

SHARPSBURG
WATER DISTRICT

REPORT ON EXAMINATION OF BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTAL INFORMATION
for the year ended December 31, 2013

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Sharpsburg Water District
Sharpsburg, Kentucky

We have audited the accompanying financial statements of the business-type activities of the Sharpsburg Water District as of and for the year ended December 31, 2013, which comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Sharpsburg Water District's management. Our responsibility is to an express opinion on these financial statements based on our audit.

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.

Management has elected to omit the Management's Discussion & Analysis which is required by the Governmental Accounting Standards Board.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we 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, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

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 the Sharpsburg 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-Matter

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Sharpsburg Water District's financial statements as a whole. The Comparative Statement of Revenues and Expenses is presented for purposes of additional analysis and is not a required part of the financial statements. The Comparative Statement of Revenues and Expenses is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The combining Comparative Statement of Revenues and Expenses has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

John T. Lane & Associates LLC

May 30, 2014

This report contains 13 pages.

SHARPSBURG WATER DISTRICT
Statement of Net Position
Proprietary Fund
December 31, 2013

ASSETS

Current Assets	
Cash and cash equivalents - unrestricted	\$ 191,775
Cash and cash equivalents - restricted (note 7)	163,003
Accounts receivable - net of allowance for doubtful accounts (note 1)	47,891
Prepaid insurance	<u>69</u>
Total Current Assets	<u>402,738</u>
Noncurrent Assets	
Capital assets: (note 1)	
Plant, equipment and lines	7,207,492
Less accumulated depreciation	<u>(1,948,469)</u>
Total Noncurrent Assets	<u>5,259,023</u>
Total Assets	<u><u>\$ 5,661,761</u></u>

LIABILITIES

Current Liabilities	
Accrued expenses	\$ 56,080
Bonds payable	30,000
Payable from restricted assets	<u>39,361</u>
Total Current Liabilities	<u>125,441</u>
Noncurrent Liabilities	
Bonds payable	<u>1,386,300</u>
Total Liabilities	<u>1,511,741</u>

NET POSITION

Invested in capital assets, net of related debt	3,842,723
Restricted	123,642
Unrestricted	<u>183,655</u>
Total Net Position	<u><u>\$ 4,150,020</u></u>

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

SHARPSBURG WATER DISTRICT
Statement of Revenues, Expenses and Changes in Net Position
Proprietary Fund
For the fiscal year ended December 31, 2013

Revenues	
User fees	\$ 729,470
Utility tax income	9,026
Other income	<u>32,106</u>
Total Revenues	<u>770,602</u>
Expenses	
Water purchased	222,252
Salaries	188,728
Employee benefits	56,331
Office expense	37,764
Insurance	16,125
Taxes	39,228
Utilities	15,796
Miscellaneous	12,112
Outside services	19,298
PSC assessment	1,351
Depreciation	166,331
Supplies & repairs	<u>23,924</u>
Total Operating Expenses	<u>799,240</u>
Operating Income (Loss)	<u>(28,638)</u>
Nonoperating Revenues (Expenses)	
Tap fees	17,922
Federal grants	40,950
State grants	23,143
Interest expense	(52,437)
Interest income	<u>125</u>
Net Nonoperating Revenues (Expenses)	<u>29,703</u>
Change in Net Position	1,065
Total Net Position - beginning	<u>4,148,955</u>
Total Net Position - ending	<u><u>\$ 4,150,020</u></u>

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

SHARPSBURG WATER DISTRICT
Statement of Cash Flows
Proprietary Fund Type
December 31, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:	
Operating revenues	\$ 769,851
Cash paid to employees	(188,728)
Cash paid for general and administrative expenses	<u>(440,194)</u>
Net Cash provided/(used) by operating activities	<u>140,929</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest earned	125
Interest paid	(52,437)
Customer deposits	<u>519</u>
Net Cash provided/(used) by investing activities	<u>(51,793)</u>
CASH FLOWS FROM CAPITAL AND FINANCING ACTIVITIES:	
Tap fees	17,922
Purchase of fixed assets	(70,228)
Bond payments	(32,800)
Capital grant	<u>64,093</u>
Net Cash provided/(used) in capital and financing activities	<u>(21,013)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	68,123
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>286,655</u>
CASH AND CASH EQUIVALENTS - END OF THE YEAR	<u><u>\$ 354,778</u></u>
RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net Operating Income	\$ (28,638)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
Depreciation	166,331
(increase) in accounts receivable	(751)
decrease in prepaid expenses	178
increase in accounts payable	<u>3,809</u>
Net cash provided/(used) by operating activities	<u><u>\$ 140,929</u></u>

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

SHARPSBURG WATER DISTRICT
Notes to the Financial Statements
December 31, 2013

The Sharpsburg Water District is a water utility which services areas of Bath County including Sharpsburg, Bethel, Reynoldsville, and parts of Nicholas County. Its sales are primarily to residential customers. The District is a corporate body set forth in Kentucky Revised Statutes (KRS) 74.070 which was created November, 1961. The District began operations in 1963. The District is subject to the regulatory authority of the Kentucky Public Service Commission pursuant to KRS 278.040.

Note 1 - Summary of Significant Accounting Policies

The accounting policies of the District conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

The Reporting Entity

The District, for financial purposes, includes all of the funds relevant to the operations of the District. The financial statements presented herein do not include agencies which have been formed under applicable state laws or separate and distinct units of government apart from the Sharpsburg Water District.

The financial statements of the District would include those of separately administered organizations that are controlled by or dependent on the District. Control or dependence is determined on the basis of financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations, accountability of fiscal matters, scope of public service, and financing relations.

Based on the foregoing criteria there are not other organizations included in these financial statements.

Depreciation Reserve Fund - Monthly transfers are required to be made into this fund in the amount of \$120. Only expenditures for capital improvements or extraordinary expenses are permitted to be paid from this fund. The District had set aside \$63,153 into this fund at December 31, 2013.

Bond and Interest Sinking Fund - Monthly transfers are required to be made into this account in an amount equal to one-sixth (1/6) of the interest becoming due on the next succeeding interest due date for all outstanding bonds and one-twelfth (1/12) of the principal of all such bonds maturing on the next succeeding due date. The required balance of the fund at December 31, 2013 was \$-0-. The District had set aside \$61,920.

Enterprise Funds

An enterprise fund 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 the Authority's principal ongoing operations. The principal operating revenues of the Authority are operating grants and tenant rental revenue. Operating expenses of the Authority include the cost of producing the revenue 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.

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

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 balance sheet. Net position (i.e., total assets net of total liabilities) are segmented into invested in capital assets, net of related debt, restricted and unrestricted components. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, and then unrestricted resources as they are needed.

Basis of Accounting

The records of the District are maintained and the budgetary process is based on the cash basis method of accounting. Adjustments have been made to conform to the accrual basis of accounting.

Inventory

The cost of inventory is recorded as a disbursement at the time of payment for the purchase.

Cash

For purposes of the statement of cash flows, the District considers all highly liquid debt instruments purchased with a maturity of one year or less to be cash equivalents. At December 31, 2013, the carrying amount of the District's deposits was \$354,778 and the bank balance was \$360,030. Of the bank balance 100% was covered by federal deposit insurance or collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Capital Assets

Capital assets purchased are capitalized at the time of purchase. Such assets are recorded at cost. Donated assets are recorded at fair market value at the date of donation.

Depreciation of property and equipment is computed by the straight-line method based upon the estimated useful lives of the assets as follows:

<u>Class</u>	<u>Life</u>
Lines and tanks	50 years
Equipment	5-10 years
Computers	3 years
Meters	15 years

The District's capitalization policy is as follows: expenditures costing more than \$1,000 with an estimated useful life greater than one year are capitalized: all others are expensed.

Net Position

Net position represents the difference between assets and liabilities. Invested in capital assets- net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any borrowing used for the acquisition, construction or improvement of those assets. Net position are recorded as restricted when there are limitations imposed on their use by external restrictions.

Accounts Receivable

The receivable reflected in the statements in the amount of \$47,891 are net of allowance for uncollectibles in the amount of \$9,226.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Note 2 - Notes Payable

The amount shown in the accompanying financial statements as notes payable represents the District's future obligation to make loan payments from future revenues. At December 31, 2013, five separate loans had outstanding balances. Details of each of these issues are summarized as follows:

Note A

Lender – Rural Development

Balance of loan - \$103,000

Rate – 7.125%

Principal due January 1

Interest due January and July 1

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Note B

Lender – Rural Development

Balance of loan - \$221,000

Rate - 5%

Principal due January 1

Interest due January and July 1

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Note C

Lender – Rural Development

Balance of loan - \$220,800

Rate – 4.5%

Principal due January 1

Interest due January 1 and July 1

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Note D

Lender – Rural Development

Balance of loan - \$240,000

Rate – 4.125%

Principal due January 1

Interest due January 1 and July 1

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Note E

Lender – Rural Development

Balance of loan - \$631,500

Rate – 2.250%

Principal due January 1

Interest due January 1 and July 1

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Five-Year Maturities

2014	\$ 30,000
2015	32,500
2016	35,500
2017	37,500
2018	40,000
Thereafter	<u>1,240,800</u>
	<u>\$1,416,300</u>

The following is a summary of changes in long-term obligations for the year:

	Outstanding 1/1/2013	Issued	Retired	Outstanding 12/31/2013	Due Within One Year
Rural Development	<u>\$ 1,449,100</u>	<u>\$ -</u>	<u>\$ 32,800</u>	<u>\$ 1,416,300</u>	<u>\$ 30,000</u>

Total interest paid during the year on long-term debt totaled \$52,437.

Note 3 - Pension Plan

The District's employees are not covered by a retirement plan.

Note 4 - Leave Policies

Annual and Sick Leave

All full time employees shall be entitled to sick leave with pay at a rate of twelve days per year. Maximum accumulation is 60. No pay upon termination.

All full time employees are entitled to vacation time as follows:

- Completion of one year – 1 week
- Completion of ten years – 2 weeks
- Completion of 15 years – 3 weeks
- Completion of 20+ years – 4 weeks

Note 5 - Changes in Capital Assets

The following is a summary of changes in the capital assets for the fiscal year:

	Balance 1/1/2013	Transfers/ Additions	Deletions	Balance 12/31/2013
Utility plant and equipment	\$ 7,137,264	\$ 70,228	\$ -	\$ 7,207,492
Acc. depreciation	\$ 1,782,138	\$ 166,331	\$ -	\$ 1,948,469
Capital assets, net of accumulated depreciation	<u>\$ 5,355,126</u>	<u>\$ 166,331</u>	<u>\$ -</u>	<u>\$ 5,259,023</u>

Note 6 - Revenue Bonds

Water and Revenue Bonds constitute special obligations of the District solely secured by a lien on and pledge of the net revenues of the water system. The revenue bonds are collateralized by the revenue of the water system and the various special funds established by the bond ordinances. The ordinances provide that the revenue of the system is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the revenue bond funds. Any remaining revenues may then be used for any lawful purpose. The ordinances also contain certain provisions, which require the District to maintain pledged revenues. The District must transfer monthly 1/6 of the next succeeding interest payment and 1/12 of the next succeeding principal payment from the operations and maintenance account into the bond and interest sinking account.

Note 7 - Restricted Cash

Restricted cash is composed of the following:

Depreciation reserve fund	\$ 63,153
Sinking fund	61,920
Hwy 36 Project	988
Tank & Salesman	231
Water Meter	<u>36,711</u>
	\$ 163,003

Note 8 – Contingencies

The District is subject to possible examinations made by Federal and State authorities who determine compliance with terms, conditions, laws, and regulations governing other grants given to the District in the current and prior years. There were no examinations for the year ended December 31, 2013. Areas of noncompliance, if any, as a result of examinations would be included as a part of the "Findings and Questioned Costs" section of this report.

Note 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 carries commercial insurance coverage for the risks to the extent deemed prudent by District management.

SUPPLEMENTAL INFORMATION

SHARPSBURG WATER DISTRICT
FINDINGS AND RESPONSES
December 31, 2013

PRIOR FINDINGS

12-01 Segregation of Duties – Repeated as 13-01

CURRENT FINDINGS

13-01 Lack of Segregation of Duties

Condition: The District has an inadequate segregation of duties within its internal control process.

Criteria: All governmental entities should design their internal control to provide an adequate segregation of duties.

Cause: The District does not have sufficient employees to adequately design its internal control.

Recommendation: The District should continue to design and implement its internal control policies to provide the maximum segregation of duties possible.

Response: We will do as recommended.

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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
Sharpsburg Water District
Sharpsburg, Kentucky

We have audited the financial statements of the business-type activities of the Sharpsburg Water District, as of and for the year ended December 31, 2013, and have issued our report thereon dated May 30, 2014. 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.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Sharpsburg 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Sharpsburg Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of the Sharpsburg 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 a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies. (13-01)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Sharpsburg 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*.

Purpose of this Report

This report is intended solely for the information and use of the audit committee, management, others within the organization and Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

John T. Lane & Associates LLC

May 30, 2014

SHARPSBURG WATER DISTRICT
 COMPARATIVE STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
 For the fiscal years ended December 31, 2012 and December 31, 2013

	<u>2012</u>	<u>2013</u>
Revenues		
User fees	\$ 732,221	\$ 729,470
Utility tax	-	9,026
Miscellaneous	<u>24,652</u>	<u>32,106</u>
Total Revenues	<u>756,873</u>	<u>770,602</u>
Expenses		
Water purchased	230,513	222,252
Salaries	181,548	188,728
Employee benefits	52,293	56,331
Office expense	27,149	37,764
Insurance	18,047	16,125
Taxes	38,797	39,228
Utilities	13,853	15,796
Miscellaneous	11,843	12,112
Outside services	11,045	19,298
PSC assessment	-	1,351
Depreciation	164,432	166,331
Supplies & repairs	<u>30,357</u>	<u>23,924</u>
Total Operating Expenses	<u>779,877</u>	<u>799,240</u>
Operating Income (Loss)	<u>(23,004)</u>	<u>(28,638)</u>
Nonoperating Revenues (Expenses)		
Tap fees	8,500	17,922
Federal grants	495,231	40,950
State grants	666,407	23,143
Interest expense	(54,672)	(52,437)
Interest income	<u>122</u>	<u>125</u>
Net Nonoperating Revenues (Expenses)	<u>1,115,588</u>	<u>29,703</u>
Change in Net Position	<u>\$ 1,092,584</u>	<u>\$ 1,065</u>

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