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Henderson County Water District

Report on Audited Financial Statements
For the fiscal years ended August 31, 2013 and 2012

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**Henderson County Water District
Management's Discussion and Analysis
For the fiscal year ended August 31, 2013**

The Henderson County Water District provides water services for the residents of Henderson and Webster Counties,, Kentucky who live outside the incorporated limits of the City of Henderson, Kentucky. The following narrative provides an overview of the financial performance of the Henderson County Water District for the fiscal year ended August 31, 2013.

Overview of the Financial Statements:

This financial report consists of three parts: 1) Management's Discussion and Analysis, 2) Financial Statements, and 3) Supplemental information. Included in the financial statements are notes which provide additional detail supporting amounts reported therein. The financial statements of the Henderson County Water District report information using accounting principles similar to those of private sector companies.

The statement of net assets, the successor to the balance sheet, includes all of the Henderson County Water District's assets and liabilities and provides information about the nature of assets and liabilities. It also provides a foundation for evaluating the financial strength of the District.

All of the revenues and expenses are accounted for on the statement of revenues, expenses, and changes in net assets. This statement measures the results of the District's operations over the past year and is used by management and others to evaluate whether it was successful in recovering all of its costs through charges for sale of water and generated a profit.

The last statement is the statement of cash flows. This statement provides information regarding the District's cash receipts, payments, investing (capital expenditures), and financing activities. The sources and uses of cash are summarized in this report which also reconciles the changes in cash balances from the beginning of the fiscal year to the end.

Financial Highlights:

The Henderson County Water Districts total assets increased by \$1,007,982 from \$14,186,757 in 2012 to \$15,194,739, primarily due to the construction in progress.

Operating revenues for 2013 decreased by \$335,083 or 12% from \$2,849,645 to \$2,514,562, primarily due to decreased consumption. Prior year had unusually dry conditions that had an impact on water usage and current fiscal year fewer commercial customers.

Operating expenses decreased by \$82,735 or 3 % from \$2,742,723 in 2012 to \$2,659,988 in 2013. The decrease was primarily due to the increased cost of water purchased from the Henderson Water Utility due to the drought experienced during the summer months of 2012.

Operating income decreased by \$252,348 or 236% from \$106,922 to (\$145,426) due to an decrease in consumption of water for current year and an increase in the bad debt provision by approximately \$23,000 during the prior year.

**Henderson County Water District
Management's Discussion and Analysis
For the fiscal year ended August 31, 2013**

Condensed Financial Information:

A summary of condensed financial information is as follows:

	<u>August 31, 2013</u>	<u>August 31, 2012</u>	<u>Change</u>	<u>Percentage</u>
Current assets	\$ 2,014,096	\$ 2,168,781	\$ (154,685)	-7%
Restricted assets	717,274	714,284	2,990	0%
Capital assets	12,463,369	11,303,692	1,159,677	10%
Total assets	<u>\$ 15,194,739</u>	<u>\$ 14,186,757</u>	<u>\$ 1,007,982</u>	<u>7%</u>
Current liabilities	\$ 507,822	\$ 492,193	\$ 15,629	3%
Long-term liabilities	5,067,449	3,829,477	1,237,972	32%
Total liabilities	<u>5,575,271</u>	<u>4,321,670</u>	<u>1,253,601</u>	<u>29%</u>
Net position				
Invested in capital assets	7,153,291	7,257,090	(103,799)	-1%
Restricted - debt service	634,902	624,424	10,478	2%
Unrestricted	1,831,275	1,983,573	(152,298)	-8%
Total net position	<u>9,619,468</u>	<u>9,865,087</u>	<u>(245,619)</u>	<u>-2%</u>
Total liabilities and net assets	<u>\$ 15,194,739</u>	<u>\$ 14,186,757</u>	<u>\$ 1,007,982</u>	<u>7%</u>

Total net assets increased by \$1,007,982. As noted earlier in this report, this is due primarily to construction in progress for the fiscal year ended August 31, 2012.

	<u>August 31, 2013</u>	<u>August 31, 2012</u>	<u>Change</u>	<u>Percentage</u>
Operating revenues	\$ 2,514,562	\$ 2,849,645	\$ (335,083)	-12%
Operating expenses	2,659,988	2,742,723	(82,735)	-3%
Operating income	(145,426)	106,922	(252,348)	-236%
Non-operating revenues, net	(192,886)	(215,673)	22,787	-11%
Capital contributions	118,584	20,955	97,629	466%
Change in net position	<u>\$ (219,728)</u>	<u>\$ (87,796)</u>	<u>\$ (131,932)</u>	<u>150%</u>

Operating revenues decreased by \$335,083 primarily due to an decrease in overall water consumption and fewer commercial customers.. Correspondingly, operating expenses decreased by \$82,735, due to 2012 increase in purchased water to meet customer demand for dry condition and an additional provision for bad debt in the amount of \$25,000 required to cover potential losses due to a major commercial customer who filed chapter 11 bankruptcy during the fiscal year ended.

**Henderson County Water District
Management's Discussion and Analysis
For the fiscal year ended August 31, 2013**

Statement of Cash Flows:

The following is a summary of cash flow activity for the fiscal years ended August 31, 2013 and 2012.

	<u>August 31, 2013</u>	<u>August 31, 2012</u>	<u>Change</u>	<u>Percentage</u>
Net cash provided by:				
Operating activities	\$ 400,985	\$ 592,603	\$ (191,618)	-32%
Non-capital financing	4,589	2,787	1,802	65%
Capital and related financing	(554,477)	(597,467)	42,990	-7%
Investing activities	16,119	(122,973)	139,092	-113%
Net change in cash equivalents	<u>\$ (132,784)</u>	<u>\$ (125,050)</u>	<u>\$ (7,734)</u>	<u>6%</u>

Cash flows from operating activities were down by \$143,913 due primarily to the decrease in operating income. Cash flows from capital and related financing activities were consistent with that of prior years. A new certificate of deposit was added to investments in prior year.

Capital Assets:

The vast majority of the assets of the Henderson County Water District are invested in the system infrastructure, similar to most utility concerns. To protect this investment, the District is diligent in continually monitoring the condition of the system and performing maintenance to ensure it remains in a state of good repair. Management monitors its financial performance regularly to ensure a reasonable return on investment is received so funds are available to provide for capital expenditures necessary to meet these objectives. The District expended \$1,754,299 on capital assets during 2013, and \$192,341, during 2012.

Long-term Debt:

As of August 31, 2012, the Henderson County Water District had \$4,013,016 in long-term debt outstanding, consisting of Revenue Bond Series B of \$280,000, and Revenue Bond Series 2006 A, in the amount of \$3,972,000. Revenues of the district are pledged to secure these obligations. Subsequent to the fiscal year ended August 31, 2012, the District has bond anticipation notes in the amount of \$1,454,710 as of August 31, 2013. The bonds are schedule to be issued in February, 2014 for Series 2013 in the amount of \$1,695,000 and 2013A in the amount of \$300,000.

Economic Factors:

Water sales for the fiscal year ending August 31, 2013 are estimated by management to remain relatively at similar levels of previous years, increasing only to pass through the annual increases required due to increased costs of water.

Contact Information:

The financial statements are designed to provide our citizens, customers, and creditors with a general overview of the Henderson County Water District's results of operations. Additional information can be obtained by contacting Mr. Pete Conrad, Superintendent of the Henderson County Water District at 655 South Main Street, Henderson, Kentucky 42420, or telephonically at 270.826.9802.



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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Henderson County Water District

Report on the Financial Statements

We have audited the accompanying financial statements of the Henderson County Water District as of and for the years ended August 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Henderson County Water District, as of August 31, 2013 and 2012, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and Schedule of Revenues, Expenses, and Changes in Net Position – Budget and Actual, information on pages 1-3 and 17 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 opinions on the financial statements that collectively comprise the Henderson County Water District's basic financial statements. The Schedules of System Maintenance, Customer Accounts, and Administrative Expenses and Insurance Coverage are presented for purposes of additional analysis and are not a required part of the basic financial statements.

Schedules of System Maintenance, Customer Accounts, and Administrative Expenses and Insurance Coverage 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, the Schedules of System Maintenance, Customer Accounts, and Administrative Expenses and Insurance Coverage are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 31, 2013, on our consideration of the Henderson County Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Henderson County Water District's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Myriad CPA Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky
December 31, 2013

Henderson County Water District
Statements of Net Position
As of August 31, 2013 and 2012

	2013	2012
Assets		
<u>Current assets:</u>		
Cash and cash equivalents	\$ 738,442	\$ 879,584
Investments, at cost	746,500	743,464
Receivables, net of allowance for uncollectible amounts	365,500	434,433
Interest receivable	4,544	4,544
Inventories	114,398	71,137
Prepaid expenses	44,712	35,619
Total current assets	2,014,096	2,168,781
<u>Property, plant and equipment:</u>		
Land	272,181	262,181
Distribution systems	17,277,992	17,050,058
Buildings	781,319	781,319
Equipment	537,912	632,508
Construction in progress	1,419,145	18,155
Less: accumulated depreciation	(7,825,180)	(7,440,529)
Total property, plant and equipment	12,463,369	11,303,692
<u>Other noncurrent assets:</u>		
Restricted cash and cash equivalents	250,576	242,218
Restricted investments, at cost	384,326	382,206
Unamortized bond costs, net	82,372	89,860
Total other noncurrent assets	717,274	714,284
Total assets	\$ 15,194,739	\$ 14,186,757
Liabilities and Net Position		
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable	\$ 125,310	\$ 121,667
Interest payable	27,838	29,480
Other liabilities	34,510	50,975
Customer security deposits	77,535	72,946
Bonds and notes payable-current portion	242,629	217,125
Total current liabilities	507,822	492,193
<u>Noncurrent liabilities:</u>		
Bonds and notes payable-net of current portion and deferred refunding loss	5,067,449	3,829,477
Total noncurrent liabilities	5,067,449	3,829,477
Total liabilities	5,575,271	4,321,670
<u>Net position:</u>		
Invested in capital assets, net of related debt	7,153,291	7,257,090
Restricted for debt service	634,902	624,424
Unrestricted	1,831,275	1,983,573
Total net position	9,619,468	9,865,087
Total liabilities and net position	\$ 15,194,739	\$ 14,186,757

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

Henderson County Water District
Statements of Revenues, Expenses, and Changes in Net Position
For the fiscal years ended August 31, 2013 and 2012

	2013	2012
<u>Operating revenues:</u>		
Water	\$ 2,409,451	\$ 2,764,639
Penalties and sundry	105,111	85,006
Total operating revenues	2,514,562	2,849,645
<u>Operating expenses:</u>		
Purchased water	1,075,564	1,163,826
Pumping utilities	42,207	42,133
Maintenance of system	263,786	230,796
Vehicle and equipment	57,640	55,687
Customer accounts	169,182	186,573
Administration	508,955	529,947
Depreciation	542,654	533,761
Total operating expenses	2,659,988	2,742,723
Operating loss	(145,426)	106,922
<u>Nonoperating revenues (expenses):</u>		
Investment income	21,275	18,901
Interest expense	(171,264)	(195,816)
Amortization of debt issue costs	(35,979)	(38,758)
Loss on disposal of assets	(6,918)	-
Total nonoperating revenues (expenses)	(192,886)	(215,673)
Loss before contributions	(338,312)	(108,751)
Capital contributions	118,584	20,955
Change in net position	(219,728)	(87,796)
Net position, beginning of year	9,839,196	9,926,992
Net position, end of year	\$ 9,619,468	\$ 9,839,196

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

Henderson County Water District
Statements of Cash Flows
For the fiscal years ended August 31, 2013 and 2012

	2013	2012
<u>Cash flows from operating activities:</u>		
Cash received from customers	\$ 2,478,384	\$ 2,655,142
Cash payments to suppliers for goods and services	(1,501,777)	(1,503,692)
Cash payments to employees for services	(680,733)	(643,853)
Other operating revenues	105,111	85,006
Net cash provided by operating activities	400,985	592,603
<u>Cash flows from noncapital financing activities:</u>		
Increase (decrease) in customer deposits	4,589	2,787
Net cash provided by noncapital financing activities	4,589	2,787
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(1,711,849)	(192,341)
Capital contributions	118,584	20,955
Proceeds from bond anticipation bond	1,454,710	-
Principal paid on revenue bond maturities and other capital notes	(243,016)	(243,016)
Interest paid on revenue bonds and other capital notes	(172,906)	(183,065)
Net cash used by capital and related financing activities	(554,477)	(597,467)
<u>Cash flows from investing activities:</u>		
(Increase) decrease in investment securities	(5,156)	(140,064)
Interest income	21,275	17,091
Net cash provided (used) by investing activities	16,119	(122,973)
Net decrease in cash and cash equivalents	(132,784)	(125,050)
Cash and cash equivalents, beginning of year	1,121,802	1,246,852
Cash and cash equivalents, end of year	\$ 989,018	\$ 1,121,802
<u>Reconciliation of operating income to net cash provided (used) by operating activities:</u>		
Operating income (loss)	\$ (145,426)	\$ 106,922
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	542,654	533,761
(Increase) decrease in accounts receivable	68,933	(109,497)
(Increase) decrease in inventories	(43,261)	46,363
(Increase) decrease in prepaid expenses	(9,093)	(3,876)
Increase (decrease) in accounts payable	3,643	1,157
Increase (decrease) in accrued liabilities	(16,465)	17,773
Net cash provided by operating activities	\$ 400,985	\$ 592,603
<u>Summary of Cash and Cash Equivalents:</u>		
Unrestricted cash equivalents	\$ 738,442	\$ 879,584
Restricted cash equivalents	250,576	242,218
Total cash equivalents	\$ 989,018	\$ 1,121,802

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

Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Henderson County Water District, “Water District”, was created by the fiscal court of Henderson and Webster Counties under the provisions by Chapter 74 of the Kentucky Revised Statutes.

The accounting and reporting framework and the more significant accounting principles are discussed in subsequent subsections of this Note. The rest of these Notes are organized to provide explanations, including required disclosures, of the Henderson County Water District financial activities for the fiscal year ended August 31, 2013.

Financial Reporting Entity:

The financial statements of the Henderson County Water District comprise a single business-type activity generally financed in whole or in part with fees charged to external customers. In evaluating how to define the Water District for financial reporting purposes, management has considered any potential component units, based upon the Water District’s ability to exercise significant oversight responsibility. Oversight responsibility was determined on the basis of the Water District’s ability to significantly influence operations, select the governing body, participate in fiscal management, and the scope of public service. Based upon the application of these criteria, no potential component units were noted.

Fund Types:

A fund is an accounting entity with a self-balancing set of accounts established to record the financial position and results of operations of a specific governmental activity. The Water District maintains the following business-type enterprise fund:

Proprietary Fund Type:

Proprietary Funds are accounted for on a flow of economic resources measurement focus. The accounting objectives are a determination of net income, financial position and changes in cash flow. All assets and liabilities associated with a proprietary fund’s activities are included on its balance sheet. Proprietary fund equity is segregated into contributed capital and retained earnings.

Measurement Focus/Basis of Accounting:

The financial statements of the Water District are prepared in accordance with generally accepted accounting principles (GAAP). The Water District’s reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements.

Proprietary fund types are accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recorded when they are earned, including unbilled water services which are accrued. Expenses are recorded at the time liabilities are incurred.

Operating income reported in proprietary fund financial statements includes revenues and expenses related to the primary, continuing operations of the fund. Principal operating revenues for proprietary funds are charges to customers for services. Principal operating expenses are the costs of providing goods or services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

Inventories:

Inventories are carried at the lower of cost (primarily first-in, first-out) or market.

Cash and Investments:

The Water District reporting entity considers highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Investments are reported at fair value which is determined using selected bases. Short-term investments are reported at cost, which approximates fair value. Cash deposits are reported at carrying amount which reasonably estimates fair value.

Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Receivables:

All receivables are reported net of estimated uncollectable amounts.

Donated Lines:

From time to time prospective users have constructed and paid for line extensions and donated these additions to the Water District. These additions are recorded at cost invoiced to the user and are depreciated at rates based on their estimated useful life. Such additions are recorded as capital contributions.

Capital Assets, Depreciation, and Amortization:

The Water District's plant and equipment with useful lives of more than one year are stated at historical cost and comprehensively reported in the basic financial statements. Donated assets are stated at fair value on the date donated. The costs of normal maintenance and repairs that do not add to the asset value or materially extend the useful life are not capitalized. The Public Service Commission has approved an upper limit of \$5,000 below which the cost of an item can be expensed. Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in operations.

Estimated useful lives for depreciable assets are as follows:

Buildings	10-50 years
Distribution systems	15-50 years
Machinery and equipment	5-10 years
Office equipment and furniture	5-10 years

Tap Fees:

Tap fees collected from new customers are recorded as capital contributions. The cost of installing the service lines and setting the water meters are capitalized and depreciated over their estimated useful lives.

Long-term Debt and Deferred Bond Costs:

In the basic financial statements, outstanding debt is reported as liabilities. Bond issuance costs are capitalized and amortized over the terms of the respective bonds using a method that approximates the effective interest method.

Compensated Absences:

Accumulated unpaid vacation amounts are reported as "Other liabilities" in the basic financial statements. The accrued compensated balance at August 31, 2013 and 2012 was \$19,483 and \$28,338, respectively.

Proprietary Fund Net Assets:

Proprietary fund net assets are divided into three components:

Invested in capital assets, net of related debt – 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.

Restricted net assets – consist of net assets that are restricted by the Water District's creditor (for example through debt covenants), by the state enabling legislation, by grantors (both federal and state), and by other contributors.

Unrestricted – all other net assets are reported in this category.

Use of Restricted Resources:

When an expense is incurred that can be paid using either restricted or unrestricted resources (net assets), the Water District's policy is to apply the expense toward restricted resources and then toward unrestricted resources.

NOTE 2 – ALLOWANCE FOR UNCOLLECTABLE ACCOUNTS

The allowance for uncollectable accounts receivable at August 31, 2013 and 2012 was \$71,067 and \$52,396, respectively.

Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012

NOTE 3 – DEPOSITS WITH FINANCIAL INSTITUTIONS

Custodial credit risk for deposits is the risk that in the event of a bank failure, the Water District's deposits may not be returned or the Water District will not be able to recover collateral securities in the possession of an outside party. At August 31, 2013, the carrying amount of the Water District's deposits, including certificates of deposit, was \$2,119,844. Of the total bank balances (including certificates of deposit), \$500,000 was covered by Federal Depository Insurance, with the remaining balance covered by pledged collateral held by the custodial banks in the Water District's name. As of the date of the auditor's report, the Water District's demand and time deposits with the local custodial banks were fully covered by Federal Depository Insurance or by pledged collateral.

Kentucky Revised Statutes authorize governmental units to invest in obligations of the United States and its agencies, obligations of the Commonwealth of Kentucky and its agencies, shares in savings and loan associates insured by federal agencies and deposits in national or state chartered banks insured by federal agencies and larger amounts in such institutions providing such banks pledge as security obligations of the United States government or its agencies.

NOTE 4 – INVESTMENTS

Investments stated at cost consisted of the following at August 31, 2013 and 2012:

	2013	2012
<u>Current:</u>		
Certificates of deposit	\$ 746,500	\$ 743,464
<u>Noncurrent (restricted):</u>		
Certificates of deposit	384,326	382,206
Total investments, at cost	\$ 1,130,826	\$ 1,125,670

NOTE 5 – RISK MANAGEMENT

The Water District is exposed to various risks related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Water District purchases commercial insurance for all risks of loss. There have been no significant reductions in insurance coverage and settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

NOTE 6 – CAPITAL ASSETS

The following is a summary of changes in capital assets for the year ended August 31, 2013 and 2012:

	Balance 8/31/2012	Increases	Decreases	Balance 8/31/2013
<u>Capital assets, not being depreciated:</u>				
Land	\$ 262,181	\$ 10,000	\$ -	\$ 272,181
Construction in progress	18,155	1,400,990	-	1,419,145
Capital assets, being depreciated:				
Distribution systems	17,050,058	287,211	(59,277)	17,277,992
Buildings	781,319	-	-	781,319
Equipment	632,508	56,098	(150,694)	537,912
Total capital assets	18,744,221	1,754,299	(209,971)	20,288,549
<u>Less: accumulated depreciation</u>				
Distribution systems	(6,750,844)	(460,815)	7,309	(7,204,350)
Buildings	(291,171)	(29,486)	-	(320,657)
Equipment	(398,514)	(52,353)	150,694	(300,173)
Total accumulated depreciation	(7,440,529)	(542,654)	158,003	(7,825,180)
Capital assets, net	\$11,303,692	\$ 1,211,645	\$ (367,974)	\$12,463,369

**Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012**

NOTE 7 –DEBT

	Beginning Balance	Additions	Payments	Amortization	Ending Balance	Current Portion	Long-term Portion
Revenue bonds series 2003 B	\$ 280,000	\$ -	\$ (85,000)	\$ -	\$ 195,000	\$ 95,000	\$ 100,000
Revenue bonds series 2006 A	3,972,000	-	(156,000)	-	3,816,000	170,000	3,646,000
Henderson County Fiscal Court note	4,032	-	(2,016)	-	2,016	2,016	-
Revenue bonds series 2013	-	1,454,710	-	-	1,454,710	-	1,454,710
Bonds/notes payable, August 31, 2013	4,256,032	1,454,710	(243,016)	-	5,467,726	267,016	5,200,710

Components of long-term debt:

Deferred defeasance 2003 B refunding	(172,722)	-	-	21,588	(151,134)	20,716	(130,418)
Deferred defeasance 2006 A refunding	(10,817)	-	-	4,303	(6,514)	3,671	(2,843)
	<u>\$4,072,493</u>	<u>\$1,454,710</u>	<u>\$ (243,016)</u>	<u>\$ 25,891</u>	<u>\$5,310,078</u>	<u>\$291,403</u>	<u>\$ 5,067,449</u>

On April 11, 2006, the Henderson County Water District issued \$4,692,000 Kentucky Rural Water Finance Corporation Public Projects refunding Revenue Bonds Series 2006 A, interest ranging from 4.0% to 4.25%, to advance refund outstanding 1997 Water Revenue Bonds and 2000 Water Revenue Bonds with outstanding balances of \$1,745,000 and \$2,600,000, respectively. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the 1997 and 2000 series bonds of \$326,367. This difference, reported in the accompanying financial statements as a deduction from bonds payable, will be charged to operations (included in “interest expense”) through the year 2025 using the effective-interest method.

On August 28, 2003, the Henderson County Water District issued \$955,000 Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds Series 2003 B, interest ranging from 2.0% to 4.5%, to advance refund outstanding 1993 Water Refunding Revenue Bonds and 1994 Water Refunding Revenue Bonds with outstanding balances of \$450,000 and \$815,000, respectively. \$401,333 of current debt service reserve and bond sinking funds were used toward the payoff of the 1993 and 1994 refunding revenue bonds. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the 1993 and 1994 series bonds of \$110,815. This difference reported in the accompanying financial statements as a deduction from bonds payable, will be charged to operations (included in “interest expense”) through the year 2014 using the effective-interest method.

Bonds and notes payable at August 31, 2013 and 2012 are comprised of the following:

	<u>2013</u>	<u>2012</u>
<u>Notes payable:</u>		
Note payable to Henderson County Fiscal Court, payable in annual installments of \$2,016 for 25 years, beginning in 1989; non-interest bearing.	\$ 2,016	\$ 4,032
Total notes payable	<u>\$ 2,016</u>	<u>\$ 4,032</u>

Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012

NOTE 7 – DEBT, continued

	2013	2012
<u>Bond anticipation notes:</u>		
Kentucky Rual Water Finance Corporation, Kentucky Bond Anticipation Note Series 2013 maximum advance \$1,695,000 and Series 2013A maximum advance \$300,000, through Regions Bank. The maximum advance or outstanding balance, whichever is less is due July 1, 2014 and accruing interest at 2.5% per annum. Interest is due on the 1st day of March and September.	\$ 1,454,710	\$ -
<u>Revenue bonds:</u>		
\$955,000 Public Projects Water Refunding Revenue Bonds dated August 15, 2003 due in annual installments of \$65,000 to \$100,000 through February 1, 2015, interest payable semiannually on February 1 and August 1, escalating from 2.0% to 4.5%.	195,000	280,000
\$4,629,000 Public Projects Water Refunding Revenue Bonds dated April 11, 2006 due in annual installments of \$136,000 to \$371,000 through January 1, 2026, interest payable semiannually on January 1 and July 1, escalating from 4.0% to 4.25%.	3,816,000	3,972,000
Deferred defeasance amount on debt refunding	(157,648)	(183,539)
Total bonds payable	5,308,062	4,068,461
Total bonds and notes payable	5,310,078	4,072,493
Less: current portion	242,629	217,125
Long-term portion	\$ 5,067,449	\$ 3,855,368

The annual requirement to amortize all bonds/notes as of August 31, 2013, including interest payments are as follows:

<u>Year ending August 31</u>	<u>Notes Payable</u>	<u>Revenue Bonds</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 2,016	\$ 265,000	\$ 235,611	\$ 502,627
2015	-	290,000	224,503	514,503
2016	-	297,500	212,645	510,145
2017	-	305,500	200,679	506,179
2018	-	324,500	249,411	573,911
Thereafter	-	3,825,562	1,919,427	5,744,989
	\$ 2,016	\$ 5,308,062	\$ 3,042,276	\$ 8,352,354

There are a number of limitations and restrictions contained in the various bond indentures. The Water District is in compliance with all significant limitations and restrictions.

Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012

NOTE 8 – PENSION PLAN

Plan Description:

The Water District contributes to the County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System (KRS). CERS provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce cost-of-living adjustments if, in its judgment, the welfare of the Commonwealth so demands.

Funding Policy:

Plan members are required to contribute 5.0% of their annual creditable compensation and the Water District is required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. The current rate is 19.55% of annual creditable compensation. The Water District's contributions to CERS for the years ending August 31, 2013, 2012, and 2011 were \$79,765, \$76,148, and \$66,079, respectively, equal to the required contributions each year.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, are required to contribute a total of 6.0% of their annual creditable compensation. For plan members who began participating prior to September 1, 2008, their contributions remain at 5.0% of their annual creditable compensation.

NOTE 9 – OTHER EMPLOYEE BENEFITS

Compensated Absences:

All employees of the Water District earn and accrue vacation and sick time. Employees accumulate two weeks paid vacation after the first year of service, three weeks after five years of service, and four weeks after twenty years of service. Employees accrue one sick day per month and may be carried over each year. Upon termination, accumulated sick days are converted to vacation days at the rate of four sick days equaling one vacation day. An employee leaving for any reason, including retirement will be paid their accumulated vacation and sick days converted to vacation as noted above. This liability is recorded in the financial statements.

Post Employment Benefits:

In addition to the pension benefits described in Note 8, The Water District participates in the Kentucky Retirement Systems Insurance Fund "Fund". The Fund was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.701 to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System "Systems". The Fund pays a prescribed contribution for the whole or partial payments of required premiums to purchase hospital and medical insurance.

**Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012**

NOTE 9 – OTHER EMPLOYEE BENEFITS, continued

For the most recent year available (June 30, 2013), insurance premiums withheld from benefit payments for members of the Systems approximated \$27,574,678 and \$1,209,245 for KERS and KERS hazardous, respectively, \$27,804,392 and \$2,068,890 for CERS and CERS hazardous, respectively, \$238,774 for SPRS. The Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous members killed in the line of duty. As of June 30, 2013, the Fund had 100,708 retirees and beneficiaries for whom benefits were available.

The amount of contribution paid by the Fund is based on years of service. 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
20 or more	100%
15-19	75%
10-14	50%
4-9	25%
Less than 4	0%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participating 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 (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on or after July 1, 2003 earn fifteen (\$15) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon death of a hazardous employee, such employee's spouse receives ten (\$10) per month for insurance benefits for each year of the deceased employee's earned hazardous service. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is not protected under the inviolable contract provisions of Kentucky Revised Statutes. The General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

In prior years, the employer's required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

Kentucky retirement Systems (KRS) commenced self-funding of healthcare benefits for its Medicare eligible retirees on January 1, 2006. A self-funded plan is one in which KRS assumes the financial risk for providing healthcare benefits to its retirees. The self-funded plan pays for claims out-of-pocket as they are presented instead of paying a predetermined premium to an insurance carrier for a fully-insured plan. KRS funds the risk of its self-insured program directly from its insurance assets. KRS selected Catalyst Rx and UMR to administer the pharmaceutical and medical benefits, respectively, for its retirees.

Stop-loss insurance can be arranged to limit the Kentucky Retirement Systems' loss to a specified amount to ensure that catastrophic claims do not upset the financial integrity of the self-funded plan. The amount of stop-loss insurance is a function of Kentucky Retirement Systems' size, nature of its business, financials, and tolerance for risk. Kentucky Retirement Systems continues to evaluate the use of stop-loss insurance.

Henderson County Water District
Notes to the Financial Statements
For the fiscal years ended August 31, 2013 and 2012

NOTE 9 – OTHER EMPLOYEE BENEFITS, continued

On August 6, 2012 the Board voted to cease self-funding of healthcare benefits for most KRS Medicare eligible retirees. The Board elected to contract with Humana Insurance Company to provide healthcare benefits to KRS' retirees through a fully-insured Medicare Advantage Plan. The Humana Medicare Advantage Plan became effective January 1, 2013.

NOTE 10 - RECLASSIFICATION OF PRIOR YEAR AMOUNTS

Some amounts on the prior year financial statements have been reclassified and restated to present a consistent comparison to current year financial statements.

NOTE 11 – SUBSEQUENT EVENTS

In accordance with ASC 855, subsequent events were evaluated through December 31, 2013, the date these financial statements were issued. The Public Service Commission issue a report requiring the increased lives of the building and structure, meters and installation and distribution system as of November 15, 2013.

Henderson County Water District
Schedule of Revenues, Expenses, and Changes in Net Position – Budget and Actual
For the fiscal year ended August 31, 2013

	<u>Actual Amounts</u>	<u>Budgeted Amounts</u>	<u>Over/Under Budget</u>
<u>Operating revenues:</u>			
Water	\$ 2,409,451	\$ 2,700,000	\$ (290,549)
Penalties and sundry	105,111	88,000	17,111
Total operating revenues	<u>2,514,562</u>	<u>2,788,000</u>	<u>\$ (273,438)</u>
<u>Operating expenses:</u>			
Purchased water	1,075,564	1,170,000	(94,436)
Pumping utilities	42,207	43,500	(1,293)
Maintenance of system	263,786	235,000	28,786
Vehicle and equipment	57,640	56,000	1,640
Customer accounts	169,182	165,000	4,182
Administration	508,955	512,504	(3,549)
Depreciation	542,654	563,152	(20,498)
Total operating expenses	<u>2,659,988</u>	<u>2,745,156</u>	<u>(85,168)</u>
Operating income	<u>(145,426)</u>	<u>42,844</u>	<u>(188,270)</u>
<u>Nonoperating revenues (expenses):</u>			
Investment income	21,275	19,000	2,275
Interest expense	(171,264)	(190,350)	19,086
Loan service fees	-	(900)	900
Loss on disposal of assets	(6,918)	-	(6,918)
Amortization of debt issue costs	(35,979)	(60,000)	24,021
Total nonoperating revenues (expenses)	<u>(192,886)</u>	<u>(232,250)</u>	<u>39,364</u>
Income (loss) before contributions	<u>(338,312)</u>	<u>(189,406)</u>	<u>(148,906)</u>
Capital contributions	118,584	-	118,584
Change in net position	<u>(219,728)</u>	<u>(189,406)</u>	<u>(30,322)</u>
Net position, beginning of year	9,839,196	9,839,196	-
Net position, end of year	<u>\$ 9,619,468</u>	<u>\$ 9,649,790</u>	<u>\$ (30,322)</u>

Henderson County Water District
Schedule of System Maintenance, Customer Accounts, and Administrative Expenses
For the fiscal years ended August 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<u>Maintenance of system:</u>		
Maintenance of mains	\$ 179,159	\$ 172,539
Materials and supplies - transmission	80,678	51,839
Materials and supplies - pumping	1,241	5,740
Maintenance of tanks	2,529	321
Rental - equipment	179	357
Total maintenance of system	<u>263,786</u>	<u>230,796</u>
<u>Customer accounts:</u>		
Salaries - meter reading	45,646	45,061
Billing and collections - labor and materials	104,700	103,253
Bad debts	18,672	37,970
Collection fees	164	289
Total customer accounts	<u>169,182</u>	<u>186,573</u>
<u>Administration:</u>		
Salaries	77,280	81,062
Vacation and unassigned salaries	53,466	80,451
Commissioner's fees	16,350	7,650
Payroll taxes	32,839	31,373
Employee benefits	204,017	198,134
Office and computer expense	7,579	10,003
Telephone and utilities	11,819	10,835
Advertising	1,729	271
Professional fees	21,720	41,022
Insurance	45,549	38,288
Contractual services	2,500	-
Regulatory commission	6,161	4,528
Maintenance - office	16,565	14,784
Miscellaneous and general	11,381	11,546
Total administration	<u>\$ 508,955</u>	<u>\$ 529,947</u>

**Henderson County Water District
Schedule of Insurance Coverage
For the fiscal years ended August 31, 2013**

Insurance Type	Coverage
<u>Fire and extended coverage:</u>	
Water tank and pump house, Office building and contents	\$4,086,672 - 90% Co-insurance
<u>Comprehensive general liability:</u>	
Bodily injury	\$3,000,000 each occurrence
Property damage	\$3,000,000 each occurrence
<u>Automobile liability:</u>	
Bodily injury	\$3,000,000 each occurrence
Property damage	\$3,000,000 each occurrence
Uninsured motorist	\$300,000 each occurrence
Flood	\$1,000,000
Business income	\$500,000
Workman's compensation	Statutory
<u>Money and securities:</u>	
Employee dishonesty	\$150,000
Crime (other than employee dishonesty)	\$150,000
Legal defense	\$100,000
Director and officer umbrella liability	\$3,000,000

Commissioners and employees are bonded.



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

To the Board of Commissioners
Henderson County Water District

We have audited the financial statements of the Henderson County Water District, as of and for the year ended August 31, 2013, which collectively comprise the Henderson County Water District's basic financial statements and have issued our report thereon dated December 31, 2013. 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.

Internal Control Over Financial Reporting

Management of Henderson County Water District, is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Henderson County Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Henderson County Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Henderson County Water District's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We noted the following deficiency in internal control over financial reporting that we consider to be material weaknesses, as defined above:

Control Risk Due to Lack of Segregation of Duties:

Due to the limited number of staff employed by the District, incompatible work functions are often performed by the same individual requiring a high degree of trust. Ideally, each key step of an accounting system should be segregated amount employees; however, this is not always feasible due to the cost versus benefit relationship inherent in providing internal control. In the process of segregating functions amount employees, management must make decisions relating to the applicable costs in relation to the expected benefits to be achieved.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in Henderson County Water District's internal control to be significant deficiencies:

Development and Implementation of Standard Form for Billing Adjustments:

The District at the current time does not have a standard process to document the authorization and approval of the superintendent when an adjustment is made. This does not allow for the ideal level of control and monitoring over this area. This situation increases the risk that an unauthorized adjustment could be made and not noted by management.

Recommendation:

Management should consider development of a standard process to document the approval of the superintendent. We will be glad to assist management in the development of a form to utilize in this process.

Modification of Deposit Levels Required for Commercial Concerns:

We noted that due to a bankruptcy of an area mine that is a customer of the Henderson County Water District, it is possible that a significant loss may occur well in excess of the amount of the mine's deposit. It is not uncommon for some utility concerns to require a deposit equal to two months of estimated billings. This is done to protect the utility against loss in the event a commercial customer experiences financial difficulties and is unable to pay.

Recommendation:

We recommend that management evaluate its deposit practices, and consider modification to the current policies going forward to increase the amount a commercial concern such as a mine is required to place on deposit prior to service being established. This will lessen the risk of loss to the District in the event a similar event reoccurs.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Henderson County Water District'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*.

We noted certain matters that we reported to management of Henderson County Water District, in a separate letter dated December 31, 2013.

This report is intended solely for the information and use of management, Board of Commissioners, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Myriad Co Group, LLC".

Henderson, Kentucky
December 31, 2013