

MCKINNEY WATER DISTRICT
AUDIT OF FINANCIAL STATEMENTS

DECEMBER 31, 2016

KERBAUGH, RODES & BUTLER, PLLC
CERTIFIED PUBLIC ACCOUNTANTS
DANVILLE, KENTUCKY

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INDEPENDENT AUDITOR'S REPORT

Chairman and Commissioners
McKinney Water District
McKinney, Kentucky 40448

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the McKinney Water District (the District) as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the comptroller general of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District, as of December 31, 2016, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 27, 2017, on our consideration of the District's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Kerbaugh, Rodas & Butler, PLLC

Kerbaugh, Rodas & Butler, PLLC
Certified Public Accountants

Danville, Kentucky
February 27, 2017

MCKINNEY WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2016

The management of McKinney Water District (the District) presents this narrative to help our readers review the accompanying annual financial statements for the year ended December 31, 2016. We have prepared this overview and analysis of the District's financial activities to add additional information to the financial schedules and the note disclosures. Our analysis will examine the financial highlights for this fiscal year and help explain the format for our readers.

Financial Highlights

- As of December 31, 2016, the District's assets (page 7) exceeded liabilities by \$1,504,548. This amount includes \$786,997 of resources that are invested in capital assets, net of related debt. \$320,705 of these resources are restricted for debt service, customer deposit refunds, or by enabling legislation. \$396,846 of these resources are unrestricted and are available to fund the District's outstanding obligations and future programs.
- Unrestricted cash and certificate of deposit balances (page 6) as of December 31, were \$268,825 and current liabilities payable from unrestricted resources (i.e. excluding principal and interest on long term debt and customer deposits) were \$38,895.
- Net position decreased by \$8,158 (page 8) which is comparable to the decrease of \$15,072 in the prior year. However, it should be noted that the current year decrease is net of depreciation expense of \$87,975, a non-cash expense. The District's net operating income was \$27,840 in the current year compared to net operating income of \$22,134 in the prior year. The primary reason for the improvement this year is due to a rate increase in 2016 of approximately 6%.
- The District's total debt decreased \$34,600 for the year ended December 31, 2016 which is equal to the scheduled payments for the year.

Overview of the Financial Statements

This discussion and analysis is intended to introduce the District's financial statements. Basic financial statements include two major sections: 1) government-wide financial statements, and 2) notes to the financial statements.

The District is a special-purpose governmental entity. It utilizes the accrual basis of accounting applicable to all *proprietary fund types*. Revenues are recognized when earned regardless of when received and expenses are recognized when incurred regardless of when paid.

Notes to the Financial Statements

Notes provide additional information that is essential to a full understanding of the information included in the financial statements. Notes provide additional details about the balances and transactions in the District's financial statements and are presented on pages 13 through 18.

Government-wide Financial Analysis

Net position may serve over time as a useful indicator of a government's financial position. 52% of the District's net position reflects its investment in capital assets (e.g. distribution system, equipment, etc.), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to its customers; consequently these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. 22% of the District's net position is restricted for customer deposit refunds, debt service, and system maintenance. The remaining 26% of the District's net position is unrestricted.

MCKINNEY WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2016

The first statement in the government-wide statements is the Statement of Net Position. The following table summarizes the Statement of Net Position (pages 6-7).

	<u>2016</u>	<u>2015</u>
Current and other assets	\$ 840,774	\$ 829,947
Capital assets	<u>1,729,397</u>	<u>1,782,589</u>
Total assets	<u>2,570,171</u>	<u>2,612,536</u>
Long-term debt outstanding	905,800	942,400
Other liabilities	<u>159,823</u>	<u>157,430</u>
Total liabilities	<u>1,065,623</u>	<u>1,099,830</u>
Net Position:		
Invested in capital assets, net of related debt	786,997	805,589
Restricted	320,705	306,742
Unrestricted (deficit)	<u>396,846</u>	<u>400,375</u>
Total net position	<u>\$ 1,504,548</u>	<u>\$ 1,512,706</u>

The second statement in the government-wide statements is the Statement of Revenues, Expenses, and Changes in Net Position. The following table outlines the major components of this statement.

	<u>2016</u>	<u>2015</u>
Revenues:		
Charges for Services	\$ 848,621	\$ 807,192
Rental Income	3,600	-
Interest Earnings	1,068	1,486
Miscellaneous	<u>23,999</u>	<u>20,586</u>
Total Revenues	<u>877,288</u>	<u>829,264</u>
Expenses:		
Operating Expenses Excluding Depreciation	760,113	718,474
Depreciation	87,975	87,170
Interest and Amortization	<u>37,358</u>	<u>38,692</u>
Total Expenses	<u>885,446</u>	<u>844,336</u>
Increase (Decrease) in Net Position	<u>\$ (8,158)</u>	<u>\$ (15,072)</u>

During the fiscal year ended December 31, 2016, the water loss percentage increased to approximately 25% from 22% in the prior year.

MCKINNEY WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2016

Capital Asset and Debt Administration

The District invests substantial resources in capital assets that support the services provided to its customers. All of the District's outstanding debt has been used to acquire or construct capital assets.

Capital Assets

The District's capital assets, net of accumulated depreciation are summarized below:

Land and right of ways	\$ 18,044
Distribution system	1,445,404
Office furniture and fixtures	4,989
Buildings and improvements	6,830
Capitalized design and interest cost	<u>254,130</u>
Total capital assets, net of depreciation	<u><u>\$ 1,729,397</u></u>

Long Term Debt

The principal outstanding on the District's long-term debt is summarized in the following table.

RDA 1992 Series C Bond	\$ 10,300
RDA 1992 Series D Bond	345,000
RDA 1999 Series A Bond	99,300
RDA 1999 Series B Bond	68,800
RDA 2000 Series A Bond	<u>419,000</u>
Total debt outstanding	<u><u>\$ 942,400</u></u>

The District's outstanding debt decreased \$34,600 for the year equal to the amount of the scheduled payments.

Economic Factors for Next Year

During the year ended December 31, 2016, the District was granted a rate increase of approximately 6% by the Kentucky Public Service Commission. Historically, the District has struggled with the impact of water losses on its operations. Going forward, keeping water losses at an acceptable level will be the primary factor in whether the District's operating results are positive or negative. The District will continue to monitor its water losses and take the necessary action to keep them at an acceptable level.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office, McKinney, KY 40448, telephone number (606) 346-2220.

MCKINNEY WATER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2016
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2015)

	<u>2016</u>	<u>2015</u>
<u>ASSETS</u>		
Current Assets:		
Cash (Note 3)	\$ 214,947	\$ 236,136
Certificates of Deposit (Note 3)	53,878	53,681
Accounts Receivable (Net of Allowance)	68,126	57,792
Inventory (Note 2)	53,596	50,562
Prepaid Expenses (Note 2)	<u>8,595</u>	<u>6,149</u>
Total Current Assets	399,142	404,320
Non-current Assets:		
Restricted Cash (Note 3)	226,120	210,901
Restricted Certificates of Deposit (Note 3)	<u>215,512</u>	<u>214,726</u>
Total Restricted Assets	441,632	425,627
Property and Equipment (Note 4):		
Land and Right of Ways	18,044	18,044
Distribution System	3,616,671	3,590,379
Other Tangible Assets	89,504	87,505
Office Furniture and Fixtures	41,870	41,870
Building and Improvements	43,178	43,178
Capitalized Design and Interest Costs	566,950	566,950
Less: Accumulated Depreciation	<u>(2,646,820)</u>	<u>(2,565,337)</u>
Net Property and Equipment	<u>1,729,397</u>	<u>1,782,589</u>
Total Assets	<u>\$ 2,570,171</u>	<u>\$ 2,612,536</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2016
(WITH COMPARATIVE TOTALS FOR DECEMBER 31, 2015)

	<u>2016</u>	<u>2015</u>
<u>LIABILITIES</u>		
Current Liabilities:		
Accounts Payable	\$ 30,407	\$ 30,143
Other Current Liabilities	<u>8,488</u>	<u>8,403</u>
Total Current Liabilities	38,895	38,546
Current Liabilities Payable From Restricted Assets:		
Customer Deposits	65,895	65,130
Accrued Interest on Debt	18,433	19,154
Current Portion - Debt (Note 5)	<u>36,600</u>	<u>34,600</u>
Total Current Liabilities Payable From Restricted Assets	120,928	118,884
Non-Current Liabilities:		
Long-Term Debt (Note 5)	<u>905,800</u>	<u>942,400</u>
Total Liabilities	<u>1,065,623</u>	<u>1,099,830</u>
<u>NET POSITION</u>		
Invested in Capital Assets, Net of Related Debt	786,997	805,589
Restricted For:		
Customer Deposits	109,800	104,313
Debt Service	81,914	82,835
Construction & Maintenance	128,991	119,594
Unrestricted	<u>396,846</u>	<u>400,375</u>
Total Net Position	<u>1,504,548</u>	<u>1,512,706</u>
Total Liabilities and Net Position	<u>\$ 2,570,171</u>	<u>\$ 2,612,536</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2016
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2015)

	<u>2016</u>	<u>2015</u>
Operating Revenue:		
Water Sales	\$ 841,621	\$ 800,692
Connection Fees	7,000	6,500
Rental Income	3,600	-
Other Operating Revenue	<u>23,707</u>	<u>20,586</u>
Total Operating Revenue	875,928	827,778
Operating Expenses	<u>760,113</u>	<u>718,474</u>
Net Operating Income Before Depreciation	115,815	109,304
Depreciation (Note 2)	<u>87,975</u>	<u>87,170</u>
Net Operating Income	27,840	22,134
Non-Operating Income (Expenses):		
Gain on Sale of Capital Assets	292	-
Interest Income	1,068	1,486
Interest Expense:		
On Long-Term Debt	(36,850)	(38,301)
Paid on Customer Deposits	<u>(508)</u>	<u>(391)</u>
Total Non-Operating Income (Expenses)	<u>(35,998)</u>	<u>(37,206)</u>
Change in Net Position	(8,158)	(15,072)
Net Position - Beginning of Year	<u>1,512,706</u>	<u>1,527,778</u>
Net Position - End of Year	<u><u>\$ 1,504,548</u></u>	<u><u>\$ 1,512,706</u></u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	<u>Tap Fees</u>	<u>Contributions In Aid Of Construction</u>	<u>Retained Deficit</u>	<u>Total</u>
Balance at January 1, 2015	\$ 211,363	\$ 2,190,707	\$ (874,292)	\$ 1,527,778
2015 Net Income (Loss)	<u>-</u>	<u>-</u>	<u>(15,072)</u>	<u>(15,072)</u>
Balance at December 31, 2015	211,363	2,190,707	(889,364)	1,512,706
2016 Net Income (Loss)	<u>-</u>	<u>-</u>	<u>(8,158)</u>	<u>(8,158)</u>
Balance at December 31, 2016	<u>\$ 211,363</u>	<u>\$ 2,190,707</u>	<u>\$ (897,522)</u>	<u>\$ 1,504,548</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF OPERATING EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2016
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2015)

	<u>2016</u>	<u>2015</u>
Source of Supply Expense:		
Water Purchases	\$ 366,884	\$ 361,763
Operation Supplies and Expense	<u>4,970</u>	<u>3,075</u>
Total	371,854	364,838
Transmission and Distribution Expense:		
Maintenance of Mains	<u>26,799</u>	<u>12,583</u>
Total	26,799	12,583
Customer Accounts Expense:		
Credit Card Processing Fees	5,781	4,912
Supplies and Postage	<u>33,950</u>	<u>32,865</u>
Total	39,731	37,777
Administrative and General:		
Salaries	169,704	170,294
Contract Labor	66,752	42,377
Insurance	11,663	14,121
Miscellaneous Expense:		
Utilities	13,254	12,193
Advertising	284	956
Bad Debts	5,123	8,236
Miscellaneous	649	221
Vehicle Gas	14,105	13,583
Payroll Taxes	13,571	13,515
Legal and Professional	5,560	5,525
Commissioners' Board and Director Fees	18,300	20,600
Other Licenses and Taxes	<u>2,764</u>	<u>1,655</u>
Total	<u>321,729</u>	<u>303,276</u>
Total Operating Expenses	<u>\$ 760,113</u>	<u>\$ 718,474</u>

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

MCKINNEY WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2015)

	<u>2016</u>	<u>2015</u>
Cash Flows From Operating Activities:		
Receipts From Customers	\$ 866,359	\$ 826,684
Payments to Suppliers	(581,969)	(536,305)
Payments to Employees	(169,704)	(170,294)
Payments of Payroll and Other Taxes	(13,571)	(14,920)
Other Receipts (Payments)	<u>-</u>	<u>1,350</u>
Net Cash Provided by (Used in) Operating Activities	<u>101,115</u>	<u>106,515</u>
Cash Flows From Non-Capital Financing Activities:		
Interest Paid on Customer Deposits	<u>(508)</u>	<u>(391)</u>
Net Cash Provided by (Used in) Non-Capital Financing Activities	<u>(508)</u>	<u>(391)</u>
Cash Flows From Capital and Related Financing Activities:		
Purchase of Fixed Assets/Construction in Progress	(42,991)	(32,486)
Proceeds from Sale of Fixed Assets	8,500	-
Retirement of Bonds	(34,600)	(32,800)
Interest Paid on Bonds	<u>(37,572)</u>	<u>(38,984)</u>
Net Cash Used in Financing Activities	<u>(106,663)</u>	<u>(104,270)</u>
Cash Flows From Investing Activities:		
Purchase of Certificates of Deposit	(982)	(1,404)
Interest Received	<u>1,068</u>	<u>1,486</u>
Net Cash Provided by (Used in) Investing Activities	<u>86</u>	<u>82</u>
Net Increase (Decrease) in Cash	(5,970)	1,936
Cash at Beginning of Year	<u>447,037</u>	<u>445,101</u>
Cash at End of Year	<u><u>\$ 441,067</u></u>	<u><u>\$ 447,037</u></u>

Continued

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

MCKINNEY WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED DECEMBER 31, 2015)
Continued

	<u>2016</u>	<u>2015</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities:		
Operating Income (Loss)	\$ 27,840	\$ 22,134
Depreciation	87,975	87,170
Decrease (Increase) in Accounts Receivable, Net	(10,334)	(1,094)
Decrease (Increase) in Inventory	(3,034)	2,661
Decrease (Increase) in Prepaid Expenses	(2,446)	(3,305)
Increase (Decrease) in Accounts Payable	264	(2,651)
Increase (Decrease) in Customer Deposits	765	1,350
Increase (Decrease) in Other Current Liabilities	<u>85</u>	<u>250</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 101,115</u>	<u>\$ 106,515</u>

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

MCKINNEY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016

1. GENERAL

McKinney Water District, (the "District") is a governmental entity operated under the control of the Lincoln County Fiscal Court. The District provides water services to the rural sections of Lincoln and Casey counties.

Prior to December of 1992, the District operated as two separate legal entities: the McKinney Water Association, Inc. and the McKinney Water District. In December of 1992, pursuant to an order of the Public Service Commission of the Commonwealth of Kentucky, the District was merged with the Association, and the District annexed the territory of the Association. The District also assumed all rights and obligations of the Association.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The District uses the accrual method of accounting which focuses on the measurement of net income similar to the approach used by commercial enterprises, and revenues are recorded when earned and expenses are recorded when incurred. The District 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 a proprietary fund's ongoing operations. The principal operating revenues of the utility are charges to customers for water service. Also, the District recognizes as operating revenue, the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.
- B. Cash includes amounts in demand deposits only.
- C. Investments consist of certificates of deposit only and are stated at cost which approximates fair value.
- D. Receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. All receivables in excess of 90 days old comprise the accounts receivable allowance for uncollectibles.
- E. Property and equipment are stated at cost, and are depreciated over the estimated useful life of the asset using the straight-line method of depreciation. Transmission lines are being depreciated over a 50 year life; office furniture and equipment over a 10 year life; pumping equipment over a 20 year life; structures and improvements over a 35 year life; meters and installations over a 35 year life; hydrants over a 40 year life; water tanks over a 30 year life; transportation equipment over a 7 year life; tools, shop and garage equipment over a 15 year life; and communications equipment over a 10 year life. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.
- F. Material inventory is stated at cost using the first-in, first-out (FIFO) method.
- G. Prepaid items include payments made to vendors that will benefit periods beyond the end of the fiscal year.

MCKINNEY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016

- H. Restricted assets represent cash for which use is limited by certain applicable bond covenants.
- I. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make use of estimates that affect reported amounts in the financial statements. Actual results could differ from estimates.

3. CASH & INVESTMENTS

Cash is composed of the following as of December 31, 2016, with restriction for use noted:

Cash on Hand		\$ 120
Cash on Deposit - Operating Account	A	48,763
Cash on Deposit - Revenue Account	B	166,064
Cash on Deposit - Customer Deposits	C	67,939
Savings Accounts:		
Debt Wervice Account	D	136,947
Depreciation Reserve Account	E	21,234
TOTAL		<u>\$ 441,067</u>

The District's investments at December 31, 2016 are as follows:

<u>Type of Investment</u>		<u>Fair Value</u>	<u>Cost</u>	<u>Interest Rate</u>	<u>Maturity Date</u>
PBK Bank Certificates of Deposit:					
CD - Revenue	B	\$ 53,878	\$ 53,878	0.60%	03/12/17
CD - Customer Deposits	C	107,756	107,756	0.60%	03/12/17
CD - Depreciation Reserve	E	107,756	107,756	0.60%	03/12/17
Total Certificates of Deposit		<u>\$ 269,390</u>	<u>\$ 269,390</u>		

The cash and certificate of deposit balances are insured for \$250,000 by the FDIC at December 31, 2016. Deposits in excess of \$250,000 have been collateralized by the bank as of December 31, 2016.

- (A) The operating and maintenance account, required by the RDA bond resolution, is used to meet the current expenses of operating and maintaining the system.
- (B) The revenue account, required by the RDA bond resolution, is used for the deposit of all funds collected and for the disbursement of funds to the proper bank accounts.
- (C) The customer deposit account is used to account for deposits received from customers.
- (D) The district is required to transfer monthly to the debt service account that amount which is necessary to meet the semi-annual installments for principal and interest on the RDA bonds outstanding.
- (E) The district is required to transfer \$600 monthly to the reserve account until \$62,880 is accumulated in the fund. The use of such fund is restricted to paying the cost of repairing or replacing, making extension or improvements or when necessary for payment of principal and interest. Whenever payments are made from the fund, the monthly payment shall be resumed until the balance again

MCKINNEY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016

reaches \$62,880. Once the balance in this account is fully funded, monthly transfers are then at the option of the District. The account is fully funded as of December 31, 2016.

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2016 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Land and Land Rights	\$ 18,044	\$ -	\$ -	\$ 18,044
Transmission Lines	2,624,575	-	-	2,624,575
Services	116,142	-	-	116,142
Meters	131,367	26,292	-	157,659
Hydrants	13,925	-	-	13,925
Pumps	261,616	-	-	261,616
Water Tank	442,754	-	-	442,754
Other Tangible Plant	87,505	16,699	(14,700)	89,504
Office Furniture and Fixtures	41,870	-	-	41,870
Buildings and Improvements	43,178	-	-	43,178
Capitalized Design and Interest Costs	566,950	-	-	566,950
Total	4,347,926	42,991	(14,700)	4,376,217
Less Accumulated Depreciation For:				
Transmission Lines	(1,665,355)	(36,912)	-	(1,702,267)
Services	(82,678)	(2,700)	-	(85,378)
Meters	(86,386)	(2,339)	-	(88,725)
Hydrants	(11,732)	(169)	-	(11,901)
Pumps	(72,837)	(12,458)	-	(85,295)
Water Tank	(220,224)	(13,165)	-	(233,389)
Other Tangible Plant	(54,326)	(5,982)	6,492	(53,816)
Office Furniture and Fixtures	(35,827)	(1,054)	-	(36,881)
Buildings and Improvements	(35,658)	(690)	-	(36,348)
Capitalized Design and Interest Costs	(300,314)	(12,506)	-	(312,820)
Total Accumulated Depreciation	(2,565,337)	(87,975)	6,492	(2,646,820)
Capital Assets, Net	\$ 1,782,589	\$ (44,984)	\$ (8,208)	\$ 1,729,397

MCKINNEY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016

5. LONG-TERM DEBT

The District issues bonds and pledges income derived from the acquired or constructed assets to pay debt service.

The District's debt at December 31, 2016 consists of the following:

USDA (Rural Development) - \$78,600 Principal amount Series C bonds dated 1992 due in annual installments of \$1,600 to \$5,300 through 2018. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	\$ 10,300
USDA (Rural Development) - \$537,000 Principal amount Series D bonds dated 1992 due in annual installments of \$5,700 to \$29,000 through 2032. Interest is due semi-annually at a rate of 5% on the unpaid balance as of January 1, and July 1 of each year.	345,000
USDA (Rural Development) - \$130,000 Principal amount Series A bonds dated 1999 due in annual installments of \$1,400 to \$6,900 through 2038. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	99,300
USDA (Rural Development) - \$90,000 Principal amount Series B bonds dated 1999 due in annual installments of \$900 to \$4,700 through 2038. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	68,800
USDA (Rural Development) - \$550,000 Principal amount Series 2000 bonds dated 2000 due in annual installments of \$7,500 to \$24,500 through 2040. Interest is due semi-annually at a rate of 3.25% on the unpaid balance as of January 1, and July 1 of each year.	<u>419,000</u>
Total Outstanding Bonds	942,400
LESS: Current Portion	<u>(36,600)</u>
Long-Term Debt	<u><u>\$ 905,800</u></u>

The annual requirements to amortize all bonds outstanding as of December 31, 2016, are as follows:

Year Ending			
December 31,	Principal	Interest	Total
2017	\$ 36,600	\$ 36,846	\$ 73,446
2018	37,200	35,306	72,506
2019	33,600	33,742	67,342
2020	35,200	32,370	67,570
2021	37,100	30,929	68,029
2022-26	208,600	130,632	339,232
2027-31	257,800	83,711	341,511
2032-36	179,500	35,455	214,955
2037-40	116,800	8,869	125,669
Total	<u>\$ 942,400</u>	<u>\$ 427,860</u>	<u>\$ 1,370,260</u>

MCKINNEY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016

Long-term liability activity for the year ended December 31, 2016 was as follows:

	Beginning Balance	Increases	Reductions	Ending Balance	Due Within One Year
RDA 1992 Series C Bond	\$ 15,000	\$ -	\$ (4,700)	\$ 10,300	\$ 5,000
RDA 1992 Series D Bond	359,000	-	(14,000)	345,000	15,000
RDA 1999 Series A Bond	101,900	-	(2,600)	99,300	2,700
RDA 1999 Series B Bond	70,600	-	(1,800)	68,800	1,900
RDA 2000 Series A Bond	430,500	-	(11,500)	419,000	12,000
Long-term Debt Total	<u>\$ 977,000</u>	<u>\$ -</u>	<u>\$ (34,600)</u>	<u>\$ 942,400</u>	<u>\$ 36,600</u>

6. RISK MANAGEMENT

The District is exposed to a variety of accidental losses, and has attempted to minimize its risk by carrying commercial insurance. There have been no significant reductions in coverage from coverage in the prior year.

7. OTHER MATTERS

(A) The District has not been assessed or paid any property, intangible or franchise tax in prior years. Since there is some uncertainty about the taxability of a "water district", the financial statements do not reflect any liability for unpaid taxes, if any.

(B) Active Meter Customers - December 31, 1,833

(C) Water Loss (Gallons):

Water Purchases	120,186,900
Water Sold and Used in Operations	<u>90,511,700</u>
Line loss	29,675,200
Percentage of Line Loss	24.69%

(D) Customer accounts receivable aging at December 31, 2016 is as follows:

Current	\$ 71,126
30-59 Days	(3,466)
60-89 Days	466
Over 90 Days	<u>59,969</u>
	<u>\$ 128,095</u>

(E) Accounts Receivable is comprised of the following as of December 31, 2016:

Customers	\$ 128,095
Allowance for Bad Debts	<u>(59,969)</u>
	<u>\$ 68,126</u>

All accounts receivable 90 days and older have been included in the allowance for uncollectible accounts.

COMPLIANCE SECTION

**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**

Chairman and Commissioners
McKinney Water District
McKinney, KY

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities of McKinney Water District (the District) as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued our report thereon dated February 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the 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 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 the 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. We did identify a certain deficiency in internal control that we consider to be a material weakness.

We consider the following deficiency to be a material weakness.

1. As is common within the system of internal control of most small organizations, the accounting function of the District does not prepare the financial statements complete with footnotes in accordance with accounting principles generally accepted in the United States of America (GAAP). Accordingly, the District has not established internal controls over the preparation of its

financial statements. This condition is considered to be a material weakness of the District's system of internal control over financial reporting.

During the course of performing an audit, it is not unusual for the auditor to prepare various journal entries to present the financial statements in accordance with the accrual basis of accounting. This reliance on the auditor to perform this function is considered to be a material weakness in the system of internal control. SAS No. 115 does not make exceptions for reporting deficiencies that are adequately mitigated with non-audit services rendered by the auditor or deficiencies for which the remedy would be cost prohibitive.

Communication of the deficiency above helps to emphasize that the responsibility for financial reporting rests entirely with the District and not the auditor. Stated another way, if an organization is unable to issue, without the auditor's involvement, complete financial statements with footnotes in accordance with generally accepted accounting principles and free of material misstatement, that inability is a symptom of a material weakness in the system of internal control.

Management's response – Management engages consultants who possess industry knowledge and expertise to provide financial and other professional services. Based on the auditor's unmodified opinion and after reading the financial statements, management believes the financial statements to be materially correct. Further, management does not think that the addition of an employee or consultant to oversee the annual financial reporting process is necessary nor would it be cost effective.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 that are required to be reported under *Government Auditing Standards*.

The District's Response to Findings

The District's response to the findings identified in our audit is described above. We did not audit the District's response and, accordingly, 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.

Kerbaugh, Rodas & Butler, PLLC

Kerbaugh, Rodas & Butler, PLLC
Certified Public Accountants

Danville, Kentucky
February 27, 2017