

UNION COUNTY WATER DISTRICT

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REPORT ON AUDIT OF FINANCIAL STATEMENTS

For the years ended December 31, 2008 and 2007

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# MCELOY, MITCHELL & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS

BUSINESS CONSULTANTS

## INDEPENDENT AUDITOR'S REPORT

PARTNERS

S. MARTIN MCELOY, JR., CPA  
ROBERT E. MITCHELL, CPA

ASSOCIATES

TODD BOWLEY  
ERIC SUDDOTH

Board of Commissioners  
Union County Water District  
Morganfield, Kentucky

We have audited the accompanying financial statements of the business-type activities of the Union County Water District as of and for the years ended December 31, 2008 and 2007, which comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Union County Water District's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Union County Water District has not presented the management's discussion and analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

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 the Union County Water District as of December 31, 2008 and 2007 and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 10, 2009 on our consideration of the Union County Water District'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 the financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Morganfield, Kentucky  
July 10, 2009

*MCELOY, MITCHELL & ASSOCIATES, LLP*

UNION COUNTY WATER DISTRICT  
Statement of Net Assets  
December 31, 2008 and 2007

ASSETS

	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents	\$ 259,577	\$ 217,673
Investments	668,022	742,964
Accounts receivable, consumers	109,508	117,086
Other assets	<u>80,211</u>	<u>85,250</u>
Total current assets	<u>1,117,318</u>	<u>1,162,973</u>
Restricted assets:		
Cash and cash equivalents	<u>61,819</u>	<u>73,711</u>
Non-current assets:		
Capital assets, net of depreciation	<u>4,403,643</u>	<u>4,486,909</u>
Other assets:		
Unamortized issuance costs	<u>5,652</u>	<u>6,984</u>
Total assets	<u><u>\$ 5,588,432</u></u>	<u><u>\$ 5,730,577</u></u>

## LIABILITIES AND NET ASSETS

	2008	2007
<b>Current liabilities:</b>		
Current portion of long-term debt	\$ 42,500	\$ 41,000
Current portion of obligation under capital lease	30,000	29,000
Accounts payable	2,989	1,883
Other accrued liabilities	42,009	47,357
	117,498	119,240
<b>Current liabilities payable from restricted assets:</b>		
Accrued interest payable	25,548	25,906
Current portion of long-term debt	14,000	13,000
	39,548	38,906
<b>Non-current liabilities:</b>		
Long-term debt, net of current portion	1,210,500	1,267,000
Capital lease obligations, net of current portion	66,000	96,000
Customer advances in aid of construction	565	3,572
	1,277,065	1,366,572
<b>Total non-current liabilities</b>	<b>1,277,065</b>	<b>1,366,572</b>
<b>Total liabilities</b>	<b>1,434,111</b>	<b>1,524,718</b>
<b>Net Assets:</b>		
Invested in capital assets, net of related debt	3,054,643	3,053,909
Restricted for debt service	22,271	34,805
Unrestricted	1,077,407	1,117,145
	4,154,321	4,205,859
<b>Total net assets</b>	<b>4,154,321</b>	<b>4,205,859</b>
<b>Total liabilities and net assets</b>	<b>\$ 5,588,432</b>	<b>\$ 5,730,577</b>

The accompanying notes are an integral part of the financial statements

**UNION COUNTY WATER DISTRICT**  
**Statement of Revenues, Expenses, and Changes in Net Assets**  
**For the years ended December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>Operating revenues:</b>		
Water sales	\$ 1,103,212	\$ 1,127,867
Other revenues	79,016	74,268
	<u>1,182,228</u>	<u>1,202,135</u>
<b>Operating expenses:</b>		
Water purchased	443,350	465,329
Fuel and power purchased for pumping	45,568	37,162
Water transmission and distribution	135,525	80,632
Customer account expense	21,455	21,180
General and administrative	395,647	385,159
Depreciation and amortization	204,400	185,310
	<u>1,245,945</u>	<u>1,174,772</u>
Total operating expenses	<u>1,245,945</u>	<u>1,174,772</u>
Operating income (loss)	<u>(63,717)</u>	<u>27,363</u>
<b>Non-operating revenues (expenses):</b>		
Interest income	34,354	42,399
Gain on sale of assets	1,231	-
Interest expense	(69,907)	(73,231)
	<u>(34,322)</u>	<u>(30,832)</u>
Total non-operating expenses	<u>(34,322)</u>	<u>(30,832)</u>
Loss before contributions	(98,039)	(3,469)
Capital contributions	46,501	392,657
Change in net assets	(51,538)	389,188
Total net assets- beginning of year	<u>4,205,859</u>	<u>3,816,671</u>
Total net assets- end of year	<u>\$ 4,154,321</u>	<u>\$ 4,205,859</u>

The accompanying notes are an integral part of the financial statements

**UNION COUNTY WATER DISTRICT**  
**Statement of Cash Flows**  
**For the years ended December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>Cash flows from operating activities:</b>		
Receipts from customers	\$ 1,189,806	\$ 1,184,443
Payments to suppliers	(727,261)	(776,015)
Payments to employees	(312,513)	(313,053)
	<u>150,032</u>	<u>95,375</u>
<b>Cash flows from non-capital financing activities:</b>	<u>-</u>	<u>-</u>
<b>Cash flows from capital and related financing activities:</b>		
Acquisition and construction of capital assets	(119,790)	(514,897)
Principal payments on bond indebtedness	(54,000)	(53,000)
Principal payments on capital lease	(29,000)	(28,000)
Interest payments on bond indebtedness	(65,405)	(67,286)
Interest payments on capital lease	(4,859)	(6,279)
Proceeds from contributed capital	46,501	392,657
Proceeds (payments) on customer advances	(3,007)	272
	<u>(229,560)</u>	<u>(276,533)</u>
<b>Cash flows from investing activities:</b>		
Purchase of investment securities	(394,173)	(1,185,726)
Proceeds from sale and maturity of investment securities	469,116	1,082,305
Investment income	34,597	42,828
	<u>109,540</u>	<u>(60,593)</u>
Net increase (decrease) in cash and cash equivalents	30,012	(241,751)
Cash and cash equivalents, beginning of year	<u>291,384</u>	<u>533,135</u>
Cash and cash equivalents, end of year	<u>\$ 321,396</u>	<u>\$ 291,384</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT  
Statement of Cash Flows, Continued  
For the years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income (loss)	\$ (63,717)	\$ 27,363
Items to reconcile net operating income to net cash provided by operations:		
Depreciation and amortization	204,400	185,310
Changes in operation assets and liabilities:		
Accounts receivable- consumers	7,578	(17,692)
Other assets	6,371	9,401
Accounts payable	1,106	1,017
Accrued interest payable	(358)	(334)
Deferred revenue	-	(111,296)
Other accrued liabilities	(5,348)	1,606
Net cash provided by operating activities	<u>150,032</u>	<u>95,375</u>
Cash and cash equivalents, end of year consisted of the following:		
Unrestricted cash and cash equivalents	\$ 259,577	\$ 217,673
Restricted cash and cash equivalents	<u>61,819</u>	<u>73,711</u>
Total cash and cash equivalents	<u>\$ 321,396</u>	<u>\$ 291,384</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2008

1. Summary of Significant Accounting Policies

The accounting policies of the Union County Water District ("District") conform to generally accepted accounting principles (GAAP) applicable to governmental enterprise units. The following summary of the more significant accounting policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

a. Reporting Entity

In evaluating how to define the entity for financial reporting purposes, management considered whether the District is a component unit of another primary government and all potential component units of the District. The District is a special-purpose district organized to construct, operate, and maintain water service facilities and supply water to customers in Union County, Kentucky. The District is governed by three appointed Commissioners who are nominated and approved by the Union County Fiscal Court. The District purchases its water supply from the City of Morganfield, Kentucky. All of the water purchased by the District has been filtered and treated. The District operates and maintains the distribution system that supplies its end users. The District's basic financial statements include the financial position and the results of operations of the District. A review of other units of local government, using the criteria set forth in generally accepted accounting principles, indicates there are no additional entities or funds for which the District has reporting responsibilities. Management has determined the District should not be considered a part of any unit of local government for reporting purposes for the following reasons:

1. The District has separate legal standing from all other units of government.
2. A primary government appoints the voting majority of the District's Board of Commissioners. However, the primary government is not able to impose its will on the District and there is no potential for the District to provide benefits to or burdens on the primary government.
3. The District is fiscally independent of all other units of local government. The District's Board of Commissioners has the sole authority to determine financial programs, establish rates (subject to Public Service Commission approval) and issue bonded debt.
4. The financial statements of other units of local government would not be misleading or incomplete without the inclusion of the District's financial statements.

b. Basis of Accounting and Presentation

The District is a single-enterprise proprietary fund and uses the accrual basis of accounting. Proprietary funds are used to account for operations that are financed in a manner similar to private business enterprise and that a periodic determination of revenues earned, expenses incurred and/or change in net assets is appropriate for capital maintenance, public policy, management control, accountability or other purposes. Under this method, revenues are recorded when earned, and expenses are recognized as soon as they result in liabilities for the benefits provided.

1. Summary of Significant Accounting Policies, Continued

b. Basis of Accounting and Presentation, Continued

The financial statements are prepared on the basis of Governmental Accounting Standards Board (GASB), Statement Number 34, Basic Financial Statements, Management Discussion and Analysis for State and Local Governments and related standards.

Capital grants are accrued when all related eligibility requirements have been met.

The District applies all Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails.

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 the proprietary funds principle ongoing operations. The principle operating revenues of the District are charges to customers for water usage. Operating expenses include the cost of providing water service, administrative expenses and depreciation on capital assets. Other revenues and expenses are reported as non-operating in the financial statements.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, restricted resources are applied first.

c. Measurement Focus

The District's capital maintenance measurement focus is all financial and economic resources. All assets and liabilities associated with the District's operations are included on the Statement of Net Assets. Depreciation is reported as a cost of operations.

d. Cash and Cash Equivalents

The District considers all highly liquid investments with an original maturity of ninety days or less to be cash equivalents.

e. Investments

KRS 66.480 permits the District to invest in U.S. Treasury obligations, U.S. Agency obligations, certain Federal instruments, repurchase agreements, commercial bank certificates of deposit, savings and loan deposits, and the Commonwealth of Kentucky investment pool.

UNION COUNTY WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2008

1. Summary of Significant Accounting Policies, Continued

f. Restricted Assets

Restricted assets are cash and cash equivalents whose use is limited by legal requirements. Restricted cash and cash equivalents represent amounts required by debt covenants to be segregated for future debt payments and accrued interest on long-term debt obligations.

g. Capital Assets

All capital assets are stated at cost. All materials for capital improvements are capitalized when purchased. Construction in progress is not depreciated until completed. Interest expense incurred during a construction period is capitalized. Depreciation is provided for by using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows:

Structures, mains, and accessories	50 years
Equipment, including hydrants and meters	5-20 years

h. Debt Issue Cost

Issue costs on bonds payable are being amortized using the outstanding bonds method.

i. Deferred Revenues

The District reports deferred revenue on its balance sheet. Deferred revenues arise when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received by the District before it has legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the District has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized.

j. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. A liability for compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the District and its employees is accrued as employees earn the rights to the benefits. The District's policy is to accrue up to 30 days of unused vacation, which is payable upon termination of employment. Employees can accrue up to 60 days of sick leave, which upon termination of employment has no monetary value.

UNION COUNTY WATER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2008

1. Summary of Significant Accounting Policies, Continued

k. Net Assets

Net assets present the difference between assets and liabilities in the statement of net assets. Net assets invested in capital assets are reduced by the outstanding balances of any borrowing used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are legal limitations imposed on their use by District legislation or external restrictions by creditors, grantors, laws or regulations of other governments.

2. Deposits

At December 31, 2008, the Union County Water District maintained deposits of \$1,001,019 at three financial institutions. Of these bank balances, \$603,797 was covered by federal depository insurance and the balance of \$397,222 was fully collateralized by pledged securities.

3. Investments

Investments are included in the balance sheet under the caption "Investments." As of December 31, 2008, Union County Water District had the following investments and maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in Years)</u>		
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>
Certificates of Deposit	\$ 668,022	\$ 480,022	\$ 188,000	\$ -
Total investments	<u>\$ 668,022</u>	<u>\$ 480,022</u>	<u>\$ 188,000</u>	<u>\$ -</u>

Interest Rate Risk

Union County Water District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The District's investments had no exposure to interest rate risk at December 31, 2008.

Credit Risk

The District has no policy regarding credit risk. The Union County Water District limits investments to U.S. Government backed securities, any corporation of the U.S. Government, Certificates of Deposit and Bankers Acceptances issued by highly rated banks, commercial paper in the highest rating category, and securities issued by a state or local government rated in one of the three highest rating categories by a nationally-recognized rating agency, and any other investment permitted by Kentucky Revised Statute 66.480. The District's investments at December 31, 2008 were exposed to minimal credit risk based on the pledged collateral by the financial institutions.

UNION COUNTY WATER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2008

3. Investments, Continued

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, Union County Water District will not be able to recover the value of its investments, or collateral securities that are in the possession of an outside party. All investments of the District comprise of certificates of deposit which are held by the District in their name. The District has no policy on custodial credit risk. The District's investments at December 31, 2008 were held in the name of the Union County Water District and were not exposed to any custodial credit risk.

4. Capital Assets

Capital asset activity consisted of the following at December 31, 2008:

	December 31, 2007	Additions	Disposals	December 31, 2008
Capital assets not depreciated				
Land and land rights	\$ 10,175	\$ -	\$ -	\$ 10,175
Capital assets depreciated				
Transport and distribution mains	4,037,523	20,388	-	4,057,911
Other transport and distribution plant	25,354	-	-	25,354
Distribution reservoirs and standpipe	2,199,112	31,180	-	2,230,292
Meters	931,894	26,827	-	958,721
Hydrants	34,523	-	-	34,523
Electric pumping equipment	561,168	23,075	-	584,243
Structures and improvements	6,738	-	-	6,738
Equipment	110,145	-	-	110,145
Transportation equipment	44,759	18,320	(19,183)	43,896
Office equipment and software	12,285	-	-	12,285
Other tangible property	10,900	-	-	10,900
	7,974,401	119,790	(19,183)	8,075,008
Capital assets depreciated under capital lease				
Distribution reservoirs and standpipe	441,980	-	-	441,980
Total assets depreciable at historical cost	8,426,556	119,790	(19,183)	8,527,163
Less accumulated depreciation	(3,939,646)	(203,057)	19,183	(4,123,520)
Capital assets, net	\$ 4,486,910	\$ (83,267)	\$ -	\$ 4,403,643

Depreciation expense amounted to \$203,057 and \$183,978 for the years ended December 31, 2008 and 2007, respectively. Amortization expense amounted to \$1,332 and \$1,331 for the years ended December 31, 2008 and 2007, respectively.

UNION COUNTY WATER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2008

5. Long-Term Debt

Long-term debt consisted of the following as of December 31, 2008 and 2007:

December 31, 2008					
	Balance Dec. 31, 2007	Additions	Deductions	Balance Dec. 31, 2008	Due Within One Year
USDA Loan	\$ 1,011,000	\$ -	\$ 14,000	\$ 997,000	\$ 14,000
KIA Assistance Agreement	310,000	-	40,000	270,000	42,500
Total long-term debt	<u>1,321,000</u>	<u>-</u>	<u>54,000</u>	<u>1,267,000</u>	<u>\$ 56,500</u>

Presented on the balance sheet under the following captions:

Current portion long-term debt	\$ 42,500
Current portion long-term debt payable from restricted assets	14,000
Long-term debt, net of current portion	<u>1,210,500</u>
	<u>\$ 1,267,000</u>

December 31, 2007					
	Balance Dec. 31, 2006	Additions	Deductions	Balance Dec. 31, 2007	Due Within One Year
USDA Loan	\$ 1,024,000	\$ -	\$ 13,000	\$ 1,011,000	\$ 14,000
KIA Assistance Agreement	350,000	-	40,000	310,000	40,000
Total long-term debt	<u>1,374,000</u>	<u>-</u>	<u>53,000</u>	<u>1,321,000</u>	<u>\$ 54,000</u>

Principal and interest requirements to retire the District's long-term obligations at December 31, 2008 were as follows:

	Principal	Interest	Total
2009	\$ 56,500	\$ 63,415	\$ 119,915
2010	60,000	61,199	121,199
2011	63,500	58,684	122,184
2012	97,000	55,649	152,649
2013	73,000	50,454	123,454
2014-2018	103,000	222,399	325,399
2019-2023	134,000	192,188	326,188
2024-2028	172,000	153,085	325,085
2029-2033	223,000	102,833	325,833
2034-2038	285,000	37,847	322,847
	<u>\$ 1,267,000</u>	<u>\$ 997,753</u>	<u>\$ 2,264,753</u>

Continued

UNION COUNTY WATER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2008

5. Long-Term Debt, Continued

Other information on the District's long-term indebtedness is summarized below:

	<u>Interest Rate</u>	<u>Final Maturity</u>	<u>Principal Balance</u>	<u>Security</u>
USDA Loan	5.125%	6/1/2013	\$ 310,000	Utility Revenues
KIA Assistance Agreement	2.5%-5.25%	1/1/1938	\$ 1,011,000	Utility Revenues

6. Capital Lease Obligations

The Union County Water District entered into a lease agreement in 1991 to finance the acquisition of an elevated water storage tank. This lease qualifies as a capital lease for accounting purposes and, therefore, the related assets have been recorded at the present value of the future minimum lease payments as of the date of the agreement which was \$402,000. The capitalized amount of the lease is being amortized over the life of the asset and is reported in depreciation expense.

The following is a summary of future lease payments required as of December 31, 2008:

2009	\$ 33,378
2010	33,808
2011	<u>34,140</u>
Total minimum lease payments*	101,326
Less amount representing interest	<u>(5,326)</u>
Present value of future minimum lease payments**	<u><u>\$ 96,000</u></u>

\* Interest rate on the capital lease is 4.15% and is imputed based on the lower of the District's incremental borrowing rate at the inception of the lease or the lessor's implicit rate of return.

\*\* Reflected in the balance sheet as current and non-current obligations under capital leases of \$30,000 and \$66,000, respectively.

UNION COUNTY WATER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2008

7. Restricted Assets

The Union County Water District had certain assets and corresponding retained earnings reserved for debt service which were restricted due to its outstanding debt. These consisted of a cash reserve and sinking fund for the United States Department of Agriculture note.

<u>Restricted Assets:</u>	<u>2008</u>	<u>2007</u>
Sinking Fund	\$ 41,012	\$ 41,337
Reserve Fund	20,807	32,374
Total restricted assets	<u>61,819</u>	<u>73,711</u>
Less: Accrued current liabilities payable from restricted assets:		
Principal	14,000	13,000
Interest	25,548	25,906
	<u>39,548</u>	<u>38,906</u>
Net assets restricted for debt service	<u>\$ 22,271</u>	<u>\$ 34,805</u>

8. County Employees Retirement System (CERS)

Effective September 1, 2004, substantially all of the District's full time employees became participants in the County Employees Retirement System. The CERS is a multi employer, cost sharing, defined benefit pension plan administered by the Board of Trustees of the Kentucky Retirement Systems (KRS). The CERS provides retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost of living adjustments (COLA) are provided at the discretion of the State legislature. Section 61.645 of the Kentucky Revised Statutes assigns authority to establish and amend benefit provision of the KRS Board of Trustees. The KRS issues a publicly available financial report that includes the financial statements and required supplementary information for the CERS. This report may be obtained by writing to Kentucky Retirements Systems, 1260 Louisville Road, Frankfort, KY 40601, or by calling 1-502-564-4646.

Funding Policy: Plan members are required to contribute 5% of their annual creditable compensation and the System is required to contribute at an actuarially determined rate. The current rate is 13.19% of annual covered payroll. The contribution requirements of the plan members and the District may be amended by the KRS Board of Trustees. Contributions for the years ended December 31 were equal to the required contributions for the year and were as follows:

<u>December 31,</u>	
2008	\$ 18,640
2007	16,723
2006	13,726

UNION COUNTY WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2008

9. Commitments

On December 19, 1986 the District entered into an agreement with the City of Morganfield, Kentucky whereby the City agrees to sell and deliver to the District and the District agrees to purchase and receive from the City all of the water required by the District up to a maximum of 1,000,000 gallons per day. The District can purchase water from other suppliers only in the event of an emergency. The agreement outlines a specific method of determining the City's cost of water produced during the previous fiscal year which is the rate charged to the District for the next year. The agreement covers a period of 42 years which expires December 19, 2028.

10. Operating Lease

The Union County Water District entered into a lease agreement with the Union County Fiscal Court to lease office space. The lease is for a term of twenty-eight months expiring December 31, 2010 with an option for three annual renewals. The monthly rent expense is \$500.

12. Risk Management

The 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, and natural disasters. The District carries commercial insurance for these types of risk of loss, including workers compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

# MC<sub>E</sub>ELROY, MITCHELL & ASSOCIATES, LLP

C E R T I F I E D   P U B L I C   A C C O U N T A N T S

B U S I N E S S   C O N S U L T A N T S

## PARTNERS

S. MARTIN M<sub>E</sub>ELROY, JR., CPA  
ROBERT E. MITCHELL, CPA

## ASSOCIATES

TODD BOWLEY  
ERIC SUDDOTH

## **Report on Internal Control Over Financial Reporting on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

To the Commissioners  
Union County Water District  
Morganfield, Kentucky

We have audited the financial statements of the business-type activities of the Union County Water District as of and for the year ended December 31, 2008, which collectively comprise the District's basic financial statements and have issued our report thereon dated July 10, 2009. We conducted our audits 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.

### **Internal Control over Financial Reporting**

In planning and performing our audit, we considered Union County Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is a material weakness.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Union County Water District'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 such provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We also noted certain other matters that we have reported to the management of the Union County Water District in a separate letter dated July 10, 2009.

The Union County Water District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the District's responses, and accordingly, we express no opinion on it.

This report is intended for the information and use of the management and the board of Commissioners of the Union County Water District. However, this report is a matter of public record and its distribution is not limited.

M. E. Elmy, M. J. Stelbel & Associates, LLP

Morganfield, Kentucky  
July 10, 2009

## Schedule of Findings

### **A-1 Control Risk Related To Lack Of Segregation Of Duties:**

Due to a limited number of personnel employed at the District, incompatible work functions are often performed by the same individual and a high degree of trust is necessitated.

**Criteria:** Ideally, each key step of an accounting system should be segregated among employees. Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition.

**Effect:** The staff size of the District limits the ability to rotate duties and implement some checking procedures. This limitation may affect the ability to record, process, summarize and report financial data.

**Recommendation:** We recommend that management always be mindful of key functions assigned to employees and provide oversight in all steps of the accounting system. Separation of all key functions in a small organization is not always feasible due to the cost versus benefit relationship inherent in providing internal control. In the process of segregating functions among employees, management must make decisions relating to the applicable costs in comparison to expected benefits achieved.

**Response:** Management concurs with the recommendation and has taken steps to separate functions and provide oversight where needed.

### **A-2 Control Risk Due to Lack of Qualifications to Fulfill Assigned Functions**

The auditor, from the District's books of original entry, prepares the financial statements and notes for the Union County Water District.

**Criteria:** Internal controls should be put in place for the District to review and approve generally accepted accounting principles (GAAP) financial statements and notes. The District is to accept full responsibility for the accuracy of the GAAP financial statements and notes.

**Effect:** Based upon the entity's present financial statements, the client's auditor is currently preparing the audit financial statements including notes.

**Recommendation:** Procedures should be implemented to allow the District to prepare their own GAAP financial statements and notes.

**Response:** Management is aware of the new situation regarding the preparation of GAAP financial statements and is currently looking into the best way to handle the situation.

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