

NORTH MCLEAN COUNTY WATER DISTRICT

AUDIT REPORT

FOR THE YEARS ENDED
DECEMBER 31, 2017 AND 2016

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Public Service
Commission

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Board of Commissioners
North McLean County Water District
McLean County, Kentucky

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying statements of net position of North McLean County Water District as of December 31, 2017 and 2016, and the related statements of revenue and expenses and changes in net position, and cash flows, and the related notes to the financial statements, for the years then ended.

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

of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of North McLean County Water District as of December 31, 2017 and 2016, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 5, 2018 on our consideration of North McLean County Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering North McLean County Water District's internal control over financial reporting and compliance.

Hoover and Morris PLLC

June 5, 2018

NORTH MCLEAN COUNTY WATER DISTRICT
STATEMENTS OF NET POSITION
December 31, 2017 and 2016

ASSETS	2017	2016
CURRENT ASSETS		
Cash in bank	\$ 193,198	\$ 264,374
Customer deposit checking	43,642	39,255
Certificates of deposit	173,547	171,647
Accounts receivable	55,145	58,446
Due from other governments	451	515
Inventory	33,063	32,187
Interest receivable	260	260
Prepaid insurance	6,743	7,673
TOTAL CURRENT ASSETS	<u>506,049</u>	<u>574,357</u>
NONCURRENT ASSETS		
Restricted Assets:		
Sinking fund reserve	46,472	30,549
Replacement and extension fund	42,880	41,297
Capital Assets:		
Utility plant	3,414,403	3,407,317
Accumulated depreciation	<u>(1,256,797)</u>	<u>(1,203,964)</u>
TOTAL NONCURRENT ASSETS	<u>2,246,958</u>	<u>2,275,199</u>
TOTAL ASSETS	<u>2,753,007</u>	<u>2,849,556</u>
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable	29,291	55,520
AquaLine payable	909	-
Taxes payable	7,078	8,602
Employee IRA withholding	355	174
Accrued interest payable	4,956	-
Customer deposits	3,200	3,000
Bonds payable	<u>12,000</u>	<u>12,000</u>
TOTAL CURRENT LIABILITIES	<u>57,789</u>	<u>79,296</u>
NONCURRENT LIABILITIES		
7 5/8% Revenue Bond, Series 1985	118,000	118,000
Customer deposits	<u>33,315</u>	<u>30,005</u>
TOTAL NONCURRENT LIABILITIES	<u>151,315</u>	<u>148,005</u>
TOTAL LIABILITIES	<u>209,104</u>	<u>227,301</u>
NET POSITION		
Net investment in capital assets	2,027,606	2,073,353
Restricted for debt requirements	56,000	56,000
Unrestricted	<u>460,297</u>	<u>492,902</u>
TOTAL NET POSITION	<u>\$ 2,543,903</u>	<u>\$ 2,622,255</u>

The notes to the financial statements are an integral part of these statements.

NORTH MCLEAN COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
December 31, 2017 and 2016

	2017	2016
OPERATING REVENUES		
Water sales	\$ 631,818	\$ 597,720
Penalties and miscellaneous	20,983	19,915
TOTAL OPERATING REVENUES	<u>652,801</u>	<u>617,635</u>
OPERATING EXPENSES		
Salaries and wages	212,615	181,418
Depreciation	65,081	64,743
Purchased water	340,812	301,542
Purchased power	6,367	4,986
Materials and supplies	33,324	25,368
Contractual services	31,930	30,518
Rents	2,040	2,060
Transportation expenses	13,795	10,260
Insurance	12,497	12,636
Miscellaneous	1,361	3,393
Advertising	884	560
Taxes	18,130	16,020
TOTAL OPERATING EXPENSES	<u>738,836</u>	<u>653,504</u>
OPERATING INCOME (LOSS)	<u>(86,035)</u>	<u>(35,869)</u>
NON-OPERATING REVENUES (EXPENSES)		
Gain on sale of assets	4,346	-
Interest income	4,025	3,438
Interest expense	(10,148)	(10,871)
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>(1,777)</u>	<u>(7,433)</u>
CHANGE IN NET POSITION BEFORE CONTRIBUTIONS	(87,812)	(43,302)
CAPITAL CONTRIBUTIONS	9,460	1,981
CHANGE IN NET POSITION	(78,352)	(41,321)
NET POSITION- BEGINNING	<u>2,622,255</u>	<u>2,663,576</u>
NET POSITION- ENDING	<u>\$ 2,543,903</u>	<u>\$ 2,622,255</u>

The notes to the financial statements are an integral part of these statements.

NORTH MCLEAN COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Receipts from customers	\$ 653,454	\$ 601,604
Other receipts	6,222	5,402
Payments to suppliers	(487,749)	(369,171)
Payments to employees	(212,615)	(181,418)
Net cash provided (used) by operating activities	<u>(40,688)</u>	<u>56,417</u>
Cash Flows from Noncapital Financing Activities		
Net cash provided(used) by noncapital financing activities	<u>-</u>	<u>-</u>
Cash Flows from Capital & Related Financing Activities		
Proceeds from sale of capital assets	7,269	-
Purchase of capital assets	(22,259)	(30,912)
Principal paid on bonds	-	(11,000)
Interest paid	(5,192)	(10,871)
Capital contributions	9,460	1,981
Net cash provided (used) by capital & related financing activities	<u>(10,722)</u>	<u>(50,802)</u>
Cash Flows from Investing Activities		
Decrease(increase) in certificates of deposit	(2,021)	(1,636)
Interest on investments	4,025	3,335
Net cash provided (used) by investing activities	<u>2,004</u>	<u>1,699</u>
Net increase (decrease) in cash & cash equivalents	(49,406)	7,314
Balances- Beginning of year	<u>344,031</u>	<u>336,717</u>
Balances- End of year	<u>\$ 294,625</u>	<u>\$ 344,031</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) By Operating Activities:		
Operating income (loss)	\$ (86,035)	\$ (35,869)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	65,081	64,743
(Increase) decrease in:		
Accounts receivable	3,365	(10,629)
Inventories	(876)	(765)
Prepaid insurance	930	(1,128)
Increase (decrease) in:		
Accounts payable	(26,229)	38,964
AquaLine payable	909	-
Taxes payable	(1,524)	927
Employee IRA withholding	181	174
Customer deposits	3,510	-
Net cash provided (used) by operating activities	<u>\$ (40,688)</u>	<u>\$ 56,417</u>

The notes to the financial statements are an integral part of these statements.

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

North McLean County Water District is a Kentucky water district that was organized in 1971. McLean County Fiscal Court appoints the Board of Commissioners that manages the water district. Accounting policies of the water district conform to generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The district applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. The district's only fund is a proprietary fund which applies Financial Accounting Standards Board (FASB) Statements and Interpretations and Pronouncements issued on or before November 30, 1989, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

REPORTING ENTITY

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

PROPRIETARY FUND ACCOUNTING

The activities of the Water District are similar to those found in the private sector. Proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Proprietary funds distinguish operating revenues and expenses from non-operating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

INVENTORY

Inventory is stated at cost determined on a "first-in, first-out basis." Inventory consists mainly of supplies to be used for future repair and maintenance.

UTILITY PLANT IN SERVICE

Utility plant in service is stated at cost. Depreciation has been provided using the straight line method. Pumping, distribution equipment, and meters are being depreciated over a 20 to 40 year life. The transmission lines are being depreciated over a 60 to 80 year life and tanks are being depreciated over a 40 to 60 year life. Vehicles and other equipment are depreciated over 5 to 15 years.

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

CONTRIBUTION IN AID OF CONSTRUCTION

With approval of the water district, customers have in some cases constructed their own water lines and donated them to the district for future maintenance, control, etc. Those assets have been recorded on the water district's books and are being depreciated under the same policy as other assets.

The water district has implemented GASB Statement No. 33, which requires capital contributions to be recognized as revenue effective for periods beginning after June 15, 2000.

CASH AND EQUIVALENTS

For purposes of the statements of cash flows, the district considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Below is a reconciliation of cash on the statements of net position to cash on the statements of cash flows.

	2017	2016
Cash in bank	\$ 193,198	\$ 264,374
Customer deposit checking	43,642	39,255
Sinking fund reserve	19,938	4,137
Replacement fund	37,847	36,265
	<u>\$ 294,625</u>	<u>\$ 344,031</u>

CASH AND INVESTMENTS

Cash includes amounts in bank accounts. The only investments include certificates of deposit. These investments are reported at cost, which reasonably estimates fair value.

KRS 66.480 authorizes the district to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

COMPENSATED ABSENCES

The District does not allow employees to accumulate unused personal or vacation days. Sick leave is earned at the rate of one day per month with a maximum accumulation of sixty days. Sick leave may only be used pursuant to a doctor's excuse and may not be converted to cash. No liability has been recorded in the accompanying financial statements. The District's policy is to recognize the cost of compensated absences when paid to employees.

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

CAPITALIZED INTEREST

The District capitalizes net interest cost as part of the cost of constructing various utility projects when material. All interest was expensed since no construction projects were financed during the current year.

ACCOUNTS RECEIVABLE

The District has not provided for an allowance for bad debts. It is management's opinion based on prior history that any uncollectible accounts would have no significant effect on the financial statements. Uncollectible accounts are written off annually directly to sales. Bad debt expense was \$3,019 for 2017 and \$2,294 for 2016.

2. DEPOSITS AND INVESTMENTS

A. Deposits

The District maintains deposits with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to law, the depository institution should pledge sufficient securities as collateral which, together with FDIC insurance equals or exceeds the amount on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge of securities should be evidenced by an agreement that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (C) an official record of the depository institution. This agreement, signed by both parties, must be sufficient to create an enforceable and perfected security interest in the collateral under Kentucky law.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the government's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240 (4). As of December 31, 2017 all deposits including the certificates of deposit held as investments were covered by FDIC insurance or a properly executed collateral security agreement.

B. Investments

As of December 31, 2017, the District had the following investment:

<u>Investment</u>	<u>Maturity</u>	<u>Fair Value (Cost)</u>
Certificates of Deposit	Greater than 90 days	\$ 205,113

Interest Rate Risk

The District does not have a formal investment policy that limits its investment maturities as a means of managing its exposure to losses arising from changes in interest rates. In general, non-negotiable certificates of deposit are not subject to interest rate risk.

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

Credit Risk

KRS 66.489 limits the District's investments in the following: obligations of the United States and of its agencies and instrumentalities, including obligations subject to repurchase agreements, obligations and contracts for future delivery or purchase of obligations backed by the United States or its agencies and obligations of any corporation of the United States Government. Certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution insured by the Federal Deposit Insurance Corporation or similar entity. Uncollateralized certificates of deposit issued by a bank or savings and loan institutions rated in one of the three highest categories by a nationally recognized rating agency. Bankers' acceptances for banks rated in one of the three highest categories by a nationally recognized rating agency. Commercial paper rated in the highest category by a nationally recognized rating agency. Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities, securities issued by a state or local government, or any instrumentality or agency thereof, in the United States and rated in one of the three highest categories by a nationally recognized rating agency. Shares of mutual funds meeting specific characteristics outlined in the statute shall be eligible investments. Also, the District is limited to investing no more than 20% in any one of the preceding investments as allowed by KRS 66.480. The District had no investment policy that would further limit its investments choices. In general, non-negotiable certificates of deposit are not subject to investment credit risk.

3. RESTRICTED ASSETS

Under the terms of the revenue bond ordinances, certain funds were created to set aside money for future bond payments. The funds that were created and a brief description follows:

Replacement and Extension Fund- Monthly transfers will be made in the amount of \$125.00 until the sum of \$32,000.00 is accumulated.

1985 Sinking Fund- Monthly transfers will be made to equal the next bond and interest payment until the sum of \$24,000.00 is accumulated. During 2017 and 2016, transfers were made to provide for the next bond and interest payment.

When restricted and unrestricted resources are available for use, it is the district's policy to use restricted resources first.

A summary of the changes in restricted assets is as follows:

	1985 Sinking Fund	Reserve Replacement Fund
BALANCE, JANUARY 1, 2016	\$ 31,389	\$ 39,464
CASH RECEIPTS		
Transfers from operations	20,732	1,656
Interest income	179	177
CASH DISBURSEMENTS		
Bond and interest payments	21,751	-
BALANCE, DECEMBER 31, 2016	30,549	41,297
CASH RECEIPTS		
Transfers from operations	20,681	1,500
Interest income	198	240
CASH DISBURSEMENTS		
Correct prior year deposit error	-	157
Bond interest payment	4,956	-
BALANCE, DECEMBER 31, 2017	\$ 46,472	\$ 42,880

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

4. PROPERTY AND EQUIPMENT

A summary of the property and equipment as of December 31, 2017 and 2016, is as follows:

	Jan. 1 2016	Increases	Decreases	Dec. 31 2016
Capital assets not being depreciated:				
Land	\$ 17,186	\$ -	\$ -	\$ 17,186
Construction in progress	-	1,500	-	1,500
Total capital assets not being depreciated	17,186	1,500	-	18,686
Capital assets being depreciated:				
Buildings and improvements	166,876	-	-	166,876
Equipment	189,041	713	-	189,754
Water distribution system	2,947,490	28,699	-	2,976,189
Vehicles	55,812	-	-	55,812
Total capital assets being depreciated	3,359,219	29,412	-	3,388,631
Less accumulated depreciation for:				
Buildings and improvements	37,384	4,606	-	41,990
Equipment	101,835	3,944	-	105,779
Water distribution system	957,213	54,163	-	1,011,376
Vehicles	42,789	2,030	-	44,819
Total accumulated depreciation	1,139,221	64,743	-	1,203,964
Total capital assets being depreciated, net	2,219,998	(35,331)	-	2,184,667
Capital assets, net	\$ 2,237,184	\$ (33,831)	\$ -	\$ 2,203,353

	Jan. 1 2017	Increases	Decreases	Dec. 31 2017
Capital assets not being depreciated:				
Land	\$ 17,186	\$ -	\$ -	\$ 17,186
Construction in progress	1,500	-	1,500	-
Total capital assets not being depreciated	18,686	-	1,500	17,186
Capital assets being depreciated:				
Buildings and improvements	166,876	-	-	166,876
Equipment	189,754	1,376	2,028	189,102
Water distribution system	2,976,189	22,381	13,063	2,985,507
Vehicles	55,812	-	80	55,732
Total capital assets being depreciated	3,388,631	23,757	15,171	3,397,217
Less accumulated depreciation for:				
Buildings and improvements	41,990	4,606	-	46,596
Equipment	105,779	3,971	1,708	108,042
Water distribution system	1,011,376	54,475	10,460	1,055,391
Vehicles	44,819	2,029	80	46,768
Total accumulated depreciation	1,203,964	65,081	12,248	1,256,797
Total capital assets being depreciated, net	2,184,667	(41,324)	2,923	2,140,420
Capital assets, net	\$ 2,203,353	\$ (41,324)	\$ 4,423	\$ 2,157,606

5. LONG-TERM DEBT

Revenue Bonds

The 1985 bondholders hold a statutory mortgage lien against the assets of the water district. There is also a pledge of net revenues of the water district for future bond and interest payments.

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

The annual requirements to amortize revenue bonds outstanding as of December 31, 2017, follows:

	Series 1985			Totals	
	Interest Jan. 1	Interest July 1	Principal Jan. 1	Interest	Principal
2018	\$ 4,956	\$ 4,499	\$ 12,000	\$ 9,455	\$ 12,000
2019	4,499	4,003	13,000	8,502	13,000
2020	4,003	3,469	14,000	7,472	14,000
2021	3,469	2,898	15,000	6,367	15,000
2022	2,898	2,249	17,000	5,147	17,000
2023-2025	4,613	2,364	59,000	6,977	59,000
	<u>\$ 24,438</u>	<u>\$ 19,482</u>	<u>\$ 130,000</u>	<u>\$ 43,920</u>	<u>\$ 130,000</u>

Changes in Long-Term Liabilities

The following is a summary of changes in long-term liabilities for the year ended December 31, 2017:

	Amount of Original Obligation	Range of Final Maturity Dates	Range of Interest Rates	Balance Jan 1, 2017	Issued	Retired	Balance Dec 31, 2017	Amount Due within One Year
1985 Revenue bonds	\$ 245,000	2017-2025	7 5/8%	\$ 130,000	\$ -	\$ -	\$ 130,000	\$ 12,000
Customer Deposits				33,005	7,425	(3,915)	36,515	3,200
TOTAL LONG TERM LIABILITIES				<u>\$ 163,005</u>	<u>\$ 7,425</u>	<u>\$ (3,915)</u>	<u>\$ 166,515</u>	<u>\$ 15,200</u>

NORTH MCLEAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2017 and 2016

6. INCOME TAXES

The water district is a local government unit which is exempt from income taxes.

7. PURCHASE COMMITMENTS

The water district is committed to purchasing water each month from the McLean County Regional Water Commission until approximately October 2055. Other than an emergency situation, the District may not purchase water from any other source without prior approval by the Commission.

8. RESTRICTED NET ASSETS

The District's net assets equivalent to the restricted assets of the revenue bonds has been restricted for revenue bond retirement.

9. RISK MANAGEMENT

The District is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees, and natural disasters. The District has obtained insurance coverage through a commercial insurance company.

10. SUBSEQUENT EVENTS

On March 6, 2018, the District borrowed \$119,430 from a local bank to pay off the USDA bonds. Changes were made to the terms of the loan agreement on March 23, 2018, when an additional principal payment was made. As a result, the final loan amount was for \$54,832, with interest at 2.6%. The loan matures March 6, 2020. Three regular payments of \$4,965 each are due in half year intervals, beginning September 2018. The final payment, estimated at \$42,457, will be due March 2020. Collateral includes inventory, equipment, and accounts receivable, as well as proceeds from the sale of any of these items.

During April 2018, the District signed a promissory note with the same bank for \$175,000 with a 2.6% interest rate and April 2020 maturity date. The loan is to be used for the construction of a pump station and to purchase property, if needed. No draws have been made on this loan. The loan is collateralized by certificates of deposit.

OTHER REPORTS

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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
North McLean County Water District
Livermore, KY 42352

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the statement of net position of North McLean County Water District as of and for the year ended December 31, 2017, and the statements of revenues, expenses and changes in net position, and cash flows, and the related notes to the financial statements, and have issued our report thereon dated June 5, 2018.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether North McLean County Water District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance 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*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered North McLean County Water 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of North McLean County Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of North McLean County Water 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or 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 significant deficiencies or material weaknesses and therefore, significant deficiencies or material weaknesses may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses that we consider to be material weaknesses.

North McLean County Water District's Response to Findings

North McLean County Water District's response to the findings identified in our audit is described in the accompanying Schedule of Findings and Responses. North McLean County Water District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Above and Meris, PLLC

June 5, 2018

NORTH MCLEAN COUNTY WATER DISTRICT
Schedule of Findings and Responses
December 31, 2017

FINDINGS

2017-1 Material Weakness:

Segregation of Duties

Condition: The small size of the District's bookkeeping staff limits segregation of duties.

Criteria: The District does not have adequate segregation of duties.

Cause: Limited number of personnel.

Effect: The District only has two office employees who handle receipts, disbursements, utility billing and adjustments, bookkeeping, tax reporting, and financial reporting. Theft could occur or a misstatement made and not be timely detected by management. Material adjusting journal entries were required for the current year.

Recommendation: We recommend office staff review each other's work and that duties be segregated as much as possible for the small organization.

Response: The District does not feel it is economically feasible to hire additional office staff. Office staff will review each other's work and try to segregate duties as much as reasonably possible.

2017-2 Material Weakness:

Financial Reporting

Condition: District personnel lack the expertise in financial reporting to draft the financial statements and related note disclosures.

Criteria: The District should have adequate controls in place over financial reporting to ensure that the financial statements are not materially misstated.

Cause: Lack of personnel with expertise in financial reporting.

Effect: The financial statements or related note disclosures could contain a material departure from US GAAP.

Recommendation: We recommend that the District carefully review the draft financial statements for errors.

Response: The District will carefully review the draft financial statements for errors.

NORTH MCLEAN COUNTY WATER DISTRICT
ANALYTICAL PROCEDURES

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Water sold	631,818	597,720	593,502	584,071	554,037	599,587	595,071	592,923	552,774	565,385
Water cost	(340,812)	(301,542)	(272,860)	(271,697)	(260,664)	(276,054)	(267,386)	(276,905)	(237,872)	(250,359)
Gross profit	291,006	296,178	320,642	312,374	293,373	323,533	327,685	316,018	314,902	315,026
Operating expenses	(332,943)	(287,219)	(298,905)	(299,117)	(272,465)	(267,187)	(259,706)	(244,585)	(222,132)	(224,201)
Interest expense	(10,148)	(10,871)	(11,550)	(12,200)	(13,052)	(13,344)	(13,878)	(14,335)	(15,310)	(16,209)
Depreciation	(65,081)	(64,743)	(63,466)	(64,012)	(63,016)	(61,685)	(76,791)	(59,518)	(53,452)	(55,422)
Other non-operating expense	-	-	-	-	-	-	-	-	(35,525)	-
Interest income	4,025	3,438	3,065	3,200	3,287	3,473	3,922	5,080	6,116	11,181
Late payment penalties/ misc.	25,329	19,915	19,520	18,895	19,749	20,839	18,969	21,565	55,556	16,877
Net income before contributions & grants	(87,812)	(43,302)	(30,694)	(40,860)	(32,124)	5,629	201	24,225	50,155	47,252
Capital contributions & grants	9,460	1,981	6,113	4,902	205,616	4,131	5,930	451,635	8,740	112,594
Net income (loss)	(78,352)	(41,321)	(24,581)	(35,958)	173,492	9,760	6,131	475,860	58,895	159,846
Gross profit %	46.06%	49.55%	54.03%	53.48%	52.95%	53.96%	55.07%	53.30%	56.97%	55.72%
Current assets	506,049	574,357	553,775	537,598	533,372	570,711	539,013	520,850	503,910	429,035
Less current liabilities	57,789	79,296	38,231	37,047	43,195	41,611	35,635	35,252	26,876	35,986
Current working capital	448,260	495,061	515,544	500,551	490,177	529,100	503,378	485,598	477,034	393,049
Total cash & CD's	499,739	547,122	538,172	518,905	518,677	559,600	522,012	503,609	456,481	429,774
Gallons purchased (1,000)	132,141	125,779	119,298	118,443	113,036	119,604	117,160	123,464	120,882	126,262
Less gallons sold/ used	107,445	100,795	99,936	97,107	93,450	99,225	100,544	102,637	99,393	102,683
Gallons lost	24,696	24,984	19,362	21,336	19,586	20,379	16,616	20,827	21,489	23,579
Water loss %	18.69%	19.86%	16.23%	18.01%	17.33%	17.04%	14.18%	16.87%	17.78%	18.67%

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June 5, 2018

To the Board of Commissioners
North McLean County Water District

We have audited the financial statements of North McLean County Water District for the year ended December 31, 2017. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated March 19, 2018. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by North McLean County Water District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2017. We noted no transactions entered into by North McLean County Water District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was:

Management's estimate of depreciation expense is based on estimated useful lives. We evaluated the key factors and assumptions used to develop depreciation in determining that it is reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. The following misstatements, detected as a result of audit procedures and corrected by management, were material either individually or in the aggregate to the financial statements:

- \$40,000 of transfers from the Construction Account were reclassified from Water Sales.
- \$10,000 transfer to the Construction Account was reclassified from Office Expense.
- Reclassified \$4,792 of meters from expense accounts.
- Accrued \$4,956 of interest on USDA bonds.
- Adjusted accounts receivable \$4,883 to correct it.
- Reclassified \$3,797 of line maintenance expense from Fixed Assets.
- Adjusted Sewer Collection Payable \$3,121 related to billing adjustments.
- Reclassified \$3,019 Bad Debt journal entry posted to Water Purchases in error.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 5, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the North McLean County Water District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as North McLean County Water District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Internal Control

By definition, there is a deficiency in internal control design. With an office staff of only two employees, the bookkeeping, payroll, cash collections, accounts receivable, and disbursement of

funds can not be completely segregated. This fact does not bear in any way on the integrity or competence of these employees. This situation does require that the commissioners regularly review transactions affecting the District's operation.

Vehicle Use

Trucks are provided to certain employees for use in District business. During 2016, the District drafted a mileage log documenting the purpose of miles driven. We recommend that the logs be periodically compared to the odometers of the vehicles to try to ensure vehicles are only used for District business.

IRA Withholding

Employees withheld \$355 of individual retirement account contributions (from their December 29, 2017 paychecks) that were never remitted. These contributions should be refunded to the employees, if not already refunded.

McLean County Withholding

When the 2016 annual reconciliation was filed with the county in January 2017, withholding of \$1,801 was remitted for the year 2016. Money should not have been remitted with the annual reconciliation, because the District had already remitted the withholding with quarterly withholding returns. A refund was obtained by the District in May 2018.

Transfers

Transfers from the Construction Account were incorrectly coded to Water Sales and transfers to the Construction Account were incorrectly coded to Office Expense. Transfers should be coded to the appropriate bank account and each bank account should be reconciled. The incorrect posting of transfers resulted in the Construction Account being out of balance \$30,000.

Water Purchases

During 2017, the McLean County Regional Water Commission took over the former City of Calhoun water plant. As a result, the rate increased by 38¢ for water purchased from them. Due to the increased rate, the District paid approximately \$32,854 more for water under the new rate than what would have been paid under Calhoun's old rate. The District applied for, and received, permission for a billing rate increase from the Kentucky Public Service Commission. However, this rate increase for billing was not effective until January 2018.

Restriction in Use

This information is intended solely for the information and use of the board of commissioners and management of North McLean County Water District and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

Obover and Morris, PLLC