

HENRY COUNTY WATER DISTRICT #2
BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORTS

At December 31, 2013 and 2012

**HENRY COUNTY WATER DISTRICT #2
BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORTS**

Years Ended December 31, 2013 and 2012

TABLE OF CONTENTS

Independent Auditor's Report	1-2
Basic Financial Statements:	
Statement of Net Position	3
Statement of Revenues, Expenses, and Changes in Fund Net Position	4
Statement of Cash Flows	5-6
Notes to Basic Financial Statements	7-18
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 <u>Government Auditing Standards</u>	19-20
Schedule of Findings and Responses	21-23

INDEPENDENT AUDITOR'S REPORT

To the Commissioners of the
Henry County Water District #2
Campbellsburg, Kentucky 40011

Report on the Financial Statements

We have audited the accompanying financial statements of Henry County Water District #2 as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Henry County Water District #2's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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 financial position of the Henry County Water District #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 accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 19 to the financial statements, in 2013, the District adopted new accounting guidance, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2014, on our consideration of the Henry County Water District #2'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 Henry County Water District #2's internal control over financial reporting and compliance.

Raisor, Zapp & Woods, PSC

RAISOR, ZAPP & WOODS, PSC
Certified Public Accountants
Carrollton, Kentucky

March 28, 2014

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF NET POSITION
December 31, 2013 and 2012

	2013	Restated 2012
ASSETS		
Current Assets:		
Cash, Including Time Deposits	\$ 364,933	\$ 433,342
Accrued Interest Receivable	93	274
Accounts Receivable (Net)	439,451	448,582
Other Receivables	-	774
Inventory	118,324	235,709
Prepaid Expense	27,202	30,690
Total Current Assets	\$ 950,003	\$ 1,149,371
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 1,722,324	\$ 1,612,642
Accrued Interest Receivable	1,915	4,733
Capital Assets (Net)	13,820,445	13,659,015
Total Noncurrent Assets	\$ 15,544,684	\$ 15,276,390
Total Assets	\$ 16,494,687	\$ 16,425,761
DEFERRED OUTFLOWS OF RESOURCES		
Deferred Loss - Early Debt Retirement	\$ 263,465	\$ 252,742
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 52,410	\$ 51,689
Accounts Payable - Construction	31,510	2,000
Retainage Payable	283,589	-
Accrued Compensated Absences	45,656	28,603
Accrued Salaries, Wages & Benefits	40,375	37,545
Accrued Payroll Taxes/Employee Withholding	16,059	38,518
Utility Tax Payable	7,556	6,731
Sales Tax Payable	435	536
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Customer Deposits	303	182
Revenue Bonds Payable	455,000	418,000
Total Current Liabilities	\$ 932,893	\$ 583,804
Noncurrent Liabilities:		
Revenue Bonds Payable (Net of Unamortized Bond Discount & Premium of \$5,524 for 2013 and \$5,908 for 2012)	\$ 6,830,524	\$ 7,265,908
Noncurrent Liabilities Payable from Restricted Assets:		
Customer Deposits Payable	73,550	67,260
Funds Held for Future Lines	-	7,000
Total Noncurrent Liabilities	\$ 6,904,074	\$ 7,340,168
Total Liabilities	\$ 7,836,967	\$ 7,923,972
NET POSITION		
Net Investment in Capital Assets	\$ 6,483,287	\$ 6,227,849
Restricted for Capital Projects	451,876	302,011
Restricted for Debt Service	1,133,113	1,151,925
Unrestricted	852,909	1,072,746
Total Net Position	\$ 8,921,185	\$ 8,754,531

HENRY COUNTY WATER DISTRICT #2
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
 For the Years Ended December 31, 2013 and 2012

	2013	Restated 2012
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 2,939,215	\$ 3,040,403
Wholesale Water Charges	230,355	215,225
Total Charges for Services	\$ 3,169,570	\$ 3,255,628
Other Charges and Miscellaneous:		
Reconnect and Disconnect Charges	\$ 28,297	\$ 29,220
Forfeited Discounts	84,993	86,802
Miscellaneous	18,907	16,082
Total Other Charges and Miscellaneous	\$ 132,197	\$ 132,104
Total Operating Revenues	\$ 3,301,767	\$ 3,387,732
Operating Expenses:		
Accounting and Collecting Labor	\$ 121,004	\$ 128,534
Chemicals	70,169	69,192
Commissioner Salaries	24,525	24,750
Continuing Education	5,431	4,688
Contractual Services-Maintenance of Mains/Distribution System	46,009	86,717
Dues	4,532	3,215
Insurance	46,136	46,902
Maintenance of Mains/Distribution System Expenses	196,158	397,408
Miscellaneous	5,285	14,395
Office Supplies and Expense	79,225	71,152
Operating Labor	595,743	551,998
Other Interest Expense	549	806
Payroll Taxes	60,104	57,423
Professional Services	50,681	80,336
Purchased Power	400,068	393,854
Regulatory Fees	6,557	5,934
Retirement Expense & Employee Benefits	315,376	337,768
Transportation Expense	23,093	20,485
Utilities	28,495	25,495
Depreciation Expense	791,267	818,065
Total Operating Expenses	\$ 2,870,407	\$ 3,139,117
Net Operating Income	\$ 431,360	\$ 248,615
Nonoperating Revenue (Expense):		
Investment Income	\$ 14,514	\$ 20,652
Interest Expense	(290,925)	(350,171)
Bond Issuance Costs	(61,389)	-
Gain (Loss) on Sale/Abandonment of Fixed Assets	(366)	-
Total Nonoperating Revenue (Expense)	\$ (338,166)	\$ (329,519)
Income (Loss) Before Contributions	\$ 93,194	\$ (80,904)
Capital Contributions	73,460	83,020
Change in Net Position	\$ 166,654	\$ 2,116
Net Position--Beginning of Year	8,754,531	8,752,415
Net Position--End of Year	\$ 8,921,185	\$ 8,754,531

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2013 and 2012

	2013	Restated 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 3,317,962	\$ 3,410,788
Payments to Suppliers	(1,240,250)	(1,743,759)
Payments to Employees	(721,389)	(699,559)
Other Receipts (Payments)	2,362	45,036
Net Cash Provided (Used) by Operating Activities	\$ 1,358,685	\$ 1,012,506
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of Capital Assets (Including Work In Process)	\$ (653,715)	\$ (456,025)
Principal Paid on Capital Debt	(3,158,000)	(399,000)
Interest Paid on Capital Debt	(291,309)	(335,127)
Bond Proceeds	2,749,277	-
Capital Contributions	66,460	60,820
Proceeds Sale of Capital Asset	13,751	-
Bond Issuance Costs	(61,389)	-
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ (1,334,925)	\$ (1,129,332)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	\$ 17,513	\$ 20,882
Net Cash Provided (Used) by Investing Activities	\$ 17,513	\$ 20,882
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 41,273	\$ (95,944)
Balances-Beginning of the Year	935,949	1,031,893
Balances-End of the Year	\$ 977,222	\$ 935,949

	Balances Per December 31, 2013 Statement of Net Position	Balances Per December 31, 2013 Statement of Cash Flows
Cash	\$ 54,898	\$ 54,898
Certificates of Deposit	310,035	-
Restricted Cash	922,324	922,324
Restricted Certificates of Deposit	800,000	-
Total Cash and Cash Equivalents, End of Year	\$ 2,087,257	\$ 977,222

	Restated Balances Per December 31, 2012 Statement of Net Position	Restated Balances Per December 31, 2012 Statement of Cash Flows
Cash	\$ 123,307	\$ 123,307
Certificates of Deposit	310,035	-
Restricted Cash	812,642	812,642
Restricted Certificates of Deposit	800,000	-
Total Cash and Cash Equivalents, End of Year	\$ 2,045,984	\$ 935,949

(Continued)

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2013 and 2012

	2013	2012
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ 431,360	\$ 248,615
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	791,267	818,065
Change in Assets and Liabilities:		
Receivables, Net	9,131	21,245
Other Receivables	774	591
Inventories	117,385	(94,720)
Prepaid Expenses	3,488	(794)
Accounts Payable	721	(8,531)
Accrued Expenses	(1,852)	26,815
Customer Meter Deposits Payable	6,411	1,220
Net Cash Provided by Operating Activities	\$ 1,358,685	\$ 1,012,506

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

At December 31, 2012 and 2013, Henry County Water District #2 had \$2,000 and \$315,099 of capitalized expenditures for construction in accounts payable on the Statement of Net Position.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES

Description of entity: Henry County Water District #2 is a rural water company serving approximately 6,300 customers in the Kentucky counties of Henry, Trimble, Carroll, Oldham and Shelby, and is regulated by the Public Service Commission of the Commonwealth of Kentucky. The water district was formed under the laws of Henry County through its Fiscal Court and began operations in 1965.

In evaluating how to define Henry County Water District #2 for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The basic -- but not the only -- criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the District is able to exercise oversight responsibilities. Based upon the application of these criteria, the District has no component units.

A summary of the District's significant accounting policies follows:

Basis of presentation and accounting: As stated in Kentucky Revised Statutes (KRS) 278.015, "any water district shall be a public utility and shall be subject to the jurisdiction of the Public Service Commission." In KRS 278.220, it is outlined that the Public Service Commission may establish a system of accounts to be kept by the utilities subject to its jurisdiction, and may prescribe the manner in which such accounts shall be kept. The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements.

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

Proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net position. Net position (total assets plus deferred outflows net of total liabilities and deferred inflows) is segregated into net investment in capital assets, restricted; and unrestricted components.

Revenues and expenses: Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the District. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities.

Debt Issuance Costs: Debt issuance Costs are expensed when incurred.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

The District adheres to the use restrictions established by Bond Agreements when expenses are incurred for which both restricted and unrestricted net position is available. The District has no policy defining which resources (restricted or unrestricted) to use first.

Property and equipment: Property and equipment purchased or constructed is stated at cost. The District's policy is to capitalize asset purchases exceeding \$500 for office equipment and \$1,000 for service equipment. The cost of meters, including installation, is recorded at the Public Service Commission approved charge of \$1,120. Interest related to costs, and major improvements, renewals and replacements is capitalized as a cost of the project. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. The range of estimated useful lives by type of asset is as follows:

- Structures & Improvements	7-60 years
- Distribution System	7-40 years
- Machinery & Equipment	3-25 years

Construction in process represents costs related to various water line extensions being installed by District employees, as well as system improvements. Expenses for maintenance and repairs that do not increase the useful life of the asset are charged to operations as they are incurred.

Inventory: Inventories of supplies are valued at the lower of cost or market on a first-in, first-out basis.

Bond Discount and Premium: The bond discount and premium are amortized over the life of the bonds.

Compensated Absences: See Note 10 for the District's policy on vacation and sick pay.

Income Taxes: The Henry County Water District #2 is not subject to income taxes.

Contributed Capital: Under the Governmental Accounting Standards Board's (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the District recognizes capital contributions as revenues, in the statement of revenues, expenses, and changes in fund net position. Capital contributions include donated property, impact fees, tap on fees and grants. Tap on fees and impact fees of \$73,460 and \$83,020 were received by the District for the years ended December 31, 2013 and 2012, respectively.

Net Position: In 2012, the District adopted Statement of Governmental Standards (GASB Statement) No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which required the District to report net position and changes the title of the Statement of Net Assets to the Statement of Net Position (effective for periods beginning after December 15, 2011). Net position comprises the various net earnings from operating and non-operating revenues, expenses, and contributions of capital. Net position is classified in the following three components: net investment in capital assets, restricted, and unrestricted net position. Net investment in capital assets consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted net position consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net position consists of all other net position not included in the above categories.

Deferred Outflows and Deferred Inflows

The District adopted GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* "GASB 65"). GASB 65 established accounting and reporting standards that reclassified certain items that were previously reported as assets and liabilities to deferred outflows of resources or deferred inflows of resources and that recognized certain items previously reported as assets and liabilities as outflows and inflows of resources. In addition, it limits the use of the term "deferred" in the financial statement presentation. The implementation of GASB 65 required the District to retroactively recognize costs of issuance as outflows of resources and restate its fiscal 2012 financial statements by eliminating any carrying amounts of bond issuance costs and related amortization thereof.

The effect of the restatement is discussed in Note 19.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimates: The preparation of financial statements 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.

Statement of Cash Flows: For the purpose of the Statement of Cash Flows, Henry County Water District #2 considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS

The Bond and Interest Sinking Account was established with the original bond issue. Under the bond resolution which established this account, it was provided that a minimum balance be maintained in this account as security to the bondholders. In order to attain the minimum balance, the monthly transfer to be made into the account for the outstanding bond issues is as follows:

$$\begin{array}{r} \text{one sixth (1/6) of the next semiannual interest payment} \\ + \text{ one twelfth (1/12) of next annual principal payment} \\ = \text{monthly transfer} \end{array}$$

While the transfers and/or segregated deposits were sufficient to meet the total obligation outstanding on all issues at December 31, 2013 and 2012, during the calendar year 2012 timely transfers were not made to the bond and interest checking account used to pay the monthly debt service resulting in overdraft charges. During calendar year 2013 all transfers were made timely as appropriate.

Upon the issuance of the original bonds, a Depreciation Account was established to provide funds for extraordinary repairs and extensions to the system and/or make up any deficiency in the Bond and Interest Sinking Account. After monthly deposits are made into the Bond and Interest Account, monthly transfers are required to be made to the Depreciation Account. The 1996 Bond Resolution (which was refinanced with the 2003 Bond Issue) required a monthly transfer of \$3,845 to accumulate to a balance of \$461,400. The 2001, 2003, 2010 and 2013 Bond Resolutions ratify and confirm the creation of the 1996 Depreciation Fund. At December 31, 2013 and 2012, the Depreciation Account was fully funded.

NOTE 3 – CASH AND INVESTMENTS

KRS 66.480 authorizes the District to invest in obligations of the United States and its agencies and instrumentalities including repurchase agreements, through sources including national and state banks chartered in Kentucky, obligations and contracts for future delivery backed by the full faith of the United States or its Agency, certificates of deposit and interest bearing accounts in institutions insured by the Federal Depository Insurance Corporation and other investments described therein provided that approved securities are pledged to secure those funds on deposit in an amount equal to the amount of those funds. The District may also invest in mutual funds meeting the requirements of the statute.

Henry County Water District #2's policies regarding deposits of cash are discussed above. The table presented below is designed to disclose the level of custody credit risk assumed by the District based upon how its deposits were insured or secured with collateral at December 31, 2013 and 2012. The categories of credit risk are defined as follows:

Category 1 – Insured by FDIC or collateralized with a depository surety bond or securities held by the District (public trust) or by its agent in its name.

Category 2 – Uninsured but collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.

Category 3 – Uninsured and uncollateralized; or collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the District's name; or collateralized with no written or approved collateral agreement.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012

NOTE 3 – CASH AND INVESTMENTS (Continued)

December 31, 2013

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Custody Credit Risk Category</u>			<u>Total Carrying Value</u>
		<u>1</u>	<u>2</u>	<u>3</u>	
Demand Deposits	\$ 1,574,398	\$ 850,560	\$ 723,838	\$ -	\$ 976,722
Certificates of Deposit	1,110,035	1,015,000	95,035	-	1,110,035
Total Deposits	\$ 2,684,433	\$ 1,865,560	\$ 818,873	\$ -	\$ 2,086,757

December 31, 2012

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Custody Credit Risk Category</u>			<u>Total Carrying Value</u>
		<u>1</u>	<u>2</u>	<u>3</u>	
Demand Deposits	\$ 1,553,778	\$ 842,773	\$ 711,005	\$ -	\$ 935,449
Certificates of Deposit	1,110,035	1,050,000	60,035	-	1,110,035
Total Deposits	\$ 2,663,813	\$ 1,892,773	\$ 771,040	\$ -	\$ 2,045,484

Reconciliation to Statement of Net Position:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Unrestricted Cash, Including Time Deposits	\$ 364,933	\$ 433,342
Restricted Cash, Including Time Deposits	1,722,324	1,612,642
Less Cash on Hand	(500)	(500)
	\$ 2,086,757	\$ 2,045,484

NOTE 4 – RESTRICTED ASSETS

Restricted cash and time deposits consist of the following:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Bond and Interest Sinking Account	\$ 524,480	\$ 540,635
Depreciation Account	606,718	606,556
Customer Deposits & Impact Charge Escrow	139,250	163,440
Construction Account	451,876	302,011
Total	\$ 1,722,324	\$ 1,612,642

Restricted receivables consist of the following:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Interest Receivable	\$ 1,915	\$ 4,733
	\$ 1,915	\$ 4,733

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$48,096 and \$93,340 at December 31, 2013 and 2012, respectively. The amount provided for bad debts represents the portion of the total amounts for which collection is unlikely, based on historical collection data.

Estimated unbilled water service revenue of \$159,938 and \$164,400 is included in accounts receivable at December 31, 2013 and 2012, respectively.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012

NOTE 6 – CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2013 and 2012, was as follows:

	Balance at January 1, 2013	Additions	Disposals	Balance at December 31, 2013
Land & Land Rights	\$ 176,617	\$ -	\$ -	\$ 176,617
Structures & Improvements	24,125,763	81,556	-	24,207,319
Distribution System	2,754,831	341,251	(611,886)	2,484,196
Machinery & Equipment	1,132,599	121,198	-	1,253,797
Construction in Process	35,434	504,365	(81,556)	458,243
Totals at Historical Cost	\$ 28,225,244	\$ 1,048,370	\$ (693,442)	\$ 28,580,172
Less: Accumulated Depreciation				
Structures & Improvements	\$ (11,874,963)	\$ (674,910)	\$ -	\$ (12,549,873)
Distribution System	(1,828,317)	(55,636)	597,769	(1,286,184)
Machinery & Equipment	(862,949)	(60,721)	-	(923,670)
Total Accumulated Depreciation	\$ (14,566,229)	\$ (791,267)	\$ 597,769	\$ (14,759,727)
Capital Assets, Net	\$ 13,659,015	\$ 257,103	\$ (95,673)	\$ 13,820,445
	Balance at January 1, 2012	Additions	Disposals	Balance at December 31, 2012
Land & Land Rights	\$ 176,617	\$ -	\$ -	\$ 176,617
Structures & Improvements	23,872,087	253,676	-	24,125,763
Distribution System	2,494,316	260,515	-	2,754,831
Machinery & Equipment	1,035,237	101,362	(4,000)	1,132,599
Construction in Process	194,962	37,656	(197,184)	35,434
Totals at Historical Costs	\$ 27,773,219	\$ 653,209	\$ (201,184)	\$ 28,225,244
Less: Accumulated Depreciation				
Structures & Improvements	\$ (11,182,239)	\$ (692,724)	\$ -	\$ (11,874,963)
Distribution System	(1,764,126)	(64,191)	-	(1,828,317)
Machinery & Equipment	(805,799)	(61,150)	4,000	(862,949)
Totals Accumulated Depreciation	\$ (13,752,164)	\$ (818,065)	\$ 4,000	\$ (14,566,229)
Capital Assets, Net	\$ 14,021,055	\$ (164,856)	\$ (197,184)	\$ 13,659,015

Included under the District's capital assets were \$4,104,621 and \$3,790,271 of fully depreciated assets, at December 31, 2013 and 2012, respectively. Land and land rights and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$791,267 and \$818,065 in 2013 and 2012, respectively.

NOTE 7 – CUSTOMER DEPOSITS/ESCROW

Customer deposits are collected upon installation of water service. This amount is to be refunded to the customer upon discontinuation of service (after the customer's bill has been paid in full) or one year pending a satisfactory payment record. Deposits received from customers are held in an interest bearing account (which is included in the financial statements as restricted cash). Records are maintained which detail the accrued interest on each customer's deposit based on the current annual rate. Accrued interest is paid annually and when the deposit is refunded.

HENRY COUNTY WATER DISTRICT #2
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
 December 31, 2013 and 2012

NOTE 8 – DEFERRED OUTFLOWS OF RESOURCES

In 2013, Henry County Water District adopted GASB 65, *Items Previously Reported as Assets and Liabilities*. Under GASBS No. 65 a consumption of net position by the District that is applicable to a future period is reported as a deferred outflow of resources. These changes were applied retroactively to the Statement of Net Position.

The following is a summary of the District's deferred outflows of resources:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Difference between the reacquisition price and the net carrying amount of the old bond issues refunded.		
2003 Bond Issue	\$ -	\$ 62,162
2010 Bond Issue	178,185	190,580
2013 Bond Issue	85,280	-
	<u>\$ 263,465</u>	<u>\$ 252,742</u>

NOTE 9 – LONG-TERM DEBT

As of December 31, 2013 and 2012, the long-term debt payable consisted of the following:

Bonds Payable:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
2001 Bond Issue, original issue amount of \$900,000, secured by water revenues. Interest is charged 2.4% to 4.75% per annum. Final maturity is January 1, 2018.	\$ -	\$ 370,000
2003 Bond Issue, original issue amount of \$2,978,000, secured by water revenues. Interest is charged 4.06% to 4.81% per annum. Final maturity is January 1, 2033.	-	2,333,000
2010 B Bond Issue, original issue amount of \$5,663,000, secured by water revenues. Interest is charged 3.20% to 4.33% per annum. Final maturity is January 1, 2028.	4,705,000	4,975,000
Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds (Flexible Term Program) Series 2013B, original issue (District Share) \$2,760,000, secured by water revenues. Interest is charged at the rates of 2.30% - 3.5% per annum. Final maturity is February 1, 2032.	<u>2,575,000</u>	<u>-</u>
Total Bonds Payable	<u>\$ 7,280,000</u>	<u>\$ 7,678,000</u>
Current Portion	\$ 455,000	\$ 418,000
Noncurrent Portion	6,825,000	7,260,000
Total Bonds Payable	<u>\$ 7,280,000</u>	<u>\$ 7,678,000</u>
Unamortized Bond Premium	5,524	5,908
Total Bonds Payable Net of Unamortized Bond Premium and Discount	<u>\$ 7,285,524</u>	<u>\$ 7,683,908</u>

Accrued Compensated Absences:

Accrued Compensated Absences (All Current)	<u>\$ 45,656</u>	<u>\$ 28,603</u>
--	------------------	------------------

**HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012**

NOTE 9 – LONG-TERM DEBT (Continued)

Kentucky Rural Water Finance Corporation Flexible Term Finance Program Series 2001D

At original issue, \$900,000 of municipal bonds were outstanding with interest rates that range from 2.4% to 4.75% per annum with maturity dates ranging from 2003-2018. On December 31, 2012, \$370,000 of bonds were outstanding on this issue. These bonds were refunded with the 2013 Series bond on February 27, 2013.

Kentucky Rural Water Finance Corporation Flexible Term Finance Program Series 2003

At original issue, \$2,978,000 of municipal bonds were outstanding with interest rates that range from 4.06% to 4.81% per annum with maturity dates ranging from 2003-2033. On December 31, 2012, \$2,333,000 of bonds were outstanding on this issue. These bonds were refunded with the 2013 Series bond on February 27, 2013.

Kentucky Rural Water Finance Corporation Public Projects Revenue Bonds, Series 2010 B

On May 13, 2010 Henry County Water District entered into a \$5,663,000 bond agreement with Kentucky Rural Water Finance Corporation. The proceeds of the bonds were used to refund the District's then outstanding Refunding Revenue Bonds, Series 1998 (principal, interest, and 1% redemption premium as required). On December 31, 2013, \$4,705,000 of the 2010B bonds were outstanding. On December 31, 2012, \$4,975,000 of bonds were outstanding on this issue.

Bonds Payable Kentucky Rural Water Finance Corporation Flexible Term Finance Program Series 2013B

On February 27, 2013, Henry County Water District #2 issued \$2,760,000, Series 2013B Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds with interest rates of 2.30% - 3.55% to advance refund \$370,000 Series 2001D and \$2,333,000 Series 2003 revenue bonds outstanding. The 2001D Series was originally issued at 2.4% to 4.75% per annum. The 2003 Series was issued at 4.06% to 4.81% per annum. The refunded bonds were redeemed on February 27, 2013 at a price equal to 100% of the principal amounts of the refunded bonds outstanding at that date. Bond issuance costs were \$61,389.

As a result of the advance refunding, the District reduced its total debt service requirements by \$476,674, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debts) of \$356,023. Final maturity on the 2013 issue is February 1, 2032.

Changes in Long-term Debt

The following is a summary of changes in long-term debt for the years ended December 31, 2013 and 2012.

December 31, 2013

	Balance at January 1, 2013	Additions	Retirements	Balance at December 31, 2013	Current Portion
Bonds Payable	\$ 7,678,000	\$ 2,760,000	\$ 3,158,000	\$ 7,280,000	\$ 455,000
Accrued Compensated Absences	28,603	17,053	-	45,656	45,656
Total Enterprise Fund Debt	<u>\$ 7,706,603</u>	<u>\$ 2,777,053</u>	<u>\$ 3,158,000</u>	<u>\$ 7,325,656</u>	<u>\$ 500,656</u>

December 31, 2012

	Balance at January 1, 2012	Additions	Retirements	Balance at December 31, 2012	Current Portion
Bonds Payable	\$ 8,077,000	\$ -	\$ 399,000	\$ 7,678,000	\$ 418,000
Accrued Compensated Absences	26,255	2,348	-	28,603	28,603
Total Enterprise Fund Debt	<u>\$ 8,103,255</u>	<u>\$ 2,348</u>	<u>\$ 399,000</u>	<u>\$ 7,706,603</u>	<u>\$ 446,603</u>

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012

NOTE 9 – LONG-TERM DEBT (Continued)

The annual requirements for all long-term debt outstanding at December 31, 2013, are as follows:

<u>Due</u>	<u>Bonds</u>	<u>Bond Interest</u>	<u>Total Principal and Interest</u>
2014	\$ 455,000	\$ 258,366	\$ 713,366
2015	470,000	245,426	715,426
2016	485,000	232,052	717,052
2017	495,000	218,242	713,242
2018	421,000	203,196	624,196
2019-2023	2,394,000	775,779	3,169,779
2024-2028	2,110,000	290,294	2,400,294
2029-2032	450,000	32,917	482,917
	<u>\$ 7,280,000</u>	<u>\$ 2,256,272</u>	<u>\$ 9,536,272</u>

The annual requirements for all long-term debt outstanding at December 31, 2012, are as follows:

<u>Due</u>	<u>Bonds</u>	<u>Bond Interest</u>	<u>Total Principal & Interest</u>
2013	\$ 418,000	\$ 320,476	\$ 738,476
2014	428,000	305,096	733,096
2015	445,000	289,324	734,324
2016	463,000	272,900	735,900
2017	479,000	255,790	734,790
2018-2022	2,258,000	1,011,121	3,269,121
2023-2027	2,498,000	488,425	2,986,425
2028-2032	689,000	88,714	777,714
	<u>\$ 7,678,000</u>	<u>\$ 3,031,846</u>	<u>\$ 10,709,846</u>

NOTE 10 – COMPENSATED ABSENCES

Vacation and sick pay are considered expenditures in the year earned.

Vacation Days

All full time employees earn one week of vacation time at the beginning of the first whole calendar year of employment and one additional day per year up to the maximum of four weeks. Only two weeks of unused vacation time may be carried over to the next year. If there is still any vacation leave remaining, the employee will be paid straight time for that portion not carried over in January of the following year. If an employee has accumulated vacation leave at time of retirement or resigning, he may have the option to use the leave time or receive payment at his/her regular rate. A terminated employee will be compensated for any accrued vacation time.

At December 31, 2013 and 2012, a liability for accrued vacation was recorded in the amount of \$45,656 and \$28,603, respectively.

Sick and Personal Days

All full time employees earn 1 sick day per month. An employee may carry over any sick leave accrued during the year that was not used, without limit. If and when the employee retires or resigns, there will be no pay for unused sick leave. Full time personnel earn 4 personal days per year with no carry-over or pay for any unused time.

At December 31, 2013 and 2012, the District had an unrecorded sick pay liability to its employees of \$129,129 and \$124,230, respectively. The estimated liabilities include required salary related payments.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012

NOTE 11 – FUND EQUITY- RESTRICTED NET POSITION

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Restricted for Capital Projects:		
Monies Reserved for Future System Improvements	\$ 451,876	\$ 302,011
Total Restricted for Capital Projects	<u>\$ 451,876</u>	<u>\$ 302,011</u>
Restricted for Debt Service:		
2001, 2003, 2010, and 2013 Bond Issues		
Cash	\$ 1,131,198	\$ 1,147,192
Add: Accrued Interest Receivable	1,915	4,733
Total Restricted for Debt Service	<u>\$ 1,133,113</u>	<u>\$ 1,151,925</u>

NOTE 12 – BAD DEBT EXPENSE

Water revenue charges have been netted with an estimated bad debt expense of \$7,916 and \$5,278 at December 31, 2013 and 2012, respectively.

NOTE 13 – INTEREST EXPENSE

Interest expense incurred for the years ended December 31, 2013 and 2012 was \$291,474 and \$350,977, respectively. No interest was capitalized in 2013 or 2012.

NOTE 14 – INSURANCE AND RELATED ACTIVITIES

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risks is covered through the purchase of commercial insurance. The District is also subject to the risks associated with employee injury. These risks are covered through premiums paid to Kentucky Employers' Mutual Insurance, a commercial insurance company.

NOTE 15 – THE COUNTY EMPLOYEES' RETIREMENT SYSTEM

Henry County Water District #2 participates in the Commonwealth of Kentucky's County Employees' Retirement System (CERS). Electing employees and all new employees of the District may participate in the System. The most recent financial report on CERS is included in the Kentucky Retirement System's annual report, June 30, 2013 and 2012. Copies of this report will be distributed to each participating employer in the Kentucky Employees Retirement System, County Employees Retirement System, and State Police Retirement System. Copies will also be available to Legislative personnel and state libraries.

Plan Description – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty position of each participating county, city and school board, and any additional eligible local agencies electing to participate in CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Prior to July 1, 2009, cost-of-living adjustments (COLA) were 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 5% 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 twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve 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. On July 1, 2013, the COLA was not granted.

**HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2013 and 2012**

NOTE 15 – THE COUNTY EMPLOYEES’ RETIREMENT SYSTEM (Continued)

Contributions - For the fiscal years ended June 30, 2013 and 2012, plan members who began participating prior to September 1, 2008, were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statue Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last 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. For the fiscal years ended June 30, 2013 and 2012, participating employers contributed 19.55% and 18.96%, respectively, of each employee’s creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012, were 19.55% and 18.96%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

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, were required to contribute a total of 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member’s account while the 1% was deposited to an account created for the payment of health insurance benefits under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members’ accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 5% of their annual creditable compensation.

The District’s total payroll for the year ended December 31, 2013 was \$776,894. Contributions were based on \$746,795 (eligible gross wages). The total pension expense for the year ended December 31, 2013 was \$143,614 and \$37,653 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2013.

The District’s total payroll for the year ended December 31, 2012 was \$779,542. Contributions were based on \$746,906 (eligible gross wages). The total pension expense for the year ended December 31, 2012 was \$144,031 and \$37,828 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2012.

The District’s contribution for the year ended June 30, 2013 and 2012, was .037% and .038%, respectively, of the System’s total contribution requirements for all employers.

For non-hazardous duty, the required contributions to the plan were as follows:

	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributions</u>
June 30, 2013	490,475,114	454,906,887	92.7%
June 30, 2012	476,185,027	447,661,027	94.0%
June 30, 2011	432,414,052	435,404,150	100.7%

The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from CERS. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance for current beneficiaries.

NOTE 16 – ECONOMIC DEPENDENCY

Henry County Water District #2 provides water services to residential and commercial customers in the Kentucky counties of Henry, Trimble, Carroll, Oldham and Shelby. The District also supplies water for resale to the cities of Eminence and New Castle located in Henry County. It should be noted that 7.1% and 7.1% of the total water charges for services revenue was received from these cities for the years ended December 31, 2013 and 2012, respectively. The wholesale rate is \$2.58 per 1,000 gallons. Also, the District supplies water for resale to West Carroll Water District at the same wholesale rate.

HENRY COUNTY WATER DISTRICT #2
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

December 31, 2013 and 2012

NOTE 17 – FUNDS HELD FOR FUTURE LINES AND CONTRIBUTED CAPITAL – IMPACT FEES

The District collects funds from developers for their allocable cost of line extensions. The amount is calculated based on the size of the line and the number of estimated hook-ups. As others pay to hook-up to the line, portions of these funds are refunded to the developer. Once a line has been completed, the developer's cost of the line is recorded as capital contributions from customers.

NOTE 18 – COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS

The District has been approved for financing for a \$2.8 million water project. The Morton Ridge waterline replacement project involves a 20 inch line replacement from the treatment plant to the Highway 42 tank financed through Kentucky Infrastructure Authority and the State Revolving Fund. TetraTech has been selected as the engineer for this project.

\$443,446 of construction costs and engineering fees relating to the Morton Ridge main upgrade project has been capitalized as construction in process. The remaining \$14,797 is for line extensions.

NOTE 19 – FINANCIAL STATEMENT RESTATEMENT

The District adopted Statement of Governmental Standards (GASB Statement) No. 65, *Items Previously Reported as Assets and Liabilities*, which amends the financial statement classification of certain items to now be included as deferred inflows and outflows categories on the Statement of Net Position. Under GASBS No. 65, debt issuance costs are no longer to be reported in the Statement of Net Position because the GASB has determined that they do not meet the definition of assets, liabilities, deferred outflows of resources, or deferred inflows of resources. Retroactive application by restating financial statements for all periods presented is required. Also during the year ended December 31, 2013 the District became aware of accumulated cash balances in the bond and interest sinking fund accounts at Regions Bank. The District transfers bond and interest amounts to Regions Bank monthly but the payment to bondholders is made semiannually. The accumulation of these monies occurred because of interest earned on these funds while being held at Regions Bank in anticipation of the semiannual bond payment. The 2001 Series bond issue cash account had a balance of \$5,321, the 2003 Series bond issue cash account had a balance of \$14,644, and the 2010 Series bond issue cash account had a balance of \$790 at December 31, 2012. These amounts were restated to Net Position and Restricted Cash – Debt Service.

The effect on the Statement of Cash Flows for the year ended December 31, 2012 is as follows:

Balances - Beginning of the Year as Originally Reported	\$	1,011,138
Add - Cash - Restricted Debt Service		20,755
Balances - Beginning of the Year - Restated	\$	1,031,893

The effect on the Statement of Net Position at December 31, 2012 is as follows:

The effect on Restricted Cash at December 31, 2012 is as follows:

Restricted Cash - as Originally Reported	\$	791,887
Add - Cash - Restricted Debt Service		20,755
Restricted Cash - Restated	\$	812,642

The effect on Net Position at December 31, 2012 is as follows:

Total Net Position as Originally Presented	\$	8,825,830
Less Net Unamortized Bond Issuance Costs		(92,054)
Add Cash - Bond and Interest Accounts - Regions Bank		20,755
Total Net Position as Restated	\$	8,754,531

HENRY COUNTY WATER DISTRICT #2
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
 December 31, 2013 and 2012

NOTE 19 – FINANCIAL STATEMENT RESTATEMENT (Continued)

The components of Net Position at December 31, 2012 after restatement are as follows:

Net investment in Capital Assets	\$ 6,227,849
Restricted for Capital Projects	302,011
Restricted for Debt Service	1,151,925
Unrestricted	<u>1,072,746</u>
 Total Net Position	 <u><u>\$ 8,754,531</u></u>

The effect on the Statement of Revenues, Expenses, and Changes in Fund Net Position for the year ended December 31, 2012 is as follows:

Change in Net Position as Originally Reported	\$ (3,871)
Add Back: Amortization Expense of Bond Issuance Costs	<u>5,987</u>
 Change in Net Position as Restated	 \$ 2,116
 Net Position, January 1, 2012 (as Restated)	 <u>8,752,415</u>
 Total Net Position as Restated	 <u><u>\$ 8,754,531</u></u>

The effect of the restatement of the Net Position at December 31, 2011 is as follows:

Net Position as Originally Reported	\$ 8,829,701
Less Net Unamortized Bond Issuance Costs	(98,041)
Add - Cash - Bond and Interest Accounts - Regions Bank	<u>20,755</u>
 Net Position as Restated, December 31, 2011	 <u><u>\$ 8,752,415</u></u>

NOTE 20 – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2012, the GASB issued Statement 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement 27*. GASB 68 is effective for periods beginning after June 15, 2014. Under this statement governments will be required to report the net pension liability associated with its' employee's pension as a liability in their accrual-based financial statements (for example, the government-wide Statement of Net Position). A government has a present obligation to pay deferred benefits earned by its employees. "Net Position Liability" represents the government's obligation to pay deferred benefits when the total pension [plan's] liability exceeds the pension plan's net assets. This reporting requirement is an important change that will more clearly depict the government's financial position. While this information will, in some cases give the appearance that a government is financially weaker than it was previously, the financial reality of the government's situation will not have changed. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

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

To the Commissioners of the
Henry County Water District #2
Campbellsburg, KY 40011

We have audited, 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, the financial statements of Henry County Water District #2 as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise Henry County Water District No. 2's basis financial statements, and have issued our report thereon dated March 28, 2014.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered Henry County Water District #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 Henry County Water District #2's internal control. Accordingly, we do not express an opinion on the effectiveness of Henry County Water District #2's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses (Items 2013-001 and 2013-002).

COMPLIANCE AND OTHER MATTERS

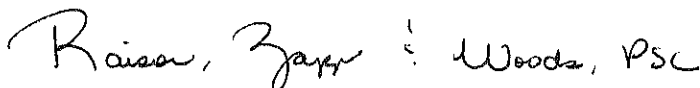
As part of obtaining reasonable assurance about whether Henry County Water District #2's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Item 2013-003.

HENRY COUNTY WATER DISTRICT #2'S RESPONSE TO FINDINGS

Henry County Water District #2's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Henry County Water District #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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



RAISOR, ZAPP, & WOODS P.S.C
Certified Public Accountants
Carrollton, Kentucky

March 28, 2014

**HENRY COUNTY WATER DISTRICT #2
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2013**

A. SUMMARY OF AUDITOR'S RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of Henry County Water District #2.
2. Two deficiencies in internal control related to the audit of the financial statements are reported in the 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. Items 2013-001 and 2013-002 were reported as material weaknesses.
3. One instance of noncompliance material to the financial statements of Henry County Water District #2, which would be required to be reported in accordance with Government Auditing Standards, was disclosed during the audit.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

GOVERNMENT AUDITING STANDARDS

DEFICIENCIES IN INTERNAL CONTROL

2013-001 SIZE OF ENTITY, CROSS-TRAINING, CHECKING PROCEDURES AND DOCUMENTATION

CONDITION:

Due to the size of the entity, cross-training and checking procedures are not in place for certain administrative positions. This limits internal control. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2012 as Item 2012-1.

CRITERIA:

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and allow timely preparation of financial data consistent with management assertions.

CAUSE:

Responsibilities associated with individual positions limit the availability of individuals to rotate duties and implement checking procedures.

EFFECT:

This limitation may affect the ability to timely and effectively record, process, summarize and report financial data.

RECOMMENDATION:

Management should strive to provide cross-training for administrative staff and implement checking processes.

RESPONSE:

We concur with the recommendation. Management believes adequate resources have been expended and control procedures implemented, that are commensurate with the staff size and responsibility of financial personnel.

**HENRY COUNTY WATER DISTRICT #2
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2013**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

2013-002 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED NOTE DISCLOSURES

CONDITION:

District financial statements, including the required disclosures, are prepared as part of the annual audit. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2012 as Item 2012-2.

CRITERIA:

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that financial statements and required notes are prepared in accordance with generally accepted accounting principles.

CAUSE:

The draft financial statements and disclosures are prepared during the audit process.

EFFECT:

Management engaged the auditor to prepare the draft of the financial statements, including the related notes to the financial statements. Management reviewed, approved, and accepted responsibility for the financial statements prior to their issuance.

RECOMMENDATION:

District management should continue to enhance its knowledge of reporting requirements in providing oversight of this service.

RESPONSE:

The outsourcing of this service is a result of management's cost benefit decision to avoid incurring internal resource costs. We concur with the recommendation and will continue to improve our overall accounting knowledge in performing our oversight responsibilities. We are aware of our responsibilities for the financial statements. We have reviewed and approved the financial statements as presented.

COMPLIANCE AND OTHER MATTERS

2013-003 VIOLATION OF KRS 424.260

CONDITION:

The Henry County Water District #2 did not advertise for bid on certain materials, supplies, equipment, or services.

CRITERIA:

KRS 424.260 requires districts to implement procedures to ascertain that any qualified purchase greater than \$20,000 is properly bid.

HENRY COUNTY WATER DISTRICT #2
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2013

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

COMPLIANCE AND OTHER MATTERS (Continued)

2013-003 VIOLATION OF KRS 424.260 (Continued)

CAUSE:

Procedures were not followed regarding Kentucky Revised Statutes.

EFFECT:

Goods and services may not be purchased at the most competitive price.

RECOMMENDATION:

The District management should review purchases for any bid requirements.

RESPONSE:

We concur with the recommendation.