

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS**

**FINANCIAL STATEMENTS WITH  
INDEPENDENT AUDITORS' REPORT**

For the year ended October 31, 2014

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Mitchell County Rural Water District No. 3  
Beloit, Kansas

We have audited the accompanying financial statements of the business-type activities of Mitchell County Rural Water District No. 3, as of and for the year ended October 31, 2014, 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.

### 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 Kansas Municipal Audit and Accounting Guide. 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 opinions.

### Basis for Qualified Opinion

Accounting principles generally accepted in the United State of America require that inventory should be recorded at cost which includes recording the direct cost of purchasing the inventory as well as subtracting the inventory at cost as it is utilized under a methodology adopted by the District and consistently applied.

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Inventory purchased and utilized is not recorded on the Statement of Net Position until the year-end inventory count. In addition, during the current year inventory count, it was determined that not all items were counted or priced correctly in the prior year, and thus, the amount by which this departure would affect the assets, net position, and changes in net position is not reasonably determinable.

### **Qualified Opinion**

In our opinion, except for the possible effects of the matters described in the 'Basis for Qualified Opinion' paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Mitchell County Rural Water District No. 3, as of October 31, 2014, and the changes in financial position for the year then ended in accordance 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 and 4 and budgetary comparison information on page 14 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.

*Pottberg, Gassman & Hoffman, Chartered.*

Pottberg, Gassman, & Hoffman, Chartered  
Manhattan, Kansas  
January 28, 2015

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS  
OCTOBER 31, 2014**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

This section of the Mitchell County Rural Water District No. 3 annual financial report presents an analysis of the District's financial performance during the year ended October 31, 2014. The District's financial performance is discussed and analyzed within the context of the accompanying annual audited financial statements and disclosures following this section.

**Financial Statements**

The attached financial statements present the assets and liabilities, revenues and expenses and changes in net position of the District on the accrual basis of accounting. The statement of net position provides information on all of the District's assets and liabilities, with the difference between the components presented as net position. Net position is reported as one of three categories: net investment in capital assets, restricted, and unrestricted. Over time, increases or decreases in net position may serve as useful indicators of whether the District's financial position is improving or deteriorating.

The statement of activities and changes in net position present information showing how the net position of the District changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., retirement plan payable). The statement of cash flows reverses the accruals to show the effect of the annual transactions on the available cash balance.

**Financial Highlights**

The District's total assets increased \$5,995 from October 31, 2013 to 2014.

The decrease in capital assets of \$43,809 from October 31, 2013 to 2014 is the net effect of additions of \$32,204 for a purchase of land, \$19,556 for a mower and Automatic Meter Reading Units, \$7,500 for a vehicle, \$4,120 for office equipment and an increase in accumulated depreciation of \$107,189.

Total liabilities decreased \$271,463. The decrease is primarily related to the district making \$270,000 in payments on the Series F, 2003 Revenue Refunding Bonds.

Total Net Position increased \$287,806. Net Position restricted for the bond reserve increased \$33,850 to meet the bond reserve requirements, net position invested in capital assets increased \$226,191, and the unrestricted net assets increased \$27,765.

There was an increase in water revenues from October 31, 2013 to 2014 due to an increase in gallons sold. Total operating expenses remained relatively flat between October 31, 2013 and 2014 with only a decrease of \$1,742.

The District realized a gain from operations of \$243,907 after recognizing depreciation expense of \$107,209. In October 31, 2013, the District realized a gain from operations of \$191,678 after recognizing depreciation expense of \$105,694. Non-operating expenses increased \$12,465 from October 31, 2013 to 2014 primarily related to the purchase of GPS Maps in the amount of \$20,989 and a decrease in interest expense of \$6,963. Operating revenues decreased \$51,364 from October 31, 2013 to 2014 primarily related to decreases of \$26,568 in income from payment plans, \$9,233 in dividends, \$8,239 in miscellaneous income and reimbursements, \$4,210 in interest income, and \$2,264 in penalty revenue as customer accounts are becoming more current.

Total cash on hand at the end of the year was \$643,004, an increase of \$28,136 over the cash on hand at October 31, 2013. Ending net position - restated was \$1,950,736 and \$2,456,826 as of October 31, 2013 to 2014 respectively and the change in net position was \$294,523 and \$261,850 for the years then ended.

**Additional Information**

The drought conditions of the past few years have eased in 2014 but many of the cattlemen remain concerned about water availability and have continued with the plan of purchasing benefit units. As a result the district has added 5 new benefit units for watering cattle and reinstalled 1 meter in an existing pasture location. The district has also added 5 new benefit units to residential sites.

In 2014, the district continues to operate under new management and the office continues to operate from its location in Beloit. The district was able to pay an additional \$155,000 toward the 2003 Revenue Refunding Bond Series F.

The water sold in 2014 was 79,346,000 gallons, an increase of 3,270,148 gallons from 2013. The District has an Emergency Water Plan on file.

All substantial interest statements from board members were completed and returned to the district office.

This financial report is designed to provide a general overview of the District's finances and demonstrate the District's commitment to public accountability. If you have any questions about this report or would like to request additional information, contact the District office at 2031 N Independence, Beloit, KS 67420.

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3**  
**STATEMENT OF NET POSITION**  
**OCTOBER 31, 2014**

<b>ASSETS</b>	
Current Assets	
Cash and Cash Equivalents	
Petty Cash	\$ 250
SVB Checking	3,216
Savings - Farmway	10,972
SVB Savings	520,021
Certificate of Deposit - GSB	58,545
Certificate of Deposit - Farmway	50,000
Total Cash and Cash Equivalents	<u>643,004</u>
Accounts Receivable - Net	6,217
Inventory	63,650
Total Current Assets	<u>712,871</u>
Noncurrent Assets	
Capital Assets	
Water System and Equipment	4,091,761
Land	38,827
Vehicles	28,900
Accumulated Depreciation	<u>(2,762,515)</u>
Total Capital Assets	<u>1,396,973</u>
Other Assets	
Certificate of Deposit - TriCentury - Bond Reserve	89,258
Principal and Interest Reserve	89,133
Certificate of Deposit - GSB - Bond Reserve	111,800
Certificate of Deposit - TriCentury - Bond Reserve	27,528
Capital Credits - Rolling Hills	29,263
Total Other Assets	<u>346,982</u>
Total Noncurrent Assets	<u>1,743,955</u>
<b>TOTAL ASSETS</b>	<b><u>\$2,456,826</u></b>
<b>LIABILITIES, DEFERRED INFLOWS AND NET POSITION</b>	
Current Liabilities	
Accounts Payable	\$ 39,264
Accrued Interest Payable	2,314
Payroll Taxes Payable	2,178
Retirement Plan Payable	84
Security Deposits	400
Current Portion of Bond Payable	200,000
Total Current Liabilities	<u>244,240</u>
Noncurrent Liabilities	
Bond Payable	200,000
Less Current Portion	<u>(200,000)</u>
Total Noncurrent Liabilities	<u>-</u>
<b>Total Liabilities</b>	<b><u>244,240</u></b>
Net Position	
Invested in Capital Assets, Net of Related Debt	1,196,973
Restricted for Bond Reserve	161,500
Unrestricted	854,113
Total Net Position	<u>2,212,586</u>
<b>TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION</b>	<b><u>\$2,456,826</u></b>

The notes to the financial statements are an integral part of this statement.

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**  
**FOR THE YEAR ENDED OCTOBER 31, 2014**

<b>OPERATING REVENUES</b>	
Water Revenues - Members	\$ 421,531
Water Revenues - Commercial	132,329
City Surcharge	13,060
Monthly Minimum	239,785
City Minimums	21,012
<b>TOTAL OPERATING REVENUES</b>	<u>827,717</u>
<b>OPERATING EXPENSES</b>	
Payroll and Payroll Taxes	118,184
Automatic Meter Reading Fees	192
Board Expense	2,900
Chemicals / Propane	181
Contract Labor	29,346
Dues	576
Employee Benefits	16,500
Fuel / Diesel / Oil	8,186
Insurance	19,941
Legal and Audit	9,773
Locates and Fees	416
Materials and Supplies	24,441
Mileage	10,127
Miscellaneous	2,213
Office Expense	6,222
Rent	9,500
Repairs and Maintenance	4,451
Utilities and Phone	36,756
Vehicle Maintenance	1,694
Water Conference Expense	1,945
Water Fees and Taxes	3,579
Water Purchases	169,478
<b>TOTAL OPERATING EXPENSES</b>	<u>476,601</u>
<b>INCOME FROM OPERATIONS BEFORE DEPRECIATION</b>	<u>351,116</u>
Depreciation	(107,209)
<b>OPERATING INCOME (LOSS)</b>	<u>243,907</u>
<b>NON-OPERATING REVENUES AND EXPENSES</b>	
Dividends	2,905
Interest Income	6,052
Miscellaneous Income and Reimbursement	28,662
Penalty Revenue	6,095
Reconnect Fees	1,600
Bad Debt Expense	(7,834)
Purchase of GPS Maps	(20,989)
Interest Expense	(14,548)
<b>TOTAL NON-OPERATING REVENUES (EXPENSES)</b>	<u>1,943</u>
<b>INCOME (LOSS) BEFORE CONTRIBUTIONS</b>	<u>245,850</u>
Capital Contributions	16,000
<b>CHANGE IN NET POSITION</b>	<u>261,850</u>
<b>NET POSITION, BEGINNING - RESTATED (SEE NOTE 15)</b>	<u>1,950,736</u>
<b>NET POSITION, ENDING</b>	<u><u>\$2,212,586</u></u>

The notes to the financial statements are an integral part of this statement.



**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED OCTOBER 31, 2014**

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Cash Received from Customers	\$ 812,840
Cash Payments to Suppliers for Goods and Services	(296,637)
Cash Payments to Employees and Professional Contractors for Services	(183,854)
Net Cash Provided (Used) by Operating Activities	<u>332,349</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Acquisition and Construction of Capital Assets	(59,512)
Principal Paid on Bond	(270,000)
Interest Paid on Bonds and Notes	(14,976)
Capital Contributions	16,000
Purchase of GPS Maps	(20,989)
Other Capital Activities	33,146
Penalties and Finance Charges	9,312
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(307,019)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Investment Income	<u>2,806</u>
Net Cash Provided (Used) by Investing Activities	<u>2,806</u>
Net Increase (Decrease) in Cash and Cash Equivalents	28,136
Cash and Cash Equivalents at January 1	614,868
Cash and Cash Equivalents at December 31	<u>\$ 643,004</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>	
Income from Operations	\$ 243,907
Depreciation	107,209
Increase in Receivables	(3,140)
Decrease in Accounts Payable	(1,463)
Decrease in Accrued Interest	(428)
Decrease in Payroll Taxes Payable	(8)
Decrease in Inventory	2,455
Increase in Retirement Plan Payable	84
Decrease in Sales Tax Payable	(48)
Decrease in Long-Term Payment Plans	(26,568)
Decrease in Unearned Revenue	10,349
Net Cash Provided by Operating Activities	<u>\$ 332,349</u>

The notes to the financial statements are an integral part of this statement.

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS  
OCTOBER 31, 2014**

**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Organization Description

Mitchell County Rural Water District No. 3, Beloit, Kansas (District), was incorporated January 11, 1973 as a quasi-municipal Corporation under Kansas Statute K.S.A. 82a-612 et seq., for the purpose of providing a water supply system for the landowners within the area of the District. The following is a summary of the District's significant accounting policies.

Basis of Accounting

The water district is a governmental organization operated as a business type entity. The District's financial information is reported on the accrual basis of accounting, in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

Operating revenues are those that are generated from primary operations. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations. All other expenses are reported as non-operating expenses, such as reimbursements for joining the water district.

Statement of Cash Flows

For purposes of the statement of cash flows, the District considers all bank deposit accounts, money market accounts and certificates of deposit classified as current assets to be cash and cash equivalents. Certificates of deposit with maturities of longer than three months can still be used by the District to meet current liabilities if they wish to pay any applicable penalties.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results could differ from those estimates.

Accounts Receivable

Accounts receivable are customer water bills that have been invoiced but remain unpaid. All receivables are current and therefore due within one year. Receivables are reported net of an allowance for uncollectible accounts. The District provides an allowance for doubtful accounts based upon review of outstanding receivables, historical collection information and existing economic conditions. The allowance for uncollectible accounts netted with accounts receivable was \$6,217 for the year ended October 31, 2014.

Capital Assets

Capital assets purchased for \$500 or more are capitalized at cost. Depreciation is recorded based on the estimated useful life of each asset using the straight-line method. The estimated useful lives of the assets range from 5 to 50 years.

Inventory

Inventory is stated at cost and consists of pipe, valves, meters, and other items needed to repair or add water lines.

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3**  
**BELOIT, KANSAS**  
**OCTOBER 31, 2014**

**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

Noncurrent Assets

Noncurrent assets primarily include capital assets and reserves for the bond. The amounts placed in the reserve often exceed the amount legally required to be restricted as they include interest earned and other monies designated by the board to be set aside to meet future obligations.

Accounts Payable

Accounts payable consist of invoices received from vendors for services or products received during the period but not yet paid.

Taxes

The District is exempt from federal and state income taxes.

**NOTE 2 – DEPOSITORY SECURITY**

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.

*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 has no designated "peak periods."

At October 31, 2014 the District's carrying amount of deposits was \$960,723 and the bank balance was \$960,009. Balances at one bank exceeded the Federal Depository Insurance Corporation (FDIC) limit and those balances in excess of FDIC limits were more than 5% of the total bank balances, which results in a concentration of credit risk per GASBS 40, paragraph 11. Of the bank balance, \$686,037 was covered by federal depository insurance and \$273,972 was collateralized with securities held by the pledging financial institutions' agents in the District's name.

The following is a comparison of depository security with balances on deposit with the District's designated depositories at October 31, 2014:

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS  
OCTOBER 31, 2014**

**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 2 – DEPOSITORY SECURITY, CONTINUED**

<u>Financial Institution</u>	<u>Demand Deposits</u>	<u>Time Deposits</u>	<u>FDIC Coverage</u>	<u>Pledged Securities</u>	<u>Unsecured Deposits</u>
First National Bank & Trust	523,972	-	250,000	273,972	-
TriCentury Bank	177,261	27,459	204,720	-	-
Farmway Credit Union	10,971	50,000	60,971	-	-
Guaranty State Bank	-	170,346	170,346	-	-

**NOTE 3 – ACCOUNTS RECEIVABLE**

Accounts receivable and the related allowance for doubtful accounts at October 31, 2014 are as follows:

Outstanding Balance	\$14,051
Allowance for Doubtful Accounts	<u>(7,834)</u>
Net	<u>\$6,217</u>

The allowance for doubtful accounts relates to one customer. Approximately 78% of remaining amount of net receivables is related to two customers. These balances are considered collectible by management as of October 31, 2014.

**NOTE 4 – CAPITAL ASSETS**

Capital assets purchased or built are capitalized at cost. Depreciation is recorded based on the estimated useful life of each asset using the straight-line method over the following estimated useful lives:

Water System	40 years
Machinery and Equipment	7 years
Computer Equipment	5 years
Computer Software	3 years.

Capital Asset Activity for the year ended October 31, 2014 was as follows:

	<u>Beginning Balance</u>	<u>Capital Acquisitions/ (Depreciation)</u>	<u>(Sales) / Disposals</u>	<u>Ending Balance</u>
Capital Assets not being Depreciated:				
Land	\$ 6,623	32,204	-	\$ 38,827
Total Capital Assets Not Being Depreciated	<u>6,623</u>	<u>32,204</u>	<u>-</u>	<u>38,827</u>
Capital Assets Being Depreciated:				
Water System and Equipment	4,012,074	-	-	4,012,074
Office & Equipment	56,011	23,676	-	79,687
Vehicles	21,400	7,500	-	28,900
Total Capital Assets Being Depreciated	<u>4,089,485</u>	<u>31,176</u>	<u>-</u>	<u>4,120,661</u>

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS  
OCTOBER 31, 2014**

**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 4 – CAPITAL ASSETS, CONTINUED**

Less Accumulated Depreciation For:

Water System and Equipment	(2,622,200)	(97,357)	-	(2,719,557)
Office & Equipment	(29,283)	(4,947)	-	(34,230)
Vehicles	(3,823)	(4,905)	-	(8,728)
Total Accumulated Depreciation	<u>(2,655,306)</u>	<u>(107,209)</u>	-	<u>(2,762,515)</u>
Net Being Depreciated	1,434,179	(107,209)	-	1,358,146
Total Capital Assets	<u>\$ 1,440,802</u>	<u>(43,829)</u>	-	<u>\$ 1,396,973</u>

**NOTE 5 – BUDGETS AND BUDGETARY ACCOUNTING**

The District is not required to adopt a legal budget; therefore, no budgetary comparison is prepared as a financial statement. The Board approves an estimated budget each year per K.S.A. 82a-628 which is used by management to internally monitor the District's expenditures and is presented as supplementary information.

**NOTE 6 – BOND PAYABLE**

On June 15, 2003, the Kansas Rural Water Financial Authority issued \$1,615,000 of bonds on behalf of the District with an effective interest rate of 3.5% to refund their Revenue Bonds Series 1995, dated July 1, 1995 in the amount of \$1,415,000. Interest payments are due semi-annually on March 1<sup>st</sup> and September 1<sup>st</sup>. Principal payments are due on September 1st maturing in 2017. For the years ended October 31, 2013 and 2014, the board has made supplemental payments on the bond to further reduce the outstanding balance. As of October 31, 2014, the remaining bond is current with \$200,000 of principal and \$2,314 of interest due within the next year.

A bond reserve is required to be maintained in an amount lesser of 10% of the bond issue amount (\$161,500) or the average annual principal and interest on all outstanding bonds (\$202,314). For the bond reserve, \$89,258, \$89,133 and \$27,528 are segregated in Certificates of Deposit at Tri-Century bank and \$110,800 is segregated in a Certificate of Deposit at Guaranty State Bank for a total of \$316,719 in reserve.

**NOTE 7 – DEBT SERVICE RATIO**

The bond issue covenants require the District to maintain net revenues in an amount that will be not less than 125% of the debt service requirements required to be paid in such fiscal year on all bonds outstanding.

Change in Net Position	\$ 261,850
Interest Expense	14,548
Amortization and Depreciation	107,209
Capital Contributions	<u>(16,000)</u>
Total Revenue Available for Debt Service	<u>\$ 367,607</u>
Debt Service Requirements	\$ 131,450
Required Percentage	125%
Net Revenue Required	<u>164,312</u>
Net Revenue Surplus (deficit)	<u>\$ 203,295</u>

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS  
OCTOBER 31, 2014**

**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 8 – LONG-TERM DEBT**

The following schedule shows the changes in long-term debt and related maturities.

<u>Description</u>	<u>Date Issued</u>	<u>Original Amount</u>	<u>Outstanding 11-1-13</u>	<u>Principal Payments</u>	<u>Outstanding 10-31-14</u>	<u>Interest Paid In 2014</u>
2003 Bond	06/15/13	<u>1,615,000</u>	<u>470,000</u>	<u>270,000</u>	<u>200,000</u>	<u>14,976</u>

**NOTE 9 - LITIGATION**

There were no legal actions involving the District as of October 31, 2014.

**NOTE 10 - CONCENTRATIONS**

All of the District's water is purchased from Mitchell County Rural Water District No. 2.

**NOTE 11 – RETIREMENT PLAN**

In June 2013, the District approved establishing a SIMPLE IRA retirement plan for employees. The District contributes 3% of the employee's salary to the plan. If employment is terminated, the IRA remains the property of the employee. For the year ended October 31, 2014, the District contributed \$3,400 to the retirement plan. The plan is maintained by First National Bank and Trust.

**NOTE 12 - COMPENSATED ABSENCES POLICY**

During the year ended October 31, 2014, the District approved a formal vacation leave policy. The policy does not address employees carry over or payment at termination/retirement of unused vacation time. The District does not have a formal sick leave policy. Therefore, a value of compensated absences as of October 31, 2014 is not reflected in the financial statements.

**NOTE 13 – RISK MANAGEMENT**

Mitchell County Rural Water District No. 3 is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. To insure against risk of these types of losses, the District has purchased commercial insurance coverage from Fouts Insurance Agency, Inc. and Citizens State Agency in Beloit, Kansas. Settled claims resulting from these risks have not exceeded commercial coverage in the past three fiscal years.

**NOTE 14– RELATED PARTIES**

All the members of the board of directors and all employees are water district customers. The only material transactions were water purchases consummated on the same terms as all other water customers. All were current at year-end.

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3  
BELOIT, KANSAS  
OCTOBER 31, 2014**

**NOTES TO THE FINANCIAL STATEMENTS**

**NOTE 15- CORRECTION OF AN ERROR**

The District determined that inventory was overstated in the previous year due to a formula error in the spreadsheet. As a result, the beginning fund balance has been restated to record a prior period adjustment to correct inventory recorded in the previous year. A reconciliation of the prior period ending fund balance to the current year beginning fund balance is as follows:

Beginning Net Position	\$ 1,924,780
Adjustment to Correct Inventory	<u>25,956</u>
Beginning Net Position, as Restated	<u>\$ 1,950,736</u>

**NOTE 16- SUBSEQUENT EVENT**

In December 2014, the District made their final debt payment on the Series F, 2003 Refunding Revenue Bonds. All amounts currently held in reserve can be released to be utilized for ongoing operations. Management has reviewed subsequent events through January 28, 2015, the date the financial statements were available to be issued.

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3**  
**BUDGETARY COMPARISON**  
**FOR THE YEAR ENDED OCTOBER 31, 2014**

	<u>Budget</u>	<u>Actual</u>	Variance Over (Under)
<b>OPERATING REVENUES</b>			
Water Revenues - Members	\$ 400,000	\$ 421,531	\$ 21,531
Water Revenues - Commercial	131,000	132,329	1,329
City Surcharge	12,997	13,060	63
Monthly Minimum	265,000	239,785	(25,215)
City Minimums	20,873	21,012	139
<b>TOTAL OPERATING REVENUES</b>	<u>829,870</u>	<u>827,717</u>	<u>(2,153)</u>
<b>OPERATING EXPENSES</b>			
Payroll and Payroll Taxes	108,150	118,184	10,034
Automatic Meter Reading Fees	-	192	192
Board Expense	275	2,900	2,625
Chemicals / Propane	500	181	(319)
Contract Labor	35,000	29,346	(5,654)
Dues	525	576	51
Employee Benefits	19,400	16,500	(2,900)
Fuel / Diesel / Oil	5,700	8,186	2,486
Insurance	16,000	19,941	3,941
Legal and Audit	12,000	9,773	(2,227)
Locates and Fees	400	416	16
Materials and Supplies	27,500	24,441	(3,059)
Mileage	20,000	10,127	(9,873)
Miscellaneous	2,950	2,213	(737)
Office Expense	9,300	6,222	(3,078)
Rent	9,000	9,500	500
Repairs and Maintenance	11,700	4,451	(7,249)
Utilities and Phone	38,000	36,756	(1,244)
Vehicle Maintenance	1,850	1,694	(156)
Water Conference Expense	-	1,945	1,945
Water Fees and Taxes	3,500	3,579	79
Water Purchases	195,000	169,478	(25,522)
<b>TOTAL OPERATING EXPENSES</b>	<u>516,750</u>	<u>476,601</u>	<u>(40,149)</u>
<b>INCOME FROM OPERATIONS BEFORE DEPRECIATION</b>	<u>313,120</u>	<u>351,116</u>	<u>37,996</u>
Depreciation	(102,500)	(107,209)	4,709
<b>OPERATING INCOME (LOSS)</b>	<u>210,620</u>	<u>243,907</u>	<u>33,287</u>
<b>NON-OPERATING REVENUES AND EXPENSES</b>			
Dividends	2,500	2,905	405
Interest Income	8,000	6,052	(1,948)
Miscellaneous Income and Reimbursement	33,100	28,662	(4,438)
Penalty Revenue	8,500	6,095	(2,405)
Reconnect Fees	2,000	1,600	(400)
Bad Debt Expense	(5,000)	(7,834)	(2,834)
Purchase of GPS Maps	-	(20,989)	(20,989)
Interest Expense	(23,000)	(14,548)	8,452
<b>TOTAL NON-OPERATING REVENUES (EXPENSES)</b>	<u>26,100</u>	<u>1,943</u>	<u>(24,157)</u>
Capital Contributions	15,000	16,000	1,000
<b>INCREASE (DECREASE) IN NET POSITION</b>	<u>\$ 251,720</u>	<u>\$ 261,850</u>	<u>\$ 10,130</u>

The notes to the financial statements are an integral part of this statement.





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## COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Board of Directors  
Mitchell County Rural Water District No. 3  
Beloit, Kansas 67420

We have audited the financial statements of the business-type activities of Mitchell County Rural Water District No. 3 (District) as of and for the year ended October 31, 2014. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information at your December Board meeting and in our letter to you dated November 4, 2014. Professional standards also require that we communicate to you the following information related to our audit.

### Significant Audit Findings

#### *Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended October 31, 2014. We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period. However your audit report details one departure from generally accepted accounting principles.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

The disclosure related to a correction of an error in the prior period. The error was related to a calculation error in the prior year's inventory account which resulted in an adjustment of \$25,956 which increased the beginning net position of the District.

The financial statement disclosures are neutral, consistent, and clear.

#### *Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing and completing the audit.

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*Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. Six adjustments were prepared prior to the beginning of the audit. One of the six entries was the prior period adjustment that was posted as of October 31, 2013 which had the effect of increasing net position \$25,956 and the remainder were for the year ended October 31, 2014 which had the effect of decreasing net position \$27,622. During the audit, adjusting and reclassifying entries were posted for a total of \$14,478, which had the effect of decreasing net position \$7,833. Lists of the entries are attached to this letter. Finally, an additional attached schedule summarizes uncorrected misstatements of the financial statements; management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

*Disagreements with Management*

For the purpose of this letter, a disagreement with management is a financial accounting, reporting or auditing matter, whether or not resolved to our satisfaction that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

*Management Representations*

We have requested certain representations from management that are included in the management representation letter dated January 28, 2015.

*Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

*Required Supplementary Information*

With respect to the required supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the required supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of the District's management and the Board of Directors and the Kansas Department of Administration, Office of Management Analysis and Standards, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

*Pottberg, Gassman & Hoffman, Chartered*

Pottberg, Gassman & Hoffman, Chartered  
Manhattan, Kansas  
January 28, 2015

**MITCHELL COUNTY RURAL WATER DISTRICT #3**  
**AUDIT ENTRIES**  
**OCTOBER 31, 2014**

	<u>Account</u>	<u>DR</u>	<u>CR</u>	<u>Net Income Effect</u>
1 Depreciation Expense	6060	20.00		
Accumulated Deprecation	1710	1.00		
Miscellaneous Income	4210		21.00	1.00
<i>Adjust Deprecation to Actual</i>				
2 Bad Debt Expense	6005	7,834.00		
Allowance for Doubtful Accounts	1425		7,834.00	-7,834.00
<i>Record Unearned Revenue</i>				
3 Land	1705	6,623.00		
Property Plant and Equipment	1700		6,623.00	0.00
<i>Reclassify Land to Its Own Line</i>				
Totals		<u>14,478.00</u>	<u>14,478.00</u>	<u>-7,833.00</u>

**MITCHELL COUNTY RURAL WATER DISTRICT #3**  
**AUDIT DIFFERENCES**  
**OCTOBER 31, 2014**

	Account	DR	CR
1 Capital Credits Rolling Hills	1930	1,712.00	
Patronage Dividends	4670		1,712.00
<i>Record capital credits earned.</i>			
2 Accounts Receivable	1420	1,275.38	
Unearned Revenue	2240		1,275.38
<i>Record Unearned Revenue</i>			
3 Bad Debt Expense - Operating Expense		1,178.90	
Bad Debt Expense - Non Operating			1,178.90

*To record current year bad-debt as an operating expense.*

Waive all adjustments as immaterial.



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## COMMUNICATION OF SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES

Board of Directors  
Mitchell County Rural Water District No. 3  
Beloit, Kansas 67420

In planning and performing our audit of the financial statements of the business-type activities of Mitchell County Rural Water District No. 3 (District) as of and for the year ended October 31, 2014, in accordance with auditing standards generally accepted in the United States of America and the *Kansas Municipal Audit and Accounting Guide*, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily 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. However as discussed below, we identified deficiencies in internal control that we consider to be significant deficiencies.

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 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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

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. We consider the following deficiencies in the District's internal control to be significant deficiencies:

### Inventories

Due to the size of the organization, the District does not have sufficient employee resources to ensure adequate segregation of duties over the inventory function. The risks to the District include errors, unintentional losses, obsolescence due to unnecessary purchases of inventory, and misappropriation of assets. The District does not have policies in place to help mitigate these risks. During the current year, a prior period adjustment was made to correct a calculation error in the prior year inventory balance. In addition, the current year count revealed items that had not been counted or were not priced correctly in the prior year. We recommend the District consider the following changes.

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- Consider keeping inventory records up-to-date throughout the year instead of waiting for the year-end inventory count. This can help to keep the value of inventory recorded on the books up-to-date and ensure that unneeded inventory is not ordered.
- Have two individuals perform the year-end inventory count and initial and date the inventory listing. This occurred in the current year.

Until the District implements appropriate controls over the inventory or unless the inventory value become immaterial, we will need to expand the scope of our audit, or continue to issue a modified opinion on the report.

**Financial Reporting**

Management is responsible for establishing and maintaining internal controls, including monitoring, and for the fair presentation in the financial statements of the financial position, changes in financial position and cash flows including the notes to the financial statements, in conformity with U.S. generally accepted accounting principals and the *Kansas Municipal Audit and Accounting Guide*.

At times, management may choose to outsource certain accounting functions due to cost or training considerations. Such accounting functions and service providers must be governed by the control policies and procedures of the entity. Management is as responsible for outsourced functions performed by a service provider, as it would be for such functions performed internally. Specifically, management is responsible for management decisions and functions; for designating an individual with suitable skill, knowledge, or experience to oversee any outsourced services; and for evaluating the adequacy and results of those services and accepting responsibility for them.

As part of the audit, management requested us to prepare a draft of your financial statements, including the related notes to the financial statements. Management reviewed, approved, and accepted responsibility for those financial statements prior to their issuance; however, management does not have the ability to evaluate the completeness of financial statement disclosures.

The existence of significant deficiencies may already be known to management and may represent a conscious decision by management or those charged with governance to accept that degree of risk because of cost or other considerations. Management is responsible for making decisions concerning costs and the related benefits. We are responsible for communication of significant deficiencies in accordance with professional standards regardless of management's decisions.

We noted other matters involving internal control and District operations that we have reported to management in a separate letter dated January 28, 2015.

This communication is intended solely for the information and use of the Board of Directors and management of Mitchell County Rural Water District No. 3 and the Kansas Department of Administration, Office of Management Analysis and Standards and is not intended to be and should not be used by anyone other than those specified parties.

*Pottberg, Gassman & Hoffman, Chartered.*

Pottberg, Gassman & Hoffman, Chartered  
Manhattan, Kansas  
January 28, 2015



Certified Public Accountants

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## MANAGEMENT COMMENTS LETTER

Board of Director's  
Mitchell County Rural Water District No. 3  
Beloit, Kansas

In planning and performing our audit of the financial statements of Mitchell County Rural Water District No. 3 (District) as of and for the year ended October 31, 2014 we considered the District's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control.

However, during our audit, we became aware of matters that are opportunities for strengthening internal controls and operating efficiency. This letter does not affect our report dated January X, 2015, on the financial statements of the District.

We will review the status of these comments during our next engagement. We have discussed these comments and suggestions with management. Our comments concerning the current year are as follows:

### Depository Securities

K.S.A. 9-1402 and 9-1405 state the District should ensure that deposits with statutorily authorized institutions are adequately secured. In the prior year, we reported that deposits at October 31, 2013 were unsecured by \$10,433. Listings of the pledged securities were obtained and reviewed throughout the year and deposits as of October 31, 2014 were adequately secured, however, deposits in the amount of \$26,410 at TriCentury bank as of June 30, 2014 were unsecured.

We recommend that the District continue to review the pledged security listings and to contact the bank if the District anticipates a large deposit or change in your account balances for which additional pledges will be required. With the closure of several accounts related to the pay-off of the debt, managing the review of the pledged securities should be easier.

### Budget

During the current year, management approved a budget which put the District in compliance with K.S.A. 82a-628. However, we did notice during audit testing that the budget was not entered into QuickBooks and we did not identify any other current year reporting in comparison to the budget. We recommend that the approved budget be entered into QuickBooks and the comparison of actual to budget be reviewed at least quarterly.

If you or any of the District employees have any questions concerning these recommendations, we would welcome the opportunity to discuss them with you. We would also like to express our appreciation to all of the District's employees for their cooperation and assistance during the course of our audit. Thank you for allowing us to be of service to you.

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This communication is intended solely for the information and use of management and the Board of Directors of Mitchell County Rural Water District No. 3 and is not intended to be and should not be used by anyone other than those specified parties.

Sincerely,

*Pottberg, Gassman & Hoffman, Chtd.*

Pottberg, Gassman & Hoffman, Chartered  
Manhattan, Kansas  
January 28, 2015