

UNION COUNTY WATER DISTRICT

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

JUN 24 2011

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REPORT ON AUDIT OF FINANCIAL STATEMENTS

For the years ended December 31, 2010 and 2009

McELROY, MITCHELL & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

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MoELROY, 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

INDEPENDENT AUDITORS' REPORT

PARTNERS

S. MARTIN MoELROY, 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, 2010 and 2009, 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.

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

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, 2010 and 2009 and the respective changes in financial position and cash flows thereof for the years 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 June 17, 2011 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.

M.E. Elroy, Mitchell & Associates, LLP

Morganfield, Kentucky
June 17, 2011

UNION COUNTY WATER DISTRICT
Statement of Net Assets
December 31, 2010 and 2009

ASSETS

	<u>2010</u>	<u>2009</u>
Current assets:		
Cash and cash equivalents	\$ 194,030	\$ 608,920
Investments	175,000	388,000
Accounts receivable, consumers	118,935	104,459
Contribution receivable	21,393	-
Other assets	<u>79,941</u>	<u>79,301</u>
Total current assets	<u>589,299</u>	<u>1,180,680</u>
Restricted assets:		
Cash and cash equivalents	<u>47,866</u>	<u>69,196</u>
Non-current assets:		
Capital assets, net of depreciation	<u>6,059,540</u>	<u>6,126,037</u>
Other assets:		
Unamortized issuance costs	<u>2,988</u>	<u>4,320</u>
Total assets	<u><u>\$ 6,699,693</u></u>	<u><u>\$ 7,380,233</u></u>

LIABILITIES AND NET ASSETS

	2010	2009
Current liabilities:		
Current portion of long-term debt	\$ 47,500	\$ 45,000
Current portion of obligation under capital lease	34,000	32,000
Accounts payable	8,166	1,580
Other accrued liabilities	55,111	45,826
	144,777	124,406
Current liabilities payable from restricted assets:		
Accrued interest payable	13,346	25,191
Current portion of long-term debt	16,000	15,000
	29,346	40,191
Non-current liabilities:		
Long-term debt, net of current portion	500,000	1,150,500
Capital lease obligations, net of current portion	-	34,000
Customer advances in aid of construction	1,197	1,634
	501,197	1,186,134
Total non-current liabilities	501,197	1,186,134
Total liabilities	675,320	1,350,731
Net Assets:		
Invested in capital assets, net of related debt	5,478,040	4,864,537
Restricted for debt service	18,520	29,005
Unrestricted	527,813	1,135,960
	6,024,373	6,029,502
Total net assets	6,024,373	6,029,502
Total liabilities and net assets	\$ 6,699,693	\$ 7,380,233

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, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating revenues:		
Water sales	\$ 1,195,306	\$ 1,034,374
Other revenues	<u>75,508</u>	<u>80,738</u>
Total operating revenues	<u>1,270,814</u>	<u>1,115,112</u>
Operating expenses:		
Water purchased	443,149	355,165
Fuel and power purchased for pumping	53,270	45,351
Water transmission and distribution	99,852	138,933
Customer account expense	26,581	23,320
General and administrative	461,528	384,751
Depreciation and amortization	<u>244,224</u>	<u>227,947</u>
Total operating expenses	<u>1,328,604</u>	<u>1,175,467</u>
Operating loss	<u>(57,790)</u>	<u>(60,355)</u>
Non-operating revenues (expenses):		
Interest income	9,340	21,214
Interest expense	<u>(44,896)</u>	<u>(66,434)</u>
Total non-operating expenses	<u>(35,556)</u>	<u>(45,220)</u>
Loss before contributions	(93,346)	(105,575)
Capital contributions	<u>88,217</u>	<u>1,980,756</u>
Change in net assets	(5,129)	1,875,181
Total net assets- beginning of year	<u>6,029,502</u>	<u>4,154,321</u>
Total net assets- end of year	<u>\$ 6,024,373</u>	<u>\$ 6,029,502</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, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Receipts from customers	\$ 1,256,338	\$ 1,120,161
Payments to suppliers	(715,493)	(632,478)
Payments to employees	(364,169)	(310,749)
	<u>176,676</u>	<u>176,934</u>
Net cash provided by operating activities		
Cash flows from non-capital financing activities:	<u>-</u>	<u>-</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(171,760)	(147,463)
Principal payments on bond indebtedness	(647,000)	(56,500)
Principal payments on capital lease	(32,000)	(30,000)
Interest payments on bond indebtedness	(54,933)	(63,413)
Interest payments on capital lease	(1,808)	(3,378)
Proceeds from contributed capital	66,824	178,235
Proceeds (payments) on customer advances	(437)	1,069
	<u>(841,114)</u>	<u>(121,450)</u>
Net cash used by capital and related financing activities		
Cash flows from investing activities:		
Purchase of investment securities	(175,000)	(450,000)
Proceeds from sale and maturity of investment securities	388,000	730,022
Investment income	15,218	21,214
	<u>228,218</u>	<u>301,236</u>
Net cash provided by investing activities		
Net increase in cash and cash equivalents	(436,220)	356,720
Cash and cash equivalents, beginning of year	<u>678,116</u>	<u>321,396</u>
Cash and cash equivalents, end of year	<u>\$ 241,896</u>	<u>\$ 678,116</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, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating loss	\$ (57,790)	\$ (60,355)
Items to reconcile net operating income to net cash provided by operations:		
Depreciation and amortization	244,224	227,947
Changes in operation assets and liabilities:		
Accounts receivable- consumers	(14,476)	5,049
Other assets	692	2,242
Accounts payable	6,586	(1,409)
Accrued interest payable	(11,845)	(357)
Other accrued liabilities	<u>9,285</u>	<u>3,817</u>
Net cash provided by operating activities	<u><u>176,676</u></u>	<u><u>176,934</u></u>

Non-cash capital financing activities:

Capital assets of \$1,802,521 were acquired in 2009 through a contribution from a local government consisting of an elevated water tank and related equipment.

Reconciliation of cash and cash equivalents:

Unrestricted cash and cash equivalents	\$ 194,030	\$ 608,920
Restricted cash and cash equivalents	<u>47,866</u>	<u>69,196</u>
Total cash and cash equivalents	<u><u>\$ 241,896</u></u>	<u><u>\$ 678,116</u></u>

The accompanying notes are an integral part of the financial statements

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.

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2010 and 2009

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.

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.

Charges for services include revenues based on exchange or exchange-like transactions, namely water and sewer use. Program-specific grants and contributions (operating and capital), include revenues arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program, are accrued when all related eligibility requirements have been met.

c. Measurement Focus

The District's cost of services or "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's cost of services or 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. Investments are recorded at fair market value. Certificates of deposit are reported at cost since the redemption terms do not consider market rates. These investments are required to be fully collateralized in accordance with provisions of KRS 66.480.

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

Capital assets are stated at cost. All materials for capital improvements are capitalized when purchased. Construction in progress is not depreciated until completed and placed into service. 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, lines, mains and accessories, and system improvements	50 years
Equipment, including hydrants and meters	5-20 years
Transportation equipment	5 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 statement of net assets. 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, 2010 and 2009

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. Proprietary fund net assets are divided into three components:

- Invested in capital assets, net of related debt- consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
- Restricted net assets- consist of net assets that are restricted by the District's creditors (for example, through debt covenants), by state enabling legislation (through restrictions on shared revenues), by grantors (both federal and state), and by other contributors.
- Unrestricted- all other net assets are reported in this category.

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

2. Deposits

At December 31, 2010, the Union County Water District maintained deposits of \$428,192 at two financial institutions. Of these bank balances, \$425,000 was covered by federal depository insurance and the balance of \$3,192 was fully collateralized by pledged securities.

3. Investments

Investments are included in the Statement of Net Assets under the caption "Investments." As of December 31, 2010, 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	\$ 175,000	\$ 175,000	\$ -	\$ -
Total investments	\$ 175,000	\$ 175,000	\$ -	\$ -

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, 2010.

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010 and 2009

3. Investments, Continued

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, 2010 were exposed to minimal credit risk based on the pledged collateral by the financial institutions.

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, 2010 were held in the name of the Union County Water District and were not exposed to any custodial credit risk.

Concentration of Credit Risk

The District places no limit on the amount that the District may invest in any one issuer. More than 5 percent of the District's investments are in certificates of deposit at United Community Bank. These investments represent 100% of the District's total investments.

4. 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>2010</u>	<u>2009</u>
Sinking Fund	\$ 34,511	\$ 41,665
Reserve Fund	13,355	27,531
Total restricted assets	<u>47,866</u>	<u>69,196</u>
Less: Accrued current liabilities payable from restricted assets:		
Principal	16,000	15,000
Interest	13,346	25,191
	<u>29,346</u>	<u>40,191</u>
Net assets restricted for debt service	<u>\$ 18,520</u>	<u>\$ 29,005</u>

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010 and 2009

5. Capital Assets

Capital asset activity consisted of the following for the year ended December 31, 2010:

	December 31, 2009	Additions	Disposals	December 31, 2010
Capital assets not depreciated:				
Land and land rights	\$ 10,175	\$ -	\$ -	\$ 10,175
Capital assets depreciated:				
Transport and distribution mains	4,082,054	17,700	-	4,099,754
Other transport and distribution plant	25,354	-	-	25,354
Distribution reservoirs and standpipe	4,089,808	23,095	-	4,112,903
Meters	980,305	30,831	-	1,011,136
Hydrants	34,523	-	-	34,523
Electric pumping equipment	609,178	79,375	-	688,553
Structures and improvements	20,202	-	-	20,202
Equipment	114,540	-	-	114,540
Transportation equipment	43,896	20,899	-	64,795
Office equipment and software	13,258	4,495	-	17,753
Other tangible property	10,900	-	-	10,900
	<u>10,024,018</u>	<u>176,395</u>	<u>-</u>	<u>10,200,413</u>
Capital assets depreciated under capital lease:				
Distribution reservoirs and standpipe	441,980	-	-	441,980
Total assets at historical cost	10,476,173	176,395	-	10,652,568
Less accumulated depreciation	<u>(4,350,136)</u>	<u>(242,892)</u>	<u>-</u>	<u>(4,593,028)</u>
Total capital assets, net	<u>\$ 6,126,037</u>	<u>\$ (66,497)</u>	<u>\$ -</u>	<u>\$ 6,059,540</u>

Depreciation expense amounted to \$242,892 and \$226,615 for the years ended December 31, 2010 and 2009, respectively. Amortization expense amounted to \$1,332 for each of the years ended December 31, 2010 and 2009.

6. Long-Term Debt

Long-term debt of the District consisted of the following as of December 31, 2010 and 2009:

	December 31, 2009				
	Balance Dec. 31, 2008	Additions	Deductions	Balance Dec. 31, 2009	Due Within One Year
USDA Loan	\$ 997,000	\$ -	\$ 14,000	\$ 983,000	\$ 15,000
KIA Assistance Agreement	270,000	-	42,500	227,500	45,000
Total long-term debt	<u>1,267,000</u>	<u>-</u>	<u>56,500</u>	<u>1,210,500</u>	<u>\$ 60,000</u>

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010 and 2009

6. Long-Term Debt, Continued

December 31, 2010					
	Balance Dec. 31, 2009	Additions	Deductions	Balance Dec. 31, 2010	Due Within One Year
USDA Loan	\$ 983,000	\$ -	\$ 602,000	\$ 381,000	\$ 16,000
KIA Assistance Agreement	227,500	-	45,000	182,500	47,500
Total long-term debt	<u>1,210,500</u>	<u>-</u>	<u>647,000</u>	<u>563,500</u>	<u>\$ 63,500</u>

Presented on the balance sheet under the following captions:

Current portion long-term debt	\$ 47,500
Current portion long-term debt payable from restricted assets	16,000
Long-term debt, net of current portion	<u>500,000</u>
	<u>\$ 563,500</u>

Principal and interest requirements to retire the District's long-term obligations at December 31, 2010 were as follows:

	Principal	Interest	Total
2011	\$ 63,500	\$ 32,318	\$ 95,818
2012	97,000	25,566	122,566
2013	73,000	20,371	93,371
2014	18,000	16,451	34,451
2015	20,000	15,478	35,478
2016-2020	114,000	60,834	174,834
2021-2025	149,000	27,290	176,290
2026	29,000	743	29,743
	<u>\$ 563,500</u>	<u>\$ 199,051</u>	<u>\$ 762,551</u>

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

	Interest Rate	Final Maturity	Principal Balance	Security
USDA Loan	5.125%	1/1/2026	\$ 381,000	Utility Revenues
KIA Assistance Agreement	2.5%-5.25%	6/1/2013	\$ 182,500	Utility Revenues

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010 and 2009

7. 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, 2010:

2011	\$ 34,140
Total minimum lease payments*	34,140
Less amount representing interest	<u>(140)</u>
Present value of future minimum lease payments**	<u>\$ 34,000</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 \$34,000 and \$0, respectively.

8. 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, 2011 with an option for three annual renewals. The monthly rent expense is \$500.

9. 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 Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601, or by calling 1-502-928-4646.

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010 and 2009

9. County Employees Retirement System (CERS), Continued

Funding Policy: Plan members are required to contribute 5% of their annual creditable compensation, those hired after September 1, 2008 are required to contribute 6%, and the System is required to contribute at an actuarially determined rate. The current rate is 16.93% 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>	
2010	\$ 32,642
2009	22,196
2008	18,640

10. 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.

11. 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.

12. Subsequent Events

In preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through June 17, 2011, the date the financial statements were available to be issued.

USDA Rural Development Loan

On January 21, 2011, the District made a voluntary prepayment on the USDA Rural Development loan of \$73,000. The remaining outstanding balance after the prepayment was \$292,000 with a revised schedule maturity of January 1, 2024.

MoELROY, MITCHELL & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS

BUSINESS CONSULTANTS

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

PARTNERS

S. MARTIN MoELROY, JR., CPA
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ASSOCIATES

TODD BOWLEY
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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, 2010, which collectively comprise the District's basic financial statements and have issued our report thereon dated June 17, 2011. 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.

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 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting. [A-1 and A-2] 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.

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 an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item [B-1].

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

We noted certain matters that we reported to management of the Union County Water District, in a separate letter dated June 17, 2011.

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. Elroy, Mitchell & Associates, LLC

Morganfield, Kentucky
June 17, 2011

Schedule of Findings & Responses

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.

Schedule of Findings & Responses

B-1 Noncompliance Related to Bid Requirement:

We identified one instance of noncompliance with procurement and contracting requirements:

The District did not comply with bid requirements for a \$67,893 project to install a pump station on McFall Road.

Criteria: The District is required by Kentucky Revised Statute (KRS) 45A to receive competitive bids on contracts where the aggregate amount of the contract exceeds \$20,000.

Effect: Procurement laws exist to ensure a fair and impartial process that gives all interested parties an opportunity to bid for public works projects. By not ensuring this process is followed, the District may not be obtaining the best price for its projects.

Recommendation: We recommend that management review procedures and controls to ensure that all future purchases and contracts are procured within the guidelines of KRS 45A.

Response: The District concurs with the finding that the cited project did not comply with required competitive bidding. To ensure compliance, the District will strengthen its internal controls, develop exception monitoring tools, and provide continual training to employees involved in purchasing activities.

The Union County Water District is committed to operating in compliance with applicable laws and regulations with regard to purchasing. We appreciate the opportunity to respond to the issues and describe our actions to address them.