

MCKINNEY WATER DISTRICT
AUDIT OF FINANCIAL STATEMENTS

DECEMBER 31, 2015

CRAIG A. BUTLER
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DANVILLE, KENTUCKY

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INDEPENDENT AUDITOR'S REPORT

Chairman and Commissioners
McKinney Water District
McKinney, Kentucky 40448

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of the McKinney Water District as of and for the year ended December 31, 2015, 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

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America 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 I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the McKinney Water District, as of December 31, 2015, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 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. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated March 21, 2016, on my consideration of the District's internal control over financial reporting and my tests of compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* in considering the McKinney Water District's internal control over financial reporting and compliance.

Craig A. Butler, CPA

Craig A. Butler
Certified Public Accountant

Danville, Kentucky
March 21, 2016

McKinney Water District
Management Discussion and Analysis
For the Year Ended December 31, 2015

The management of the McKinney Water District presents this narrative to help our readers review the accompanying annual financial statements for the year ended December 31, 2015. We have prepared this overview and analysis of the District's financial activities to add additional information to the financial schedules and the note disclosures. Our analysis will examine the financial highlights for this fiscal year and help explain the format for our readers.

Financial Highlights

- As of December 31, 2015, the District's assets (page 8) exceeded liabilities by \$1,512,706. This amount includes \$805,589 of resources that are invested in capital assets, net of related debt. \$306,742 of these resources are restricted for debt service, customer deposit refunds, or by enabling legislation. \$400,375 of these resources are unrestricted and are available to fund the District's outstanding obligations and future programs.
- Unrestricted cash and certificate of deposit balances (page 7) as of December 31, were \$289,817 and current liabilities payable from unrestricted resources (i.e. excluding principal and interest on long term debt and customer deposits) were \$38,546.
- Net position decreased by \$15,072 (page 9) which is comparable to the decrease of \$13,990 in the prior year. However, it should be noted that the current year decrease is net of depreciation expense of \$87,170, a non-cash expense. The District's net operating income was \$22,134 in the current year compared to a net operating loss of \$43,124 in the prior year. The primary reason for the improvement this year is due to a decrease in water losses which were approximately 21% this year compared to 29% in the prior year.
- The District's total debt decreased \$32,800 for the year ended December 31, 2015 equal to the scheduled payments for the year.

Overview of the Financial Statements

This discussion and analysis is intended to introduce the District's financial statements. Basic financial statements include two major sections: 1) government-wide financial statements, and 2) notes to the financial statements.

The McKinney Water District is a special-purpose governmental entity. It utilizes the accrual basis of accounting applicable to all *proprietary fund types*. Revenues are recognized when earned regardless of when received and expenses are recognized when incurred regardless of when paid.

Notes to the Financial Statements

Notes provide additional information that is essential to a full understanding of the information included in the financial schedules. Notes provide additional details about the balances and transactions in the District's financial statements and are presented on pages 14 through 19.

Government-wide Financial Analysis

Net position may serve over time as a useful indicator of a government's financial position. 53% of the District's net position reflects its investment in capital assets (e.g. distribution system, equipment, etc.), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to its customers; consequently these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. 20% of the District's

McKinney Water District
Management Discussion and Analysis
For the Year Ended December 31, 2015

net position is restricted for customer deposit refunds, debt service, and system maintenance. The remaining 27% of the District's net position is unrestricted.

The first statement in the government-wide statements is the Statement of Net Position. The following table summarizes the Statement of Net Position (pages 7-8).

	2015	2014
Current and other assets	\$ 829,947	\$ 824,869
Capital assets	1,782,589	1,844,966
 Total assets	<u>2,612,536</u>	<u>2,669,835</u>
 Long-term debt outstanding	942,400	977,000
Other liabilities	157,430	165,057
 Total liabilities	<u>1,099,830</u>	<u>1,142,057</u>
 Net position:		
Invested in capital assets, net of related debt	805,589	835,166
Restricted	306,742	282,971
Unrestricted (deficit)	400,375	409,641
 Total Net Position	<u>\$ 1,512,706</u>	<u>\$ 1,527,778</u>

The second statement in the government-wide statements is the Statement of Revenues, Expenses, and Changes in Net Position. The following table outlines the major components of this statement.

	2015	2014
 Revenues:		
Charges for services	\$ 807,192	\$ 783,203
Grants and contributions	-	67,482
Rental Income	-	3,600
Interest earnings	1,486	1,708
Miscellaneous	20,586	21,986
 Total Revenues	<u>829,264</u>	<u>877,979</u>
 Expenses:		
Operating expenses, excluding depreciation	718,474	749,881
Depreciation	87,170	102,032
Interest and amortization	38,692	40,056
 Total Expenses	<u>844,336</u>	<u>891,969</u>
 Increase (decrease) in net position	<u>\$ (15,072)</u>	<u>\$ (13,990)</u>

McKinney Water District
Management Discussion and Analysis
For the Year Ended December 31, 2015

The District experienced water losses in excess of 30% for the fiscal years ended December 31, 2010 and 2011. This high rate of water loss was a primary contributor to the large decrease in net assets over these two years. However, in 2012, the District took measures to address the high water loss percentages and was very successful in bringing the losses down considerably. In fact, the water loss percentage for 2012 and 2013 was 18% and 20%, respectively. During the fiscal year ended December 31, 2014, the water loss percentages increased to just over 29% for the year. During the fiscal year ended December 31, 2015, the water loss percentage decreased to approximately 21% for the year.

Capital Asset and Debt Administration

The District invests substantial resources in capital assets that support the services provided to its customers. All of the District's outstanding debt has been used to acquire or construct capital assets.

Capital Assets

The District's capital assets, net of accumulated depreciation are summarized below:

Land and right of ways	\$ 18,043
Distribution system	1,484,347
Office furniture and fixtures	6,042
Buildings and improvements	7,520
Capitalized design and interest costs	266,637
Construction in process	-
Total, net of depreciation	<u>\$ 1,782,589</u>

Long Term Debt

The principal outstanding on the District's long-term debt is summarized in the following table.

	<u>Total</u>
RDA 1992 Series C Bond	\$ 15,000
RDA 1992 Series D Bond	359,000
RDA 1999 Series A Bond	101,900
RDA 1999 Series B Bond	70,600
RDA 2000 Series A Bond	430,500
Total	<u>\$ 977,000</u>

The District's outstanding debt decreased \$32,800 for the year equal to the amount of the scheduled payments.

McKinney Water District
Management Discussion and Analysis
For the Year Ended December 31, 2015

Economic Factors for Next Year

During the year ended December 31, 2005, the District was granted a rate increase of approximately 23% by the Kentucky Public Service Commission in order to return to profitability and build its reserves to fund future capital projects. During the three fiscal years ended December 31, 2006, 2007, and 2008, the District made some much needed line repairs which resulted in lowered water losses and thus an increase in net income. During the year ended December 31, 2009, unusually high repair and contract labor expenses prevented the District from achieving a net asset increase. Also, during the fiscal year ended December 31, 2010, increased water losses prevented the District from achieving a net asset increase. Furthermore, due to high volumes of water loss, the District did not achieve a net asset increase for the fiscal year ended December 31, 2011. However, as stated previously, the District made tremendous progress during the fiscal years ended December 31, 2012, and 2013 in getting their water losses under control and as a result the District experienced an increase in its net assets for these years. However, in 2014, water loss percentages increased to levels as seen in years prior to 2012 which resulted in a net loss from operations of \$43,124. For the year ended December 31, 2015, water losses decreased to approximately 21% which was the primary factor that improved the District's net operating results for the year. Going forward, the District will continue to monitor its water losses and take the necessary action to keep them at an acceptable level.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office, McKinney, KY 40448, telephone number (606) 346-2220.

MCKINNEY WATER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2015
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2014)

	<u>2015</u>	<u>2014</u>
<u>ASSETS</u>		
Current Assets:		
Cash (Note 3)	\$ 236,136	\$ 251,623
Certificates of Deposit (Note 3)	53,681	53,401
Accounts Receivable (Net of Allowance)	57,792	56,698
Inventory (Note 2)	50,562	53,223
Prepaid Expenses (Note 2)	<u>6,149</u>	<u>2,844</u>
Total Current Assets	404,320	417,789
Non-current Assets:		
Restricted Cash (Note 3)	210,901	193,478
Restricted Certificates of Deposit (Note 3)	<u>214,726</u>	<u>213,602</u>
Total Restricted Assets	425,627	407,080
Property and Equipment (Note 4):		
Land and Right of Ways	18,044	18,044
Distribution System	3,590,379	3,564,573
Other Tangible Assets	87,505	87,505
Office Furniture and Fixtures	41,870	39,284
Building and Improvements	43,178	43,178
Capitalized Design and Interest Costs	566,950	566,950
Construction in Process	-	3,600
Less: Accumulated Depreciation	<u>(2,565,337)</u>	<u>(2,478,168)</u>
Net Property and Equipment	<u>1,782,589</u>	<u>1,844,966</u>
Total Assets	<u>\$ 2,612,536</u>	<u>\$ 2,669,835</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2015
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2014)

	<u>2015</u>	<u>2014</u>
<u>LIABILITIES</u>		
Current Liabilities:		
Accounts Payable	\$ 30,143	\$ 32,794
Accounts Payable - Contractors	-	7,693
Other Current Liabilities	<u>8,403</u>	<u>8,153</u>
Total Current Liabilities	38,546	48,640
Current Liabilities Payable From Restricted Assets:		
Customer Deposits	65,130	63,780
Accrued Interest on Debt	19,154	19,837
Current Portion - Debt (Note 5)	<u>34,600</u>	<u>32,800</u>
Total Current Liabilities Payable From Restricted Assets	118,884	116,417
Non-Current Liabilities:		
Long-Term Debt (Note 5)	<u>942,400</u>	<u>977,000</u>
Total Liabilities	<u>1,099,830</u>	<u>1,142,057</u>
<u>NET POSITION</u>		
Invested in Capital Assets, Net of Related Debt	805,589	835,166
Restricted For:		
Customer Deposits	104,313	98,365
Debt Service	82,835	82,268
Construction & Maintenance	119,594	102,338
Unrestricted	<u>400,375</u>	<u>409,641</u>
Total Net Position	<u>1,512,706</u>	<u>1,527,778</u>
Total Liabilities and Net Position	<u>\$ 2,612,536</u>	<u>\$ 2,669,835</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2015
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2014)

	<u>2015</u>	<u>2014</u>
Operating Revenue:		
Water Sales	\$ 800,692	\$ 772,203
Connection Fees	6,500	11,000
Rental Income	-	3,600
Other Operating Revenue	<u>20,586</u>	<u>21,986</u>
 Total Operating Revenue	827,778	808,789
Operating Expenses	<u>718,474</u>	<u>749,881</u>
 Net Operating Income Before Depreciation	109,304	58,908
Depreciation (Note 2)	<u>87,170</u>	<u>102,032</u>
 Net Operating Income	22,134	(43,124)
Non-Operating Income (Expenses):		
Interest Income	1,486	1,708
Interest Expense:		
On Long-Term Debt	(38,301)	(39,673)
Paid on Customer Deposits	<u>(391)</u>	<u>(383)</u>
 Total Non-Operating Income (Expenses)	<u>(37,206)</u>	<u>(38,348)</u>
Change in Net Position Before Capital Contributions	(15,072)	(81,472)
Capital Contributions-Government	<u>-</u>	<u>67,482</u>
 Change in Net Position	(15,072)	(13,990)
Net Position - Beginning of Year	<u>1,527,778</u>	<u>1,541,768</u>
Net Position - End of Year	<u>\$ 1,512,706</u>	<u>\$ 1,527,778</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	Contributions In Aid Of Construction	Retained Deficit	Total
	Tap Fees		
Balance at January 1, 2014	\$ 211,363	\$ 2,123,225	\$ (792,820) \$ 1,541,768
2014 Capital Contributions-Government		67,482	\$ 67,482
2014 Net Income Before Capital Contributions	-	-	(81,472) (81,472)
Balance at December 31, 2014	211,363	2,190,707	(874,292) 1,527,778
2015 Capital Contributions-Government	-	-	-
2015 Net Income (Loss) Before Capital Contributions	-	-	(15,072) (15,072)
Balance at December 31, 2015	<u>\$ 211,363</u>	<u>\$ 2,190,707</u>	<u>\$ (889,364) \$ 1,512,706</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF OPERATING EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2015
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2014)

	<u>2015</u>	<u>2014</u>
Source of Supply Expense:		
Water Purchases	\$ 361,763	\$ 377,280
Operation Supplies and Expense	<u>3,075</u>	<u>3,242</u>
Total	364,838	380,522
Transmission and Distribution Expense:		
Maintenance of Mains	<u>12,583</u>	<u>23,496</u>
Total	12,583	23,496
Customer Accounts Expense:		
Credit Card Processing Fees	4,912	4,113
Supplies and Postage	<u>32,865</u>	<u>26,677</u>
Total	37,777	30,790
Administrative and General:		
Salaries	170,294	161,180
Contract Labor	42,377	66,167
Insurance	14,121	11,179
Miscellaneous Expense:		
Utilities	12,193	12,168
Advertising	956	474
Bad Debts	8,236	2,999
Miscellaneous	221	489
Vehicle Gas	13,583	16,447
Payroll Taxes	13,515	12,802
Legal and Professional	5,525	10,850
Commissioners' Board and Director Fees	20,600	18,650
Other Licenses and Taxes	<u>1,655</u>	<u>1,668</u>
Total	<u>303,276</u>	<u>315,073</u>
Total Operating Expenses	<u>\$ 718,474</u>	<u>\$ 749,881</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2014)

	<u>2015</u>	<u>2014</u>
Cash Flows From Operating Activities:		
Receipts From Customers	\$ 826,684	\$ 808,596
Payments to Suppliers	(536,305)	(562,694)
Payments to Employees	(170,294)	(161,180)
Payments of Payroll and Other Taxes	(14,920)	(12,988)
Other Receipts (Payments)	<u>1,350</u>	<u>520</u>
Net Cash Provided by (Used in) Operating Activities	<u>106,515</u>	<u>72,254</u>
Cash Flows From Non-Capital Financing Activities:		
Interest Paid on Customer Deposits	(391)	(383)
Grant Receipts	<u>-</u>	<u>101,964</u>
Net Cash Provided by (Used in) Non-Capital Financing Activities	<u>(391)</u>	<u>101,581</u>
Cash Flows From Capital and Related Financing Activities:		
Purchase of Fixed Assets/Construction in Progress	(32,486)	(179,765)
Retirement of Bonds	(32,800)	(31,800)
Interest Paid on Bonds	<u>(38,984)</u>	<u>(40,337)</u>
Net Cash Used in Financing Activities	<u>(104,270)</u>	<u>(251,902)</u>
Cash Flows From Investing Activities:		
Purchase of Certificates of Deposit	(1,404)	(1,593)
Interest Received	<u>1,486</u>	<u>1,708</u>
Net Cash Provided by (Used in) Investing Activities	<u>82</u>	<u>115</u>
Net Increase (Decrease) in Cash	1,936	(77,952)
Cash at Beginning of Year	<u>445,101</u>	<u>523,053</u>
Cash at End of Year	<u>\$ 447,037</u>	<u>\$ 445,101</u>

Continued

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

MCKINNEY WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2014)
Continued

	<u>2015</u>	<u>2014</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities:		
Operating Income (Loss)	\$ 22,134	\$ (43,124)
Depreciation	87,170	102,032
Decrease (Increase) in Accounts Receivable	(1,094)	(193)
Decrease (Increase) in Inventory	2,661	2,800
Decrease (Increase) in Prepaid Expenses	(3,305)	3,789
Increase (Decrease) in Accounts Payable	(2,651)	4,948
Increase (Decrease) in Customer Deposits	1,350	520
Increase (Decrease) in Other Current Liabilities	<u>250</u>	<u>1,482</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 106,515</u>	<u>\$ 72,254</u>

Non-Cash Financing and Investing Activities:
Construction in process, paid subsequent to year-end

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

McKinney Water District
Notes to Financial Statements
December 31, 2015

1. GENERAL

McKinney Water District, (the "District") is a governmental entity operated under the control of the Lincoln County Fiscal Court. The District provides water services to the rural sections of Lincoln and Casey counties.

Prior to December of 1992, the District operated as two separate legal entities: the McKinney Water Association, Inc. and the McKinney Water District. In December of 1992, pursuant to and order of the Public Service Commission of the Commonwealth of Kentucky, the District was merged with the Association, and the District annexed the territory of the Association. The District also assumed all rights and obligations of the Association.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The District uses the accrual method of accounting which focuses on the measurement of net income similar to the approach used by commercial enterprises, and revenues are recorded when earned and expenses are recorded when incurred. The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's ongoing operations. The principal operating revenues of the utility are charges to customers for water service. Also, the District recognizes as operating revenue, the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.
- B. Cash includes amounts in demand deposits only.
- C. Investments consist of certificates of deposit only and are stated at cost which approximates fair value.
- D. Receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. All receivables in excess of 90 days old comprise the accounts receivable allowance for uncollectibles.
- E. Property and equipment are stated at cost, and are depreciated over the estimated useful life of the asset using the straight-line method of depreciation. Transmission lines are being depreciated over a 50 year life; office furniture and equipment over a 10 year life; pumping equipment over a 20 year life; structures and improvements over a 35 year life; meters and installations over a 35 year life; hydrants over a 40 year lifewater tanks over a 30 year life; transportation equipment over a 7 year life; tools, shop and garage equipment over a 15 year life; and communications equipment over a 10 year life. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.
- F. Material inventory is stated at cost using the first-in, first-out (FIFO) method.
- G. Prepaid items include payments made to vendors that will benefit periods beyond the end of the fiscal year.

McKinney Water District
Notes to Financial Statements
December 31, 2015

H. Restricted assets represent cash for which use is limited by certain applicable bond covenants.

I. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make use of estimates that affect reported amounts in the financial statements. Actual results could differ from estimates.

3. CASH & INVESTMENTS

Cash is composed of the following as of December 31, 2015, and 2014, with restriction for use noted:

		2015	2014
Cash on Hand		\$ 120	\$ 120
Cash on Deposit - Operating Account	A	53,969	142,016
Cash on Deposit - Revenue Account	B	182,048	109,487
Cash on Deposit - Customer Deposits	C	62,079	55,343
Cash on Deposit - Construction Account	D	-	-
Savings Accounts:			
Debt Service Account	E	136,590	134,905
Depreciation Reserve Account	F	<u>12,231</u>	<u>3,230</u>
 TOTAL		<u>\$ 447,037</u>	<u>\$ 445,101</u>

The District's investments at December 31, 2015 are as follows:

Type of Investment		Fair Value	Cost	Interest Rate	Maturity Date
PBK Bank Certificates of Deposit:					
CD - Revenue	B	\$ 53,681	\$ 53,681	0.60%	03/12/16
CD - Customer Deposits	C	107,363	107,363	0.60%	03/12/16
CD - Depreciation Reserve	F	<u>107,363</u>	<u>107,363</u>	0.60%	03/12/16
Total Certificates of Deposit		<u>\$ 268,407</u>	<u>\$ 268,407</u>		

The cash and certificate of deposit balances are insured for \$250,000 by the FDIC at December 31, 2015 and 2014. Deposits in excess of \$250,000 have been collateralized by the bank as of December 31, 2015 and 2014.

- (A) The operating and maintenance account, required by the RDA bond resolution, is used to meet the current expenses of operating and maintaining the system.
- (B) The revenue account, required by the RDA bond resolution, is used for the deposit of all funds collected and for the disbursement of funds to the proper bank accounts.
- (C) The customer deposit account is used to account for deposits received from customers.
- (D) The construction account is utilized by the District to account for receipts and disbursements of various construction projects as needed.

McKinney Water District
Notes to Financial Statements
December 31, 2015

- (E) The district is required to transfer monthly to the debt service account that amount which is necessary to meet the semi-annual installments for principal and interest on the RDA bonds outstanding.
- (F) The district is required to transfer \$600 monthly to the reserve account until \$62,880 is accumulated in the fund. The use of such fund is restricted to paying the cost of repairing or replacing, making extension or improvements or when necessary for payment of principal and interest. Whenever payments are made from the fund, the monthly payment shall be resumed until the balance again reaches \$62,880. Once the balance in this account is fully funded, monthly transfers are then at the option of the District. The account is fully funded as of December 31, 2015 and 2014.

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2015 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Land and Land Rights	\$ 18,043	\$ -	\$ -	\$ 18,043
Transmission Lines	2,624,575	-	-	2,624,575
Services	116,142	-	-	116,142
Meters	105,562	25,805	-	131,367
Hydrants	13,925	-	-	13,925
Pumps	261,616	-	-	261,616
Water Tank	442,754	-	-	442,754
Other Tangible Plant	87,506	-	-	87,506
Office Furniture and Fixtures	39,282	2,587	-	41,869
Buildings and Improvements	43,178	-	-	43,178
Capitalized Design and Interest Costs	566,951	-	-	566,951
Construction in Process	3,600	-	(3,600)	-
Total	<u>4,323,134</u>	<u>28,392</u>	<u>(3,600)</u>	<u>4,347,926</u>
Less accumulated depreciation for:				
Transmission Lines	(1,628,443)	(36,912)	-	(1,665,355)
Services	(79,978)	(2,700)	-	(82,678)
Meters	(84,915)	(1,471)	-	(86,386)
Hydrants	(11,563)	(169)	-	(11,732)
Pumps	(60,379)	(12,458)	-	(72,837)
Water Tank	(207,059)	(13,165)	-	(220,224)
Other Tangible Plant	(48,237)	(6,089)	-	(54,326)
Office Furniture and Fixtures	(34,818)	(1,009)	-	(35,827)
Buildings and Improvements	(34,968)	(690)	-	(35,658)
Capitalized Design and Interest Costs	(287,808)	(12,506)	-	(300,314)
Total accumulated depreciation	<u>(2,478,168)</u>	<u>(87,169)</u>	<u>-</u>	<u>(2,565,337)</u>
Capital Assets, Net	<u>\$ 1,844,966</u>	<u>\$ (58,777)</u>	<u>\$ (3,600)</u>	<u>\$ 1,782,589</u>

McKinney Water District
Notes to Financial Statements
December 31, 2015

5. LONG-TERM DEBT

The District issues bonds and pledges income derived from the acquired or constructed assets to pay debt service.

The District's debt at December 31, 2015 consists of the following:

USDA (Rural Development) - \$78,600 Principal amount Series C bonds dated 1992 due in annual installments of \$1,600 to \$5,300 through 2018. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	\$ 15,000
USDA (Rural Development) - \$537,000 Principal amount Series D bonds dated 1992 due in annual installments of \$5,700 to \$29,000 through 2032. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	359,000
USDA (Rural Development) - \$130,000 Principal amount Series A bonds dated 1999 due in annual installments of \$1,400 to \$6,900 through 2038. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	101,900
USDA (Rural Development) - \$90,000 Principal amount Series B bonds dated 1999 due in annual installments of \$900 to \$4,700 through 2038. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	70,600
USDA (Rural Development) - \$550,000 Principal amount Series 2000 bonds dated 2000 due in annual installments of \$7,500 to \$24,500 through 2040. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	<u>430,500</u>
Total Outstanding Bonds	977,000
LESS: Current Portion	<u>(34,600)</u>
Long-Term Debt	<u>\$ 942,400</u>

The annual requirements to amortize all bonds outstanding as of December 31, 2015 are as follows:

Year Ending				
December 31,	Principal	Interest	Total	
2016	\$ 34,600	\$ 38,298	\$ 72,898	
2017	36,600	36,846	73,446	
2018	37,200	35,306	72,506	
2019	33,600	33,742	67,342	
2020	35,200	32,370	67,570	
2021-25	199,800	138,840	338,640	
2026-30	247,700	93,966	341,666	
2031-35	203,300	43,077	246,377	
2036-40	<u>149,000</u>	<u>13,712</u>	<u>162,712</u>	
Total	<u>\$ 977,000</u>	<u>\$ 466,157</u>	<u>\$ 1,443,157</u>	

McKinney Water District
Notes to Financial Statements
December 31, 2015

Long-term liability activity for the year ended December 31, 2015 was as follows:

	Beginning Balance	Increases	Reductions	Ending Balance	Due Within One Year
RDA 1992 Series C Bond	\$ 19,500	\$ -	\$ (4,500)	\$ 15,000	\$ 4,700
RDA 1992 Series D Bond	372,000	-	(13,000)	359,000	14,000
RDA 1999 Series A Bond	104,400	-	(2,500)	101,900	2,600
RDA 1999 Series B Bond	72,400	-	(1,800)	70,600	1,800
RDA 2000 Series A Bond	<u>441,500</u>	<u>-</u>	<u>(11,000)</u>	<u>430,500</u>	<u>11,500</u>
Long-term Debt Total	<u>\$ 1,009,800</u>	<u>\$ -</u>	<u>\$ (32,800)</u>	<u>\$ 977,000</u>	<u>\$ 34,600</u>

6. RISK MANAGEMENT

The District is exposed to a variety of accidental losses, and has attempted to minimize its risk by carrying commercial insurance. There have been no significant reductions in coverage from coverage in the prior year.

7. OTHER MATTERS

(A) The District has not been assessed or paid any property, intangible or franchise tax in prior years. Since there is some uncertainty about the taxability of a "water district", the financial statements do not reflect any liability for unpaid taxes, if any.

	2015	2014
(B) Active Meter Customers – December 31,	1,840	1,832
(C) Water Loss:		
Water Purchases – Gallons	115,745,500	129,577,700
Water Sold and Used in Operations	<u>90,488,400</u>	<u>91,018,200</u>
Line Loss	26,275,100	38,559,500
Percentage of Line Loss	21.82%	29.76%

(D) Customer accounts receivable aging at December 31, 2015 is as follows:

Current	\$ 60,133
30-59 Days	(3,059)
60-89 Days	718
Over 90 Days	<u>55,777</u>
	<u>\$ 113,569</u>

McKinney Water District
Notes to Financial Statements
December 31, 2015

(E) Accounts Receivable is comprised of the following as of December 31, 2015:

Customers	\$ 113,569
Allowance for Bad Debts	<u>(55,777)</u>
	<u><u>\$ 57,792</u></u>

All accounts receivable 90 days and older have been included in the allowance for uncollectible accounts.

8. CHANGE IN ACCOUNTING ESTIMATE

Pursuant to an order from the Kentucky Public Service Commission (PSC), the District modified the estimated useful lives of certain asset groups effective January 1, 2015 to conform to PSC's "Approved Service Life". For the most part, the estimated lives were extended which resulted in a decrease of approximately \$15,000 in the amount of depreciation reported during the current fiscal year. This change in accounting estimate will also result in lower depreciation expense in subsequent years for capital assets in service as of the end of the current fiscal year.

COMPLIANCE SECTION

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

Chairman and Commissioners
McKinney Water District
McKinney, KY

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities of the McKinney Water District as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the McKinney Water District's basic financial statements and have issued my report thereon dated March 21, 2016.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I 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 my opinion 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, I do not express an opinion on the effectiveness of the District's internal control.

My consideration of the 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 below, I identified certain deficiencies in internal control that I consider to be material weaknesses and/or significant deficiencies.

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 reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. I consider the following deficiency to be a material weakness.

1. As is common within the system of internal control of most small organizations, the accounting function of the McKinney Water District does not prepare the financial statements complete with footnotes in accordance with accounting principles generally accepted in the United States of America (GAAP). Accordingly, the District has not established internal controls over the preparation of its financial statements. This condition is considered to be a material weakness of the District's system of internal control over financial reporting.

During the course of performing an audit, it is not unusual for the auditor to prepare various journal entries to present the financial statements in accordance with the GAAP basis of accounting. This reliance on the auditor to perform this function is considered to be a material weakness in the system of internal control. SAS No. 115 does not make exceptions for reporting deficiencies that are adequately mitigated with non-audit services rendered by the auditor or deficiencies for which the remedy would be cost prohibitive.

Communication of the control deficiency above helps to emphasize that the responsibility for financial reporting rests entirely with the District and not the auditor. Stated another way, if an organization is unable to issue, without the auditor's involvement, complete financial statements with footnotes in accordance with generally accepted accounting principles and free of material misstatement, that inability is a symptom of a significant deficiency in the system of internal control.

Management's response – Management engages consultants who possess industry knowledge and expertise to provide financial and other professional services. Based on the auditor's unqualified opinion and after reading the financial statements, management believes the financial statements to be materially correct. Further, management does not think that the addition of an employee or consultant to oversee the annual financial reporting process is necessary nor would it be cost effective.

Compliance and Other Matters

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

The District's Response to Findings

The District's response to the findings identified in my audit is described above. I did not audit the District's response and, accordingly, express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results 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.

Craig A. Butler, CPA

Craig A. Butler
Certified Public Accountant

Danville, Kentucky
March 21, 2016