 | 702,776 | 242,192 |
| 2016 | 701,412 | 223,926 |
| 2017 | 696,775 | 209,506 |
| 2018 | 701,821 | 193,400 |
| 2019-2023 | 3,152,949 | 691,910 |
| 2024-2028 | 1,352,016 | 376,484 |
| 2029-2033 | 984,999 | 192,929 |
| 2034-2038 | 537,911 | 65,558 |
| 2039-2041 | <u>58,925</u> | <u>2,376</u> |
| | <u>\$9,865,996</u> | <u>\$ 2,457,433</u> |

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

14. ADVANCES FOR CONSTRUCTION

Water Projects

| | |
|---------------------|------------|
| Bad Fork | |
| Abandoned Mine Land | \$ 231,397 |
| In House Projects | 835,619 |
| Debt Service money | |
| Coal Severance | 582,527 |
| Tank Rehabilitation | |
| Coal Severance | 1,254,807 |

Sewer Projects

| | |
|---|---------------------------|
| Phelps Waste Water | |
| Kentucky Infrastructure Authority | 122,441 |
| Douglas WTP | |
| LGEDF Funds | 50,174 |
| Henry Clay Sewer Projects: | |
| COE Section 531 | 45,391 |
| LGEDF Funds | 92,641 |
| Belfry Pond | |
| Coal Severance | 281,707 |
| Private Funding | 1,833,110 |
| Water Waste Rehab | |
| Coal Severance | <u>71,451</u> |
| <u>Total Advances for Construction</u> | <u>\$5,401,265</u> |

15. MANAGEMENT SERVICE AGREEMENT

In January, 2011 the District entered into another five (5) year agreement with a management service company to manage the daily operations, water facilities and waste water facilities for the District. Each period during the term commencing January 1 and ending the following December 31 shall be referred to as an "Agreement Year". Either party shall have the right, without cause, to terminate the agreement at the end of the third agreement year. Notice of termination shall be given in writing no less than 120 days in advance of the effective date of termination. The management service company compensation under the agreement shall consist of an annual fee. The annual fee for the first year, which shall be the period January 1, 2011 through December 31, 2011, shall be \$7,632,000. The annual fee shall be adjusted annually to provide that management service company will be paid 70% of the increase in total operating revenue based on the District's two most recent prior year's audits. If the annual revenue decreases, there will likewise be a downward adjustment in the fee based on the same ratio. Included in the annual fee is the allowance for maintenance and repair, which shall initially be \$564,000. The maintenance and repair budget shall adjust annually in direct proportion with any adjustment in the annual fee.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

On March 27, 2014 the District renewed another three (3) year agreement with a management service company to manage the daily operations, water facilities and waste water facilities for the District. Each period during the term commencing January 1 and ending the following December 31 shall be referred to as an "Agreement Year". Either party shall have the right, without cause, to terminate the agreement at the end of the third agreement year. Notice of termination shall be given in writing no less than 120 days in advance of the effective date of termination. The management service company compensation under the agreement shall consist of an annual fee. The annual fee for the first year, which shall be the period January 1, 2014 through December 31, 2014, shall be \$7,680,850. The annual fee for 2015 and 2016, shall be \$7,757,660.

Total management fees paid for this service for the year ended December 31, 2013 were \$7,602,935 less certain expenses assumed by the management service company totaling \$344,047, resulting in net payment of \$7,258,888.

In April 2009 certain amendments to the management service agreement contract were agreed to as follows:

- 1.) Management service company will provide the District a \$500,000 loan. This loan will be amortized over a period of five (5) years at a simple interest rate of 5% per annum. For each full month that the contract remains in effect or is extended or renewed, the management service company agrees to "forgive" or otherwise not require that a payment actually be made from the District to the management service company. Should the contract or any renewal or extension not be in place between the District and the management service company the total amount of the unamortized balance of the loan at the time of the contract has ended or is no longer in effect. Should repayment of the loan be required, the loan will be repaid at \$9,436 per month and matures as follows:

| | Principal | Interest |
|------|------------------|---------------|
| 2014 | <u>37,353</u> | <u>390</u> |
| | <u>\$ 37,353</u> | <u>\$ 390</u> |

INDEPENDENT AUDITORS'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

Board of Commissioners
Mountain Water District
Pikeville, KY

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 statement of the business type activities of Mountain Water District as of and for the year December 31, 2013, and the related notes to the financial statements, which collectively comprise Mountain Water District's basic financial statements and have issued my report thereon dated September 4, 2014.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented; or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies; in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Mountain Water District's financial statements are free from material misstatement, I performed test 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results to that testing; and not to provide an opinion on the effectiveness of the organization'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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Richard F. Paulmann, CPA, LLC.

Richard F. Paulmann CPA-MBA

Crestwood, KY
September 4, 2014