

SANDY HOOK WATER DISTRICT
AUDIT OF FINANCIAL STATEMENTS
For The Year Ended December 31, 2013

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INDEPENDENT AUDITORS' REPORT

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Sandy Hook Water 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 as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 auditors consider 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.

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

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

Opinion

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

Other Matters

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 23, 2014, on our consideration of the 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 the District's internal control over financial reporting and compliance.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky
April 23, 2014

SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2013

ASSETS

CURRENT ASSETS

Cash - Unrestricted	\$ 56,889
Cash - Restricted	268,727
Accounts Receivable	56,528
Land Option	1,000
Prepaid Expenses	<u>7,144</u>

Total Current Assets 390,288

NONCURRENT ASSETS

Capital Assets - Net of Accumulated Depreciation

Land	142,498
Construction in Progress	113,686
Land Improvements	8,161
Buildings and Building Improvements	749,045
Wells and Springs	33,346
Electric Pumping Equipment	12,647
Transmission and Distribution	5,351,939
Treatment Plant	96,583
Miscellaneous Equipment	17,738
Furniture and Fixtures	478
Transportation Equipment	<u>2,511</u>

Total Noncurrent Assets 6,528,632

TOTAL ASSETS \$ 6,918,920

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

**SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2013**

LIABILITIES AND NET POSITION

CURRENT LIABILITIES

Accrued Interest	\$	27,103
Due to City of Sandy Hook		15,949
Accrued Taxes		6,957
Accrued Salaries		894
Accrued Retirement Expense		3,655
Unearned Revenues		2,833
Compensated Absences		6,319
Accounts Payable		12,578
Accounts Payable - Construction		5,072
Loan Payable - Kentucky Rural Water Finance Corp.		38,686
Bonds Payable		29,100

Total Current Liabilities		149,146
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LONG-TERM BONDS PAYABLE		1,022,500
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OTHER LIABILITIES

Customer Deposits		24,476
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TOTAL LIABILITIES		1,196,122
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NET POSITION

Invested in Capital Assets, Net of Related Debt		5,438,346
Restricted for:		
Debt Service		117,009
Depreciation Reserve		98,824
Construction		5,072
Sewer Collections		15,949
Unrestricted		47,598

TOTAL NET POSITION		5,722,798
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TOTAL LIABILITIES AND NET POSITION	\$	6,918,920
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The accompanying notes are an integral part of the financial statements.

SANDY HOOK WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSTION
For The Year Ended December 31, 2013

OPERATING REVENUES

Water Sales	\$ 459,281
Service Revenues	25,363
Miscellaneous Revenues	<u>15,703</u>
 Total Operating Revenues	 500,347

OPERATING EXPENSES

Water Expenses	
Advertising	331
Contract Labor	80
Depreciation	186,409
Dues and Subscriptions	2,713
Lease Expense	1,107
Legal and Accounting Services	20,078
Miscellaneous	10,033
Office Supplies	3,412
Payroll Taxes	12,147
Postage	6,045
Insurance	42,017
Repairs and Maintenance	23,920
Retirement	37,007
Salaries and Wages	177,601
Supplies and Testing	19,008
Taxes and Licenses	915
Telephone and Utilities	65,739
Travel and Automobile	<u>12,394</u>
 Total Operating Expenses	 <u>620,956</u>

NET OPERATING INCOME (LOSS) (120,609)

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

SANDY HOOKWATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For The Year Ended December 31, 2013

NON OPERATING REVENUES (EXPENSES)

Grant Proceeds	75,000
Interest Expense	(52,264)
Interest Income	<u>260</u>
Total Non Operating Revenues (Expenses)	<u>22,996</u>
Net Change in Net Position	<u>(97,613)</u>
Net Position - Beginning	<u>5,820,411</u>
Total Net Position - Ending	<u><u>\$ 5,722,798</u></u>

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

**SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2013**

CASH FLOWS FROM OPERATING ACTIVITIES

Payments from Customers	\$ 485,061
Payments for Sewer Collection Fees	6,400
Payments to Vendors	(176,899)
Payments for Payroll and Related Expenses	<u>(254,270)</u>
Net Cash Provided (Used) by Operating Activities	60,292

**CASH FLOWS FROM CAPITAL AND
RELATED FINANCING ACTIVITIES**

Grant Proceeds	75,000
Loan Proceeds - Interim Financing	38,686
Construction in Progress	(108,614)
Payments on Capital Debt	<u>(80,858)</u>
Net Cash Provided (Used) by Capital and Related Financing Activities	(75,786)

CASH FLOWS FROM INVESTING ACTIVITIES

Cash Received from Interest	<u>259</u>
Net Cash Provided (Used) by Investing Activities	<u>259</u>
INCREASE (DECREASE) IN CASH	(15,235)
CASH AT BEGINNING OF YEAR	<u>340,851</u>
CASH AT END OF YEAR	<u><u>\$ 325,616</u></u>

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

**SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2013**

Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:

Net Operating Income	\$ (120,609)
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	186,409
Changes in Assets (Liabilities):	
Accounts Receivable	(13,161)
Land Option	(1,000)
Accounts Payable	(2,187)
Accrued Compensated Absences	2,041
Accrued Taxes	436
Accrued Payroll Taxes	1,128
Due to City of Sandy Hook	3,575
Accrued Retirement Expenses	(615)
Unearned Revenue	2,833
Customer Deposits	1,442
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Net Cash Provided (Used) by Operating Activities	<u><u>\$ 60,292</u></u>

Supplementary Information

Interest Paid	<u><u>\$ 52,264</u></u>
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The accompanying notes are an integral part of the financial statements.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Sandy Hook Water District (the District) is presented to assist in understanding the District's financial statements. The financial statements and notes are representations of the District's management, who are responsible for their integrity and objectivity. These accounting policies, as applied to the aforementioned financial statements, conform to generally accepted accounting principles applicable to governmental units.

Regulatory Requirements

The District is subject to the regulatory authority of the Kentucky Public Service Commission (“PSC”) pursuant to KRS 278.040.

Organization & Activity

The District was created in accordance with Chapter 74 of the Kentucky Revised Statutes in 1957. The purpose of the District is to provide water services to residents in Sandy Hook, Kentucky and the surrounding area.

Financial Reporting Entity

The District complies with GASB Statements No. 14, “The Financial Reporting Entity” and No. 39, “Determining Whether Certain Organizations Are Component Units.” These Statements establish standards for defining and reporting on the financial reporting entity. They define component units as legally separate organizations for which the officials of the primary government are financially accountable and other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete. The District is not considered a component unit of any other governmental unit for financial reporting purposes.

The District considered all potential component units in determining what organizations should be included in its financial statements. Based on an evaluation of the established criteria, management determined that there were no component units to include in the District’s financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The District’s financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Board (APB) Opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

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

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Position. Net Position is segregated into “invested in capital assets, net of related debt”; “restricted”; and “unrestricted” components.

The District’s various bond resolutions or ordinances require the establishment of certain accounts, which are referred to as “funds”. These required accounts are maintained as part of accounting records of the Water Fund. They include the Sinking Fund (Debt Service), Revenue Fund and Depreciation Reserve Fund (Repairs and Maintenance). These are not “funds” as the term is used in generally accepted accounting principles, but are separate “accounts” used to delineate the accounting and reporting for bond related money and repayment security requirements. The balances and activity that occur in these various accounts represent specific segments of the Water Utility enterprise fund as reported in the District’s financial statements.

The enterprise fund used by the District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the District’s ongoing operations. The principal operating revenues are charges to customers for sales and services that are provided to them. The District also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water 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 nonoperating revenues and expenses.

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 they are needed.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Budgeting

In accordance with Kentucky Revised Statute 65.065, the District is required to submit a balanced budget to the Elliott County Fiscal Court prior to December 1. The budget includes proposed expenditures and means of financing them for the upcoming year. Annual budgets are adopted on a basis consistent with generally accepted accounting principles. Expenditures may not legally exceed budgeted appropriations at the fund level. All appropriations lapse at calendar year end.

Allowance for Doubtful Accounts

No allowance for doubtful accounts has been established. The District considers all receivables to be fully collectible based on their strict cut-off policy. If amounts become uncollectible, the amounts due are offset by any customer deposit held and the balance charged to operations when that determination is made.

Accounts Receivables

Accounts receivables are stated at face amount and include billed and unbilled receivables due as of 12/31/2013. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed on December 30, 2013 was for customer usage from approximately November 25 through December 25, 2013. The entire amount is considered accounts receivable as of December 31, 2013. The billing mailed on January 31, 2014 was for usage from approximately December 25, 2013 through January 25, 2014. Approximately five days of this billing is considered unbilled receivables at December 31, 2013.

Deposits and Investments

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).

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, Plant and Equipment

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., water distribution systems, and similar items) are reported as a component of noncurrent assets in the basic financial statements. Capital assets are generally defined by the District as being those assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

The reported value excludes the costs of normal maintenance and repairs that are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate.

Depreciation is charged as an expense against operations. Capital assets of the District are depreciated using the straight-line method over their estimated useful lives in years.

The depreciation expense provided on proprietary fund assets during the period ended December 31, 2013 is \$186,409.

Capitalized Interest On Indebtedness

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is reflected in the capitalized value of the asset constructed. The total interest expense incurred by the District during the current fiscal year was \$52,264. No capitalizable interest was incurred during the year ended December 31, 2013.

Cash and Cash Equivalents

For the purpose of these financial statements, cash and cash equivalents consist of unrestricted and restricted cash on hand, demand and savings deposits and certificates of deposit.

Inventory and Prepaid Items

The District maintains an inventory of supplies to make minor repairs to the water district systems. It is the policy of the water district to expense the items as they are purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. An example of a prepaid item for the District is property and liability insurance premiums.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Restricted Net Position

Some of the District's assets have certain constraints that have been placed on how they can be used. By definition, restricted assets are cash or other assets, whose use in whole or in part are restricted for specific purposes bound by virtue of contractual agreements, legal requirements or enabling legislation.

Certain proceeds of the District's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because their use is limited by applicable bond covenants. The "debt service" accounts are used to segregate resources accumulated for debt service payments over the next twelve months. The "depreciation reserve" account is used to report resources set aside to meet unexpected contingencies or to fund asset renewals, replacements and extensions.

The District collects sewer revenues on behalf of the City of Sandy Hook. The amount owed to the City of Sandy Hook as of December 31, 2013 is reported as a component of restricted net position.

The District began a construction project during 2013. The construction account is used to report resources set aside to pay construction costs as they become due.

Federal Income Tax

The District is exempt from federal income tax since it is a governmental entity. Accordingly, the financial statements include no provision for income taxes.

Use of Estimates

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

NOTE B – RESTRICTIONS ON CASH

Bond Sinking Fund

Deposits into Bond Sinking Funds are required to be made monthly in order to accumulate funds for payment of bond principle and interest. At December 31, 2013, \$54,859 was required to be on deposit to meet payments of interest and principal due on bonds at January 1, 2014. The balance in this account at December 31, 2013 was \$117,009.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE B – RESTRICTIONS ON CASH (Continued)

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various bond documents. The District was required to deposit \$2,760 per month into the account. At December 31, 2013, \$97,200 was the required balance of the Depreciation Reserve account. The District had \$98,824 in this account for the purpose of maintaining the water system.

Restricted Cash Accounts

The District is required to maintain special deposit accounts for customer deposits and long-term debt obligations. The following is a listing of restricted cash accounts of the District:

Customer Deposits Account	\$ 28,003
Construction Account	5,072
Deposit Escrow Account	3,870
Sewer Revenue Held for the City of Sandy Hook	15,949
Bond and Interest Sinking Fund	117,009
Depreciation Reserve Fund	<u>98,824</u>
Total Restricted Cash Accounts	<u><u>\$ 268,727</u></u>

NOTE C – CASH AND INVESTMENTS

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds 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 or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, 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. As of December 31, 2013, these requirements were met.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the District's deposits may not be returned to it. As of December 31, 2013, the bank balance was \$329,767.

The bank balances were either insured by FDIC or covered by pledged collateral, as of December 31, 2013.

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

NOTE D – PROPERTY, PLANT, AND EQUIPMENT

The District’s major classes of utility capital assets and accumulated depreciation are shown below:

	Balance 12/31/2012	Additions	Disposals	Balance 12/31/2013
Land	\$ 142,498	\$	\$	\$ 142,498
Construction in Progress		113,686		113,686
Land Improvements	16,320			16,320
Buildings and Building Improvements	906,007			906,007
Wells and Springs	78,896			78,896
Transmission and Distribution	7,283,195			7,283,195
Treatment Plant	420,514			420,514
Electric Pumping Equipment	30,344			30,344
Miscellaneous Equipment	102,087			102,087
Furniture and Fixtures	5,876			5,876
Transportation Equipment	62,266		6,500	55,766
Total	9,048,003	113,686	6,500	9,155,189
Accumulated Depreciation:				
Land Improvements	7,071	1,088		8,159
Buildings and Building Improvements	139,263	17,699		156,962
Wells and Springs	43,628	1,922		45,550
Transmission and Distribution	1,785,490	145,766		1,931,256
Treatment Plant	312,903	11,028		323,931
Electric Pumping Equipment	16,391	1,306		17,697
Miscellaneous Equipment	82,040	2,309		84,349
Furniture and Fixtures	5,345	53		5,398
Transportation Equipment	54,517	5,238	6,500	53,255
Total	2,446,648	186,409	6,500	2,626,557
Fixed Assets Net of A/D	\$ 6,601,355	\$ (72,723)	\$ 0	\$ 6,528,632

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE E – SHORT TERM DEBT

On December 5, 2013, the District entered into a Loan Agreement with Kentucky Rural Water Finance Corporation and Regions Bank as interim financing for the construction of waterline extensions in the maximum amount of \$504,000. Principal and interest payments at a rate of 2.5% are required on the earlier of (i) the business day following the receipt of the proceeds of permanent financing in the form of bonds purchased by Rural Development or (ii) the maturity date of August 1, 2014. As of December 31, 2013, the principal balance outstanding was \$38,686.

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Business-type Activities:</u>					
Interim Financing	\$ 0	\$ 38,686	\$	\$ 38,686	\$ 38,686
<u>Business-type Activities</u>					
Current Liabilities	\$ 0	\$ 38,686	\$	\$ 38,686	\$ 38,686

NOTE F – BONDS PAYABLE

1. Waterworks Revenue Series 1988

On May 25, 1988, the District entered into an agreement with Rural Development to issue \$237,000 in Waterworks Revenue Bonds for the purpose of financing the cost of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 6.25% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2013, the principal balance outstanding was \$166,000. Debt service requirements for year ending December 31, 2013, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2014	\$ 10,376	\$ 6,000
2015	10,000	7,000
2016	9,562	8,000
2017	9,062	8,000
2018	8,562	50,000
2019-2023	33,814	70,000
2024-2028	14,688	17,000
Totals	\$ 96,064	\$ 166,000

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE F – BONDS PAYABLE (CONTINUED)

2. Waterworks Revenue Bond Series 1991

On July 24, 1991, the District entered into an agreement with Rural Development to issue \$316,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2013, the principal balance outstanding was \$208,000. Debt service requirements for year ending December 31, 2013, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2014	\$ 10,400	\$ 8,000
2015	10,000	8,000
2016	9,600	9,000
2017	9,150	9,000
2018	8,700	10,000
2019-2023	35,650	57,000
2024-2028	19,800	73,000
2029-2030	2,550	34,000
Totals	\$ 105,850	\$ 208,000

3. Waterworks Revenue Bond Series 1992

On May 27, 1992, the District entered into an agreement with Rural Development to issue \$70,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2013, the principal balance outstanding was \$50,100. Debt service requirements for year ending December 31, 2013, and thereafter are as follows:

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE F – BONDS PAYABLE (CONTINUED)

3. Waterworks Revenue Bond Series 1992 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2014	\$ 2,506	\$ 1,600
2015	2,426	1,700
2016	2,340	1,800
2017	2,250	1,900
2018	2,156	2,000
2019-2023	9,178	11,600
2024-2028	5,962	14,800
2029-2032	1,884	14,700
Totals	<u>\$ 28,702</u>	<u>\$ 50,100</u>

4. Waterworks Revenue Bonds Series 1995

On April 27, 1995, the District entered into an agreement with Rural Development to issue \$259,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2013, the principal balance outstanding was \$195,500. Debt service requirements for year ending December 31, 2013, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2014	\$ 8,798	\$ 5,500
2015	8,550	6,000
2016	8,280	6,000
2017	8,010	6,500
2018	7,718	7,000
2019-2023	33,660	39,500
2024-2028	23,872	49,000
2029-2033	11,860	61,500
2034	652	14,500
Totals	<u>\$ 111,400</u>	<u>\$ 195,500</u>

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013

NOTE F – BONDS PAYABLE (CONTINUED)

5. Waterworks Revenue Bonds Series 2001

On June 20, 2001, the District entered into an agreement with Rural Development to issue \$495,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2013, the principal balance outstanding was \$432,000. Debt service requirements for year ending December 31, 2013, and thereafter are as follows:

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2014	\$ 19,440	\$ 8,000
2015	19,080	8,500
2016	18,698	8,500
2017	18,316	9,000
2018	17,910	9,500
2019-2023	82,688	55,000
2024-2028	69,188	68,000
2029-2033	52,472	84,500
2034-2038	31,636	105,500
2039-2041	6,908	75,500
Totals	<u>\$ 336,336</u>	<u>\$ 432,000</u>

6. Long Term Debt Maturity in the Aggregate

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2014	\$ 51,520	\$ 29,100
2015	50,056	31,200
2016	48,480	33,300
2017	46,788	34,400
2018	45,046	78,500
2019-2023	194,990	233,100
2024-2028	133,510	221,800
2029-2033	68,766	194,700
2034-2038	32,288	120,000
2039-2041	6,908	75,500
Totals	<u>\$ 678,352</u>	<u>\$ 1,051,600</u>

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE F – BONDS PAYABLE (CONTINUED)

7. Changes in Long-term Liabilities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
<u>Business-type Activities:</u>					
Revenue Bonds	\$ 1,080,200	\$	\$ 28,600	\$ 1,051,600	\$ 29,100
<u>Business-type Activities</u>					
Long-term Liabilities	<u>\$ 1,080,200</u>	<u>\$ 0</u>	<u>\$ 28,600</u>	<u>\$ 1,051,600</u>	<u>\$ 29,100</u>

NOTE G – NET POSITION

Equity is classified as net position and displayed in three components:

- Invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets;
- Restricted net position - resulting from constraints placed on net position by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and
- Unrestricted net position - those assets that do not meet the definition of restricted net position or invested in capital assets.

NOTE H – RETIREMENT

The District has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement System. This is a cost-sharing multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute.

Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008 are required to contribute 6 percent of their salary to be allocated as follows: 5% will go to the member's account and 1% will go to the KRS insurance fund. The District's contribution rate for nonhazardous employees was 19.55 percent for the first six months of 2013 and 18.89 percent for the last six months of 2013.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE H – RETIREMENT (Continued)

The District’s contribution for calendar year 2011 was \$32,185, 2012 was \$32,251 and 2013 was \$37,007.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

CERS also provides post retirement health care coverage as follows:

For member participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

Years of Service	% Paid by Insurance Fund	% Paid by Member through Payroll Deduction
20 or more	100%	0%
15-19	75%	25%
10-14	50%	50%
4-9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount.

Historical trend information showing the CERS’ progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems’ annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

NOTE I – INSURANCE COVERAGE

The District is exposed to various risks of loss. The District carries commercial insurance for risks of loss. As of December 31, 2013, there were no known losses for which an accrual was considered necessary and no estimated claims that have been incurred, but not reported.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2013**

NOTE J – COMPENSATED ABSENCES

It is the District's policy to permit its employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave because the District does not have a policy to pay any amounts when employees separate from service with the District. The unused vacation or annual leave is considered a vested employee benefit.

In recognition of the resulting obligation, the District has accrued a liability for earned but unused vacation leave, having determined that payment of such compensation is probable and having developed a reasonable estimate based upon current salary costs and annual leave balances as of December 31, 2013. The liability for compensated absences at December 31, 2013 was \$6,319.

NOTE K – CONSTRUCTION IN PROGRESS

Construction in progress consists of \$113,686 associated with a waterline extension project.

NOTE L – SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 23, 2014, which is the date the financial statements were available to be issued.

Morgan-Franklin, LLC

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Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

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 financial statements of the business-type activities of Sandy Hook Water District, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise Sandy Hook Water District's basic financial statements, and have issued our report thereon dated April 23, 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of Sandy Hook Water District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying comments and recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the

Independent Auditors' 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*

accompanying comments and recommendations as items 2013-1 and 2013-2 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying comments and recommendations as items 2013-3 and 2013-4 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Sandy Hook 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, 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*.

Sandy Hook Water District's Responses to Findings

Sandy Hook Water District's responses to the findings identified in our audit are described in the accompanying comments and recommendations. The District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky
April 23, 2014

**SANDY HOOK WATER DISTRICT
COMMENTS AND RECOMMENDATIONS
DECEMBER 31, 2013**

MATERIAL WEAKNESSES

2013-1 The District Should Have Adequate Controls Over The Preparation Of The Financial Statements Being Audited

Condition: The District should have adequate controls over the preparation of the financial statements being audited.

Criteria: SAS 115 states that an entity must have sufficient controls in place to prepare a full set of GAAP financial statements, including full disclosures.

Effect: Management may not be able to identify deficiencies in reporting.

Cause: Lack of controls over the preparation of the financial statements.

Recommendation: We recommend that The District's management develop adequate controls over the preparation of the financial statements.

Management may engage a qualified individual with suitable skills to review the draft audit in order to advise management sufficiently for them to be able to take responsibility for the financial statements.

Or management could implement the following controls.

1. Review draft financial statements by comparing to year-end QuickBooks reports that were prepared by management.
2. Read footnotes accompanying the financial statement to ensure no discrepancies between footnotes and financial statements.
3. Review a disclosure checklist and compare to the footnotes for omitted or inaccurate disclosures.

These controls could be documented by initialing and dating the draft financial statement and disclosure checklist.

District's Response: It is not cost effective.

2013-2 The District Lacks Adequate Internal Controls Over Inventory

Condition: The District maintains inventory of items needed to make minor repairs to the water distribution system. The District does not track inventory that is utilized by maintenance employees for such repairs.

**SANDY HOOK WATER DISTRICT
COMMENTS AND RECOMMENDATIONS
DECEMBER 31, 2013**

MATERIAL WEAKNESSES (CONTINUED)

2013-2 The District Lacks Adequate Internal Controls Over Inventory (Continued)

Criteria: The District should track all transactions involving inventory. Whenever maintenance employees use inventory they should document the part number, the dollar value of the part, the date, and their initials at a minimum. This information should be used to update the inventory balances.

Effect: Misappropriations of inventory could occur and not be detected in a timely manner.

Cause: Lack of adequate internal controls over inventory.

Recommendation: We recommend the District establish adequate internal controls over inventory.

District's Response: We will purchase inventory as needed.

SIGNIFICANT DEFICIENCIES

2013-3 The District Should Have Adequate Internal Controls Over Disbursements

Condition: During our audit, we tested twenty-five disbursements and noted the following:

- One instance in which a purchase order was not utilized.
- The District utilized a debit card.
- One instance in which an auto fuel expense was coded to supplies.

Criteria: The following are examples of good internal controls:

- Purchase orders are a good way to track purchases and that the amounts invoiced are the amounts originally approved.
- The Department for Local Government Budget Manual strongly discourages the use of debit cards because they allow for weak control over disbursements.
- Invoices should be properly coded.

Effect:

- Purchases may be made without prior approval.
- Weakness in internal controls over disbursements.
- Expenditure categories are under or overstated.

Cause: Lack of adequate internal controls over disbursements.

**SANDY HOOK WATER DISTRICT
COMMENTS AND RECOMMENDATIONS
DECEMBER 31, 2013**

SIGNIFICANT DEFICIENCIES (CONTINUED)

2013-3 The District Should Have Adequate Internal Controls Over Disbursements (Continued)

Recommendation: We recommend the District reevaluate their controls over disbursements to determine the controls that would best address the findings listed under the condition section above. The District may determine the controls listed above under the criteria section are adequate or may decide to implement other controls to eliminate such internal control weaknesses in the future.

District's Response: No response.

2013-4 The District Should Develop A Collection Policy For Past Due Accounts

Condition: While performing our audit, it was noted that the District does not have a written policy for collections on past due accounts.

Criteria: Good internal controls dictate the district should establish a written collection policy for past due accounts.

Effect: Revenues due the District that are potentially collectible remain unpaid.

Cause: The District's failure to establish a collection policy for past due accounts.

Recommendation: We recommend that the District establish a written policy for the collection of past due accounts.

District's Response: We will write a policy concerning past due accounts.