

**McCREARY COUNTY WATER DISTRICT**

P.O. Box 488  
Whitley City, KY 42653  
(606) 376-2540

October 2, 2014

Mr. Jeff Cline  
PSC  
P.O. Box 615  
Frankfort, KY 40602-0615

RECEIVED

OCT - 7 2014

PUBLIC SERVICE  
COMMISSION

RE: McCreary County Water District  
December 31, 2013 and 2012 Annual Report  
Water & Sewer Divisions

Dear Mr. Cline:

Please find enclosed is the McCreary County Water District Independent Auditor's Report and Combined Financial Statements December 31, 2013 and 2012 for both the water and sewer divisions.

If you have any questions, please feel free to contact me at (606) 376-2540.

Sincerely,



Stephen T. Owens, Manager/Supt.  
McCreary County Water District

STO/kt

Enclosure

McCreary County Water District,  
Water and Sewer Divisions

\* \* \* \*

Independent Auditor's Report  
and Combined Financial Statements  
December 31, 2013 and 2012

McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
BASIC FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2013 and 2012

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McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2013 AND 2012

Our discussion and analysis of the McCreary County Water District, Water and Sewer Divisions' financial performance provides an overview of the Company's financial activities for the years ended December 31, 2013 and 2012. This information is presented in conjunction with the audited financial statements that follow this section.

Financial Highlights

For the year ended December 31, 2013, total operating and non-operating revenues (including capital contributions) totaled \$4,682,125 and operating expenses and non-operating expenses amounted to \$5,333,792, creating a decrease in net position of \$651,667. At year end, net position totaled \$33,019,514 of which \$31,200,042 (net of related debt) was invested in capital assets, and \$715,408 was restricted for debt service and construction. This left a net amount of \$1,104,064 of unrestricted net position.

For the year ended December 31, 2012, total operating and non-operating revenues (including capital contributions) totaled \$4,061,030 and operating expenses and non-operating expenses amounted to \$5,361,892, creating a decrease in net position of \$1,300,862. At year end, net position totaled \$33,671,181 of which \$31,590,801 (net of related debt) was invested in capital assets, and \$811,120 was restricted for debt service and construction. This left a net amount of \$1,269,260 of unrestricted net position.

Overview of the Financial Statements

This report consists of Management's Discussion and Analysis, Financial Statements and Supplementary information. The Financial Statements include notes which explain in detail some of the information included in the Financial Statements.

Required Financial Statements

The financial statements of McCreary County Water District, Water and Sewer Divisions report information of the Company using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The Statement of Net Position includes all of utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to utility creditors (liabilities). It also provides the basis for evaluation of the capital structure of the utility and assessing the liquidity and financial flexibility of the utility.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Position. This statement measures the success of utility's operations over the past year and can be used to determine whether the utility has successfully recovered all its costs through its user fees and other charges, profitability and credit worthiness.

The final required financial statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

**McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2013 AND 2012**

Condensed Comparative Financial Analysis:

McCreary County Water District  
Water and Sewer Divisions  
Statement of Net Position-Summary  
December 31, 2013 and 2012

Assets	<u>2013</u>	<u>2012</u>
Total Current Assets	\$ 1,509,608	\$ 1,750,020
Total Restricted Assets	715,408	811,120
Net Capital Assets	<u>41,686,550</u>	<u>42,227,200</u>
Total Assets	<u>\$ 43,911,566</u>	<u>\$ 44,788,340</u>
 Liabilities		
Total Current Liabilities	\$ 732,566	\$ 782,011
Total Non-current Liabilities	10,159,486	10,335,148
Total Liabilities	<u>\$ 10,892,052</u>	<u>\$ 11,117,159</u>
 Net Position:		
Invested in capital assets, net of related debt	\$ 31,200,042	\$ 31,590,801
Restricted for debt service and construction	715,408	811,120
Unrestricted	<u>1,104,064</u>	<u>1,269,260</u>
Total Net Position	<u>\$ 33,019,514</u>	<u>\$ 33,671,181</u>

The largest portion per year (94.49% and 93.82% respectively) of the utility's net position reflects its investment in capital assets, less any related debt used to acquire those assets still outstanding. The utility used these capital assets to provide services to citizens and consumers; consequently, these assets are not available for future spending.

Restricted net position per year (2.17% and 2.41% respectively) represent resources that are subject to external restrictions on how they may be used.

The balance per year (3.34% and 3.77% respectively) of unrestricted net position may be used to meet the utility's ongoing obligations to citizens, consumers and creditors.

**McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2013 AND 2012**

McCreary County Water District  
Water and Sewer Divisions  
Statement of Operations  
For the Years Ended December 31, 2013 and 2012

	2013	2012
Total operating revenues	\$ 3,848,665	\$ 3,874,970
Total operating expenses	5,007,369	5,017,764
Operating loss	(1,158,704)	(1,142,794)
Total non-operating revenue (expenses)	(279,714)	(273,734)
Loss before capital contributions	(1,438,418)	(1,416,528)
Capital contributions	786,751	115,666
Change in net position	(651,667)	(1,300,862)
Beginning of year	33,671,181	34,972,043
End of year	\$ 33,019,514	\$ 33,671,181

During 2013, net position decreased by \$651,667 and consisted of operating loss of (\$1,158,704), net non-operating revenue and expenses of (\$279,714) and capital contributions of \$786,751.

During 2012, net position decreased by \$1,300,862 and consisted of operating loss of (\$1,142,794), net non-operating revenues and expenses of (\$273,734) and capital contributions of \$115,666.

Capital Asset Changes

At December 31, 2013, the Utility had invested \$41,686,550 in capital assets, net of accumulated depreciation. This amount represents a net decrease of \$540,650 from the previous year. The net decrease consisted of additions to capital assets of \$997,134 less depreciation expense of \$1,537,784. The additions were mainly financed with proceeds of capital grants.

At December 31, 2012, the Utility had invested \$42,227,200 in capital assets, net of accumulated depreciation. This amount represents a net increase of \$616,637 from the previous year. The net increase consisted of additions to capital assets of \$2,176,578 less depreciation expense of \$1,559,941. The additions were mainly financed with proceeds of capital grants.

Debt Administration

At December 31, 2013, the utility had total debt equal to \$10,486,508 which consisted of \$10,408,442 of bonds outstanding, \$68,760 of notes payable, and capital leases of \$9,306. At the beginning of the year total debt equaled \$10,636,399. The decrease in debt of \$149,891 was due to scheduled principal payments and debt defeasement of \$2,209,197 exceeded new debt of \$2,059,306.

At December 31, 2012, the utility had total debt equal to \$10,636,399, which consisted of \$10,494,306 of bonds outstanding, \$137,923 of note payables, and capital leases of \$4,170. At the beginning of the year total debt equaled \$9,003,929. The increase in debt was due to finishing construction for various upgrades and additions which exceeded scheduled principle payments on preexisting debt of \$287,113.

McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2013 AND 2012

Request for Information

This financial report is designed to provide our customers and creditors with a general overview of McCreary County Water District, Water and Sewer Divisions' finances and to demonstrate utility's accountability for the funds it receives. If you have any questions about this report or need any additional information, please contact the McCreary County Water District, Whitley City, Kentucky.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners  
McCreary County Water District  
Water and Sewer Divisions  
Whitley City, Kentucky 42653

**Report on the Financial Statements**

We have audited the accompanying combined financial statements of the business-type activities of McCreary County Water District, Water and Sewer Divisions as of and for the years ended December 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.

**Auditor's Responsibility**

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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 includes 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

McCreary County Water District  
Water and Sewer Divisions  
Whitley City, Kentucky 42653  
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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 combined financial statements referred to above present fairly, in all material respects, the respective financial position of McCreary County Water District, Water and Sewer Divisions as of December 31, 2013 and 2012, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

#### **Change in Accounting Principle**

As described in Note 1 to the financial statements, in 2012, 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*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 1 through 4 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 combined financial statements that collectively comprise McCreary County Water District, Water and Sewer Divisions' basic financial statements. The accompanying combining statements of net position, revenues, expenses and changes in net position, and cash flows are presented for purposes of additional analysis, and are not a required part of the combined financial statements of the McCreary County Water District, Water and Sewer Divisions. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements.

The combining statements referred to above and the schedule of expenditures of federal awards 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

**Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2014, on our consideration of McCreary County Water District, Water and Sewer Divisions' 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 the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering McCreary County Water District's internal control over financial reporting and compliance.

***Faulkner, King & Wenz, PSC***

September 18, 2014

McCREARY COUNTY WATER DISTRICT,  
 WATER AND SEWER DIVISIONS  
 COMBINED STATEMENTS OF NET POSITION  
 DECEMBER 31, 2013 and 2012

**ASSETS**

	2013	2012
<b>Current assets:</b>		
Cash and cash equivalents	\$ 649,171	\$ 894,539
Unbilled revenues	234,908	204,602
Accounts receivable	362,554	383,055
Other receivables	3,204	9,181
Inventory	227,812	229,154
Prepaid expenses	31,959	29,489
Total current assets	1,509,608	1,750,020
<b>Non-current assets:</b>		
Restricted assets:		
Cash	385,179	517,535
Investments	330,229	293,585
Capital assets:		
Utility plant	56,467,514	56,297,068
Less accumulated depreciation	(17,542,896)	(16,005,112)
Construction in process	2,761,932	1,935,244
Total non-current assets	42,401,958	43,038,320
Total assets	\$ 43,911,566	\$ 44,788,340

**LIABILITIES**

<b>Current liabilities:</b>		
Accounts payable	\$ 127,741	\$ 154,713
Accrued interest	134,542	200,478
Taxes payable	15,476	16,388
Other accrued expenses	89,621	71,832
Customer deposits	38,164	37,349
Capital equipment lease - current	1,701	4,170
Notes payable - current	18,306	43,773
Revenue bonds - current portion	307,015	253,308
Total current liabilities	732,566	782,011
<b>Non-current liabilities:</b>		
Capital equipment lease - non current	7,605	-
Notes payable - long term	50,454	94,150
Revenue bonds - net current portion	10,101,427	10,240,998
Total non-current liabilities	10,159,486	10,335,148
Total liabilities	\$ 10,892,052	\$ 11,117,159

**NET POSITION**

Invested in capital assets, net		
of related debt	\$ 31,200,042	\$ 31,590,801
Restricted for debt service and construction	715,408	811,120
Unrestricted	1,104,064	1,269,260
Total net position	\$ 33,019,514	\$ 33,671,181

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

McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
COMBINED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION  
FOR THE YEARS ENDED DECEMBER 31, 2013 and 2012

	2013	2012
<b>Operating revenues</b>		
Residential sales	\$ 2,265,810	\$ 2,258,435
Commercial sales	324,256	307,012
Industrial sales	7,582	5,023
Governmental sales	1,145,281	1,200,348
Other sales	105,736	104,152
Total operating revenues	3,848,665	3,874,970
<b>Operating expenses</b>		
General and administrative costs	177,401	162,989
Payroll and related expenses	1,998,980	1,927,070
Repairs and maintenance	89,039	117,442
Other supplies and expenses	1,165,962	1,104,425
Bond issue costs	38,203	145,897
Depreciation and amortization	1,537,784	1,559,941
Total operating expenses	5,007,369	5,017,764
Operating loss	(1,158,704)	(1,142,794)
<b>Nonoperating revenues (expenses)</b>		
Interest income	8,726	19,418
Other income	37,983	50,976
Interest expense	(326,423)	(344,128)
Net nonoperating expenses	(279,714)	(273,734)
Loss before contributions	(1,438,418)	(1,416,528)
Capital grants received	786,751	115,666
Change in net position	(651,667)	(1,300,862)
Total net position beginning of year (restated for 2012)	33,671,181	34,972,043
Total net position end of year	\$ 33,019,514	\$ 33,671,181

The accompanying notes are an integral part of the financial statements

**McCREARY COUNTY WATER DISTRICT  
WATER AND SEWER DIVISIONS  
COMBINED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
<b>Cash Flows from Operating Activities</b>		
Cash received from customers	\$ 3,843,029	\$ 4,041,754
Operating expenses:		
General and administrative	(177,401)	(162,989)
Payroll and related expenses	(1,998,980)	(1,927,070)
Repairs and maintenance	(89,039)	(117,442)
Bond issue costs	(38,203)	(145,897)
Other supplies and expenses	(1,176,370)	(1,334,024)
Net cash provided by operating activities	363,036	354,332
 <b>Cash Flows from Capital and Related Financing Activities</b>		
Acquisition and construction of capital assets	(987,828)	(2,176,578)
Principal paid on debt	(2,209,197)	(4,966,786)
Proceeds from debt borrowings	2,050,000	6,599,256
Interest paid on debt	(392,359)	(266,362)
Capital contributions	786,751	115,666
Net cash used in capital and related financing activities	(752,633)	(694,804)
 <b>Cash Flows from Investing Activities</b>		
Interest income from investments	10,534	17,654
Other cash receipts	37,983	50,976
Net cash provided by investing activities	48,517	68,630
 Net decrease in cash and cash equivalents	(341,080)	(271,842)
 Cash and cash equivalents, at beginning of year	1,705,659	1,977,501
Cash and cash equivalents, at end of year	\$ 1,364,579	\$ 1,705,659
 Unrestricted cash and cash equivalents	\$ 649,171	\$ 894,539
Restricted cash and cash equivalents	715,408	811,120
Total cash and cash equivalents, at end of year	\$ 1,364,579	\$ 1,705,659
 <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Non-cash transactions:		
Direct financing of fixed asset purchases	\$ 9,306	\$ -

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

**McCREARY COUNTY WATER DISTRICT,**  
**WATER AND SEWER DIVISIONS**  
**COMBINED STATEMENTS OF CASH FLOWS (CONTINUED)**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
<b>Reconciliation of operating loss to net cash provided by operating activities:</b>		
Operating loss	\$ (1,158,704)	\$ (1,142,794)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	1,537,784	1,559,941
Change in assets and liabilities:		
(Increase) decrease in receivables	(5,636)	166,784
Decrease (increase) in inventories	1,342	(61,934)
(Increase) decrease in prepaids	(2,470)	9,216
(Decrease) in accounts payable	(26,972)	(186,149)
Increase in customer deposits	815	8,743
Increase in accrued expenses	16,877	525
<b>Net cash provided by operating activities</b>	<b>\$ 363,036</b>	<b>\$ 354,332</b>

McCREARY COUNTY WATER DISTRICT  
WATER AND SEWER DIVISIONS  
NOTES TO THE COMBINED FINANCIAL STATEMENTS  
DECEMBER 31, 2013 and 2012

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies of the McCreary County Water District, Water and Sewer Divisions (the District) conform to accounting principles generally accepted in the United States of America (GAAP). The District applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements, in which case, GASB prevails. The following is a summary of the more significant policies:

**Reporting Entity**

The District, consisting of McCreary County Water District Water Division, and McCreary County Water District Sewer Division has been consolidated for reporting purposes. The entities share the same board of commissioners, central offices and employees.

The District is a special district formed for the express purpose of providing water and sewer service within the confines of McCreary County, Kentucky and East Pine Knot Estates. McCreary County Fiscal Court appoints an independent board of commissioners to govern the district. The District operates as an independent entity in that it: is legally separate; holds corporate powers of organization; the Fiscal Court does not impose their will upon the District; and the District does not impose financial benefit or burden upon the Fiscal Court.

**Basis of Presentation**

GASB Statement of Accounting Standards No. 34, as amended by GASB 63, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB 34) established standards for external financial reporting for all state and local governmental entities which includes a statement of net position, a statement of revenues, expenses and changes in net position and a statement of cash flows. It requires the classification of net position into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt - This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of "invested in capital assets, net of related debt." Rather, that portion of the debt is included in the same net position component as the unspent proceeds.
- Restricted - This component of net position consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted - This component of net position consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

McCREARY COUNTY WATER DISTRICT  
WATER AND SEWER DIVISIONS  
NOTES TO THE COMBINED FINANCIAL STATEMENTS  
DECEMBER 31, 2013 and 2012

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The District is an individual fund and is accounted for as a business-type activity fund. It is financed and operated in a manner similar to a private business enterprise where the intent of the governing body is that costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed primarily through user charges.

**Basis of Accounting**

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made, regardless of the measurement focus applied. The District's financial statements are prepared on the accrual basis of accounting. By utilizing this method, revenues are recognized when they are earned, and expenses are recognized as they are incurred.

Operating income reported in the financial statements includes revenues and expenses related to the continuing operation of the fund. Principal operating revenues are charges to customers for sales or 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.

When both restricted and unrestricted resources are available for use it is the District's policy to use restricted resources first, then unrestricted resources as needed.

**Use of Estimates and Assumptions**

In preparing financial statements that conform with generally accepted accounting principles, management makes estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Accordingly, actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the allowance for doubtful accounts for accounts receivable.

**Compensated Absences**

Vacation - Vacation days are accrued at the following rate:

- 5 days per year for years 0-3
- 10 days per year for years 3-10
- 15 days per year for years 10-15
- 20 days per year for years 15-xx

These days are carried over if unused; however, all employees must take five days of vacation per year.

Sick - Employees earn one sick day for every two months of employment and may carry over a total of twelve days.

These unpaid compensated absences, if applicable, are recorded as accrued liabilities.

**Cash and Cash Equivalents**

For purposes of the statement of cash flows, the District considers all highly liquid investments with maturity of ninety days or less to be cash equivalents.

McCREARY COUNTY WATER DISTRICT  
WATER AND SEWER DIVISIONS  
NOTES TO THE COMBINED FINANCIAL STATEMENTS  
DECEMBER 31, 2013 and 2012

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Accounts Receivable**

Trade accounts receivable are stated at the amount management expects to collect from balances outstanding at year-end. Management closely monitors outstanding balances and writes off balances that are deemed to be uncollectible. The allowance for doubtful accounts of \$142,470 and \$131,900 for the years ended December 31, 2013 and 2012 has been established to reserve for those balances that the entity believes to be uncollectible.

**Inventories**

Inventories are stated at the lower of cost or market on the basis of "first-in, first-out" (FIFO) inventory method.

**Capital and operating grants**

Grants that are restricted to the purchase of capital assets are recorded as other income, per GASB 33. The District received \$786,751 and \$115,666 in grants for the years ended December 31, 2013 and 2012 respectively.

**Capital Assets**

Utility plant is stated at original cost and depreciated over its estimated useful lives using the straight-line method. Expenditures for maintenance and repairs are expensed when incurred. Renewals and betterments are capitalized. The range of useful lives used in computing depreciation is:

<u>Classification</u>	<u>Range of lives</u>
Buildings	40 years
Water systems	40 years
Machinery & equipment	5 years

Total depreciation expense was \$1,537,784 and \$1,559,941 for the years ended December 31, 2013 and 2012 respectively.

**Prior period adjustment - Unamortized debt discount and expense**

In prior years, these costs were being amortized as non-operating expenses over the life of the debt issue using the straight line method. Amortization expense was \$5,714 for the year ended December 31, 2012. The District recorded a prior period adjustment of \$58,376 effective January 1, 2012 to write off bond issue costs which were previously capitalized. Governmental Accounting Standards Board Statement No. 65 mandated this accounting change. This adjustment is reported as an adjustment to the beginning of year net position. The impact of this retroactive accounting change on previously-reported amounts for the year ended December 31, 2012 is as follows:

	January 1 2012 <u>Net Position</u>	2012 Change in <u>Net Position</u>	December 31 2012 <u>Net Position</u>
Amounts as previously reported	\$35,030,419	\$(1,160,679)	\$33,869,740
Prior-period adjustment	(58,376)	(140,183)	(198,559)
Amounts as restated	<u>\$34,972,043</u>	<u>\$(1,300,862)</u>	<u>\$33,671,181</u>

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**NOTE 2 - CASH DEPOSITS AND INVESTMENTS**

The investment policies of the District are governed by State statute. Major provisions of the District's investment policy include: depositories must be FDIC insured banking institutions; depositories must fully insure or collateralize all demand and time deposits and repurchase agreements; and securities collateralizing repurchase agreements are to be held by independent third parties.

**Bank Deposits**

The fair market value of deposits and investments was equivalent to the reported values. All deposits are checking or savings accounts. The carrying amount of the District's bank deposits was \$1,033,350 and \$1,410,133 for the years ended December 31, 2013 and 2012 respectively and the respective bank balances totaled \$1,103,559 and \$1,612,438 respectively for the years then ended. The bank balances are covered by \$500,000 of FDIC insurance. The remaining bank balances were fully collateralized. The deposits are categorized to give an indication of the level of risk assumed by the District at year end. The categories are described as follows:

- Category 1 - Insured
- Category 2 - Collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.
- Category 3 - Collateralized with securities held by the pledged financial institution in the institution's name.

Deposits at December 31, 2013, categorized by level of risk, are:

	Risk Category			Bank Balance	Book Value
	1	2	3		
Unrestricted deposits					
Operating accounts	\$ 207,606	\$ -	\$ 306,520	\$ 514,126	\$ 443,917
Depreciation funds	204,254		-	204,254	204,254
Restricted deposits					
Debt service funds	-	-	297,039	297,039	297,039
Depreciation funds	88,140	-	-	88,140	88,140
<b>Total deposits</b>	<b>\$ 500,000</b>	<b>\$ -</b>	<b>\$ 603,559</b>	<b>\$ 1,103,559</b>	<b>\$1,033,350</b>

Deposits at December 31, 2012, categorized by level of risk, are:

	Risk Category			Bank Balance	Book Value
	1	2	3		
Unrestricted deposits					
Operating accounts	\$ 107,199	\$ -	\$ 416,352	\$ 523,551	\$ 448,079
Depreciation funds	317,801		126,718	444,519	444,519
Restricted deposits					
Debt service funds	-	-	442,435	442,435	442,535
Depreciation funds	75,000	-	-	75,000	75,000
<b>Total deposits</b>	<b>\$ 500,000</b>	<b>\$ -</b>	<b>\$ 985,505</b>	<b>\$ 1,485,505</b>	<b>\$1,410,133</b>

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**NOTE 2 - CASH DEPOSITS AND INVESTMENTS (CONTINUED)**

The District also had \$1,000 and \$1,941 of petty cash on hand for the years ended December 31, 2013 and 2012 respectively.

**Investments**

At December 31, 2013 and 2012, the District's investments included the Federated Treasury Obligations Fund (a money market fund). The investments are categorized to give an indication of the level of risk assumed by the District at year end. The categories are described as follows:

- Category 1 - Investments that are insured, registered or for which the securities are held by the District or its agent in the District's name.
- Category 2 - Uninsured and unregistered investments for which the securities are held by the bank's trust departments or agents in the District's name.
- Category 3 - Uninsured and unregistered investments for which the securities are held by the banks, or by their trust departments or agents but not in the District's name.

Investments at December 31, 2013 categorized by level of risk, are:

	Risk Category			Book Value	Fair Value
	1	2	3		
Treasury MM Fund	<u>\$330,229</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$330,229</u>	<u>\$330,229</u>
Total investments	<u>\$330,229</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$330,229</u>	<u>\$330,229</u>

Investments at December 31, 2012, categorized by level of risk, are:

	Risk Category			Book Value	Fair Value
	1	2	3		
Treasury MM Fund	<u>\$293,585</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$293,585</u>	<u>\$293,585</u>
Total investments	<u>\$293,585</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$293,585</u>	<u>\$293,585</u>

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**NOTE 3 - RESTRICTED ASSETS**

The restricted assets in the accompanying financial statements are restricted as to use by ordinance (Note 7), external parties or by board designation. A schedule of restricted assets at December 31, 2013 and 2012 are:

**A schedule of restricted assets at December 31, 2013 are:**

	Cash	Investments at cost	Total
Debt service funds	\$ 297,039	\$ -	\$ 297,039
Construction funds	-	-	-
Depreciation funds	88,140	-	88,140
Treasury MM fund	-	330,229	330,229
<b>Total restricted assets</b>	<b><u>\$ 385,179</u></b>	<b><u>\$ 330,229</u></b>	<b><u>\$ 715,408</u></b>

**A schedule of restricted assets at December 31, 2012 are:**

	Cash	Investments at cost	Total
Debt service funds	\$ 442,535	\$ -	\$ 442,535
Construction funds	-	-	-
Depreciation funds	75,000	-	75,000
Treasury MM fund	-	293,585	293,585
<b>Total restricted assets</b>	<b><u>\$ 517,535</u></b>	<b><u>\$ 293,585</u></b>	<b><u>\$ 811,120</u></b>

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**NOTE 4 - CAPITAL ASSETS**

The following represents the activity for the year ended December 31, 2013:

	Balance 12/31/2012	Additions	Disposals	Transfers	Balance 12/31/2013
Operating fixed assets:					
Land	\$ 255,769	\$ 2,500	\$ -	\$ -	\$ 258,269
Buildings & Improvements	17,061,368	23,166	-	111,544	17,196,078
Treatment equipment	3,253,190	-	-	(3,377)	3,249,813
Distributions	22,555,260	6,434	-	-	22,561,694
Services/meters	3,660,394	20,360	-	-	3,680,754
Other equipment	<u>9,511,087</u>	<u>9,819</u>	<u>-</u>	<u>-</u>	<u>9,520,906</u>
	56,297,068	62,279	-	108,167	56,467,514
Accumulated depreciation	<u>(16,005,112)</u>	<u>(1,537,784)</u>	<u>-</u>	<u>-</u>	<u>(17,542,896)</u>
	40,291,956	(1,475,505)	-	108,167	38,924,618
Construction in progress	<u>1,935,244</u>	<u>934,855</u>	<u>-</u>	<u>(108,167)</u>	<u>2,761,932</u>
Utility plant, net	<u>\$42,227,200</u>	<u>\$ (540,650)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$41,686,550</u>

The following represents the activity for the year ended December 31, 2012:

	Balance 12/31/2011	Additions	Disposals	Transfers	Balance 12/31/2012
Operating fixed assets:					
Land	\$ 255,769	\$ -	\$ -	\$ -	\$ 255,769
Buildings & Improvements	17,021,176	40,192	-	-	17,061,368
Treatment equipment	3,249,813	3,377	-	-	3,253,190
Distributions	22,122,622	24,163	-	408,475	22,555,260
Services/meters	3,631,994	28,400	-	-	3,660,394
Other equipment	<u>9,472,809</u>	<u>48,178</u>	<u>( 9,900)</u>	<u>-</u>	<u>9,511,087</u>
	55,754,183	144,310	( 9,900)	408,475	56,297,068
Accumulated depreciation	<u>(14,455,071)</u>	<u>(1,559,941)</u>	<u>9,900</u>	<u>-</u>	<u>(16,005,112)</u>
	41,299,112	(1,415,631)	-	408,475	40,291,956
Construction in progress	<u>311,451</u>	<u>2,032,268</u>	<u>-</u>	<u>(408,475)</u>	<u>1,935,244</u>
Utility plant, net	<u>\$41,610,563</u>	<u>\$ 616,637</u>	<u>\$ -)</u>	<u>\$ -</u>	<u>\$42,227,200</u>

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**NOTE 5 - LONG-TERM DEBT**

Outstanding long-term debt consists of revenue bonds collateralized by the revenues of the District, and two capital leases for equipment. Revenues of the District are to be used first to pay operating and maintenance expenses and second to establish and maintain the revenue bond funds. The District is in compliance with all significant financial requirements as of December 31, 2013.

The District's bonded indebtedness and other long-term debt at December 31, 2013 and 2012, are summarized as follows:

<u>Bond issue</u>	<u>Rate</u>	<u>Original Issue</u>	<u>Principal O/S 2013</u>	<u>Principal O/S 2012</u>
<b>Water District</b>				
Takeuchi Financial	7.200%	\$ 38,463	\$ -	\$ 2,034
Forcht Bank	3.300%	128,075	-	51,576
Ricoh Financial	12.75%	9,306	9,306	-
RD Series 2013 D	Variable	1,415,000	1,415,000	-
RD 2013 Series A	1.875%	635,000	635,000	-
RD 2005 Series A	4.125%	750,000	687,500	697,500
RD 2008 Series A	4.125%	325,000	309,300	313,500
RD 2008 Series A	4.125%	150,000	142,800	144,700
RD Series 2012 D	Variable	3,205,000	3,145,000	3,205,000
RD Series 2012 D-1	Variable	1,935,000	1,300,000	1,799,256
KIA CD2-01	1.000% *	1,510,000	943,342	1,013,850
KRWFC	Variable	2,050,000	-	1,456,000
<b>Sewer District</b>				
RD 2005 Series A	4.125%	290,000	265,500	269,500
RD Series 2012 D	Variable	1,595,000	1,565,000	1,595,000
N/P - Bank of McCreary Co.	6.000%	167,000	68,760	86,347
IOS Capital	7.130%	11,482	-	2,136
		<u>14,214,326</u>	<u>10,486,508</u>	<u>10,636,399</u>
Less current maturities			<u>(327,022)</u>	<u>(301,251)</u>
Total long-term debt			<u>\$10,159,486</u>	<u>\$10,335,148</u>

\* The original issue of the KIA CD2-01 loan is \$1,510,000. As of December 31, 2013, the District had borrowed \$1,474,999 of the original amount.

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**NOTE 5 - LONG-TERM DEBT (CONTINUED)**

The District's bonded indebtedness and other long-term debt at December 31, 2013 is detailed as follows:

	Principal Balance 12/31/2012		Borrowings	Principal Payments		Principal Balance 12/31/2013		Current	Long-Term	
<b>Water District</b>										
Takeuchi Fin.	\$	2,034	\$	-	\$	2,034	\$	-	\$	-
Forcht Bank		51,576		-		51,576		-		-
Ricoh Finance		-		9,306		-		9,306	1,701	7,605
2005 Series A		697,500		-		10,000		687,500	10,500	677,000
2008 Series A		313,500		-		4,200		309,300	4,300	305,000
2008 Series A		144,700		-		1,900		142,800	2,000	140,800
2012 Series D		3,205,000		-		60,000		3,145,000	85,000	3,060,000
2012 Series D1		1,799,256		-		499,256		1,300,000	-	1,300,000
2013 Series D		-		635,000		-		635,000	-	635,000
2013 Series A		-		1,415,000		-		1,415,000	90,000	1,325,000
KRWFC		1,456,000		-		1,456,000		-	-	-
KIA CD2-01		1,013,850		-		70,508		943,342	71,215	872,127
<b>Sewer District</b>										
2005 Series A		269,500		-		4,000		265,500	4,000	261,500
2012 Series D		1,595,000		-		30,000		1,565,000	40,000	1,525,000
N/P - BOMC		86,347		-		17,587		68,760	18,306	50,454
IOS Capital		2,136		-		2,136		-	-	-
		<u>\$10,636,399</u>		<u>\$ 2,059,306</u>		<u>\$ 2,209,197</u>		<u>\$10,486,508</u>	<u>\$ 327,022</u>	<u>\$10,159,486</u>

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**NOTE 5 - LONG-TERM DEBT (CONTINUED)**

The District's bonded indebtedness and other long-term debt at December 31, 2012 is detailed as follows:

	Principal Balance 12/31/2011		Borrowings	Principal Payments	Principal Balance 12/31/2012	Current	Long-Term
<b>Water District</b>							
Takeuchi Fin.	\$ 25,521	\$ -	\$ -	\$ 23,487	\$ 2,034	\$ 2,034	\$ -
Forcht Bank	77,244	-	-	25,668	51,576	26,518	25,058
1993 Series A	620,000	-	-	620,000	-	-	-
1997 Series A	319,500	-	-	319,500	-	-	-
2001 Series A	2,220,000	-	-	2,220,000	-	-	-
2005 Series A	707,000	-	-	9,500	697,500	10,000	687,500
2008 Series A	317,500	-	-	4,000	313,500	4,000	309,500
2008 Series A	146,500	-	-	1,800	144,700	1,800	142,900
2012 Series D	-	3,205,000	-	-	3,205,000	60,000	3,145,000
2012 Series D1	-	1,799,256	-	-	1,799,256	-	1,799,256
KRWFC	1,525,000	-	-	69,000	1,456,000	73,000	1,383,000
KIA CD2-01	1,083,658	-	-	69,808	1,013,850	70,508	943,342
<b>Sewer District</b>							
1997 Series A	815,000	-	-	815,000	-	-	-
2002 Series A	766,000	-	-	766,000	-	-	-
2005 Series A	273,500	-	-	4,000	269,500	4,000	265,500
2012 Series D	-	1,595,000	-	-	1,595,000	30,000	1,565,000
N/P - BOMC	102,596	-	-	16,249	86,347	17,255	69,092
IOS Capital	4,910	-	-	2,774	2,136	2,136	-
	<u>\$9,003,929</u>	<u>\$ 6,599,256</u>		<u>\$ 4,966,786</u>	<u>\$10,636,399</u>	<u>\$ 301,251</u>	<u>\$10,335,148</u>

The long-term debt service requirements are as follows:

Year	Principal		Interest		Total	
	Water	Sewer	Water	Sewer	Water	Sewer
2014	\$ 264,716	\$ 62,306	\$ 244,947	\$ 72,959	\$ 509,663	\$ 135,265
2015	301,795	67,900	237,431	69,880	539,226	137,780
2016	309,167	70,100	229,770	66,832	538,937	136,932
2017	316,595	60,954	222,752	64,157	539,347	125,111
2018	321,621	50,000	215,682	62,414	537,303	112,414
201-2023	1,710,408	278,000	959,956	285,862	2,670,364	563,862
2024-2028	1,496,146	330,000	734,977	233,102	2,231,123	563,102
2029-2033	1,225,000	393,500	521,216	164,071	1,746,216	557,571
2034-2038	1,070,600	405,000	320,786	79,829	1,391,386	484,829
2039-2043	801,700	168,000	144,156	18,291	945,856	186,291
2044-2048	478,000	13,500	58,054	608	536,054	14,108
2049-2052	291,500	-	10,964	-	302,464	-
	<u>\$8,587,248</u>	<u>\$1,899,260</u>	<u>\$3,900,691</u>	<u>\$1,118,005</u>	<u>\$12,487,939</u>	<u>\$3,017,265</u>

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NOTE 5 - LONG-TERM DEBT (CONTINUED)

2005 Series A - McCreary County Water District Waterworks Revenue Bond, dated August 31, 2005, due in annual installments through April 1, 2045, bearing an interest rate of 4.125%.

2008 Series A - McCreary County Water District Waterworks Revenue Bond, dated April 8, 2008, due in annual installments through April 8, 2048 bearing an interest rate of 4.125%

2008 Series A - McCreary County Water District Waterworks Revenue Bond, dated April 8, 2008, due in annual installments through April 8, 2048 bearing an interest rate of 4.125%

KRWFC - McCreary County Water District Waterworks Revenue Bond, dated March 24, 2004, due in annual installments through January 1, 2030, bearing a variable interest rate. This loan was paid off in 2013 with proceeds from new bond issues at lower interest rates.

KIA CD2-01 Fund C - As of December 31, 2005 the District had drawn \$1,474,999 on a KIA loan secured by a pledge of revenues. The loan bears an interest rate of 1.00% with a life of twenty years maturing in 2025.

Forcht Bank - Installment loan dated November 10, 2009, due in monthly installments through November 10, 2014, bearing an interest rate of 3.30%. Was paid off in 2013.

2012 Series D - McCreary County Water District Waterworks Revenue Bond, dated May 30, 2012, due in annual installments through January 1, 2040 bearing a variable interest rate.

2012 Series D1 - McCreary County Water District Waterworks Revenue Bond, dated September 30, 2012, due in annual installments through April 1, 2052 bearing a variable interest rate.

2013 Series D - McCreary County Water District Waterworks Revenue Bond, dated February 27, 2013, due in annual installments through October 1, 2052 bearing a variable interest rate.

2013 Series A - McCreary County Water District Waterworks Revenue Bond, dated February 27, 2013, due in annual installments through July 1, 2030 bearing an interest rate of 1.875%.

2012 Series D - McCreary County Water District Sewer System Revenue Bond, dated May 30, 2012, due in annual installments through February 1, 2041, bearing a variable interest rate.

2005 Series A - McCreary County Water District Sewer System Revenue Bond, dated August 31, 2005, due in annual installments through January 1, 2045, bearing an interest rate of 4.125%.

Bank of McCreary County - Installment loan dated February 9, 2007, due in bi-annual installments through February 9, 2017, bearing an interest rate of 6.0%.

Takeuchi Financial - A capital lease was started on May 15, 2011 for the use of equipment purchased from Wilson Equipment Company. The lease bears an interest rate of 7.2% with a life of twenty months and ended on January 15, 2013.

IOS Capital - A capital lease was started on July 16, 2009 for the use of equipment purchased from IKON Office Solutions. The lease bears an interest rate of 7.13% with a life of four years and ended on July 16, 2013.

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**NOTE 5 - LONG-TERM DEBT (CONTINUED)**

Ricoh Finance - A capital lease was started on December 30, 2013 for the use of equipment purchased from IKON Office Solutions. The lease bears an interest rate of 12.75% with a life of four years ending on January 30, 2018.

As reflected on page 20, the District paid off one bond issue, bearing a variable interest rate, with the proceeds of the various 2013 debt obligations at lower interest rates.

**NOTE 6 - NET POSITION**

GASB Statement No. 34 (as amended by GASB 63) requires the delineation of Net Position as Invested in Property, Plant and Equipment, (capital investments), Restricted and Unrestricted.

The balance of capital investments represents funds that have been used to acquire pump stations, storage facilities, meter stations, etc., constructed and operated by the District, net of outstanding debt. The balance was \$31,200,042 and \$31,590,801 for the years ended December 31, 2013 and 2012 respectively.

The District has the following restricted net position that is reserved in accordance with the District's various bond ordinances (Note 7):

	<u>2013</u>	<u>2012</u>
Construction	\$ -0-	\$ -0-
Depreciation	88,140	75,000
Debt Service	297,039	442,535
Treasury MM Fund	<u>330,229</u>	<u>293,585</u>
Total Restricted	<u>\$ 715,408</u>	<u>\$ 811,120</u>

The District has a balance of \$1,104,064 and \$1,269,260 for unrestricted net position at December 31, 2013 and 2012 respectively.

**NOTE 7 - COMPLIANCE WITH BOND ORDINANCES**

The District is in compliance with its bond ordinances that require the District to maintain certain reserves and restricted assets as follows:

Bond and Interest Fund - In order to fund the McCreary County Water District and Water Sewer debt, the District makes deposits into these funds to pay for current maturing principal portions and associated interest of bond issues.

Bond Sinking Funds - McCreary County Water District is required by ordinances to transfer funds into various sinking funds for future debt retirement.

Depreciation Fund - The bond resolutions authorizing the bond issues of the water and sewer system require transfers into various depreciation funds to be used for plant acquisitions, extensions and extraordinary repairs and maintenance. Transfers can cease when the fund balance reaches specified levels. The balance in the depreciation fund as of December 31, 2013 and 2012 equaled \$292,394 and \$519,519 respectively. The required balance is \$88,140 and \$75,000 respectively.

Construction Funds - The District is required to transfer funds into various funds for the use of funding future projects.

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**NOTE 8 - PENSION PLAN**

The District has elected to participate in the County Employees' Retirement System (CERS) which is administered by the Board of Trustees of the Kentucky Retirement Systems. This is a multi-employer defined benefit plan that covers substantially all regular full-time employees of county, school board, municipal and other local agencies electing to participate. Upon election to participate in the CERS, each employee has the option to participate. However, all subsequent employees must participate and the employer is required to continue participation.

The District had a total of 28 and 27 employees at December 31, 2013 and 2012 covered by the CERS who contributed 5.00%. The employer contributed 19.55% through June, and 18.89% through December of 2013 and 18.96% through June, and 19.55% through December in 2012. The District's contribution was \$183,997 and \$184,535 for the years ended December 31, 2013 and 2012 respectively while the employees contributed \$47,885 and \$47,883 for the years then ended respectively.

The amount shown below as "actuarial accrued liability" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems (PERS). The measure is independent of the actuarial funding method used to determine contributions to the System.

Vesting in a retirement benefit begins immediately upon entry into the System. The participant has a fully vested interest after the completion of sixty months of service, twelve of which are current service. At a minimum, terminated employees are refunded their contributions with credited interest at 3% compounded annually through June 30, 1981, 6% thereafter through June 30, 1986 and 4% thereafter. All required contributions were paid at year end or within thirty (30) days thereafter. The percentage of the District's contribution to total employers' contribution in the CERS for the year is not known.

The CERS total actuarial accrued liability was \$12,503,100,000 and the net assets available for the benefits were \$7,438,800,000 as of June 30, 2013, which is the latest information available. Also see Note 11.

**NOTE 9 - RISK MANAGEMENT**

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the District also carries commercial insurance for all other risks of loss such as workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three calendar years.

**NOTE 10 - FAIR VALUE MEASUREMENTS**

FASB Statement No. 157, *Fair Value Measurements*, as codified by Accounting Standards Codification (ASC) 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels: Level 1 inputs consist of unadjusted quoted prices in active markets for identical assets and have the highest priority, and Level 3 inputs have the lowest priority. The District uses appropriate valuation techniques based on the available inputs to measure the fair value of its investments. When available, the District measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. No Level 2 or 3 inputs were used by the District.

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**NOTE 10 - FAIR VALUE MEASUREMENTS (CONTINUED)**

*Level 1 Fair Value Measurements*

The fair value of the Federated Treasury Obligations Fund (a money market fund) is based on quoted net asset values of the investments held by the District at year-end.

The following table sets forth by level, within the fair value hierarchy, the District's assets at fair value:

Assets at Fair Value as of December 31, 2013

	Level 1	Level 2	Level 3	Total
Treasury MM fund	<u>\$330,229</u>	-	-	<u>\$330,229</u>
Total assets at fair value	<u>\$330,229</u>	-	-	<u>\$330,229</u>

Assets at Fair Value as of December 31, 2012

	Level 1	Level 2	Level 3	Total
Treasury MM fund	<u>\$293,585</u>	-	-	<u>\$293,585</u>
Total assets at fair value	<u>\$293,585</u>	-	-	<u>\$293,585</u>

**NOTE 11 - SUBSEQUENT EVENTS**

Subsequent events were evaluated through September 18, 2014, which is the date the financial statements were available to be issued.

In June 2012 the GASB approved a pair of related Statements that reflect substantial changes to the accounting and financial reporting of state and local government employers and pension plans. Statement No. 67, *Financial Reporting for Pension Plans*, addresses financial reporting for state and local government pension plans. Statement No. 68, *Accounting and Financial Reporting for Pensions*, addresses financial reporting for state and local government employers whose employees are provided with pensions through pension plans that are covered under Statement No. 67.

The guidance contained in these Statements will change how governments calculate and report the costs and obligations associated with pensions in important ways. It is designed to improve the decision - usefulness of reported pension information and to increase the transparency, consistency, and comparability of pension information across governments.

Under the pension standards now in effect, cost-sharing employers have not been required to present actuarial information about pensions. Instead, information has been required to be presented in the pension plan's own financial statements for all of the participating governments combined.

McCREARY COUNTY WATER DISTRICT  
WATER AND SEWER DIVISIONS  
NOTES TO THE COMBINED FINANCIAL STATEMENTS  
DECEMBER 31, 2013 and 2012

NOTE 11 - SUBSEQUENT EVENTS

Through its research, the GASB concluded that the needs of users of information regarding cost-sharing employers do not differ significantly from those interested in single and agent employers. Therefore, the GASB believes it is important to give users of the financial statements of cost-sharing employers access to better, more transparent financial information. Consequently, under the new standards the GASB is requiring that cost-sharing governments report a net pension liability, pension expense, and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective mounts for all the governments in the plan.

Statement No. 68 will take effect for pension plan employers in fiscal years beginning after June 15, 2014 (that is, for years ended June 30, 2015 or later). The District is currently evaluating the effects of this statement on its financial statements. This accounting change will first affect the McCreary County Water District for the fiscal year ending December 31, 2015.

**Supplemental Information**

**McCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
COMBINING STATEMENT OF NET POSITION  
DECEMBER 31, 2013**

ASSETS	McCreary County		Eliminations	Total
	Water	Sewer		
<b>Current assets:</b>				
Cash and cash equivalents	\$ 641,867	\$ 7,304	\$	\$ 649,171
Unbilled revenues	186,681	48,227		234,908
Accounts receivable, net	295,021	67,533		362,554
Other receivables	1,209	1,995		3,204
Due from associated division	538,654	-	(538,654)	-
Inventory	193,094	34,718		227,812
Prepaid expenses	31,959	-		31,959
Total current assets	<u>1,888,485</u>	<u>159,777</u>	<u>(538,654)</u>	<u>1,509,608</u>
<b>Non-current assets:</b>				
Restricted cash and cash equivalents	357,933	27,246		385,179
Investments	330,229	-		330,229
<b>Capital assets:</b>				
Utility plant	37,977,014	18,490,500		56,467,514
Less accumulated depreciation	(12,689,457)	(4,853,439)		(17,542,896)
Construction in process	2,761,932	-		2,761,932
Total non-current assets	<u>28,737,651</u>	<u>13,664,307</u>		<u>42,401,958</u>
Total assets	<u>\$ 30,626,136</u>	<u>\$ 13,824,084</u>	<u>\$ (538,654)</u>	<u>\$ 43,911,566</u>
<b>LIABILITIES</b>				
<b>Current liabilities:</b>				
Accounts payable	\$ 105,582	\$ 22,159	\$	\$ 127,741
Accrued interest	98,477	36,065		134,542
Due to associated division	-	538,654	(538,654)	-
Taxes payable	14,024	1,452		15,476
Other accrued expenses	79,881	9,740		89,621
Customer deposits	38,164	-		38,164
Capital equipment lease - current	1,701	-		1,701
Notes payable - current	-	18,306		18,306
Revenue bonds - current portion	263,015	44,000		307,015
Total current liabilities	<u>600,844</u>	<u>670,376</u>	<u>(538,654)</u>	<u>732,566</u>
<b>Non-current liabilities:</b>				
Capital equipment lease - net current	7,605	-		7,605
Notes payable - long term	-	50,454		50,454
Revenue bonds - net current portion	8,314,927	1,786,500		10,101,427
Total non-current liabilities	<u>8,322,532</u>	<u>1,836,954</u>		<u>10,159,486</u>
Total liabilities	<u>\$ 8,923,376</u>	<u>\$ 2,507,330</u>	<u>\$ (538,654)</u>	<u>\$ 10,892,052</u>
<b>NET POSITION</b>				
Invested in capital assets, net of related debt	\$ 19,462,241	\$ 11,737,801	\$	\$ 31,200,042
Restricted for debt service and construction	688,162	27,246		715,408
Unrestricted	1,552,357	(448,293)		1,104,064
Total net position	<u>\$ 21,702,760</u>	<u>\$ 11,316,754</u>	<u>\$ -</u>	<u>\$ 33,019,514</u>

See Independent Auditor's Report.

**MCCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION  
FOR THE YEAR ENDED DECEMBER 31, 2013**

	McCreary County		Total
	Water	Sewer	
<b>Operating revenues</b>			
Residential sales	\$ 2,020,550	\$ 245,260	\$ 2,265,810
Commercial sales	206,871	117,385	324,256
Industrial sales	4,121	3,461	7,582
Governmental sales	743,252	402,029	1,145,281
Other sales and fees	85,137	20,599	105,736
Total operating revenues	<u>3,059,931</u>	<u>788,734</u>	<u>3,848,665</u>
<b>Operating expenses</b>			
General and administrative costs	147,179	30,222	177,401
Payroll and contractual services	1,606,190	392,790	1,998,980
Repairs and maintenance	-	89,039	89,039
Other supplies and expenses	781,017	384,945	1,165,962
Bond issue costs	40,069	(1,866)	38,203
Depreciation	968,528	569,256	1,537,784
Total operating expenses	<u>3,542,983</u>	<u>1,464,386</u>	<u>5,007,369</u>
Operating (loss)	<u>(483,052)</u>	<u>(675,652)</u>	<u>(1,158,704)</u>
<b>Nonoperating revenues (expenses)</b>			
Interest income	8,548	178	8,726
Other income	37,983	-	37,983
Interest expense	(250,025)	(76,398)	(326,423)
Total nonoperating revenues	<u>(203,494)</u>	<u>(76,220)</u>	<u>(279,714)</u>
Loss before contributions	(686,546)	(751,872)	(1,438,418)
Capital grants received	<u>781,980</u>	<u>4,771</u>	<u>786,751</u>
Change in net position	95,434	(747,101)	(651,667)
Total net position on December 31, 2012	<u>21,607,326</u>	<u>12,063,855</u>	<u>33,671,181</u>
Total net position on December 31, 2013	<u>\$ 21,702,760</u>	<u>\$ 11,316,754</u>	<u>\$ 33,019,514</u>

See Independent Auditor's Report

MCCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
COMBINING STATEMENT OF CASH FLOWS  
DECEMBER 31, 2013

	Water	Sewer	Total
<b>Cash Flows from Operating Activities</b>			
Cash received from customers	\$ 3,017,707	\$ 825,322	\$ 3,843,029
Operating expenses:			
General and administrative	(147,179)	(30,222)	(177,401)
Payroll and related expenses	(1,606,190)	(392,790)	(1,998,980)
Repairs and maintenance	-	(89,039)	(89,039)
Bond issue costs	(40,069)	1,866	(38,203)
Other supplies and expenses	(786,902)	(389,468)	(1,176,370)
Net cash provided (used) by operating activities	<u>437,367</u>	<u>(74,331)</u>	<u>363,036</u>
 <b>Cash Flows from Capital and Related Financing Activities</b>			
Acquisition and construction of capital assets	(979,968)	(7,860)	(987,828)
Principal paid on debt	(2,155,474)	(53,723)	(2,209,197)
Proceeds from debt borrowings	2,050,000	-	2,050,000
Interest paid on debt	(306,221)	(86,138)	(392,359)
Capital contributions	<u>781,980</u>	<u>4,771</u>	<u>786,751</u>
Net cash used in capital and related financing activities	<u>(609,683)</u>	<u>(142,950)</u>	<u>(752,633)</u>
 <b>Cash Flows from Investing Activities</b>			
Interest income from investments	9,960	574	10,534
Other cash receipts	<u>37,983</u>	<u>-</u>	<u>37,983</u>
Net cash provided by investing activities	<u>47,943</u>	<u>574</u>	<u>48,517</u>
 Net (decrease) in cash and cash equivalents	(124,373)	(216,707)	(341,080)
Cash and cash equivalents, at beginning of year	<u>1,454,402</u>	<u>251,257</u>	<u>1,705,659</u>
Cash and cash equivalents, at end of year	<u>\$ 1,330,029</u>	<u>\$ 34,550</u>	<u>\$ 1,364,579</u>
 Unrestricted cash and cash equivalents	\$ 641,867	\$ 7,304	\$ 649,171
Restricted cash and cash equivalents	<u>688,162</u>	<u>27,246</u>	<u>715,408</u>
Total cash and cash equivalents, at end of year	<u>\$ 1,330,029</u>	<u>\$ 34,550</u>	<u>\$ 1,364,579</u>

See Independent Auditor's Report.

MCCREARY COUNTY WATER DISTRICT,  
WATER AND SEWER DIVISIONS  
COMBINING STATEMENT OF CASH FLOWS (CONTINUED)  
DECEMBER 31, 2013

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
<b>Reconciliation of operating loss to net cash provided by operating activities:</b>			
Operating loss	\$ (483,052)	\$ (675,652)	\$ (1,158,704)
Adjustments to reconcile operating loss to net cash provided by operating activities:			
Depreciation and amortization	968,528	569,256	1,537,784
Change in assets and liabilities:			
(Increase) decrease in receivables	(12,008)	6,372	(5,636)
(Increase) decrease in inventories	(20,439)	21,781	1,342
(Increase) in prepaids	(2,470)	-	(2,470)
(Decrease) increase in accounts payable	984	(27,956)	(26,972)
Increase in customer deposits	815	-	815
Increase in accrued expenses	15,225	1,652	16,877
<b>Net cash provided (used) by operating activities</b>	<u>\$ 467,583</u>	<u>\$ (104,547)</u>	<u>\$ 363,036</u>

See Independent Auditor's Report.

McCreary County Water District  
 Schedule of Expenditures of Federal Awards  
 December 31, 2013

<u>Pass-through Grantor/ Program Title</u>	<u>Federal CFDA #</u>	<u>Program/Award</u>	<u>Award Amount</u>	<u>Receipts FYE 12/31/13</u>	<u>Expenditures FYE 12/31/13</u>
Rural Development	10.760	Rural Development Water Plant 1 Upgrade Loan / Grant	<u>2,705,000</u>	<u>817,688</u>	<u>817,688</u> Major
		Total	<u>2,705,000</u>	<u>817,688</u>	<u>817,688</u>

**Notes to Schedule of Expenditures of Federal Awards**

**Note 1. Basis of Presentation**

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of McCreary County Water District under programs of the federal government for the year ended December 31, 2013. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of McCreary County Water District, it is not intended to and does not present the financial position, changes in net assets, or cash flows of McCreary County Water District.

**Note 2. Summary of Significant Accounting Policies**

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

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

Board of Commissioners  
McCreary County Water District  
Water and Sewer Divisions  
Whitley City, Kentucky 42653

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the combined financial statements of the business-type activities of the McCreary County Water District, Water and Sewer Divisions (the District), as of and for the year ended December 31, 2013, and the related notes to the financial statements which collectively comprise the District's basic financial statements and have issued our report thereon dated September 18, 2014.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

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

Board of Commissioners  
McCreary County Water District  
Water and Sewer Divisions  
Whitley City, Kentucky 42653  
Page 2

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the 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*.

**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.

***Faulkner, King & Wenz, PSC***

September 18, 2014

**FAULKNER, KING & WENZ, PSC**  
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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

McCreary County Water District  
Whitley City, Kentucky

**Report on Compliance for Each Major Federal Program**

We have audited the compliance of McCreary County Water District, Water and Sewer divisions, with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2013. McCreary County Water District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

**Auditor's Responsibility**

Our responsibility is to express an opinion on compliance for each of McCreary County Water District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about McCreary County Water District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of McCreary County Water District's compliance.

**Opinion on Each Major Federal Program**

In our opinion, McCreary County Water District, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2013.

**Report on Internal Control Over Compliance**

Management of McCreary County Water District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered McCreary County Water District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of McCreary County Water District's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.

*A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

McCreary County Water District  
Whitley City, Kentucky  
Page 3

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Faulkner, King & Wenz, PSC*

September 18, 2014

McCreary County Water District  
Schedule of Findings and Questioned Costs  
Year Ended December 31, 2013

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**A. Summary of Audit Results**

1. The auditor's report expresses an unqualified opinion on the financial statements of McCreary County Water District.
2. No significant deficiencies, material weaknesses, or instances of noncompliance were reported or identified during the audit of the financial statements.
3. No significant deficiencies, material weaknesses, instances of noncompliance, or other audit findings relating to the audit of the major federal award programs were reported or identified, which are required to be reported under section .510(a) of OMB A-133.
4. We have issued an unqualified opinion on compliance for major programs.
5. The programs tested as major programs are as follows:

RD Grant	10.760
RD Loan	10.760
6. The threshold for distinguishing Types A and B programs was \$300,000.
7. McCreary County Water District was not determined to be a low-risk auditee.

**B. Findings - Financial Statements Audit**

None

**C. Findings and Questioned Costs - Major Federal Award Program Audit**

None