

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
FINANCIAL STATEMENTS
December 31, 2014 and 2013
With Independent Auditor's Report

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KIRKPATRICK, SPRECKER & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Sedgwick County Rural Water District No. 2

We have audited the accompanying financial statements of Sedgwick County Rural Water District No. 2, which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of operations, changes in fund equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit and Accounting Guide. Those standards require that we plan and perform the audits 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 Sedgwick County Rural Water District No. 2 as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Kirkpatrick, Sprecker & Company, LLP

KIRKPATRICK, SPRECKER & COMPANY, LLP
Wichita, Kansas

February 18, 2015

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
COMPARATIVE BALANCE SHEETS
December 31, 2014 and 2013

ASSETS

	<u>2014</u>	<u>2013</u>
Cash and cash equivalents	\$ 573,591	\$ 532,607
Accounts receivable - customers	56,794	52,263
Prepaid insurance	3,013	2,894
Deposits	100	100
Property and equipment at cost		
Water system and line	2,738,099	2,621,520
Office equipment	10,182	10,182
Construction in progress	<u>67,360</u>	<u>47,265</u>
	2,815,641	2,678,967
Less - accumulated depreciation	<u>1,100,198</u>	<u>997,411</u>
Property and equipment - net of depreciation	<u>1,715,443</u>	<u>1,681,556</u>
Unamortized loan cost	15,044	15,866
Loan reserve account	<u>141,131</u>	<u>124,397</u>
Total assets	<u><u>2,505,116</u></u>	<u><u>2,409,683</u></u>

LIABILITIES AND FUND EQUITY

Accounts payable	\$ 24,364	\$ 18,713
Accrued interest payable	15,138	14,644
Other accrued expenses	912	916
Unearned revenue	86,550	72,800
Notes payable	<u>1,148,761</u>	<u>1,077,756</u>
Total liabilities	<u>1,275,725</u>	<u>1,184,829</u>
Fund equity		
Reserved for note requirements	145,211	128,477
Unreserved	<u>1,084,180</u>	<u>1,096,377</u>
Total fund equity	<u>1,229,391</u>	<u>1,224,854</u>
Total liabilities and fund equity	<u><u>2,505,116</u></u>	<u><u>2,409,683</u></u>

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

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
COMPARATIVE STATEMENTS OF CHANGES IN FUND EQUITY
For the Years Ended December 31, 2014 and 2013

	<u>Unreserved</u>	<u>Berkadia Note Reserves</u>	<u>KDHE Note Reserves</u>	<u>Total Note Reserves</u>	<u>Combined Totals</u>
Fund equity at December 31, 2012	\$ 1,072,845	\$ 14,422	\$ 116,490	\$ 130,912	\$ 1,203,757
Net income for 2013	21,097	-	-	-	21,097
Releases	10,342	(10,342)	-	(10,342)	-
Transfers- reserve requirement	<u>(7,907)</u>	<u>-</u>	<u>7,907</u>	<u>7,907</u>	<u>-</u>
Fund equity at December 31, 2013	1,096,377	4,080	124,397	128,477	1,224,854
Net income for 2014	4,537	-	-	-	4,537
Transfers- reserve requirement	<u>(16,734)</u>	<u>-</u>	<u>16,734</u>	<u>16,734</u>	<u>-</u>
Fund equity at December 31, 2014	<u><u>1,084,180</u></u>	<u><u>4,080</u></u>	<u><u>141,131</u></u>	<u><u>145,211</u></u>	<u><u>1,229,391</u></u>

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

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
COMPARATIVE STATEMENTS OF OPERATIONS
For the Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenue		
Sale of water	\$ 441,878	\$ 421,859
Benefit unit sales	13,686	13,924
Hook-up and franchise fees	21,818	24,389
Total operating revenue	<u>477,382</u>	<u>460,172</u>
 Operating expenses		
Water purchases	212,493	169,789
Depreciation	102,787	81,162
Repairs and maintenance	59,181	44,974
Wages	37,425	37,433
Utilities	18,223	15,633
Professional fees	12,799	14,714
Miscellaneous expense	6,483	10,867
Operator fees	9,600	9,600
Rent	5,752	5,752
Insurance	4,622	4,491
Office supplies	5,681	3,940
Payroll taxes	3,320	3,184
Meeting expense	2,873	2,357
Clean drinking water fee	1,361	2,276
Dues and fees	2,889	2,082
Total operating expenses	<u>485,489</u>	<u>408,254</u>
 Earnings (loss) from operations before other income and expenses	<u>(8,107)</u>	<u>51,918</u>
 Other income (expense)		
Interest earned	283	302
Interest expense	(33,532)	(30,456)
Amortization of loan costs	(821)	(667)
Other income	46,714	-
Total other income (expense)	<u>12,644</u>	<u>(30,821)</u>
 Net income	<u>4,537</u>	<u>21,097</u>

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

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
COMPARATIVE STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities		
Net income	\$ 4,537	\$ 21,097
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	102,787	81,162
Amortization of loan costs	821	667
(Increase) decrease in accounts receivable	(4,530)	9,351
(Increase) decrease in other assets	(119)	4
Increase (decrease) in accounts payable and other accrued expenses	6,141	(31)
Increase (decrease) in unearned revenue	13,750	(2,750)
Income from forgiveness of long-term debt	<u>(45,510)</u>	<u>-</u>
Net cash provided by operating activities	<u>77,877</u>	<u>109,500</u>
 Cash flows from investing activities		
Purchase of property assets	<u>(136,674)</u>	<u>(135,536)</u>
Net cash applied to investing activities	<u>(136,674)</u>	<u>(135,536)</u>
 Cash flows from financing activities		
Proceeds from long-term debt	152,443	71,165
Payment of long-term debt	<u>(52,662)</u>	<u>(49,225)</u>
Net cash provided by financing activities	<u>99,781</u>	<u>21,940</u>
 Net decrease in cash	40,984	(4,096)
 Cash at beginning of year	<u>532,607</u>	<u>536,703</u>
 Cash at end of year	<u>573,591</u>	<u>532,607</u>
 <u>Supplemental Disclosure of Cash Flow Information</u>		
Cash paid during the year for interest	33,038	31,067

Schedule of Noncash Investing and Financing Activities

During the year ended December 31, 2014, the District made deposits to a loan reserve with a deposit of \$16,734 from proceeds of the note payable to KDHE.

During the year ended December 31, 2013, the District made deposits to a loan reserve with a deposit of \$7,907 from proceeds of the note payable to KDHE.

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

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

1. Summary of significant accounting policies

Description of operations

The District provides water to farms and rural residents of Sedgwick County within the District. The District extends credit to customers, substantially all of whom are local residents. There were 512 customers receiving services from the District at December 31, 2014 and 2013. The District purchases its water from the City of Valley Center, Kansas.

Basis of reporting

The Water District has established a system of accounting to reflect compliance with the applicable laws of the State of Kansas. The accounts used are accounted for as an enterprise fund since it is the stated intent that costs of providing water service to benefit units on a continuing basis be financed or recovered primarily through user charges. The accrual basis of accounting is used.

U.S. generally accepted accounting principles for governmental units require that *Management's Discussion and Analysis* introduce the basic financial statements and provide management's analytical overview of the District's financial activities. These financial statements are not accompanied by *Management's Discussion & Analysis*.

Use of estimates

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

Tax returns

The District is a Kansas Municipality and is not required to file Federal or State income tax returns.

Accounts receivable

Accounts receivable arise from water sales and are stated at the unpaid balance. Accounts are due fifteen days following the billing. Late fees of ten percent of the outstanding balance are added to the account after the fifteenth day. The District considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made.

Depreciation

The cost of the water system is depreciated on the straight-line method over estimated useful lives ranging from ten to forty years. The costs of other property assets are depreciated on the straight-line method over their respective estimated useful lives ranging from five to ten years.

Amortization

Issuance costs of the Kansas Department of Health and Environment (KDHE) loans are amortized using the straight-line method over the repayment terms of the loans.

Cash and cash equivalents

For purposes of the statement of cash flows, cash includes cash accounts in the bank and certificates of deposit. Cash equivalents include highly liquid debt instruments purchased with maturity of three months or less, and certificates of deposit with a local bank.

Benefit units

Benefit units are rights that entitle the unit holder to water service. Proceeds received from the sale of benefit units are not recognized as revenue until the benefit unit is receiving services from the District.

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

2. Cash and cash equivalents

The following is a summary of cash accounts at December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Petty cash	\$ 100	\$ 100
Checking accounts at bank	340,209	313,125
Savings account at bank	86,754	72,932
Certificate of deposit accounts at bank	<u>146,528</u>	<u>146,450</u>
Total cash	<u><u>573,591</u></u>	<u><u>532,607</u></u>

3. Notes payable

Notes payable consist of the following at December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Note payable to the State, secured by property assets, due in semi-annual installments of \$36,541, including interest at 3.51%	\$ 824,963	\$ 867,954
Note payable to the State, secured by property assets, due in semi-annual installments of \$19,858, including interest at 2.29%	310,922	193,593
Mortgage payable to a commercial mortgage company, secured by property assets, due in annual installments of \$4,114, including interest at 5%	<u>12,876</u>	<u>16,209</u>
	<u><u>1,148,761</u></u>	<u><u>1,077,756</u></u>

The following is an analysis of scheduled maturities of notes payable for years ending December 31:

2015	\$ 60,825
2016	62,871
2017	64,988
2018	64,969
2019	65,194
Thereafter	<u>829,914</u>
	<u><u>1,148,761</u></u>

Under the terms of the debt agreements with the commercial mortgage company the District is required to establish a reserve account. The reserve account will be used only for the purpose of paying the cost of repairing and replacing any damage to the system which may be caused by any unforeseen catastrophe, for making extension or improvements to the system and when necessary, for the purpose of making payments of principal and interest on the notes in the event the amount in the debt service account is insufficient to meet such payments. During the year ended December 31, 2013, the District paid off one of the loans, which required a reserve amount of \$10,342, and these funds were released. As of December 31, 2014 and 2013, the balance of the reserve account was \$4,080.

(continued)

SEDGWICK COUNTY RURAL WATER DISTRICT NO. 2
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

3. Notes payable (continued)

The District entered into an additional loan agreement with the State during the year ended December 31, 2012. Proceeds from this loan were used to fund the 85th street and radio read projects. The total amount borrowed was \$360,936, of which \$45,510 was forgiven by the State.

The loan agreements with the State includes certain restrictive covenants, including a debt service coverage ratio. The District was in compliance with the debt service coverage ratio as of December 31, 2014, and December 31, 2013.

As part of the loan agreements with the State, reserve accounts have been established with the State and funded with proceeds from the loans. The reserve accounts will be used to prevent default on the loan in the event the District is unable to make scheduled payments on the loans. The balance of these funds shall not be less than 10% of the original loan amounts. The reserve funds have been invested by the State with the earnings to be applied to future loan repayments made by the District. As of December 31, 2014 and 2013, the balance of the reserve account was \$141,131 and \$124,379, respectively.

4. Operating lease obligations

The following is a schedule by years of future minimum rental payments required under an operating lease for the District office with noncancellable terms as of December 31, 2014:

2015	\$ <u>5,400</u>
Total	5,400

Total rental expense under all operating leases was \$5,752 for the years ended December 31, 2014 and 2013.

5. Related parties

All board members of the District are also benefit unit owners and customers, as required under the District's by-laws.

The District has contracted a local company to maintain and make repairs, including materials, to the District's distribution system. The owner of the company is the husband of the general manager of the District. Members of the Board review payments to the company. The District paid the company \$68,834 and \$49,886 for the years ended December 31, 2014 and 2013, respectively.

6. Concentrations and risks

The District purchases all of its water from the City of Valley Center, Kansas. In addition, the District is subject to annexation in part or in whole by other municipalities.

7. Subsequent events

The District has evaluated subsequent events through February 18, 2015, the date which the financial statements were available to be issued, and except for the above, none requiring disclosure were identified.

