

**FLEMING COUNTY
WATER ASSOCIATION, INC.**

AUDIT OF FINANCIAL STATEMENTS

For The Year Ended December 31, 2014

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Independent Auditors' Report

To the Board of Directors of
Fleming County Water Association, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of Fleming County Water Association, Inc. (a nonprofit organization), which comprise the statement of financial position as of December 31, 2014, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

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.

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

To the Board of Directors of
Fleming County Water Association, Inc.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fleming County Water Association, Inc., as of December 31, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 24, 2015, on our consideration of Fleming County Water Association, Inc.'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 Fleming County Water Association, Inc.'s internal control over financial reporting and compliance.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

April 24, 2015

FLEMING COUNTY WATER ASSOCIATION, INC.
STATEMENT OF FINANCIAL POSITION
December 31, 2014

ASSETS

CURRENT ASSETS

Cash - Unrestricted	\$ 439,503
Cash - Restricted	227,188
Accounts Receivable	141,102
Unbilled Receivables	75,925
Inventory	91,065
Prepaid Expenses	<u>9,965</u>
 Total Current Assets	 984,748

NONCURRENT ASSETS

Cash - Restricted	<u>203,486</u>
 Total Noncurrent Assets	 203,486

PROPERTY AND EQUIPMENT

(Net of Accumulated Depreciation)

Land	54,273
Construction In Progress	777,111
Land Improvements	46,016
Buildings and Building Improvements	137,451
Machinery and Equipment	78,739
Vehicles	53,881
Tools, Shop and Garage Equipment	1,833
Communication Equipment	11
Office Furniture and Equipment	18,399
Water Lines	7,167,011
Tanks and Pumping Equipment	<u>477,948</u>
 Total Property and Equipment	 <u>8,812,673</u>

TOTAL ASSETS	<u><u>\$ 10,000,907</u></u>
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The accompanying notes are an integral part of the financial statements.

FLEMING COUNTY WATER ASSOCIATION, INC.
STATEMENT OF FINANCIAL POSITION
December 31, 2014

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accrued Payroll Taxes	\$	5,953
Accounts Payable		69,204
Accounts Payable - Construction		108,820
Accrued Retirement Expense		1,302
Unearned Revenues		10,129
Accrued School and Sales Tax		7,277
Accrued Interest		47,014
Notes Payable		<u>63,099</u>
 Total Current Liabilities		 312,798

LONG-TERM LIABILITIES

Compensated Absences		53,904
Notes Payable		<u>3,056,064</u>
 Total Long-Term Liabilities		 3,109,968

OTHER LIABILITIES

Customer Deposits		<u>74,020</u>
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TOTAL LIABILITIES 3,496,786

NET ASSETS

Temporarily Restricted		430,674
Unrestricted		<u>6,073,447</u>

TOTAL NET ASSETS 6,504,121

TOTAL LIABILITIES AND NET ASSETS \$ 10,000,907

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

FLEMING COUNTY WATER ASSOCIATION, INC.
STATEMENT OF ACTIVITIES
For The Year Ended December 31, 2014

CHANGE IN UNRESTRICTED NET ASSETS:

OPERATING REVENUES

Water Collection	\$	1,720,280
Utility Relocation Proceeds		19,780
Late Penalties		35,590
Member Dues		3,050
Tap-On Fees		41,029
Miscellaneous Services		39,660
 Net Operating Revenues		 1,859,389

OPERATING EXPENSES

Salaries and Wages - Employees		354,427
Salaries and Wages - Directors		14,400
Employee Benefits		144,989
Purchased Water		623,822
Purchased Power		16,414
Taxes Other Than Income		30,954
Materials and Supplies		74,981
Contracted Services		54,377
Transportation Expense		46,173
Insurance		22,841
Advertising		1,578
Depreciation		271,642
Waterline Relocation Expenses		20,184
Miscellaneous Expenses		13,878
 Total Operating Expenses		 1,690,660

NET OPERATING INCOME 168,729

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

FLEMING COUNTY WATER ASSOCIATION, INC.
STATEMENT OF ACTIVITIES
For The Year Ended December 31, 2014

NON OPERATING REVENUES (EXPENSES)

Interest Expense	(117,990)
Interest Income	<u>659</u>
Total Non Operating Revenues (Expenses)	<u>(117,331)</u>

Change in Unrestricted Net Assets: 51,398

CHANGE IN TEMPORARILY RESTRICTED NET ASSETS:

REVENUE

Investment Income	<u>878</u>
Change in Temporarily Restricted Net Assets:	878
Net Assets- Beginning	<u>6,451,845</u>
Total Net Assets - Ending	<u><u>\$ 6,504,121</u></u>

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

FLEMING COUNTY WATER ASSOCIATION, INC.
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2014

CASH FLOWS FROM OPERATING ACTIVITIES

Payments from Customers	\$ 1,780,119
Late Penalties	35,590
Miscellaneous Services	39,660
Utility Relocation Proceeds	19,780
Member Dues	3,050
Payments to Vendors	(903,334)
Payments for Payroll and Related Expenses	<u>(567,121)</u>

Net Cash Provided/(Used) by Operating Activities: 407,744

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Additions to Capital Assets	(722,193)
Net (Deposits)/Withdrawals into or from Dep. Reserve Fund	(417)
Net (Deposits)/Withdrawals into or from Debt Service Fund	(463)
Interest Paid on Capital Debt	(117,990)
Proceeds from Debt Issued	668,134
Reduction in Notes Payable	<u>(252,950)</u>

Net Cash Provided/(Used) by
Capital and Related Financing Activities (425,879)

CASH FLOWS FROM INVESTING ACTIVITIES

Cash Received From Interest	<u>1,537</u>
Net Cash Provided/(Used) by Investing Activities	<u>1,537</u>

INCREASE/(DECREASE) IN CASH (16,598)

CASH AT BEGINNING OF YEAR 456,101

CASH AT END OF YEAR \$ 439,503

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

FLEMING COUNTY WATER ASSOCIATION, INC.
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2014

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

Net Operating Income	\$ 168,729
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	271,642
Changes in Assets/Liabilities:	
Accounts Receivable	(2,830)
Inventory	(31,053)
Accrued Wages	(3,015)
Accounts Payable - Retirement	1,301
Accounts Payable	(17)
Unearned Revenues	3,673
Accrued Payroll Taxes	3,074
Compensated Absences	(23,711)
Accrued School and Sales Tax	1,984
Customer Deposits	<u>17,967</u>
Net Cash Provided/Used by Operating Activities	<u>\$ 407,744</u>

Supplementary Information

Total Interest Cost	\$ 117,990
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The accompanying notes are an integral part of the financial statements.

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Fleming County Water Association, Inc. (the Association) is presented to assist in understanding the Association's financial statements. The financial statements and notes are representations of the Association'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.

Organization & Activity

The Association was incorporated in the Commonwealth of Kentucky as a nonprofit corporation in 1969. The Association operates a public water distribution system serving residential, commercial and agricultural customers. As of December 31, 2014 the Association served approximately 4,000 customers. The Kentucky Public Service Commission regulates the Association.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The basic financial statements provide information about the Association's activities.

"Measurement Focus" is an accounting term used to describe which transaction and types of balances are recorded within the various financial statements. The expression, "Basis of Accounting", refers to when transactions or events are recorded regardless of measurement focus applied.

Because of the "businesslike" characteristics of the Association's operations, the accompanying financial statements report uses the economic resources measurement focus and the accrual basis of accounting. The accounting objective of the "economic resources" measurement focus is the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported.

Under full accrual accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred or economic asset used, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As the means for delivering services to its customers, the Association utilizes an office building, infrastructure, office equipment, equipment and vehicles. To provide the resources that are necessary to pay for water services and the related support functions, the Association charges its customers monthly user fees, which are based on the specific level of services that they are receiving. Because the operations of the Association closely mirror those of a typical, commercial company, its accounting records reflect a similar approach for measuring its business activity.

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

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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

The Association has presented its financial statements in accordance with generally accepted accounting principles for not-for-profit organizations. Under this guidance, the Association is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

A summary of the net asset categories included in the accompanying financial statements is as follows:

Unrestricted Net Assets

Unrestricted, undesignated net assets are available for the various programs and administration of the Association.

Temporarily Restricted Net Assets

The Association is required to maintain special deposit accounts for long-term debt obligations. Restricted Accounts are made up of the Debt Service Account of \$226,683, the Depreciation Reserve Account in the amount of \$203,486, and the Construction Account in the amount of \$505 for a total of \$430,674.

Permanently Restricted Net Assets

Permanently restricted net assets consist of donor-restricted contributions, which are required to be held in perpetuity, and income from the assets held is available for either general operations or specific purposes, in accordance with donor stipulations. There are no permanently restricted net assets at December 31, 2014.

Budgeting

The Association prepares annual operating budgets for the managerial control of expenditures and for the monitoring of cash flows during the fiscal year. Project-length budgets, which generally encompass more than one fiscal year, are also prepared for major construction projects. Both the operating and project-length expenditure plans are prepared on the cash basis of accounting, which significantly differs from the accrual basis of accounting that the Association uses in the preparation of its financial statements.

These managerial budgets that are prepared for operations each year or at the inception of a major construction project are not adopted by the Board as legally imposed restrictions on expenditures. Basically, the operating budgets provide management with a tool for estimating and monitoring cash flows in each fiscal period. Accordingly, budgetary comparisons are not presented in the accompanying financial statements.

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Doubtful Accounts

No allowance for doubtful accounts has been established. The Association 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 and Unbilled Receivables

Accounts receivable are stated at face amount. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed on December 26, 2014 was for customer usage from approximately November 15 through December 15, 2014. The entire amount is considered accounts receivable as of December 31, 2014. The billing mailed on January 30, 2015 was for usage from approximately December 15, 2014 through January 15, 2015. Fifty percent of this billing is considered unbilled receivables at December 31, 2014.

Customer receivables are used as collateral for outstanding Rural Development debt.

Advertising Costs

The Association expenses advertising costs as incurred.

Property, Plant and Equipment

Capital assets, which include, property, plant, equipment, and infrastructure assets (e.g., water distribution systems, sewer collection systems and similar items) are reported as a component of noncurrent assets in the basic financial statement. Capital assets are generally defined by the Association as being those assets with an initial individual cost of more than \$750 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.

	Capitalization Threshold	Useful Life (Years)
Land Improvements	\$ 5,000	20-50
Buildings and Building Improvements	\$ 5,000	35-40
Machinery and Equipment	\$ 4,000	7-10
Vehicles/Trailers	\$ 5,000	5-7
Tools, Shop & Garage Equipment	\$ 750	7-10
Communication Equipment	\$ 1,000	10-15
Office Furniture and Equipment	\$ 1,000	5-10
Water Lines - Meters/Mains/System Lines/ Plant/Radio Read	\$ 5,000	10-50
Tanks and Pumping Equipment	\$ 5,000	20-50

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, Plant and Equipment (Continued)

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 Association are depreciated using the straight-line method over their estimated useful lives in years.

The depreciation expense during the period ended December 31, 2014 is \$271,642.

Cash and Cash Equivalents

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

Inventory and Prepaid Items

Included in inventory are materials and supplies to support maintenance work on the Association's infrastructure. All inventories maintained by the Association are valued at cost.

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 Association is property and liability insurance premiums.

Federal Income Tax

Income of the Association is exempt from tax under Internal Revenue Code Section 501(c)(12). Accordingly, the financial statements include no provision for income taxes.

All significant tax positions have been considered by management. It has been determined that it is more likely than not that all tax positions would be sustained upon examination by taxing authorities. Federal tax returns are subject to examination by taxing authorities generally for three years after they are filed.

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

Sinking Fund

Deposits into Sinking Funds are required to be made monthly in order to accumulate funds for payment of loan principle and interest. At December 31, 2014, \$174,201 was required to be on deposit to meet payments of interest and principal due on loans for 2015. The balance in this account at December 31, 2014 was \$226,683.

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE B – RESTRICTIONS ON CASH (Continued)

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various loan documents. The Association was required to deposit \$415 per month into the account. At December 31, 2014, \$198,476 was the required balance of the Depreciation Reserve account. The Association had \$203,486 in this account for the purpose of maintaining the water system.

Construction

The Construction Account is being maintained to record revenues and expenses associated with the 2012 Waterline Extension project. The balance in this account at December 31, 2014 was \$505.

NOTE C – CASH DEPOSITS WITH FINANCIAL INSTITUTIONS

The Association's funds are on deposit at a local financial institution. At December 31, 2014, the carrying amount of the Association's cash was \$870,177 and the bank balances were \$873,399. The difference between the carrying amount and the bank balances results from deposits in transit and outstanding checks. As of December 31, 2014, the bank balances were either insured by FDIC or covered by pledged collateral.

Deposits Covered By Federal Insurance	\$286,790
Deposits Collateralized	<u>586,609</u>
Total Bank Balance	<u>\$873,399</u>

NOTE D – COMPENSATED ABSENCES

It is the Association's policy to permit its employees to accumulate earned but unused vacation and sick pay benefits. The unused vacation or annual leave is considered a vested employee benefit.

In recognition of the resulting obligation, the Association has accrued a liability for earned but unused vacation and sick 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, 2014. The liability for compensated absences at December 31, 2014 was \$53,904.

NOTE E – INSURANCE COVERAGE

The Association is exposed to various risks of loss. The Association carries commercial insurance for risks of loss. As of December 31, 2014, there were no known losses for which an accrual was considered necessary and no estimated claims that have been incurred, but not reported.

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE F – PROPERTY, PLANT AND EQUIPMENT

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

	Reporting Entity			Ending Balance
	Beginning Balance	Increases	Decreases	
Capital Assets Not Being Depreciated:				
Land	\$ 54,273	\$	\$	\$ 54,273
Construction In Progress	1,063	776,048		777,111
Total Capital Assets Not Being Depreciated	55,336	776,048		831,384
Capital Assets, Being Depreciated:				
Land Improvements	53,767			53,767
Buildings and Improvements	235,944			235,944
Machinery and Equipment	126,852			126,852
Vehicles	166,577	21,418		187,995
Tools, Shop & Garage Equipment	23,926			23,926
Communication Equipment	8,041			8,041
Office Furniture and Equipment	109,590	12,342		121,932
Water Lines	10,385,779	21,205		10,406,984
Tanks and Pumping Equipment	680,590			680,590
Total Capital Assets Being Depreciated	11,791,066	54,965		11,846,031
Less Accumulated Depreciation for:				
Land Improvements	(5,343)	(2,408)		(7,751)
Buildings and Improvements	(92,594)	(5,899)		(98,493)
Machinery and Equipment	(35,979)	(12,134)		(48,113)
Vehicles	(116,639)	(17,475)		(134,114)
Tools, Shop & Garage Equipment	(21,693)	(400)		(22,093)
Communication Equipment	(7,904)	(126)		(8,030)
Office Furniture and Equipment	(96,822)	(6,711)		(103,533)
Water Lines	(3,027,731)	(212,242)		(3,239,973)
Tanks and Pumping Equipment	(188,395)	(14,247)		(202,642)
Total Accumulated Depreciation	(3,593,100)	(271,642)		(3,864,742)
Total Capital Assets, Being Depreciated, Net	8,197,966	(216,677)		7,981,289
Governmental Activities Capital Assets, Net	\$ 8,253,302	\$ 559,371	\$ 0	\$ 8,812,673

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE G – LONG-TERM DEBT

1. On December 13, 1988 the Association entered into a promissory note agreement with Rural Development in the amount of \$300,000 for the purpose of providing a water distribution system in Fleming County, Kentucky. Annual principal and interest payments at a rate of 5.75% are required on December 13. As of December 31, 2014, this agreement was paid in full.
2. On July 14, 1992 the Association entered into a promissory note agreement with Rural Development in the amount of \$504,000 for the purpose of providing a water distribution system in Fleming County, Kentucky. Annual principal and interest payments at a rate of 5% are required on July 14. As of December 31, 2014, the principal balance outstanding was \$348,714. Debt service requirements for year ending December 31, 2014, and thereafter are as follows:

Year Ended December 31	Scheduled Principal	Scheduled Interest
2015	\$ 12,425	\$ 17,458
2016	13,047	16,836
2017	13,699	16,184
2018	14,384	15,499
2019	15,103	14,780
2020-2024	87,627	61,788
2025-2029	111,837	37,578
2030-2032	80,592	8,425
Totals	\$ 348,714	\$ 188,548

3. On October 13, 1994 the Association entered into a promissory note agreement with Rural Development in the amount of \$185,600 for the purpose of providing a water distribution system. Annual principal and interest payments at a rate of 4.5% are required on October 13. As of December 31, 2014, the principal balance outstanding was \$133,486. Debt service requirements for year ending December 31, 2014, and thereafter are as follows:

Year Ended December 31	Scheduled Principal	Scheduled Interest
2015	\$ 4,269	\$ 6,016
2016	4,461	5,824
2017	4,662	5,623
2018	4,871	5,414
2019	5,091	5,194
2020-2024	29,104	22,321
2025-2029	36,269	15,156
2030-2034	44,759	6,348
Totals	\$ 133,486	\$ 71,896

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE G – LONG-TERM DEBT (CONTINUED)

4. On October 13, 1994 the Association entered into a promissory note agreement with Rural Development in the amount of \$700,000 for the purpose of providing a water distribution system. Annual principal and interest payments at a rate of 4.5% are required on October 13. As of December 31, 2014, the principal balance outstanding was \$503,542. Debt service requirements for the year ending December 31, 2014, and thereafter are as follows:

Year Ended December 31	Scheduled Principal	Scheduled Interest
2015	\$ 16,093	\$ 22,694
2016	16,818	21,969
2017	17,574	21,213
2018	18,365	20,422
2019	19,191	19,596
2020-2024	109,715	84,220
2025-2029	136,726	57,209
2030-2034	169,060	24,008
Totals	<u>\$ 503,542</u>	<u>\$ 271,331</u>

5. On April 23, 1997 the Association entered into a promissory note agreement with Rural Development in the amount of \$529,000 for the purpose of providing a water distribution system. Annual principal and interest payments at a rate of 5% are required on April 23. As of December 31, 2014, the principal balance outstanding was \$422,356. Debt service requirements for year ending December 31, 2014, and thereafter are as follows:

Year Ended December 31	Scheduled Principal	Scheduled Interest
2015	\$ 10,218	\$ 21,147
2016	10,728	20,637
2017	11,266	20,099
2018	11,828	19,537
2019	12,420	18,945
2020-2024	72,060	84,765
2025-2029	91,968	64,857
2030-2034	117,377	39,448
2035-2037	84,491	8,627
Totals	<u>\$ 422,356</u>	<u>\$ 298,062</u>

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE G – LONG-TERM DEBT (CONTINUED)

6. On November 22, 2000 the Association entered into a promissory note agreement with Rural Development in the amount of \$267,980 for the purpose of providing a water distribution system. Annual principal and interest payments at a rate of 4.5% are required on November 22. As of December 31, 2014, the principal balance outstanding was \$224,669. Debt service requirements for the year ending December 31, 2014, and thereafter are as follows:

<u>Year Ended December 31</u>	<u>Scheduled Principal</u>	<u>Scheduled Interest</u>
2015	\$ 4,731	\$ 10,118
2016	4,944	9,905
2017	5,167	9,682
2018	5,399	9,450
2019	5,642	9,207
2020-2024	32,255	41,990
2025-2029	40,197	34,048
2030-2034	50,092	24,153
2035-2039	62,424	11,821
2040	13,818	629
Totals	<u>\$ 224,669</u>	<u>\$ 161,003</u>

7. On August 18, 2004 the Association entered into a promissory note agreement with Rural Development in the amount of \$554,000 for the purpose of providing water lines. Annual principal and interest payments at a rate of 4.5% are required on August 18. As of December 31, 2014, the principal balance outstanding was \$458,004. Debt service requirements for the year ending December 31, 2014, and thereafter are as follows:

<u>Year Ended December 31</u>	<u>Scheduled Principal</u>	<u>Scheduled Interest</u>
2015	\$ 10,088	\$ 20,610
2016	10,541	23,281
2017	11,017	24,329
2018	11,511	25,424
2019	12,030	26,567
2020-2024	68,774	84,716
2025-2029	85,704	67,786
2030-2034	106,804	46,686
2035-2039	133,096	20,394
2040	8,439	380
Totals	<u>\$ 458,004</u>	<u>\$ 340,173</u>

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE G – LONG-TERM DEBT (CONTINUED)

8. On May 28, 2009 the Association entered into a promissory note agreement with Rural Development in the amount of \$375,000 for the purpose of providing potable water to rural areas of Fleming County, Kentucky. Annual principal and interest payments at a rate of 3.265% are required on May 28. As of December 31, 2014, the principal balance outstanding was \$360,258. Debt service requirements for the year ending December 31, 2014, and thereafter are as follows:

Year Ended December 31	Scheduled Principal	Scheduled Interest
2015	\$ 5,275	\$ 13,059
2016	5,466	12,868
2017	5,664	12,670
2018	5,869	12,465
2019	6,082	12,252
2020-2024	33,882	57,788
2025-2029	40,485	51,185
2030-2034	48,374	43,296
2035-2039	57,801	33,869
2040-2044	69,065	22,605
2045-2049	82,295	9,146
Totals	\$ 360,258	\$ 281,203

9. On November 7, 2012, the Association entered in a promissory note agreement with Rural Development in the amount of \$957,000 for the purpose of providing a portion of the cost of acquiring and constructing a water facility. The principal and interest shall be paid over 40 years with an interest rate not to exceed 2.75%. As of December 31, 2014, the Association has drawn \$668,134 on the loan. An interest only payment of \$15,905 will be due on September 9, 2015.

NOTE H – LONG TERM DEBT IN THE AGGREGATE

Year Ended December 31	Scheduled Principal	Scheduled Interest
2015	\$ 63,099	\$ 127,007
2016	66,005	111,320
2017	69,049	109,800
2018	72,227	108,211
2019	75,559	106,541
2020-2024	433,417	437,588
2025-2029	543,186	327,819
2030-2034	617,058	192,364
2035-2039	337,812	74,711
2040-2044	91,322	23,614
2045-2049	82,295	9,146
Totals	\$ 2,451,029	\$ 1,628,121

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE I – CHANGES IN LONG-TERM DEBT

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Business-type Activities:</u>					
Promissory Notes	\$ 2,703,979	\$ 668,134	\$ 252,950	\$ 3,119,163	\$ 63,099
<u>Business-type Activities</u>					
Long-term Liabilities	\$ 2,703,979	\$ 668,134	\$ 252,950	\$ 3,119,163	\$ 63,099

NOTE J – RECONCILIATION OF LONG-TERM DEBT IN THE AGGREGATE

	<u>December 31, 2014</u>
Scheduled Principal Debt Payments	\$ 2,451,029
Unscheduled Principal Debt Payments	<u>668,134</u>
Total Long-Term Debt in the Aggregate	<u>\$ 3,119,163</u>

NOTE K – RETIREMENT

401K

In July 1992, the Association elected to participate in a 457 Prototype Plan. The Association established the plan open to all eligible employees and later discovered that it was not a money purchase plan but was in fact an eligible deferred compensation plan under section 457(b) of the Code which could not include all its rank and file employees. The Association now holds all of the deferred compensation contributed by itself and its employees to the plan in trust for their exclusive benefit, in violation of the requirements of section 457(b)(6) that a plan be unfunded and that its assets remain part of the employer's general assets. To correct this violation the Association froze the plan on December 31, 2007 when it had \$633,446 in assets. There was a withdrawal of \$14,386 during 2014 by an employee due to retirement. As of December 31, 2014, the plan had a balance of \$801,475 including \$31,305 in earnings for the year.

In January 2008, the Association elected to participate in a 401(K) Retirement Saving Plan. The Association contributes 10% of the employees' salary to the plan. Employees may elect to contribute a portion of their compensation to the plan. Employees are eligible to participate in the plan when they attain the age of 21 and have completed 180 days of service to the Association. Benefits generally occur at an employee's normal (age 65) or early retirement date (age 55), unless they postpone their actual retirement. Upon termination employees will only be entitled to receive the vested percentage of their account balance.

The Association's contribution for the year ended December 31, 2014 was \$36,021.

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2014

NOTE L – RELATED PARTIES

The president of the board is a director and chief financial officer of the depository institution where the Association's bank accounts are held.

An employee of the Association is a partner of Muse Supply; expenditures remitted to this company during 2014 were \$165.

NOTE M – SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 24, 2015, which is the date the financial statements were available to be issued.

FLEMING COUNTY WATER ASSOCIATION, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2014

<u>Program Title</u>	<u>Pass- Through Grantor's Number</u>	<u>Federal CFDA No.</u>	<u>Expenditures</u>
U.S. Department of Agriculture			
Water and Waste Disposal Systems for Rural Communities			
Direct Loan	N/A	10.760	<u>\$ 776,048</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 776,048</u></u>

FLEMING COUNTY WATER ASSOCIATION, INC.
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended December 31, 2014

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Fleming County Water Association, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirement of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

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 Board of Directors of
Fleming County Water Association, Inc.

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 Fleming County Water Association, Inc. (a nonprofit organization), which comprise the statement of financial position as of December 31, 2014, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 24, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Fleming County Water Association, Inc.'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 Fleming County Water Association, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Fleming County Water Association, Inc.'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 schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 deficiency described in the accompanying schedule of findings and questioned costs as item 2014-001 to be a material weakness.

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 schedule of findings and questioned costs as items 2014-002, and 2014-003 to be significant deficiencies.

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*

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Fleming County Water Association, Inc.'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*.

Fleming County Water Association, Inc.'s Responses to Findings

Fleming County Water Association, Inc.'s responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Association'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 organization'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 organization'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 24, 2015

Morgan-Franklin, LLC

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Independent Auditors' Report On Compliance For Each Major Program And On Internal Control Over Compliance Required By OMB Circular A-133

To the Board of Directors of
Fleming County Water Association, Inc.

Report on Compliance for Each Major Federal Program

We have audited Fleming County Water Association, Inc.'s compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Fleming County Water Association, Inc.'s major federal programs for the year ended December 31, 2014. Fleming County Water Association, Inc.'s major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditors' Responsibility

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

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

Opinion on Each Major Federal Program

In our opinion, Fleming County Water Association, Inc. complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2014.

Independent Auditors' Report On Compliance For Each Major Program And On Internal Control Over Compliance Required By OMB Circular A-133

Report on Internal Control over Compliance

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

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

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

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

Morgan - Franklin, LLC

Morgan-Franklin, LLC

April 24, 2015

FLEMING COUNTY WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2014

A. SUMMARY OF AUDITORS' RESULTS

1. The auditors' report expresses an unmodified opinion on the financial statements of Fleming County Water Association, Inc.
2. Two significant deficiencies and one material weakness disclosed during the audit of the financial statements are reported 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*.
3. No instances of noncompliance material to the financial statements of Fleming County Water Association, Inc., which would be required to be reported in accordance with *Government Auditing Standards*, were disclosed during the audit.
4. No significant deficiencies or material weaknesses in internal control over major federal award programs are reported in the Independent Auditors' Report on Compliance for Each Major Program and on Internal Control over Compliance Required by OMB Circular A-133.
5. The auditors' report on compliance for the major federal award programs for Fleming County Water Association, Inc. expresses an unmodified opinion on all major federal programs.
6. There are no audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
7. The program tested as a major program was: U.S. Department of Agriculture Water and Waste Disposal Systems for Rural Communities (CFDA 10.760).
8. The threshold used for distinguishing between Type A and B programs was \$300,000.
9. Fleming County Water Association, Inc. was not determined to be low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

MATERIAL WEAKNESS

2014-001 The Association Lacks Adequate Internal Controls Over Inventory

Condition: The Association maintains inventory of items needed to make minor repairs to the water distribution system.

- A work order is completed for each repair recording all items used.
- The Association charges materials and supplies as expenditures when acquired (purchase method).
- The inventory on hand at the end of the period is recorded as an asset.
- Each maintenance employee has a key to the storage building where inventory is maintained.

An inventory count was completed on December 31, 2014.

Of the seven (7) items haphazardly chosen, from the stock status report, and counted during the observation of the year-end inventory counts we noted the following:

- Five (5) items where the auditor's count did not match the final count recorded on the end of year inventory count report provided by the client.

FLEMING COUNTY WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2014

B. FINDINGS - FINANCIAL STATEMENT AUDIT (Continued)

MATERIAL WEAKNESS (Continued)

2014-001 The Association Lacks Adequate Internal Controls Over Inventory (Continued)

Condition (Continued):

- One (1) instance where the physical count of the item differed significantly from the inventory report. The superintendent indicated a large number of the item was off site for refurbishment and that he had e-mail correspondence to support this statement.
- Based on total inventory population the calculated projected misstatement was \$27,320.

Criteria: The consumption method must be used by proprietary fund financial statements presented on the accrual basis of accounting. The Association 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 in the accounting system.

Cause: The lack of adequate internal controls over inventory.

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

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

Fleming County Water Association's Response: The Association has been tracking inventory through written service orders and invoices, and has implemented processes and procedures in 2014 to fully utilize the inventory software which interacts with the accounting system. Beginning in January 2015, all written service orders and inventory tracking is entered into the accounting system and reconciled monthly. Additionally, field processes have been updated to include a weekly truck stock report, and warehouse supply checklist.

SIGNIFICANT DEFICIENCIES

2014-002 The Association Should Have Adequate Controls Over The Preparation Of The Financial Statements Being Audited

Condition: The Association does not have adequate controls over the preparation of the financial statements being audited.

Criteria: SAS 112 states that an entity must have sufficient controls in place to prepare a full set of GAAP financial statements, including full disclosures.

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

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

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

FLEMING COUNTY WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2014

B. FINDINGS - FINANCIAL STATEMENT AUDIT (Continued)

SIGNIFICANT DEFICIENCIES (Continued)

2014-002 The Association Should Have Adequate Controls Over The Preparation Of The Financial Statements Being Audited (Continued)

Recommendation (Continued):

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 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.

Fleming County Water Association's Response: The Association is a small utility employing (11) employees and its size limits the amount of internal control that can be maintained. Management feels that all measures are taken within the Association's capacity to see that certain internal controls procedures are followed in the preparation of the Financial Statements. The Financial Statements are prepared by Office Personnel and presented to the Superintendent for review. Financial statements include budget statements, present to prior year comparison and year end reports. The Superintendent reviews and approves all purchases, reviews and approves all invoices before payment is issued, reviews all payments and checks, and reviews all bank statements each month to check for possible deficiencies in the bank statements. The cost of engaging professional accountants to prepare the monthly financial statements would be a financial burden on the association resulting in higher rates for its members.

2014-003 The Association Lacks Adequate Controls Over Disbursements

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

- The Association is not following written purchasing procedures.

While performing other procedures, we noted the following:

- Purchase requests were not completed for any purchases.

FLEMING COUNTY WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2014

B. FINDINGS - FINANCIAL STATEMENT AUDIT (Continued)

SIGNIFICANT DEFICIENCIES (Continued)

2014-003 The Association Lacks Adequate Controls Over Disbursements (Continued)

Criteria:

- In accordance with the written purchasing policies, the purchasing of supplies, equipment and contractual services must allow for fair and competitive price quotations or bidding from potential vendors. A purchase request describing the type of purchase or item and quantity desired shall be completed. The purchase request shall be signed by the staff member initiating the purchase.

Cause: Lack of adequate controls over disbursements.

Effect:

- Items may not be purchased at the most competitive prices.
- Purchases may be occurring without proper approval.

Recommendation: We recommend the Association establish written controls over disbursements and determine the controls that would best address the findings listed under the condition section above. The Association 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.

Fleming County Water Association's Response: Management currently receives price sheets and compares pricing of vendors for daily supply purchasing and competitively bids large equipment to insure competitive prices. Management agrees that the current policy needs to be updated to reflect current procedures for fair and competitive purchasing.

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT

NONE

D. SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS

NONE