

Levee Road Water Association, Inc.

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Financial Statements and
Independent Auditor's Report
December 31, 2014 and 2013

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Levee Road Water Association, Inc.

Report on the Financial Statements

We have audited the accompanying statements of financial position of Levee Road Water Association, Inc., as of and for the years ended December 31, 2014 and 2013 and the related statements of activities, changes in net assets, cash flows, and notes to the financial statements for the years then ended, which collectively comprise Levee Road Water Association, Inc.'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 the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

To the Board of Directors
Levee Road Water Association, Inc.
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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Levee Road Water Association as of December 31, 2014 and December 31, 2013, and the respective changes in net assets, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated July 29, 2015, on our consideration of Levee Road 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 Levee Road Water Association, Inc.'s internal control over financial reporting and compliance.

Faulkner, King & Wenz, PSC

July 29, 2015

LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2014 AND 2013

ASSETS	<u>2014</u>	<u>2013</u>
CURRENT ASSETS		
Cash	\$ 3,450	\$ 3,867
Accounts receivable (net)	41,552	41,529
Prepaid expenses	<u>3,410</u>	<u>3,101</u>
 TOTAL CURRENT ASSETS	 <u>48,412</u>	 <u>48,497</u>
RESTRICTED ASSETS		
Accrued interest receivable	32	34
Cash - reserve accounts	<u>130,923</u>	<u>153,558</u>
 TOTAL RESTRICTED ASSETS	 <u>130,955</u>	 <u>153,592</u>
PROPERTY AND EQUIPMENT		
Water system	2,401,657	2,398,201
Vehicles	34,764	34,764
Services & Hydrants	7,161	7,161
Office equipment	<u>25,626</u>	<u>24,116</u>
	2,469,208	2,464,242
Less accumulated depreciation	<u>(1,158,159)</u>	<u>(1,086,723)</u>
Net property and equipment	<u>1,311,049</u>	<u>1,377,519</u>
OTHER ASSETS		
Prepaid lease	<u>5,500</u>	<u>6,000</u>
 TOTAL ASSETS	 <u><u>\$ 1,495,916</u></u>	 <u><u>\$ 1,585,608</u></u>

LIABILITIES AND NET ASSETS

	<u>2014</u>	<u>2013</u>
CURRENT LIABILITIES		
Accounts payable	\$ 24,503	\$ 24,119
Taxes payable	1,062	1,068
Water deposits payable	2,800	2,680
Accrued interest payable	2,264	2,343
Notes payable - current portion	<u>4,521</u>	<u>4,241</u>
 TOTAL CURRENT LIABILITIES	 35,150	 34,451
 Noncurrent notes payable	 <u>89,496</u>	 <u>94,005</u>
 TOTAL LIABILITIES	 <u>124,646</u>	 <u>128,456</u>
 NET ASSETS		
 Unrestricted net assets - general	 (736,937)	 (672,202)
Unrestricted net assets - tap on fees	462,511	461,021
Unrestricted net assets - grants	1,514,741	1,514,741
Temporarily restricted net assets	<u>130,955</u>	<u>153,592</u>
 TOTAL NET ASSETS	 <u>1,371,270</u>	 <u>1,457,152</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 1,495,916</u>	 <u>\$ 1,585,608</u>

LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED DECEMBER 31, 2014 and 2013

	2014	2013
OPERATING INCREASES IN UNRESTRICTED NET ASSETS		
Water sales	\$ 236,600	\$ 235,998
Other water revenues	447	20
TOTAL OPERATING INCREASES IN UNRESTRICTED NET ASSETS	237,047	236,018
OPERATING DECREASES IN UNRESTRICTED NET ASSETS		
Water purchased	134,220	105,548
Salaries and payroll taxes	47,946	43,712
Directors fees	12,000	11,800
Office supplies	5,823	5,838
Office rental	6,000	6,400
Testing and lab fees	8,684	6,966
Insurance	5,511	5,005
Telephone and utilities	4,407	5,374
Professional services	8,795	8,700
Travel	1,722	1,500
Advertising	771	627
Repairs and maintenance	6,163	12,782
Rent	600	600
Provision for doubtful accounts	0	4,683
Miscellaneous	544	3,719
Contract labor	4,104	4,775
TOTAL OPERATING DECREASES IN UNRESTRICTED NET ASSETS	247,290	228,029
OPERATING (DECREASE) INCREASE IN UNRESTRICTED NET ASSETS BEFORE DEPRECIATION	(10,243)	7,989
Depreciation	71,436	71,215
OPERATING DECREASE IN UNRESTRICTED NET ASSETS	(81,679)	(63,226)
NONOPERATING INCREASES (DECREASES) IN UNRESTRICTED NET ASSETS		
Interest income	503	365
Interest expense	(6,196)	(6,463)
	(5,693)	(6,098)
NET DECREASE IN UNRESTRICTED NET ASSETS	\$ (87,372)	\$ (69,324)

**LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2014 and 2013**

	<u>Unrestricted Net assets</u>	<u>Temporarily Restricted Net assets</u>	<u>Contributed Capital Members</u>	<u>Contributed Capital Grants</u>	<u>Total</u>
Balances, January 1, 2013	\$ (607,027)	\$ 157,741	\$ 458,031	\$ 1,500,685	\$ 1,509,430
2013 net change in unrestricted net assets	(69,324)				(69,324)
Transfers	4,149	(4,149)			-
Membership dues			290		290
Grants				14,056	14,056
Tap-on fees			2,700		2,700
Balances, December 31, 2013	(672,202)	153,592	461,021	1,514,741	1,457,152
2014 net change in unrestricted net assets	(87,372)				(87,372)
Transfers	22,637	(22,637)			-
Membership dues			140		140
Grants				-	-
Tap-on fees			1,350		1,350
Balances, December 31, 2014	<u>\$ (736,937)</u>	<u>\$ 130,955</u>	<u>\$ 462,511</u>	<u>\$ 1,514,741</u>	<u>\$ 1,371,270</u>

LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2014 and 2013

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating decrease in unrestricted net assets	\$ (81,679)	\$ (63,226)
Adjustments to reconcile operating decrease in unrestricted net assets to net cash provided by operating activities:		
Depreciation	71,436	71,215
Provision for doubtful accounts	0	4,683
Changes in operating assets and liabilities		
(Increase) in accounts receivable	(23)	(6,332)
Decrease in prepaid expenses	191	303
Increase in accounts payable	384	14,698
(Decrease) in taxes payable	(6)	(1,058)
Increase (Decrease) in water deposits payable	120	(560)
	(9,577)	19,723
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(4,966)	(17,066)
Interest paid on RD loans	(6,275)	(6,720)
Principal payments on borrowings	(4,229)	(7,655)
Proceeds from grants	-	14,056
Proceeds from membership dues	140	290
Proceeds from tap-on fees	1,350	2,700
	(13,980)	(14,395)
 CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income received	505	391
	(23,052)	5,719
 (DECREASE) INCREASE IN CASH		
	(23,052)	5,719
 CASH AT BEGINNING OF YEAR	157,425	151,706
 CASH AT END OF YEAR	\$ 134,373	\$ 157,425
 CASH CONSISTS OF:		
Cash - unrestricted (overdraft)	\$ 3,450	\$ 3,867
Cash - restricted	130,923	153,558
	\$ 134,373	\$ 157,425

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Introduction:

Levee Road Water Association, Inc. (the Association) is a water utility which operates in Montgomery County, Kentucky, and its sales are primarily to residential customers. The Association was incorporated July 20, 1970 as a nonstock, nonprofit corporation formed under the provisions of Chapter 273 of the Kentucky Revised Statutes (KRS).

Regulation Requirements:

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

Basis of Accounting:

The accrual basis of accounting is used for financial statement reporting purposes.

Basis of presentation:

Financial statement presentation follows the recommendations of the ASC 958-205-05 (formerly Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations.") Under ASC 958-205-05, the Association is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. Accordingly, all net assets of the Association have been recorded as unrestricted or temporarily restricted.

Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Association considers all highly liquid debt instruments purchased with a maturity of one year or less to be cash equivalents.

The Association's deposits at December 31, 2014 were entirely covered by federal depository insurance.

Property, plant and equipment:

Property, plant and equipment are stated at original cost. The cost of repairs and maintenance is charged to the proper expense account as incurred. Property replacements are capitalized and retirements are charged to the proper plant account and depreciation provision. The thresholds for capitalization are:

Buildings and grounds	\$5,000
Building improvements	\$2,000
Water systems	\$3,000
Land	\$5,000
Vehicles and equipment	\$1,000

Depreciation:

Depreciation is applied on the straight-line method over the estimated useful life of the asset and is recognized in accordance with ASC 958-360-05 (formerly SFAS No. 93, "Recognition of Depreciation by Not-for-Profit Organizations"). The range of useful lives used in computing depreciation is:

<u>Classification</u>	<u>Range of lives</u>
Buildings	20-40 years
Water plant	25-40 years
Water systems	10-30 years
Office equipment	7-10 years
Other equipment	7 years
Vehicles	5 years

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Depreciation (continued):

Total depreciation expense was \$71,436 and \$71,215 for the years ended December 31, 2014 and 2013, respectively.

Purchased Water Costs:

Water purchases are charged to expense as delivered to the distribution system. The Association is economically dependent on Mt. Sterling Water and Sewer System as the sole supplier of water.

Contributed Capital:

Water tap-on fees, donated water lines and grant proceeds are accounted for as contributed capital and are restricted for use in financing capital improvements to the water system.

Estimates:

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

Customer Accounts Receivable:

Accounts receivable are stated at the amounts management expects to collect from outstanding charges for water sales less an allowance for doubtful accounts of \$3,632 and \$20,268 for years ended December 31, 2014 and 2013, respectively.

The following table presents the balance in the allowance for doubtful accounts as of December 31, 2014 and 2013:

	2014	2013
Allowance for Doubtful Accounts:		
Beginning balance	\$20,268	\$15,585
Net Charge-offs	(16,636)	-0-
Provision	-0-	4,683
Ending balance	\$ 3,632	\$20,268

The Association generally charges off past due accounts at the point which the accounts are more than 120 days past due and the responsible party is no longer a water customer of the Association. The allowance for doubtful accounts is estimated based on an analysis of customer accounts which are past due over 30 days. Percentages of the balance of each age group of accounts are included in the allowance calculation, including an allocation of 100% of accounts outstanding for more than 90 days.

Capitalized interest:

The Association follows the policy of capitalizing interest as a component of construction cost.

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Tax Status:

The Association is a nonprofit tax-exempt organization as prescribed by Internal Revenue Code, Section 501 c (12). Accordingly, the financial statements include no provision for income taxes.

The Accounting Standards Codification (ASC) 740-10-50, (formerly the Financial Accounting Standards Board Interpretation (FIN 48), *Accounting for Uncertainty in Income Taxes*,) requires entities to disclose known or anticipated positions of income tax uncertainty. The Association is not aware of any uncertain income tax positions as of July 29, 2015. The Association has never been audited by the Internal Revenue Service (IRS). However, the tax years of 2011 forward could be subject to examination by the IRS or other applicable tax jurisdictions.

NOTE 2 - UTILITY PLANT IN SERVICE

The cost of Water System assets is summarized below by major categories:

	<u>2014</u>	<u>2013</u>
Water towers	\$ 586,576	\$ 586,576
Transmission and distribution mains	1,265,634	1,265,634
Meters and meter installations	549,447	545,991
Total cost	<u>\$ 2,401,657</u>	<u>\$ 2,398,201</u>

NOTE 3 - LONG-TERM DEBT

Long-term debt as of December 31, 2014 and 2013 consists of the following:

	<u>2014</u>		<u>2013</u>	
	<u>Current</u>	<u>Noncurrent</u>	<u>Current</u>	<u>Noncurrent</u>
Rural Development, dated November 6, 1985, annual payment due each November, with interest rate of 7%, interest and principal payment of \$7,808, final payment due November 6, 2025	\$3,587	\$56,871	\$3,354	\$60,446
Rural Development, dated January 30, 1995, annual payment due each January, with interest rate of 5.25%, interest and principal payment of \$2,696, final payment due January, 2035	<u>934</u>	<u>32,625</u>	<u>887</u>	<u>33,559</u>
Total	<u>\$4,521</u>	<u>\$ 89,496</u>	<u>\$ 4,241</u>	<u>\$ 94,005</u>

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

NOTE 3 - LONG-TERM DEBT (CONTINUED)

The loans on the previous page are secured by statutory mortgage liens on the water supply distribution system as well as all present and future contract rights, accounts receivable, and general intangibles of the Association and are subject to early redemption by the Association prior to maturity. The loan agreements also outline various compliance requirements.

Installments due for principal and interest for each of the next five years and in total are as follows:

Years ended <u>December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015 (included in current liabilities)	\$ 4,521	\$ 5,983	\$ 10,504
2016	4,810	5,694	10,504
2017	5,130	5,374	10,504
2018	5,471	5,033	10,504
2019	5,834	4,670	10,504
Later years	<u>68,251</u>	<u>25,248</u>	<u>93,499</u>
Total	<u>\$ 94,017</u>	<u>\$ 52,002</u>	<u>\$ 146,019</u>

NOTE 4 - SPECIAL FUNDS AND RESTRICTIONS

The debt agreements with Rural Development require the following accounts be maintained by the utility as long as any outstanding debt remains:

General account - All operating funds received shall be deposited in this account. Funds will be used for operating and maintenance expenses and will be transferred to other accounts as needed.

Funded depreciation reserve account - The Association must deposit \$150 monthly into this account. These funds may be used for debt service or for unusual repairs or improvements if proper approvals are obtained and no funds are available in the general account. The balance as of December 31, 2014 and 2013 was \$24,249 and \$37,178, respectively.

Debt service reserve account - Required deposits of \$1,500 are to be made monthly into this account. Funds are to be used to make payments on Rural Development loans. The account was established per Rural Development loan requirements. The balance as of December 31, 2014 and 2013 was \$106,674 and \$116,380, respectively.

NOTE 5 - RELATED PARTY TRANSACTIONS

In addition to salaries and directors fees paid, the Association paid board members and certain members of their immediate families a total of \$12,238 and \$9,525 in 2014 and 2013, respectively, for expenses relating to testing, travel, contract labor and repairs and maintenance.

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

NOTE 6 - COMMITMENTS AND CONTINGENCIES

The Association has received grants from Rural Development, Appalachian Regional Commission, Housing and Urban Development, and Kentucky Infrastructure Authority in connection with the construction of water lines and towers. These grants require the fulfillment of certain conditions as set forth in the terms of the grant. Failure to fulfill the conditions could result in the return of the funds to grantors. Management is not aware of any violations of these conditions.

NOTE 7 - CONCENTRATION OF CREDIT RISK

The Association sells water to residential, agricultural, and commercial customers in rural Montgomery County, Kentucky, and is subject to the credit risks associated with serving an agricultural based area.

NOTE 8 - RISK MANAGEMENT

The Association is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the Association also carries commercial insurance for other risks of losses such as workers' compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 9 - Subsequent Events

Subsequent events for Levee Road Water Association, Inc. have been evaluated through July 29, 2015, which is the date the financial statements were available to be issued.

FAULKNER, KING & WENZ, PSC
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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*

To the Board of Directors
Levee Road 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 the financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of Levee Road Water Association, Inc. as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise Levee Road Water Association, Inc.'s basic financial statements, and have issued our report thereon dated July 29, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Levee Road 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Levee Road Water Association, Inc.'s internal control. Accordingly, we do not express an opinion of the effectiveness of Levee Road Water Association, Inc.'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 on the next page, that we consider to be significant deficiencies.

Finding: 2014-1

- Condition: While management is knowledgeable in regard to the numbers reported in the financial statements, identifying and applying new authoritative guidance in regard to information reported in the notes to those statements is outside the scope of management's training and experience.
- Management Response and Corrective Action Plan: It does not appear that it would be economically feasible for our organization to enlarge its staff or contract an individual with appropriate skill and knowledge in applying new authoritative guidance. Thus, it is important that our Board provide oversight and independent review functions.

Finding: 2014-2

- Condition: Lack of segregation of duties.
- Management Response and Corrective Action Plan: It does not appear that it would be economically feasible for our organization to enlarge its staff. Thus, it is important that our Board provide oversight and independent review functions.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Levee Road Water Association, Inc.'s financial statements are free of 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*.

Levee Road Water Association, Inc.'s Response to Findings

Levee Road Water Association, Inc.'s response to the findings identified in our audit is described above. This response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Faulkner, King & Wenz, PSC

July 29, 2015