

**RURAL WATER DISTRICT #2, INC.
LINN COUNTY, KANSAS**

Regulatory Basis Financial Statement,
Independent Auditors' Report,
Regulatory-Required Supplementary Information,
and Client Requested Supplementary Information
For the Year Ended December 31, 2014

**RURAL WATER DISTRICT #2, INC.
LINN COUNTY, KANSAS**

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Diehl
Banwart
Bolton

Certified Public Accountants PA

INDEPENDENT AUDITORS' REPORT

Board of Directors and management
Rural Water District #2, Inc.
Linn County, Kansas

We have audited the accompanying summary statement of receipts, expenditures, and unencumbered cash, regulatory basis of Rural Water District, #2, Inc., Linn County, Kansas, as of and for the year ended December 31, 2014 and the related notes to the financial statement.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the Kansas Municipal Audit and Accounting Guide as described in Note 1 to meet the financial reporting requirements of the State of Kansas; this includes determining that the regulatory basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the *Kansas Municipal Audit and Accounting Guide*. Those standards require we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, 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 statement 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 statement.

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

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1 of the financial statement, the financial statement is prepared by Rural Water District #2, Inc., Linn County, Kansas to meet the requirements of the State of Kansas on the basis of the financial reporting provisions of the Kansas Municipal Audit and Accounting Guide, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statement of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles" paragraph, the financial statement referred to above does not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Rural Water District #2, Inc., Linn County, Kansas as of December 31, 2014, or changes in financial position and cash flows thereof for the year then ended.

Unqualified Opinion on Regulatory Basis of Accounting

In our opinion, the financial statement referred to above presents fairly, in all material respects, the aggregate cash and unencumbered cash balance of Rural Water District #2, Inc., Linn County, Kansas as of December 31, 2014, and the aggregate receipts and expenditures for the year then ended in accordance with the financial reporting provisions of the Kansas Municipal Audit and Accounting Guide described in Note 1.

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the summary statement of receipts, expenditures, and unencumbered cash, regulatory basis (basic financial statement) as a whole. The schedule of receipts and expenditures-actual, regulatory basis (Schedule 1 as listed in the table of contents) is presented for analysis and is not a required part of the basic financial statement, however is required to be presented under the provisions of the Kansas Municipal Audit and Accounting Guide. The Client Requested Supplemental Information (Balance Sheet and Schedule of Net Income (Loss), as listed in the table of contents) is presented for analysis and is not a required part of the basic financial statement and is not required to be presented under the provisions of the Kansas Municipal Audit and Accounting Guide. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statement. The information has been subjected to the auditing procedures applied in the audit of the basic financial statement and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statement or to the basic financial statement itself, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statement as a whole, on the basis of accounting described in Note 1.

Diehl, Banwart, Bolton, CPAs, PA
DIEHL, BANWART, BOLTON, CPAs, PA

February 7, 2015
Fort Scott, Kansas

**RURAL WATER DISTRICT #2, INC.
LINN COUNTY, KANSAS**

Notes to Financial Statement
For the Year Ended December 31, 2014

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statement of the Rural Water District #2, Inc., Linn County, Kansas, has been prepared in order to show compliance with the cash basis and budget laws of the State of Kansas. The Kansas Municipal Audit and Accounting Guide (KMMAG), as approved by the director of the Kansas Division of Accounts and Reports, establishes the guidelines for the regulatory basis of accounting in the state of Kansas. The more significant of the District's accounting policies follow.

Nature of Organization: The Rural Water District #2, Inc., Linn County, Kansas, is located in the eastern part of Linn County, Kansas. The District is a municipal corporation governed by an elected seven-member council. The District purchases treated water from the City of Pleasanton, Kansas and Public Wholesale Water Supply District #13 (PWWSO #13) and sells the water to over 800 rural customers. To continue serving its patrons, the District is dependent upon the City of Pleasanton and PWWSO #13 to provide adequate, reasonably priced water.

Reporting Entity

This financial statement presents the Rural Water District #2, Inc., Linn County, Kansas, (primary government). There are no related municipal entities which should be accounted for in the District's financial statement.

Basis of Presentation - Fund Accounting

A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restriction, or limitations.

The following types of funds comprise the financial activities of the Rural Water District #2, Inc., Linn County, Kansas:

Business fund: funds financed in whole or part by fees charged to users of the goods or services (i.e. enterprise and internal service fund, etc.)

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Regulatory Basis of Accounting and Departures from Accounting Principles Generally Accepted in the United States of America

The KMAAG regulatory basis of accounting involves the recognition of cash, cash equivalents, marketable investments, and certain accounts payable and encumbrance obligations to arrive at a net unencumbered cash and investments balance on a regulatory basis for each fund, and the reporting of changes in unencumbered cash and investments of a fund resulting from the difference in regulatory basis receipts and regulatory basis expenditures for the fiscal year. All recognized assets and liabilities are measured and reported at cost, unless they have been permanently impaired and have no future cash value or represent no future obligation against cash. The KMAAG regulatory basis does not recognize capital assets, long-term debt, accrued receivables and payables, or any other assets, liabilities or deferred inflows or outflows, other than those mentioned above.

The District has approved a resolution that is in compliance with K.S.A. 75-1120a(c), waiving the requirement for application of generally accepted accounting principles and allowing the District to use the regulatory basis of accounting.

Budgetary Information

Kansas statutes do not require budgets for rural water districts.

Deposits and Investments

Deposits and investments include a money market checking account and certificates of deposit. Kansas statutes permit investment in checking accounts, savings accounts, certificates of deposit, and, in certain cases, obligations of the U.S. Treasury.

Compensated Absences

The District does not provide sick or vacation benefits beyond the year earned, but pays employees for unused vacation days before year end.

Income Taxes: Rural Water District #2, Inc., of Linn County, Kansas, is recognized by the Internal Revenue Service as a not-for-profit municipality corporation, and is exempt from Federal and State income taxes. Accordingly, this financial statement does not include a provision for income taxes.

Termination and Post Employment Benefits

The District does not offer termination or post employment benefits.

2. **STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

Compliance with Kansas Statutes

This financial statement has been prepared in order to show compliance with the cash basis laws and Statutes of the State of Kansas. The District was in apparent compliance with the cash basis laws and Statutes of the State of Kansas.

3. DEPOSITS AND INVESTMENTS

K.S.A. 9-1401 establishes the depositories which may be used by the District. The statute requires banks eligible to hold the District's funds have a main or branch bank in the county in which the District is located, or in an adjoining county if such institution has been designated as an official depository, and the banks provide an acceptable rate of return on funds. In addition, K.S.A. 9-1402 requires the banks to pledge securities for deposits in excess of FDIC coverage. The District has no other policies that would further limit interest rate risk.

K.S.A. 12-1675 limits the District's investment of idle funds to time deposits, open accounts, and certificates of deposit with allowable financial institutions; U.S. government securities; temporary notes; no-fund warrants; repurchase agreements; and the Kansas Municipal Investment Pool. The District has no investment policy that would further limit its investment choices, but has limited the investments to time deposits at the local bank.

Concentration of credit risk. State statutes place no limit on the amount the District may invest in any one issuer as long as the investments are adequately secured under K.S.A. 9-1402 and 9-1405.

Custodial credit risk – deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. State statutes require the District's deposits in financial institutions to be entirely covered by federal depository insurance or by collateral held under a joint custody receipt issued by a bank within the State of Kansas, the Federal Reserve Bank of Kansas City, or the Federal Home Loan Bank of Topeka, except during designated "peak periods" when required coverage is 50%. The District does not have any "peak periods" designated. All deposits were legally secured at December 31, 2014.

At December 31, 2014, the District's carrying amount of deposits was \$276,847.45 and the bank balance was \$279,749.47. The bank balance was held by two banks resulting in a concentration of credit risk. All of the bank balance was covered by federal depository insurance. At year end the District did not have any securities held by the pledging financial institutions' agents in the District's name.

4. BENEFIT UNIT DEPOSITS

Customers of the District are required to pay a deposit for a benefit unit prior to connecting to a rural water line. Six new benefit units were added during the year totaling \$25,000.

5. RISK MANAGEMENT

The water district is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; employees' health and life; and natural disasters. The water district manages these risks of loss through various insurance policies. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years.

6. FIXED ASSETS

As discussed in Note 1, regulatory basis financial statements do not record property, plant and equipment as assets of the District. In addition, depreciation expense in the assets is not recorded. However, the District does keep track of fixed assets and the depreciation thereon for internal monitoring.

In connection with Fixed Asset accounting, plant and equipment are capitalized at cost and are depreciated on the straight-line method over the estimated useful life of the assets as follows:

Office Equipment and Automobiles	5 Years
Machinery	7 Years
Plant and Equipment	15 to 50 Years

Maintenance and repairs are charged to expense as incurred. Major renewals and improvements are capitalized.

Fixed assets and accumulated depreciation changed for the year as follows:

Fixed Asset	Beginning Balance	Additions	Deletion	Ending Balance
Materials & Construction	\$ 2,603,471.54	\$ 65,495.60	\$ -	\$ 2,668,967.14
Office Building	79,917.80	-	-	79,917.80
Plant Equipment	74,029.77	-	-	74,029.77
Engineering Fees	131,512.55	-	-	131,512.55
Inspection Fees	33,637.09	-	-	33,637.09
Easements	7,020.05	-	-	7,020.05
Automobile	17,920.00	-	-	17,920.00
Office Equipment	14,156.59	-	-	14,156.59
Legal & Title	30,820.50	-	-	30,820.50
	<u>\$ 2,992,485.89</u>	<u>\$ 65,495.60</u>	<u>\$ -</u>	<u>\$ 3,057,981.49</u>
Accumulated Depreciation	<u>\$ (1,717,173.27)</u>	<u>\$ (68,205.37)</u>	<u>\$ -</u>	<u>\$ (1,785,378.64)</u>

7. ECONOMIC DEPENDENCY

The District purchases water for resale from the City of Pleasanton, Kansas and PWWSD #13. Water purchased for the year was as follows:

	<u>2014</u>
City of Pleasanton	\$ 40.97
PWWSD #13	<u>379,674.32</u>
	<u>\$ 379,715.29</u>

8. LONG-TERM OBLIGATIONS

The District entered into a 40 year water purchase contract with the City of Pleasanton, Kansas on May 28, 1980. The District is obligated to purchase \$30,000 from the City of Pleasanton, Kansas each year. On January 17, 2014, the District reached a settlement with the City of Pleasanton, Kansas through mediation resulting in the City being allowed to provide water service to an area that was previously in the District's service area and the District paying the City a one time payment of \$30,000 in exchange for the City releasing the District from its water purchase contract.

The District entered into a 40 year water purchase contract with PWWSD #13 on July 19, 2005. The District is obligated to purchase at least 69.6 million gallons of water from PWWSD #13 each year.

9. RETIREMENT PLAN

The District matches 50 percent of employees' contributions, up to three percent of the employees' salary, to employees' individual retirement accounts (IRA) with Oppenheimer Financial. The Plan covers full and part time employees who open an IRA with Oppenheimer Financial. The District's contributions for 2014 totaled \$1,987.06.

10. SUBSEQUENT EVENTS

Management has evaluated events and transactions occurring subsequent to December 31, 2014 through February 7, 2015, the date the financial statements were available to be issued. During this period, there were no subsequent events requiring recognition in the financial statement or disclosure in the notes to the financial statement, except that on December 27, 2013, the District filed suit in Linn County District Court against PWWSD #13 relating to the District's water supply purchase contract with PWWSD #13. The lawsuit relates to interpretation of the contract and asks the Court to determine that under the provisions of the contract, PWWSD #13 owes the District \$122,373.62, in the form of credits against the District's future water bills for water paid for but not used (overage) for the year 2012. It is PWWSD #13's position that the District is only owed \$3,630.55 for that overage. The lawsuit also requests the Court to determine that its "Tier Two" pricing policy violates the terms of the contract by not treating every member of PWWSD #13, as of the time of its water facilities construction, equally. PWWSD #13's disagrees with the District's interpretation of the contract on both counts. The District intends to vigorously pursue this litigation, and feels there is a fair likelihood of a favorable outcome. The suit only seeks to gain payment from PWWSD #13 and no actual loss in the form of additional monies being paid to PWWSD #13 by the District is anticipated.

**REGULATORY-REQUIRED
SUPPLEMENTARY INFORMATION**

RURAL WATER DISTRICT #2, INC.
LINN COUNTY, KANSAS
WATER UTILITY FUND

Schedule of Regulatory Basis Receipts and Expenditures - Actual
For the Year Ended December 31, 2014

Cash Receipts	<u>Actual</u>
Operating Receipts	
Metered water sales	\$ 598,014.20
Penalties	8,859.51
Nonoperating Receipts	
Interest income	1,130.23
Miscellaneous income	9,866.85
Benefit Unit deposits	25,000.00
KDOT reimbursements	49,287.07
Total Cash Receipts	<u>692,157.86</u>
Expenditures	
Operating Expenditures	
Water Purchased	379,715.29
Repairs and maintenance	1,306.99
Contract labor	8,586.09
Operating supplies	47,329.55
Utilities and telephone	6,607.59
Office supplies	4,220.45
Insurance	8,174.80
Salaries	67,711.62
Payroll taxes	6,898.75
Employee benefits	4,681.97
Dues and subscriptions	626.90
Legal and accounting	16,159.13
Professional fees	32,639.38
Water testing	872.01
Mileage and travel	10,519.07
Postage	5,292.13
Sugar Valley line extension project	3,839.08
Miscellaneous expense	8,233.97
Nonoperating Expenditures	
Capital Outlay additions	65,495.60
Capital Outlay deletions	-
KDOT Projects	49,287.07
City of Pleasanton Settlement	30,000.00
Total Expenditures	<u>758,197.44</u>
Receipts Over (Under) Expenditures	(66,039.58)
Unencumbered Cash, Beginning	<u>260,421.63</u>
Unencumbered Cash, Ending	<u>\$ 194,382.05</u>

**CLIENT REQUESTED
SUPPLEMENTARY INFORMATION**

RURAL WATER DISTRICT #2, INC.
LINN COUNTY, KANSAS
WATER UTILITY FUND

Balance Sheets
December 31, 2013 and 2014

ASSETS	2013	2014
Current Assets		
Cash in Bank - Operating	\$ 96,224.49	\$ 144,900.48
Total Cash and Cash Equivalentas	96,224.49	144,900.48
CD - Operating	205,017.08	131,946.97
Prepaid Expenses	5,552.67	-
Total Current Assets	<u>306,794.24</u>	<u>276,847.45</u>
Property, Plant, and Equipment		
Materials and Construction	2,603,471.54	2,668,967.14
Engineering Fees	131,512.55	131,512.55
Legal and Title Work	30,820.50	30,820.50
Inspection Fees	33,637.09	33,637.09
Easements and Leases	7,020.05	7,020.05
Plant Equipment	74,029.77	74,029.77
Office Equipment	14,156.59	14,156.59
Automobile	17,920.00	17,920.00
Office Building	79,917.80	79,917.80
	<u>2,992,485.89</u>	<u>3,057,981.49</u>
Less: Accumulated Depreciation	(1,717,173.27)	(1,785,378.64)
Net Property, Plant, and Equipment	<u>1,275,312.62</u>	<u>1,272,602.85</u>
Other Assets		
Meter Deposits	90.00	-
Total Other Assets	<u>90.00</u>	<u>-</u>
 TOTAL ASSETS	 <u>\$ 1,582,196.86</u>	 <u>\$ 1,549,450.30</u>
 LIABILITIES AND EQUITY		
Current Liabilities		
Accounts Payable	\$ 40,819.94	\$ 82,465.40
Total Current Liabilities	<u>40,819.94</u>	<u>82,465.40</u>
Equity		
Contributed Equity		
Benefit Unit Deposits	881,325.00	906,325.00
U.S. Treasury Grants	461,687.59	461,687.59
State of Kansas Grants	521,467.19	521,467.19
Total Contributed Equity	<u>1,864,479.78</u>	<u>1,889,479.78</u>
Retained Earnings (Deficit)	(323,102.86)	(422,494.88)
Total Equity	<u>1,541,376.92</u>	<u>1,466,984.90</u>
 TOTAL LIABILITIES AND EQUITY	 <u>\$ 1,582,196.86</u>	 <u>\$ 1,549,450.30</u>

RURAL WATER DISTRICT #2, INC.
LINN COUNTY, KANSAS
WATER UTILITY FUND
Schedule of Net Income (Loss)
For the Years Ended December 31, 2012 and 2013

	2013	2014
	<u>Actual</u>	<u>Actual</u>
Cash Receipts		
Operating Receipts		
Metered water sales	\$ 579,569.84	\$ 598,014.20
Penalties	9,531.69	8,859.51
Total Operating Cash Receipts	<u>589,101.53</u>	<u>606,873.71</u>
Operating Expenditures		
Water Purchased	439,216.82	379,715.29
Repairs and maintenance	3,602.98	1,306.99
Contract labor	17,327.50	8,586.09
Operating supplies	26,906.41	47,329.55
Utilities and telephone	5,835.15	6,607.59
Office supplies	5,856.74	4,220.45
Insurance	13,731.81	8,174.80
Salaries	62,690.26	67,711.62
Payroll taxes	4,871.88	6,898.75
Legal and accounting	6,748.00	16,159.13
Mileage and travel	5,825.80	10,519.07
Postage	4,372.72	5,292.13
Sugar Valley line extension project	8,549.00	3,839.08
Miscellaneous expense	44,690.30	47,054.23
Total Expenditures	<u>650,225.37</u>	<u>613,414.77</u>
Operating Receipts Over (Under) Expenditures	<u>(61,123.84)</u>	<u>(6,541.06)</u>
Nonoperating Receipts (Expenses)		
Interest income	1,288.62	1,130.23
Miscellaneous income	4,622.29	9,866.85
Benefit Unit deposits	31,000.00	25,000.00
Capital Outlay additions	(3,837.54)	(65,495.60)
Capital Outlay deletions	10,119.15	-
KDOT Projects reimbursements	-	49,287.07
KDOT Projects	-	(49,287.07)
City of Pleasanton settlement	-	(30,000.00)
Total Nonoperating Receipts (Expenses)	<u>43,192.52</u>	<u>(59,498.52)</u>
Total Receipts Over (Under) Expenses	(17,931.32)	(66,039.58)
Unencumbered Cash, Beginning	278,352.95	260,421.63
Unencumbered Cash, Ending	<u>\$ 260,421.63</u>	<u>\$ 194,382.05</u>
Total Receipts Over (Under) Expenses	\$ (17,931.32)	\$ (66,039.58)
Non Operating Expenses:		
Add back Capital Outlay Additions	3,837.54	65,495.60
Less Capital Outlay Deletions	(10,119.15)	-
Less Estimated Depreciation Expense	(67,380.92)	(68,205.37)
Net Income (Loss)	<u>\$ (91,593.85)</u>	<u>\$ (68,749.35)</u>