

HARDIN COUNTY WATER DISTRICT NO. 2

INDEPENDENT AUDITOR'S REPORT
ON FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

YEARS ENDED DECEMBER 31, 2013 AND 2012

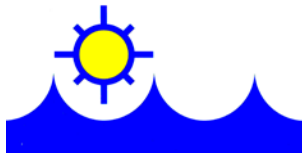
HARDIN COUNTY WATER DISTRICT NO. 2

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LETTER OF TRANSMITTAL



Hardin County Water District No. 2

360 Ring Road • P.O. Box 970 • Elizabethtown, KY 42702

Telephone (270) 737-1056 • Fax (270) 737-2301 • www.hardincountywater2.org

Board of Commissioners: Mike Bell, Cordell Tabb, John Effinger, Morris Miller, Tim Davis

General Manager: James Jeffries

February 21, 2014

Dear Hardin County Water District No. 2 Board of Commissioners,

We are pleased to submit the Financial Report for Hardin County Water District No. 2 for the year ended December 31, 2013. This report has been prepared in accordance with generally accepted accounting principles (GAAP), as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board.

Responsibility for both the accuracy of the data presented and the completeness and fairness of presentation, including all disclosures, rests with the District. We believe the data as presented is accurate, that it is presented in a manner designed to fairly set forth the financial position and the results of operations of the District as measured by its continued compliance with all state, federal and local reporting and accounting regulations, and that all disclosures necessary to enable the reader to gain maximum understanding of the District's financial affairs have been included.

District management's narrative on the financial activities of the District is in the Management's Discussion and Analysis (MD&A) section of this report immediately following the Independent Auditor's Report. The letter of transmittal is written to complement the MD&A and the financial statements, and should be read from that perspective, and in conjunction with all other sections of the report.

This report is a joint effort between our staff and Stiles, Carter, and Associates, Certified Public Accountants. I would like to recognize Ms. Amber Pike for her role in leading the District in this effort. I also recognize Ms. Lea Ona Sims for her continued role in keeping the finances of the District. Mr. Brian Woosley was the lead auditor for Stiles, Carter, and Associates and our staff spent several hours working closely with Mr. Woosley to complete this report.

Financial Performance and Highlights

Operating revenue for 2013 was \$8,531,494, down 0.1% from 2012's performance of \$8,541,028. This result follows the other metrics of active customer count and volume delivered by the water treatment plant, both of which were down slightly for the year.

The District Staff held a tight grip on expenses in 2013. Total operating expenses for 2013 finished at \$6,251,297, a decrease from the 2012 result of \$6,261,013. The decrease without depreciation is \$58,962, or 1.3%. Operating expenses without depreciation hit \$4.5 million in 2010 and has been capped at that level for 3 years now.

Your Water Professionals
An Equal Opportunity Provider and Employer

Capital Improvement and Projects

The District construction crew completed the final phase of the E-town Loop project, laying over 4300 feet of 24" ductile iron pipe along Overall-Phillips Road and Highway 31W. Approximately \$400,000 of District operation reserve funds were required to complete the funding of the project. The E-town Loop has been a 20 year effort of the District and is now complete.

Construction crews also completed the first section of the North South Connector. This is a 16" ductile iron connection on the right-of-way of the new Patriot Parkway that will provide a high volume interconnection with District No. 1. A BRAC grant in the amount of \$495,000 was used to purchase the materials for this first section that measured 9,965 feet of pipeline. The first section was tied into the distribution system at Highway 220 and put into service. The second section of the project will involve another 3.5 miles of pipeline and the connection with District 1. It is estimated that \$700,000 of materials will be required to complete the project.

The Springfield Tank project was approved by DOW and a contract with Phoenix Fabricators was signed for the construction of the tank in 2012. Phoenix completed the pillar by the close of that year and was ready for the District to put water in the tank by November of 2013 as per the schedule. The District completed the funding of the project by using \$270,000 of operational reserves.

The Springfield Tank will be filled from the Case Loop Pump Station which was awarded to Scott and Ritter Construction. The project was kicked off in the spring of 2013 and was to be completed by the end of the year. The project ran 2 months behind schedule and was in operation in February of 2014. The construction cost of \$622,500 was wholly funded from District operational reserves.

Also, during the 2013 construction season, the District expanded the Customer Service Center located at 360 Ring Road, Elizabethtown. ICON Engineering was selected to be the architects and the construction contract was awarded to EH Construction at a cost of \$744,800. The District took occupancy of the 3265 square foot expansion in September, and the first meeting in the new board room was held on September 17, 2013. The project was also funded from District reserves.

On whole, the District is managing a record amount of capital projects. By the close of 2013, there were over \$50M in capital projects under way. This amount is peaking and we expect that, over the next three years, capital spending will return to normal levels under \$10M.

Water Operations

The District water treatment plant treated and delivered 1.83 billion gallons during the year. This was flat against the 1.84 billion gallons delivered in 2012. Capacity utilization was an average of 65.3% as total gallons sold to customers finished at 1.56 billion gallons versus 1.55 billion gallons in 2012. The distribution leak percentage did see significant favorable movement in 2013. The T&D department responded to 245 leaks in 2013 compared to 308 in 2012. The leak percentage landed at 11.5%, down from 14.9% in 2012.

The District had no violations for water quality or reporting requirements. We experienced favorable audits in all areas including: workers compensation audit, DOW audit, PSC inspection, fire safety inspection, bacteriological laboratory inspection, and the fluoride inspection. The District did not issue any boil water advisories during the year.

Your Water Professionals
An Equal Opportunity Provider and Employer

Distribution personnel installed 172 new meters during the year compared to 320 for 2012. The outlook for new meter sales continues to be pessimistic. New meters kept pace with a slight erosion of occupancy in the service area resulting in a customer count of 17,200 at the end of the year compared to 17,263 at the end of 2012.

Safety remains a priority in the day-to-day culture of the District. While employees of the District face very specific hazards including working in trenches, around highways, and in heavy construction environments; we continue to make safety our first concern. District employees experienced no lost-time accidents and no OSHA recordable accidents for 2013. Our sights are still on becoming the only water district in the State of Kentucky to win the Governor's Safety Award twice, a goal that requires 250,000 hours worked without a lost-time accident.

Elizabethtown Water Works Acquisition

On September 17, the Board executed a Letter of Intent with the City Council of Elizabethtown to purchase the City's water works and acquire their customer base of approximately 10,000 customers. By the close of 2013, GRW Engineering was under contract to perform a 6 month study for the merger of the two distribution systems and evaluate the condition of the City's water assets. Stiles, Carter, and Associates were tapped to perform the independent financial analysis.

The acquisition also places the conversion of the City Springs water treatment plant conversion to chloramines squarely on the District. Kenvirons Engineering was hired to perform the preliminary engineering report for this conversion and advise the District on the design, construction schedule and probable cost for the modifications.

Current wisdom suggests that the closure of the acquisition will take place in October of 2014. The approval process includes the Division of Water, Public Service Commission, County Fiscal Court, and finally the two parties to the transaction.

Closing Remarks

Your District continues to excel. Major projects are being completed while even bigger projects are being launched. Water efficiency continues to improve while overall water costs are the same as they were three years ago in 2010. We continue to be challenged with a capital project load of \$50 million going into 2014 with the added task of absorbing 10,000 new customers through the Elizabethtown acquisition. We believe that 2013 was worthy of celebration, and still, the best is yet to come.

It has been a pleasure for the staff to bring these results to the Board of Commissioners for their consideration and review. On behalf of all the employees of the District, it has been a pleasure to provide the highest quality service to our customers for another year.



James R. Jeffries
General Manager

INDEPENDENT AUDITOR'S REPORT

CHRIS R. CARTER, CPA
SCOTT KISSELBAUGH, CPA
BRIAN S. WOOSLEY, CPA



STILES, CARTER & ASSOCIATES, P.S.C.

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Hardin County Water District No. 2 as of and for the years ended December 31, 2013 and 2012, and the related notes to the 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

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Hardin County Water District No. 2, as of December 31, 2013 and 2012, and the respective changes in financial position and cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the District adopted GASB No. 65, *Items Previously Reported as Assets* and GASB 66, *Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62* during the year.

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 7-11 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Hardin County Water District No. 2's basic financial statements. Schedules I and II are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

The letter of transmittal and Schedule III have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2014, on our consideration of Hardin County Water District No. 2's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 Hardin County Water District No. 2's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Stiles, Carter & Associates".

Certified Public Accountants
Elizabethtown, Kentucky
February 21, 2014

REQUIRED SUPPLEMENTARY INFORMATION

**HARDIN COUNTY WATER DISTRICT NO. 2
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2013**

The discussion and analysis of Hardin County Water District No. 2's financial performance provides an overall review of the District's financial activities for the year ended December 31, 2013. The intent of this discussion and analysis is to review the District's financial performance as a whole. Readers should also review the basic financial statements and notes to the basic financial statements to enhance their understanding of the District's financial performance.

FINANCIAL HIGHLIGHTS

- The ending cash and investment balance for the District was \$20.8 million. The balance at December 31, 2012, was \$20.7 million. This reflects an increase in cash and investments during the year of \$.1 million.
- The District completed the Case Loop, North/South Connector, Springfield Tank and Office Expansion projects. The District continued the Louisville Water Interconnection, and Nolin River Projects and began the West Bryan Road Project
- The District signed a letter of intent to purchase the City of Elizabethtown, Kentucky, water system.
- The District invested approximately \$4.4 million in capital assets during the year.

USING THIS ANNUAL REPORT

The basic financial statements report information about the District using full accrual accounting methods as utilized by similar business activities in the private sector. The basic financial statements include a statement of net position; a statement of revenues, expenses, and changes in fund net position; a statement of cash flows; and notes to the basic financial statements.

The ***statement of net position*** presents the financial position of the District on a full accrual historical cost basis. The statement presents information on all of the District's assets and liabilities, with the difference reported as net position. Over time, increases and decreases in net position are one indicator of whether the financial position of the District is improving or deteriorating.

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the ***statement of revenues, expenses, and changes in fund net position*** presents the results of the District's activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the District's recovery of its costs. Rate setting policies use different methods of cost recovery not fully provided for by generally accepted accounting principles. The primary objectives of the rate model are to improve equity among customer classes and to ensure that capital costs are allocated on the basis of long-term capacity needs, ensuring that growth pays for growth.

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

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

ENTITY-WIDE FINANCIAL ANALYSIS

Net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$56.6 million and \$53.1 million as of December 31, 2013 and 2012.

The largest portion of the District's net position reflects its investment in infrastructure and capital assets (e.g., land, buildings, vehicles, equipment, transmission and distribution systems and construction in progress), less any related debt used to acquire those assets that is outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets.

(Table 1)
Summary of Net Position
as of December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Assets		
Current and		
Other Assets	\$ 21,901,545	\$ 21,810,822
Capital Assets	<u>52,318,346</u>	<u>49,623,359</u>
Total Assets	<u>74,219,891</u>	<u>71,434,181</u>
Liabilities		
Long-term liabilities	15,766,538	16,708,762
Other Liabilities	<u>1,851,611</u>	<u>1,653,229</u>
Total Liabilities	<u>17,618,149</u>	<u>18,361,991</u>
Net Position		
Net investment in capital assets	35,376,479	31,882,499
Restricted for debt service	2,342,331	2,325,504
Unrestricted	<u>18,882,932</u>	<u>18,864,187</u>
Total Net Position	<u>\$ 56,601,742</u>	<u>\$ 53,072,190</u>

Unrestricted net position, the portion of net position that can be used to finance day-to-day operations (without constraints established by debt covenants, enabling legislation or other legal requirements), was stable at \$18.9 million at December 31, 2013. Restricted net position increased \$17 thousand (.7%). Net investment in capital assets increased by \$3.5 million (10.9%).

(Table 2)
Changes in Net Position
Years Ended December 31, 2013 and 2012

	2013	2012
OPERATING REVENUES:		
Water sales	\$ 8,232,221	\$ 8,239,333
Other operating income	299,273	301,695
Total operating revenues	8,531,494	8,541,028
OPERATING EXPENSES:		
Power purchased	400,095	422,513
Purchased water	529	2,497
Pumping and treatment labor	420,741	449,330
Purification supplies and expense	464,194	499,310
Transmission and distribution labor	1,163,600	1,126,329
Transmission and distribution supplies and expense	179,915	213,231
Transmission and distribution maintenance and repairs	50,968	43,592
Equipment rental	991	636
Transportation expense	178,327	197,721
Water treatment maintenance and expense	59,317	90,496
General and administrative expenses	1,649,671	1,581,655
Depreciation	1,682,949	1,633,703
Total operating expenses	6,251,297	6,261,013
OPERATING INCOME	2,280,197	2,280,015
NON-OPERATING REVENUES (EXPENSES):		
Investment income	(305,337)	685,322
Other income	107,191	96,207
Gain (loss) on disposal of assets	(9,862)	14,101
Interest expense on long-term debt	(550,960)	(816,561)
Interest expense on customer deposits	(512)	(1,509)
Amortization of bond discount and expense	(70,469)	(77,982)
TOTAL NON-OPERATING REVENUES (EXPENSES)	(829,949)	(100,422)
Capital contributions	2,079,301	3,172,304
Increase in net position	\$ 3,529,549	\$ 5,351,897

Operating revenue was down.09% as compared to the prior year. Total operating expenses decreased .16%. Interest expense on long-term debt decreased 32.5% as the District refunded its 2003 Series and 2005A Series revenue bonds in 2012. The District continues to receive capital contributions through the State of Kentucky, the Federal government, other governments and individual developers.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2013 and 2012, the District had \$52.3 million and \$49.6 million invested in a variety of capital assets, as reflected in the following table:

(Table 3)
Capital Assets (Net of Depreciation)
as of December 31, 2013 and 2012

	2013	2012
Non-Depreciable Assets:		
Land and land rights	\$ 687,483	\$ 600,983
Depreciable Assets:		
Structures and improvements	2,983,240	2,328,949
Supply mains	838,465	882,564
Water treatment plant	7,286,657	7,383,993
Standpipes, tanks and foundations	6,400,390	4,274,469
Transmission and distribution mains	27,966,150	25,100,005
Services and meters	3,653,632	3,618,849
Hydrants	29,053	61,743
Office furniture and fixtures	175,639	32,853
Transportation equipment	353,278	409,124
Communication equipment	-	-
Other property and equipment	159,109	82,699
Capital assets in service	50,533,096	44,776,231
Construction in progress	1,785,250	4,847,128
Total capital assets, net of depreciation	<u>\$ 52,318,346</u>	<u>\$ 49,623,359</u>

(Table 4)
Changes in Capital Assets
Years Ended December 31, 2013 and 2012

	2013	2012
Beginning balance	\$ 49,623,359	\$ 46,506,267
Additions	4,396,198	5,406,674
Retirements	(18,262)	(655,879)
Depreciation	(1,682,949)	(1,633,703)
Ending balance	<u>\$ 52,318,346</u>	<u>\$ 49,623,359</u>

Debt

At December 31, 2013 and 2012, the District had \$17 million and \$18.1 million, in revenue bonds outstanding. A total of \$1 million is due within the 2014 calendar year. During 2012, the District refunded in 2003 Series and 2005 Series A revenue bonds. The District completed the refunding to reduce its total debt service payments over the next 27 years by \$1,908,329 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$1,028,496.

(Table 5)
Outstanding Debt
as of December 31, 2013 and 2012

	2013	2012
Revenue bonds	\$ 17,028,000	\$ 18,068,000
Unamortized discount/premium	(206,072)	(233,337)
Deferred amount on refundings	(325,239)	(368,444)
	<u>\$ 16,496,689</u>	<u>\$ 17,466,219</u>

District Challenges for the Future

The District continues to be financially sound. However, the current state and national financial climate requires the District to remain prudent.

The District will continue to use careful planning and monitoring of finances to provide quality services to its customers.

Contacting the District's Financial Management

This financial report is designed to provide our customers, investors and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives and spends. If you have questions about this report or need additional financial information, contact James Jeffries, General Manager, 360 Ring Road, Elizabethtown, Kentucky 42701, (270) 737-1056.

BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2STATEMENTS OF NET POSITIONDECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,483,713	\$ 3,312,902
Investments	13,733,218	13,092,944
Accounts receivable, net	728,121	688,652
Prepaid insurance	64,386	28,298
Prepaid postage	-	24,252
State grants receivable	-	52,248
Materials and supplies	300,362	332,090
TOTAL CURRENT ASSETS	18,309,800	17,531,386
NONCURRENT ASSETS:		
Restricted cash and cash equivalents	2,613,407	3,301,098
Restricted investments	978,338	978,338
Capital assets, net of accumulated depreciation	52,318,346	49,623,359
TOTAL NONCURRENT ASSETS	55,910,091	53,902,795
TOTAL ASSETS	74,219,891	71,434,181
<u>LIABILITIES</u>		
CURRENT LIABILITIES:		
Accounts payable	129,810	109,246
Construction projects payable	445,178	274,641
Accrued taxes	26,079	23,923
Accrued liabilities	43,570	43,669
Accrued vacation	92,633	82,106
Customer deposits	34,094	31,394
Customer advances for construction	43,250	48,250
Bonds payable	1,037,000	1,040,000
TOTAL CURRENT LIABILITIES	1,851,614	1,653,229
NONCURRENT LIABILITIES:		
Customer deposits	306,849	282,543
Bonds payable	15,459,689	16,426,219
TOTAL NONCURRENT LIABILITIES	15,766,538	16,708,762
TOTAL LIABILITIES	17,618,152	18,361,991
<u>NET POSITION</u>		
Net investment in capital assets	35,376,479	31,882,499
Restricted for debt service	2,342,331	2,325,504
Unrestricted	18,882,929	18,864,187
TOTAL NET POSITION	\$ 56,601,739	\$ 53,072,190

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

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION

YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
OPERATING REVENUES:		
Water sales	\$ 8,232,221	\$ 8,239,333
Other operating income	<u>299,273</u>	<u>301,695</u>
TOTAL OPERATING REVENUES	8,531,494	8,541,028
OPERATING EXPENSES:		
Power purchased	400,095	422,513
Purchased water	529	2,497
Pumping and treatment labor	420,741	449,330
Purification supplies and expense	464,194	499,310
Transmission and distribution labor	1,163,600	1,126,329
Transmission and distribution supplies and expense	179,915	213,231
Transmission and distribution maintenance and repairs	50,968	43,592
Equipment rental	991	636
Transportation expense	178,327	197,721
Water treatment maintenance and expense	59,317	90,496
General and administrative expenses	1,649,671	1,581,655
Depreciation	<u>1,682,949</u>	<u>1,633,703</u>
TOTAL OPERATING EXPENSES	<u>6,251,297</u>	<u>6,261,013</u>
OPERATING INCOME	2,280,197	2,280,015
NON-OPERATING REVENUES (EXPENSES):		
Investment income	(305,337)	685,322
Other income	107,191	96,207
Gain on disposal of assets	(9,862)	14,101
Interest expense on long-term debt	(550,960)	(816,561)
Interest expense on customer deposits	(512)	(1,509)
Amortization of bond discount and expense	<u>(70,469)</u>	<u>(77,982)</u>
TOTAL NON-OPERATING REVENUES (EXPENSES)	(829,949)	(100,422)
CAPITAL CONTRIBUTIONS	<u>2,079,301</u>	<u>3,172,304</u>
CHANGE IN NET POSITION	3,529,549	5,351,897
NET POSITION, beginning of year	<u>53,072,190</u>	<u>47,720,293</u>
NET POSITION, end of year	<u><u>\$ 56,601,739</u></u>	<u><u>\$ 53,072,190</u></u>

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

HARDIN COUNTY WATER DISTRICT NO. 2STATEMENTS OF CASH FLOWSYEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 8,512,025	\$ 8,537,333
Payments to suppliers	(2,464,661)	(2,688,833)
Payments to employees	(2,010,745)	(1,956,055)
NET CASH PROVIDED BY OPERATING ACTIVITIES	4,036,619	3,892,445
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Principal payments on bonds	(1,040,000)	(6,979,000)
Proceeds from bonds	-	6,074,608
Acquisition of capital assets	(4,163,259)	(4,376,010)
Contributions in aid of construction	2,032,053	3,148,663
Interest on long-term debt	(550,960)	(816,561)
Sale of capital assets	7,600	14,101
Customer deposit interest	(512)	(1,509)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(3,715,078)	(2,935,708)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(1,479,951)	(1,640,111)
Other income	107,191	96,207
Investment income	534,339	475,707
NET CASH USED BY INVESTING ACTIVITIES	(838,421)	(1,068,197)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(516,880)	(111,460)
CASH AND CASH EQUIVALENTS, beginning of year	6,614,000	6,725,460
CASH AND CASH EQUIVALENTS, end of year	\$ 6,097,120	\$ 6,614,000
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:		
Interest paid during the year	\$ 551,472	\$ 818,070
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 2,280,197	\$ 2,280,015
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	1,682,949	1,633,703
Provision for bad debts	44,627	2,131
(Increase) in accounts receivable	(19,469)	(3,695)
(Increase) in prepaids	(11,836)	(14,615)
Increase (Decrease) in accounts payable	20,561	(23,391)
Increase in customer deposits	27,006	26,024
Increase in accrued taxes payable	2,156	757
(Decrease) in accrued liabilities	(99)	(7,990)
Increase (decrease) in accrued vacation	10,527	(494)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 4,036,619	\$ 3,892,445

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

NOTES TO BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2013 AND 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Brief history - The Hardin County Water District No. 2 was organized pursuant to the provisions of Kentucky Revised Statutes KRS 74.010 and KRS 44.020 in order to provide a water supply for the residents of Hardin County, Kentucky.

The District's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The District follows the accounting policies and procedures set forth by the National Association of Regulatory Utility Commissioners and the guidance provided by the American Water Works Association in *Water Utility Accounting* and is regulated by the Kentucky Public Service Commission. The more significant accounting policies established in GAAP and used by the District are discussed below.

A. REPORTING ENTITY

These financial statements present the District's financial activities. As defined by GASB No. 14, *The Financial Reporting Entity*, as amended by GASB No. 39, *Determining Whether Certain Organizations Are Component Units* the criteria for inclusion in the reporting entity involve those cases where the District or its officials appoint a voting majority of an organization's governing body, and is either able to impose its will on the organization or there is a potential for the organization to provide specific financial benefits to or to impose specific financial burdens on the District or the nature and significance of the relationship between the District and the organization is such that exclusion would cause the District's financial statements to be incomplete. Applying this definition, the District does not include any component units in its reporting entity.

B. BASIC FINANCIAL STATEMENTS

All activities of the District are accounted for within a single proprietary (enterprise) fund. The focus of proprietary fund measurement is upon determination of operating income, changes in net position, financial position, and cash flows. The GAAP applicable are those similar to businesses in the private sector. Enterprise funds are required to be used to account for operations for which a fee is charged to external users for goods or services and the activity is financed with debt that is solely secured by a pledge of the net revenues.

During the year ended December 31, 2013, the District adopted the provisions of GASB Statement 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

C. BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues or expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied. The proprietary fund financial statements are presented on the accrual basis of accounting. Nonexchange revenues, including intergovernmental revenues and grants, are reported when all eligibility requirements have been met. Fees and charges and other exchange revenues are recognized when earned and expenses are recognized when incurred.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012

D. FINANCIAL STATEMENT AMOUNTS

1. Cash and investments – The District's cash balances are held at multiple financial institutions. Investments are stated at fair value based on quoted market prices.
2. Cash and cash equivalents – The District has defined cash and cash equivalents to include cash on hand and demand deposits. The District considers all highly liquid debt instruments (including restricted assets) purchased with a maturity of three months or less to be cash equivalents.
3. Restricted Assets – Restricted assets consist of demand deposit savings accounts and certificates of deposit. The cost basis approximates market value.
4. Materials and supplies – Materials and supplies is composed of items used in the capital construction process.
5. Accounts Receivable - The allowance method is used to record uncollectible accounts.- At December 31, 2013 and 2012, accounts receivable was stated net of an allowance for uncollectible accounts of \$60,000 and \$80,000. Bad debt expense for 2013 was \$44,627 and 2012 was \$2,131. The District does not believe there is any credit risk associated with these receivables due to the large customer base and small individual account balances.
6. Capital Assets – Capital assets in service and construction in progress with an original cost of \$5,000 or more are recorded at historical cost, if purchased or constructed. Assets acquired through contributions from developers or other customers are capitalized at their estimated fair market value, if available, or at engineers' estimated fair market value or cost to construct at the date of the contribution. Maintenance and repairs, which do not significantly extend the value or life of property, plant and equipment, are expensed as incurred. Assets are depreciated on the straight-line method. Depreciation is calculated using the following estimated useful lives:

	<u>Years</u>
Source of supply equipment	15-50
Water treatment plant	10-40
Transmission and distribution systems	10-50
Equipment	3-20
Structures and improvements, including buildings	10-50
Office furniture, equipment and vehicles	3-20
Meters	10-20
7. Compensated absences – The District accrues unpaid vacation when earned by the employee.
8. Defining Operating Revenues and Expenses – The District distinguishes between operating and non-operating revenue and expenses. Operating revenues and expenses consist of charges for services and the costs of providing those services, including depreciation and excluding interest cost. All other revenues and expenses are reported as non-operating.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2013 AND 2012

9. Net Position – Net position is divided into three components:
 - a. Net investment in capital assets – consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
 - b. Restricted net position – consist of net position that is restricted by the District's creditors (for example, through debt covenants), by grantors (federal, state and local) and by other contributors.
 - c. Unrestricted – all other net position is reported in this category.
10. Use of Restricted Resources – When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the District's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.
11. Amortization – Bond discounts and deferred amounts on refundings are being amortized using the interest method over the life of each respective bond issue.
12. Capital Contributions – Contributions are recognized in the Statement of Revenues, Expenses and Changes in Fund Net Position when earned. Contributions include capacity fees, capital grants, and other supplemental support by other utilities and industrial customers and federal, state and local grants in support of system improvements.
13. Long-term Obligations – Long-term obligations are reported at face value, net of applicable premiums and discounts. Premiums and discounts and gains or losses on advance refundings and defeasances are deferred and amortized over the life of the bonds.
14. Use of Estimates - Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 – DEPOSITS AND INVESTMENTS

DEPOSITS

Custodial Credit Risk—Deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned or that the District will not be able to recover collateral securities in the possession of an outside party. As of December 31, 2013 and 2012, \$5,417,630 and \$6,120,992 of the District's bank balance of \$5,917,630 and \$6,620,992 was exposed to custodial credit risk. For 2013 and 2012, of the amount exposed to custodial credit risk, the entire amount was collateralized by securities held by the pledging financial institution.

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012*INVESTMENTS*

At December 31, 2013 and 2012, the District had the following investments and maturities:

	<u>12/31/2013</u> <u>Fair Value</u>	<u>Average Credit</u> <u>Quality/Ratings</u>	<u>Maturities</u>
Bond Mutual Funds	\$ 4,372,395	Unrated	8.3 years average
Bond Mutual Funds	1,070,278	Unrated	8.2 years average
Bond Mutual Funds	5,417,128	Unrated	5.15 years average
Bond Mutual Funds	2,873,418	Unrated	10.82 years average
Treasury Money Market Fund	1,246,477	Unrated	Less than 1 year
Total Investments	<u>\$ 14,979,696</u>		

	<u>12/31/2012</u> <u>Fair Value</u>	<u>Average Credit</u> <u>Quality/Ratings</u>	<u>Maturities</u>
Bond Mutual Funds	\$ 4,467,423	Unrated	5.5 years average
Bond Mutual Funds	1,174,364	Unrated	9.3 years average
Bond Mutual Funds	5,527,815	Unrated	13.4 years average
Bond Mutual Funds	1,923,341	Unrated	25.0 years average
Treasury Money Market Fund	1,233,262	Unrated	Less than 1 year
Total Investments	<u>\$ 14,326,205</u>		

The funds listed above are not rated. The individual investments within the funds are rated no lower than BBB.

*Investment Policies**District Policy*

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Generally, the District's investing activities are under the custody of the District Commissioners. Investing policies comply with the State Statutes. Kentucky Revised Statute 66.480 defines the following items as permissible investments:

- Obligations of the United States and of its agencies and instrumentalities;
- Obligations of any corporation of the United States Government;
- Obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or a United States government agency;
- Uncollateralized certificates of deposit issued by any bank or savings and loan institution rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- Certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation or similar entity or which are collateralized, to the extent uninsured, by any obligations, including surety bonds, permitted by KRS 41.240(4)
- Bankers' acceptances for banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012

- Commercial paper rated in the highest category by a nationally recognized rating agency;
- Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities;
- Securities issued by a state or local government, or any instrumentality of agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a nationally recognized rating agency; and
- Shares of mutual funds, each of which shall have the following characteristics:
 1. The mutual fund shall be an open-end diversified investment company registered under the Federal Investment Company Act of 1940, as amended;
 2. The management company of the investment company shall have been in operation for at least five (5) years; and
 3. All of the securities in the mutual fund shall be eligible investments pursuant to this section.

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. The District policy provides that, to the extent practicable, investments are matched with anticipated cash flows. Investments are diversified to minimize the risk of loss resulting from over-concentration of assets in a specific maturity period, a single issuer, or an individual class of securities. **Concentration of Credit Risk** is the risk of loss attributed to the magnitude of the District's investment in a single issuer. U.S. Government securities and investments in mutual funds are excluded from this risk. The District does not have more than 5% or more of investments subject to the concentration of credit risk disclosure in any one issuer.

Custodial Credit Risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District did not have any investments in securities at December 31, 2013 and 2012.

NOTE 3 - RESTRICTED CASH

The District has restricted cash for various purposes including debt service, future construction and customer deposits. The following schedule represents restricted cash at December 31, 2013 and 2012:

<u>Restricted For</u>	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Debt service	\$ 1,095,853	\$ 1,092,260
Depreciation fund	205,285	204,333
Escrow	30,635	35,423
Construction	707,421	1,407,561
Customer deposits	306,073	306,596
	<u>\$ 2,345,267</u>	<u>\$ 3,046,173</u>

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012NOTE 4 – CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2013 follows.

	Balance at December 31, 2012	Additions	Retirements	Balance at December 31, 2013
Non-Depreciable Assets:				
Land and land rights	\$ 600,983	\$ 86,500	\$ -	\$ 687,483
Depreciable Assets:				
Structures and improvements	3,453,751	742,213	-	4,195,964
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	10,979,100	129,419	-	11,108,519
Standpipes, tanks and foundations	6,404,603	2,287,202	-	8,691,805
Transmission and distribution mains	33,915,215	3,552,710	-	37,467,925
Services and meters	5,807,135	336,426	(37,502)	6,106,059
Hydrants	307,738	-	(64,458)	243,280
Office furniture and fixtures	330,754	164,958	(99,250)	396,462
Transportation equipment	1,188,971	59,905	(38,266)	1,210,610
Communication equipment	55,270	-	(55,270)	-
Other property and equipment	365,868	98,743	(32,648)	431,963
Capital assets in service	65,173,353	7,458,076	(327,394)	72,304,035
Construction in progress	4,847,128	3,583,811	(6,645,689)	1,785,250
Total capital assets	70,020,481	11,041,887	(6,973,083)	74,089,285
Less accumulated depreciation for:				
Structures and improvements	1,124,802	87,922	-	1,212,724
Supply mains	881,401	44,099	-	925,500
Water treatment plant	3,595,107	226,755	-	3,821,862
Standpipes, tanks and foundations	2,130,134	161,281	-	2,291,415
Transmission and distribution mains	8,815,210	686,565	-	9,501,775
Services and meters	2,188,286	301,643	(37,502)	2,452,427
Hydrants	245,995	14,428	(46,196)	214,227
Office furniture and fixtures	297,901	22,172	(99,250)	220,823
Transportation equipment	779,847	115,751	(38,266)	857,332
Communication equipment	55,270	-	(55,270)	-
Other property and equipment	283,169	22,333	(32,648)	272,854
Total accumulated depreciation	20,397,122	1,682,949	(309,132)	21,770,939
Net capital assets	\$ 49,623,359	\$ 9,358,938	\$ (6,663,951)	\$ 52,318,346

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012

Capital asset activity for the year ended December 31, 2012 follows.

	Balance at December 31, 2011	Additions	Retirements	Balance at December 31, 2012
Non-Depreciable Assets:				
Land and land rights	\$ 555,983	\$ 45,000	\$ -	\$ 600,983
Depreciable Assets:				
Structures and improvements	3,159,371	294,380	-	3,453,751
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	10,979,100	-	-	10,979,100
Standpipes, tanks and foundations	6,404,603	-	-	6,404,603
Transmission and distribution mains	33,501,226	413,989	-	33,915,215
Services and meters	5,507,352	344,476	(44,693)	5,807,135
Hydrants	307,738	-	-	307,738
Office furniture and fixtures	330,754	-	-	330,754
Transportation equipment	1,168,356	66,589	(45,974)	1,188,971
Communication equipment	55,270	-	-	55,270
Other property and equipment	349,287	16,581	-	365,868
Capital assets in service	64,083,005	1,181,015	(90,667)	65,173,353
Construction in progress	1,277,348	4,225,659	(655,879)	4,847,128
Total capital assets	65,360,353	5,406,674	(746,546)	70,020,481
Less accumulated depreciation for:				
Structures and improvements	1,041,368	83,434	-	1,124,802
Supply mains	837,302	44,099	-	881,401
Water treatment plant	3,373,389	221,718	-	3,595,107
Standpipes, tanks and foundations	1,968,853	161,281	-	2,130,134
Transmission and distribution mains	8,130,673	684,537	-	8,815,210
Services and meters	1,951,600	281,379	(44,693)	2,188,286
Hydrants	231,566	14,429	-	245,995
Office furniture and fixtures	281,750	16,151	-	297,901
Transportation equipment	709,677	116,144	(45,974)	779,847
Communication equipment	55,270	-	-	55,270
Other property and equipment	272,638	10,531	-	283,169
Total accumulated depreciation	18,854,086	1,633,703	(90,667)	20,397,122
Net capital assets	\$ 46,506,267	\$ 3,772,971	\$ (655,879)	\$ 49,623,359

During the years ended December 31, 2013 and 2012, the District capitalized no interest in either year and expensed \$551,472 and \$818,070 of interest.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2013 AND 2012

NOTE 5 – LONG-TERM OBLIGATIONS

The construction costs of the District's water facilities have been financed by issuance of revenue bonds authorized under Kentucky Revised. All assets of the District are pledged as collateral for these bonds. Information relating to the outstanding bond issues is summarized below:

Issue	Interest Rate	Face Amount	Bonds Due 12/31/2013	Bonds Due 12/31/2012
2002 Series C	2.0% - 3.75%	\$3,020,000	\$ 405,000	\$ 800,000
2004 Series A	2.0% - 4.0%	2,940,000	2,015,000	2,130,000
2005 Series B	4.1%	1,775,000	1,290,000	1,365,000
2007 Series A	4.00%	2,480,000	2,393,000	2,423,000
2010 Series A	2.0% - 4.125%	5,625,000	5,070,000	5,280,000
2012 Series	1.0% - 3.75%	6,070,000	5,855,000	6,070,000

The District requires new customers to provide a \$60 deposit for initial water service. Current customers in good standing who add additional service locations are not required to pay an additional deposit.

Long-term liability activity for the year ended December 31, 2013, was as follows:

	Balance at December 31, 2012	Additions	Reductions	Balance at December 31, 2013	Amount Due Within One Year
Bonds payable:					
Revenue bonds	\$ 18,068,000	\$ -	\$ (1,040,000)	\$ 17,028,000	\$ 1,037,000
Unamortized bond premium/discount	(233,337)	-	27,265	(206,072)	
Deferred amounts on bond refundings	(368,444)	-	43,205	(325,239)	
Total bonds payable	17,466,219	-	(969,530)	16,496,689	1,037,000
Other liabilities:					
Customer deposits	313,937	99,051	(72,045)	340,943	34,094
Accrued vacation	82,106	92,633	(82,106)	92,633	92,633
Customer advances for construction	48,250	10,000	(15,000)	43,250	43,250
Total other liabilities	444,293	201,684	(169,151)	476,826	169,977
Long-term liabilities	\$ 17,910,512	\$ 201,684	\$ (1,138,681)	\$ 16,973,515	\$ 1,206,977

Long-term liability activity for the year ended December 31, 2012, was as follows:

	Balance at December 31, 2011	Additions	Reductions	Balance at December 31, 2012	Amount Due Within One Year
Bonds payable:					
Revenue bonds	\$ 18,977,000	\$ 6,070,000	\$ (6,979,000)	\$ 18,068,000	\$ 1,040,000
Unamortized bond premium/discount	(394,714)	4,608	156,769	(233,337)	
Deferred amounts on bond refundings	(281,013)	(126,726)	39,295	(368,444)	
Total bonds payable	18,301,273	5,947,882	(6,782,936)	17,466,219	1,040,000
Other liabilities:					
Customer deposits	287,910	64,860	(38,833)	313,937	31,394
Accrued vacation	82,600	82,106	(82,600)	82,106	82,106
Customer advances for construction	33,250	35,000	(20,000)	48,250	48,250
Total other liabilities	403,760	181,966	(141,433)	444,293	161,750
Long-term liabilities	\$ 18,705,033	\$ 6,129,848	\$ (6,924,369)	\$ 17,910,512	\$ 1,201,750

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012

Bond maturities and Sinking Fund requirements in each of the next five years and in five year increments thereafter are as follows at December 31, 2013:

Year	Principal	Revenue Bonds		Totals
		Interest		
2014	\$ 1,037,000	\$ 562,819	\$	1,599,819
2015	648,000	538,325		1,186,325
2016	669,000	520,328		1,189,328
2017	696,000	500,611		1,196,611
2018	717,000	479,515		1,196,515
2019-2023	4,026,000	2,026,479		6,052,479
2024-2028	3,747,000	1,316,893		5,063,893
2029-2033	2,810,000	734,306		3,544,306
2034-2038	1,531,000	377,912		1,908,912
2039-2043	567,000	166,837		733,837
2044-2048	580,000	60,120		640,120
Total	<u>\$ 17,028,000</u>	<u>\$ 7,284,145</u>	<u>\$</u>	<u>24,312,145</u>

Year	Sinking Fund Requirements
2014	\$ 1,599,819
2015	1,186,325
2016	1,189,328
2017	1,196,611
2018	1,196,515
2019-2023	6,052,479
2024-2028	5,063,893
2029-2033	3,544,306
2034-2038	1,908,912
2039-2043	733,837
2044-2048	640,120
Total	<u>\$ 24,312,145</u>

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012

Under covenants of the bond ordinances, certain funds have been established. These funds and their current financial requirements are presented as follows:

Revenue Fund

All receipts for services are deposited into this fund and, subsequently, disbursed into the following required funds:

Bond and Interest Redemption Funds

There is to be a monthly deposit of an amount equal to 1/12 of the next ensuing principal payment due and 1/6 of the next ensuing interest payment due for the 2002 Series C, 2004 Series A, 2005 B, 2007 Series A, and 2010 Series A and 2012 Series.

Depreciation Fund

This fund receives, on a monthly basis, \$18,700. This fund also receives the proceeds from the sale of any property or equipment. This fund may be used to purchase new or replacement property and equipment.

Operation and Maintenance Fund

This fund receives, on a monthly basis, sufficient amounts to pay current expenses from the Revenue Fund after the above transfers have been made. This fund is used to pay operating expenditures. This account is funded until it reaches 2 months of forecasted operating expenses. Any surplus left may be added to the Bond and Interest Redemption Fund.

NOTE 6 - RETIREMENT PLAN

Plan Description - The District participates in the County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System's Board of Trustees. CERS provides benefits to its participants upon retirement. CERS issues a publicly available financial report that includes financial statements and required supplementary information for the retirement plan. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601 or by calling 502-564-4646.

Funding Policy - Plan members employed before September 1, 2008, are required to contribute 5% of their annual covered salary and those hired on or after September 1, 2008, are required to contribute 6% of their annual covered salary. The District is required to contribute at an actuarially determined rate. The rates at December 31, 2013, 2012 and 2011 were 18.89%, 19.55% and 18.96% of covered payroll. The contribution requirements of the District are established and may be amended by the Kentucky Retirement System's Board of Trustees. The District's contributions to CERS for the years ended December 31, 2013, 2012 and 2011 were \$380,314, \$364,924, and \$327,116. Employee contributions were \$101,794, \$96,359 and \$92,045 and covered payroll was \$2,010,746, \$1,959,853 and \$1,815,074. All payments were made to the retirement system in the amount of the annually required contributions.

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

CERS also provides post-retirement health care coverage as follows:

For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

Years of Service	% Paid By Insurance Fund	% Paid By Member Through Payroll Deduction
20 or more	100%	0%
15 - 19	75%	25%
10 - 14	50%	50%
4 - 9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount.

NOTE 8 – CAPITAL CONTRIBUTIONS

The following schedule details the sources of capital contributions for the years ended December 31, 2013 and 2012:

Source	2013	2012
State of Kentucky	\$ 1,973,710	\$ 2,826,114
Tap Fees	95,591	193,200
Developers	10,000	152,990
	<u>\$ 2,079,301</u>	<u>\$ 3,172,304</u>

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2013 AND 2012(CONCLUDED)NOTE 9 – RENTAL AGREEMENTS

The District has entered into agreements to lease space on its water towers to various customers. Rental income during the years ended December 31, 2013 and 2012 was \$98,545 and \$82,004. The following schedule represents future payments to be received. Each agreement provides for optional renewals. The schedule below reflects payments to be received under current agreements and does not include renewals after the current term.

2014	\$ 82,577
2015	82,577
2016	82,577
2017	82,577
2018	<u>28,566</u>
Total	<u>\$ 358,874</u>

NOTE 10 – COMMITMENTS

The District has entered into construction commitments toward its construction projects. Also, the District has received certain funding commitments from governmental agencies for current and planned construction projects.

On September 17, 2013, the District signed a letter of intent with the City of Elizabethtown, Kentucky, to purchase the City's water system.

NOTE 11 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The District was insured for workers' compensation, general liability and automobile liability coverage under a retrospectively rated commercial policy.

OTHER SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS
DECEMBER 31, 2013

	\$ 3,020,000 2002 SERIES C		\$ 2,940,000 2004 SERIES A	
	<u>BOND</u>	<u>INTEREST</u>	<u>BOND</u>	<u>INTEREST</u>
2014	\$ 405,000	\$ 7,594	\$ 125,000	\$ 74,926
2015			125,000	70,708
2016			135,000	66,158
2017			145,000	61,113
2018			155,000	55,563
2019			160,000	49,575
2020			170,000	43,140
2021			175,000	36,413
2022			190,000	29,200
2023			200,000	21,400
2024			215,000	13,100
2025			220,000	4,400
2026				
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2048				
	<u>\$ 405,000</u>	<u>\$ 7,594</u>	<u>\$ 2,015,000</u>	<u>\$ 525,696</u>

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2013

(CONTINUED)

	\$ 1,775,000 2005 SERIES B		\$ 2,480,000 2007 SERIES A		\$ 5,625,000 2010 SERIES A	
	BOND	INTEREST	BOND	INTEREST	BOND	INTEREST
2014	\$ 80,000	\$ 51,250	\$ 32,000	\$ 95,080	\$ 215,000	\$ 171,344
2015	85,000	47,868	33,000	93,780	220,000	166,994
2016	85,000	44,383	34,000	92,440	225,000	162,122
2017	90,000	40,795	36,000	91,040	230,000	156,288
2018	95,000	37,003	37,000	89,580	235,000	149,894
2019	105,000	32,903	39,000	88,060	245,000	142,987
2020	105,000	28,598	40,000	86,480	250,000	135,250
2021	115,000	24,088	42,000	84,840	260,000	126,800
2022	120,000	19,270	44,000	83,120	265,000	117,940
2023	130,000	14,145	46,000	81,320	275,000	108,656
2024	135,000	8,713	47,000	79,460	290,000	98,588
2025	145,000	2,973	49,000	77,540	300,000	87,707
2026			51,000	75,540	310,000	76,075
2027			54,000	73,440	325,000	63,772
2028			56,000	71,240	340,000	50,676
2029			58,000	68,960	345,000	36,976
2030			60,000	66,600	360,000	22,876
2031			63,000	64,140	380,000	7,838
2032			66,000	61,560		
2033			68,000	58,880		
2034			71,000	56,100		
2035			74,000	53,200		
2036			77,000	50,180		
2037			80,000	47,040		
2038			84,000	43,760		
2039			87,000	40,340		
2040			91,000	36,780		
2041			94,000	33,080		
2042			98,000	29,240		
2043			102,000	25,240		
2044			106,000	21,080		
2045			111,000	16,740		
2046			115,000	12,220		
2047			120,000	7,520		
2048			128,000	2,560		
	\$ 1,290,000	\$ 351,989	\$ 2,393,000	\$ 2,058,180	\$ 5,070,000	\$ 1,882,783

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS
DECEMBER 31, 2013
(CONTINUED)

	\$ 6,070,000 2012 SERIES		TOTAL ALL ISSUES	
	<u>BOND</u>	<u>INTEREST</u>	<u>BOND</u>	<u>INTEREST</u>
2014	\$ 180,000	\$ 162,625	\$ 1,037,000	\$ 562,819
2015	185,000	158,975	648,000	538,325
2016	190,000	155,225	669,000	520,328
2017	195,000	151,375	696,000	500,611
2018	195,000	147,475	717,000	479,515
2019	200,000	143,525	749,000	457,050
2020	205,000	139,347	770,000	432,815
2021	210,000	134,806	802,000	406,947
2022	215,000	129,891	834,000	379,421
2023	220,000	124,725	871,000	350,246
2024	230,000	119,238	917,000	319,099
2025	235,000	113,425	949,000	286,045
2026	245,000	107,119	606,000	258,734
2027	245,000	100,381	624,000	237,593
2028	255,000	93,506	651,000	215,422
2029	265,000	86,356	668,000	192,292
2030	270,000	78,663	690,000	168,139
2031	280,000	70,063	723,000	142,041
2032	295,000	60,719	361,000	122,279
2033	300,000	50,675	368,000	109,555
2034	210,000	41,750	281,000	97,850
2035	220,000	34,225	294,000	87,425
2036	230,000	26,063	307,000	76,243
2037	235,000	17,344	315,000	64,384
2038	250,000	8,250	334,000	52,010
2039	85,000	1,969	172,000	42,309
2040	10,000	188	101,000	36,968
2041			94,000	33,080
2042			98,000	29,240
2043			102,000	25,240
2044			106,000	21,080
2045			111,000	16,740
2046			115,000	12,220
2047			120,000	7,520
2048			128,000	2,560
	<u>\$ 5,855,000</u>	<u>\$ 2,457,903</u>	<u>\$ 17,028,000</u>	<u>\$ 7,284,145</u>

HARDIN COUNTY WATER DISTRICT NO. 2SCHEDULE II - GENERAL AND ADMINISTRATIVE EXPENSESYEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Salaries	\$ 779,806	\$ 738,545
Commissioner's salaries	30,289	30,250
Employee benefits	368,534	400,935
Materials and supplies	43,717	55,670
Professional fees and contractual services	48,801	40,022
Insurance	86,078	80,023
Advertising	1,945	1,590
Provision for bad debts	44,627	2,131
Other general and administrative	245,874	232,489
	<u>\$ 1,649,671</u>	<u>\$ 1,581,655</u>

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE III - ORGANIZATION DATA

DECEMBER 31, 2013

WATER COMMISSIONERS

Michael Bell - Chairman
Morris Miller - Secretary/Treasurer
Cordell Tabb - Member
John Effinger - Member
Tim Davis - Member

ATTORNEY

Damon R. Talley - Hodgenville, Kentucky

GENERAL MANAGER

James Jeffries

CALENDAR YEAR

January 1 to December 31

INTERNAL CONTROL AND FISCAL COMPLIANCE

CHRIS R. CARTER, CPA
SCOTT KISSELBAUGH, CPA
BRIAN S. WOOSLEY, CPA



STILES, CARTER & ASSOCIATES, P.S.C.

CERTIFIED PUBLIC ACCOUNTANTS

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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**

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Hardin County Water District No. 2, as of and for the year ended December 31, 2013, and the related notes to the financial statements and have issued our report thereon dated February 21, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Hardin County Water District No. 2's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Hardin County Water District No. 2's internal control. Accordingly, we do not express an opinion on the effectiveness of Hardin County Water District No. 2's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses as item 2013-01 that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hardin County Water District No. 2's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Hardin County Water District No. 2's Response to Findings

Hardin County Water District No. 2's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Hardin County Water District No. 2's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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



Certified Public Accountants
Elizabethtown, Kentucky
February 21, 2014

SCHEDULE OF FINDINGS AND RESPONSES

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE OF FINDINGS AND RESPONSES
FOR THE YEAR ENDED DECEMBER 31, 2013

SIGNIFICANT DEFICIENCIES

REFERENCE NUMBER 2013-01 FINANCIAL STATEMENT PRESENTATION

Criteria: The District's management is responsible for establishing and maintaining internal controls over the application of transactions and the preparation of financial statements.

Condition: As part of the audit, we noted that significant adjustments were required in order to prevent capital assets and revenue from being overstated.

Cause: The District did not make all necessary adjustments when closing the year.

Effect: The financial statements required adjustment of significant items.

Recommendation: We recommend District management and financial personnel continue to increase their awareness and knowledge of all procedures and processes involved in preparing financial statements and develop internal control policies to ensure proper financial statement presentation.

Management Response: Management will improve operations to ensure that necessary adjustments are made in accordance with the normal closing process.