

**RED RIVER WASTEWATER
AUTHORITY, INC.**

AUDIT OF FINANCIAL STATEMENTS

For the Year Ended June 30, 2017

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Morgan and Associates, LLC

Brenda K. Morgan, CPA

749 Broadway Street
P.O. Box 428
West Liberty, KY 41472

Phone: (606) 743-1884
Fax: (606) 743-1895
www.bkmorgancpa.com

Independent Auditors' Report

To the Board of Directors
Red River Wastewater Authority, Inc.
Stanton, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Red River Wastewater Authority, Inc. (the Authority), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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
Red River Wastewater Authority, Inc.
Stanton, Kentucky

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Red River Wastewater Authority, Inc., as of June 30, 2017, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2017, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Morgan and Associates, LLC

West Liberty, Kentucky

October 16, 2017

RED RIVER WASTEWATER AUTHORITY, INC.
STATEMENT OF NET POSITION
June 30, 2017

ASSETS

CURRENT ASSETS

Cash - Unrestricted	\$ 30,842
Cash - Restricted for Debt Service	471,247
Prepaid Insurance	30,567
Accounts Receivable - Wastewater Fees	<u>217,993</u>
Total Current Assets	750,649

NONCURRENT ASSETS

Land-Stanton WWTP Location	365,742
Machinery and Equipment	17,250
Waste Water Treatment Plant	12,515,966
Accumulated Depreciation	<u>(1,053,347)</u>
Total Noncurrent Assets	<u>11,845,611</u>

TOTAL ASSETS **12,596,260**

LIABILITIES

CURRENT LIABILITIES

Accounts Payable	15,968
Payroll Liabilities	4,847
Accrued Interest	45,937
Line of Credit	100
Bond Payable	<u>85,000</u>

TOTAL CURRENT LIABILITIES **151,852**

NONCURRENT LIABILITIES

Bond Payable	<u>4,572,000</u>
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TOTAL LIABILITIES **4,723,852**

NET POSITION

Invested in Capital Assets, Net of Related Debt	7,142,674
Restricted for Debt Service	471,247
Unrestricted	<u>258,487</u>

TOTAL NET POSITION **\$ 7,872,408**

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

RED RIVER WASTEWATER AUTHORITY, INC.
STATEMENT OF REVENUES, EXPENSES, AND CHANGES
IN NET POSITION
For the Year Ended June 30, 2017

OPERATING INCOME

Wastewater Income - Wastewater Fees	\$ 651,993
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Total Operating Income	651,993
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OPERATING EXPENSES

Board Member Fees	19,400
Depreciation Expense	420,649
Insurance	35,464
Legal	3,025
Miscellaneous	3,516
Supplies	12,360
Water Testing Fees	23,725
Plant Expense	1,859
Professional Fees	18,090
Repair & Maintenance	34,632
Utilities	187,228
Fuel	2,334
Payroll	142,527

Total Operating Expenses	904,809
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NET OPERATING INCOME (LOSS)	(252,816)
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NON-OPERATING REVENUES (EXPENSES)

Interest Expense	(88,879)
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Total Non-Operating Revenues (Expenses)	(88,879)
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CHANGE IN NET POSITION	(341,695)
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Net Position - Beginning	8,214,103
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Total Net Position - Ending	\$ 7,872,408
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The accompanying notes are an integral part of the financial statements.

RED RIVER WASTEWATER AUTHORITY, INC.
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES

Customer Wastewater Fees	\$ 658,820
Payments to Vendors	(319,663)
Payments for Payroll & Related Expenses	<u>(163,451)</u>
Net Cash Provided (Used) by Operating Activities:	175,706

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Interest Payment	<u>(4)</u>
Net Cash Provided (Used) by Non-Capital Financing Activities:	(4)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Principal Payment and L/T Debt	(83,000)
Interest Payment	<u>(88,875)</u>
Net Cash Provided (Used) by Capital and Related Financing Activities:	<u>(171,875)</u>

INCREASE (DECREASE) IN CASH	3,827
CASH AT BEGINNING OF YEAR	<u>498,262</u>
CASH AT END OF YEAR	<u><u>\$ 502,089</u></u>

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

Net Operating Income	\$ (252,816)
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:	
Depreciation Expense	420,649
Increase (Decrease) Accounts Payable	(478)
(Increase) Decrease Accounts Receivable	6,827
Increase (Decrease) Payroll Liabilities	<u>1,524</u>
Net Cash Provided (Used) by Operating Activities	<u><u>\$ 175,706</u></u>

Supplemental Information:

<u>Interest Charged to Expense</u>	<u><u>\$ 88,879</u></u>
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The accompanying notes are an integral part of the financial statements.

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Authority's financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

A. Financial Reporting Entity

The Authority was incorporated in the Commonwealth of Kentucky as a nonprofit corporation in December 2008 under KRS Chapter 273.161 to 273.390, inclusive, Chapter 58.180, Chapter 65.210 to 65.300, and Chapter 76.232. The purpose for which the Authority is organized is exclusively to assist and cooperate with, and to act on behalf of, at the direction of and as the agency, instrumentality and constituted authority of the City of Clay City, City of Stanton and the Powell County Fiscal Court in effecting and maintaining high quality wastewater transmission, pumping and treatment services for the City of Clay City and the City of Stanton.

B. Basis of Presentation

The Authority's resources are allocated to and accounted for in these basic financial statements as an enterprise fund type of the proprietary fund group. The enterprise fund is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to its customers on a continuing basis be financed or recovered primarily through user charges, or where the governing body had decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other policies. Net position represents the amount available for future operations.

C. Proprietary Fund

The proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the statement of net position and the operating statements present increases (revenues) and decreases (expenditures) in net total position. Under the accrual basis of accounting, revenues are recognized when earned, including unbilled sewer services which are accrued. Expenses are recognized at the time the liability is incurred.

Proprietary funds distinguish 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 principal ongoing operations. Operating expenses for the proprietary funds include the cost of contractual services, supplies and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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

D. Cash and Cash Equivalents

For the purpose of these financial statements, cash and cash equivalents consist of restricted and unrestricted cash on hand and demand deposits. Deposits are carried at cost, which approximates fair value.

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

E. Budgeting

In accordance with the Interlocal Agreement, the Authority shall establish and approve an annual budget, containing all anticipated cost and revenue sources for capital and operational activities. Monthly management reports to the board shall include year-to-date budget reports. A copy of the Authority's annual budget shall be provided to the Parties (City of Clay City, City of Stanton, and Powell County Fiscal Court) not later than April 1st of each year.

Project-length budgets, which generally encompass more than one fiscal year, are prepared for major construction projects. Project-length expenditure plans are prepared on the cash basis of accounting, which significantly differs from the accrual basis of accounting that the Authority uses in the preparation of its financial statements.

These managerial budgets that are prepared at the inception of a major construction project are not adopted by the Board as legally imposed restrictions on expenditures. Basically, the 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.

F. Property, Plant and Equipment

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, equipment, and infrastructure assets (roads and bridges) that have a useful life of more than one reporting period based on the Authority's capitalization policy, are reported as a component of noncurrent assets. Such assets are recorded at historical cost or estimated historical cost when purchased or constructed.

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction in Progress are not depreciated. Interest incurred during construction is capitalized. Capital assets and infrastructure are depreciated using the straight-line method of depreciation over the estimated useful life of the asset.

	Capitalization Threshold	Useful Life (Years)
Land Improvements	\$ 12,500	10-60
Buildings and Building Improvements	\$ 25,000	10-75
Machinery and Equipment	\$ 5,000	3-25
Vehicles	\$ 5,000	3-25
Infrastructure	\$ 20,000	10-50

G. 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.

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Net Position

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

- Invested in capital assets, net of related debt – Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvements of those assets.
- Restricted net position – Consists of net position with constraints placed on the use either by (1) external groups; or (2) law through constitutional provisions or enabling legislation.
- Unrestricted net position – All other net position that does not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

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

I. Allowance for Doubtful Accounts

Management has elected to record bad debt expense using the direct write-off method. Generally accepted accounting principles require that the allowance method be used to reflect bad debt expense. However, management does not believe the effect of the use of the direct write-off method to be materially different from the results that would be obtained if the allowance method is followed.

J. 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 July 10, 2017 was for customer usage from May 30 through June 27, 2017. The entire amount is considered accounts receivable as of June 30, 2017. The billing mailed on August 2, 2017 was for usage from June 27 through July 28, 2017. The four (4) days in June of this billing are considered unbilled receivables at June 30, 2017.

NOTE 2 – CASH DEPOSITS WITH FINANCIAL INSTITUTIONS

The Authority maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). KRS 66.480 authorizes the Authority to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the Authority and the depository institution, signed by both parties, that is (a) in

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 2 – CASH DEPOSITS WITH FINANCIAL INSTITUTIONS (Continued)

writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. Except for approval reflected in official minutes of the board or committee, these requirements were met.

GASB Statement No. 72, Fair Value Measurement and Application, became effective in fiscal year 2016 which requires the measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques.

The carrying amount of the following financial instruments approximate fair value because of the short maturity of the instruments: cash equivalents.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the Authority's deposits may not be returned. The Authority does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240(4). On June 30, 2017, the Authority's bank balance was \$533,548. These deposits were covered by FDIC insurance or a properly executed collateral security agreement.

Deposits Covered by Federal Insurance	\$250,000
Deposits Collateralized	<u>283,548</u>
Total Bank Balance at June 30, 2017	<u>\$533,548</u>

NOTE 3 – RESTRICTIONS ON CASH

Bond Sinking Fund

The bond covenants requires one-sixth of the next succeeding interest payment and one-twelfth of the next succeeding principal payment of any current bond to be deposited into this fund. The money that accumulates in this fund is to be used to pay current interest and principal on bonds as they come due. The amount in the Sinking Fund Reserve as of June 30, 2017 was \$289,726.

Excess Construction Funds

Per the Bond document, **Article 3 Construction Account: Interim Financing; Application of Proceeds; Arbitrage Limitations** Section 301. Construction Account; Application of Proceeds of Bonds; Other Transfers and Deposits

A. Application of Proceeds of Current Bonds

(7) Disposition of Balance in Construction Account After completion of Project. "When the project has been completed and all construction costs have been paid in full, as certified by the Engineers forth Authority and/or by Rural Development (RD), any balance then remaining in the Construction Account may, with the consent of RD, be applied to the cost of constructing additional improvements to the System (the "Additional Construction"). If such

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 3 – RESTRICTIONS ON CASH (Continued)

Excess Construction Funds (Continued)

Additional Construction is to be undertaken by the Contractors previously engaged in the Project, such Additional Construction may be authorized by a change order.

If there is a balance remaining in the Construction Account after such Additional Construction, such balance (subject to legal requirements as to possible refund of any allocated portion of the balance derived from Grant Proceeds) shall be transferred to the Sinking Fund, whereupon said Construction Account shall be closed. Such remaining balance in the Construction Account so transferred to the Sinking fund shall be used by the Authority immediately to prepay principal installments due on the Current bonds in the inverse order of maturities without prepayment penalty, provided further that any balance insufficient to prepay at least \$100 of the principal payment falling due in any year on the Bonds will be transferred to the Debt Reserve Fund.”

The amount in the Construction Account as of June 30, 2017 was \$181,521. As stated above, if these funds are used to prepay bonds, it would be in addition to the regularly scheduled payments.

NOTE 4 – PROPERTY, PLANT AND EQUIPMENT

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

	Balance 6/30/2016	Additions	Disposals	Balance 6/30/2017
<u>Business Activities</u>				
Capital Assets not Being Depreciated:				
Land	\$ 365,742	\$	\$	\$ 365,742
Total Capital Assets not Being Depreciated	365,742			365,742
Capital Assets Being Depreciated:				
Wastewater Treatment Plant	12,515,966			12,515,966
Machinery & Equipment	17,250			17,250
Total Capital Assets Being Depreciated	12,533,216			12,533,216
Less Accumulated Depreciation for:				
Wastewater Plant	(625,798)	(417,199)		(1,042,997)
Machinery & Equipment	(6,900)	(3,450)		(10,350)
Total Accumulated Depreciation	(632,698)	(420,649)		(1,053,347)
Total Capital Assets, Being Depreciated, Net	11,900,518	(420,649)		11,479,869
Business-Type Activities Capital Assets, Net	<u>\$12,266,260</u>	<u>\$ (420,649)</u>	<u>\$</u>	<u>\$11,845,611</u>

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 5 – LINE OF CREDIT

B. On September 12, 2016, the Authority amended the promissory note with Whitaker Bank, Inc. in the maximum amount of \$50,000 as a revolving line of credit for the purpose of business expenses. Principal and interest payments at a rate of 4.150% are required upon maturity on September 12, 2017. As of June 30, 2017, the principal balance outstanding was \$100.

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Business-type Activities:</u>					
Lines of Credit	\$ 100	\$	\$	\$ 100	\$ 100
<u>Business-type Activities</u>					
Current Liabilities	\$ 100	\$ 0	\$ 0	\$ 100	\$ 100

NOTE 6 – LONG TERM DEBT

On February 22, 2013, the Authority issued \$4,900,000 in Sewer System Revenue Bonds from the United States Department of Agriculture (USDA), Rural Development for the purpose of financing the cost (not otherwise provided) of the construction of a new regional wastewater treatment facility. Semiannual interest payments at a 1.875% interest rate are required on January 1 and July 1 of each year beginning July 1, 2013, and annual principal payments are required on January 1 of each year beginning January 1, 2015. The bonds will be paid in full January 2052. As of June 30, 2017, the principal balance on these bonds was \$4,657,000. Debt service requirements are:

Fiscal Year Ended June 30	Principal	Interest
2018	\$ 85,000	\$ 87,319
2019	87,000	85,725
2020	89,000	84,094
2021	91,500	82,425
2022	93,500	80,709
2023-2027	505,000	376,312
2028-2032	571,000	326,560
2033-2037	646,000	270,272
2038-2042	731,000	206,617
2043-2047	827,500	134,531
2048-2052	930,500	53,016
	<u>\$ 4,657,000</u>	<u>\$ 1,787,580</u>

RED RIVER WASTEWATER AUTHORITY, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 7 – CHANGES IN LONG-TERM LIABILITIES

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Business-type Activities:</u>					
Revenue Bond	\$ 4,740,000	\$	\$ (83,000)	\$ 4,657,000	\$ 85,000
Business-type Activities Long Term Liabilities	<u>\$ 4,740,000</u>	<u>\$ 0</u>	<u>\$ (83,000)</u>	<u>\$ 4,657,000</u>	<u>\$ 85,000</u>

NOTE 8 – SICK AND VACATION LEAVE

Sick Leave/Personal Emergency Leave

Full-time employees shall accrue sick leave time/personal emergency leave time at a rate of eight (8) hours per month worked, and may accrue an amount not to exceed four hundred-eighty (480) hours, which may be carried into a subsequent fiscal year.

Sick leave time for part-time permanent employees shall be accrued at a rate proportional to their regular work hours based on the accrual rate of full-time employees.

Accrued sick leave/personal emergency time is not paid upon retirement or termination of employment.

Vacation Leave Time

Vacation leave time for full-time employees shall be accrued at a rate of eighty (80) hours after the first year of employment, each year thereafter up to and through the 5th year. Thereafter, employees shall receive an additional eight (8) hours each successive year but not to exceed 120 hours in any year.

Vacation leave time for part-time employees shall be accrued at a rate proportional to their regular work hours based on the accrual rate for full-time employees.

The Authority's policies and procedures do not address the payout of accrued vacation upon termination; therefore, there is no liability for accrued absences included in the financial statements.

NOTE 9 – RELATED PARTIES

The Authority's legal counsel is the son-in-law of a board member of the Authority.

NOTE 10 – RISK MANAGEMENT

Significant losses are covered by commercial insurance.

NOTE 11 – SUBSEQUENT EVENTS

Subsequent events have been evaluated through October 16, 2017, which is the date the financial statements were available to be issued.

Morgan and Associates, LLC

Brenda K. Morgan, CPA

749 Broadway Street
P.O. Box 428
West Liberty, KY 41472

Phone: (606) 743-1884
Fax: (606) 743-1895
www.bkmorgancpa.com

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
Red River Wastewater Authority, Inc.
Stanton, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Red River Wastewater Authority, Inc. (the Authority), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated October 16, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority'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 Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority'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. We did identify certain a deficiency in internal control, described in the accompanying comments and recommendations as item 2017-001 that we consider to be a significant deficiency.

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* (Continued)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Red River Wastewater Authority, 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying comments and recommendations as item 2017-002.

Red River Wastewater Authority, Inc.'s Responses to the Findings

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

Purpose of this Report

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

Morgan and Associates, LLC

Morgan and Associates, LLC
West Liberty, Kentucky

October 16, 2017

RED RIVER WASTEWATER AUTHORITY, INC.
Comments and Recommendations
For the Year Ended June 30, 2017

SIGNIFICANT DEFICIENCY

2017-001 The District Lacks Adequate Internal Controls Over Payroll

Condition: While performing payroll testing we noted the following:

- Time sheets were not being kept for the Plant Manager.
- Time sheets provided for full-time employees were not signed by the employee or supervisor.
- The accumulation of vacation/sick days used/accrued was not being adequately tracked.
- It would appear one (1) employee had dependent coverage for health, vision, and dental insurance but no deductions from payroll for this coverage were noted.

Criteria: Pursuant to KRS 337.320 every employer shall keep a record of (a) the amount paid each pay period to each employee; (b) the hours worked each day and each week by each employee; and (c) such other information as the commissioner requires. To further strengthen internal controls, the timesheets should be signed by the employee and by the employee's immediate supervisor for verification and attestation of the accuracy of time reported.

The accumulation of vacation/sick days used/accrued for all employees should be updated at least monthly.

Per the Authority's Employee Benefit Plan it pays 100% of coverage for employees. Employees have the option to add additional dependent coverage at their own expense.

Effect: The accumulation and use of vacation/sick time cannot be accurately tracked for all employees. Additional costs to the Authority in health, vision, and dental insurance for not recovering dependent coverage from employee(s).

Cause: The Authority lacks adequate internal controls over the recording of vacation and sick time. The Authority is not adhering to the current Employee Benefits Plan which states "...Employees have the option of including other family members, individually or as a group, but are required to cover the additional expense."

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

The Authority's Response: I have directed plant manager to work with book keeper in correcting payroll time cards. Health coverage will be addressed.

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MATERIAL NONCOMPLIANCE

2017-002 The Authority Should Comply With Bond Covenants

Condition: During our audit, we noted the following:

- Revenue Fund has not been established.
- The Sinking Fund is not invested in Certificates of Time Deposit or a savings account.
- Debt Reserve Fund has not been established. The required amount at June 30, 2017 is \$60,120.
- An annual audit was not mailed to Rural Development within 90 days of the end of the fiscal year.
- The Construction account was not invested in Certificates of Time Deposit or a savings account.
- Construction Fund was not closed and funds transferred to the Sinking Fund to pay debt.
- Wire transfers in the amount of \$36,500 were made from the Construction Fund to the General Fund and Payroll account.

Criteria: Pursuant to the bond documents:

- A separate account shall be established as a Revenue Fund. All revenues should be deposited here and then transferred to other accounts.
- All monies in the Sinking Fund shall be invested in Certificates of Time Deposit or savings accounts.
- There should be at least \$1,670 each month transferred from the Revenue Fund to the Debt Reserve Fund until there is accumulated a sum of at least \$200,400 to be maintained as long as any of the current bonds are outstanding and unpaid.
- An annual audit shall be made of the books and accounts no later than ninety (90) days after the close of each fiscal year, copies shall be promptly mailed to the RD without request.
- All deposits in the Construction account shall be invested for the benefit of such Construction account in Certificates of Deposit or savings account.
- Per the Bond document,

Article 3 Construction Account: Interim Financing; Application of Proceeds; Arbitrage Limitations

Section 301. Construction Account; Application of Proceeds of Bonds; Other Transfers and Deposits

B. Application of Proceeds of Current Bonds

(7) Disposition of Balance in Construction Account After Completion of Project.

“When the project has been completed and all construction costs have been paid in full, as certified by the Engineers for the Authority and/or by Rural Development (RD), any balance then remaining in the Construction Account may, with the consent of RD, be applied to the cost of constructing additional improvements to the System (the “Additional Construction”). If such Additional Construction is to be undertaken by the Contractors previously engaged in the Project, such Additional Construction may be authorized by a change order.

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If there is a balance remaining in the Construction Account after such Additional Construction, such balance (subject to legal requirements as to possible refund of any allocated portion of the balance derived from Grant Proceeds) shall be transferred to the Sinking Fund, whereupon said Construction Account shall be closed. Such remaining balance in the Construction Account so transferred to the Sinking fund shall be used by the Authority immediately to prepay principal installments due on the Current bonds in the inverse order of maturities without prepayment penalty, provided further that any balance insufficient to prepay at least \$100 of the principal payment falling due in any year on the Bonds will be transferred to the Debt Reserve Fund.”

- Money can only be expended from the Construction account with written consent from Rural Development as long as any outstanding bonds are owned by Rural Development, and then, only by checks signed by the Chairman and Treasurer.

Effect: The Authority may not be in compliance with bond requirements.

Cause: Lack of knowledge of bond requirements.

Recommendation: We recommend the Authority familiarize themselves with all bond covenants and comply with the bond requirements.

We also recommend that based on Article 3 Section B(7) of the bond documents, the Authority determine if any of the remaining construction funds should be returned to granting agencies or the entire balance be used to prepay the principle on the bonds. If the remaining construction funds are used to prepay bonds, this would be in addition to the regularly scheduled payment.

The Authority's Response: Have a call into [KRADD Representative] who was manager of construction project. Once construction was completed in October 2013 and in a meeting with board & [Rural Development Area Specialist] it was agreed the Authority could keep excess grant money for equipment & etc. I will work on getting letter from [Rural Development Area Specialist].