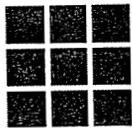


PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

JUN 26 2012

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ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010



WISE, BUCKNER, SPROWLES
& ASSOCIATES, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

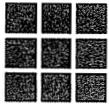
CAMPBELLSVILLE, KENTUCKY 42718
E-mail: wbscpa@windstream.net
www.wlbcpas.com
(270) 465-6842



ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

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WISE, BUCKNER, SPROWLES
& ASSOCIATES, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

GREGORY S. WISE, CPA
SHIRLEY M. BUCKNER, CPA
JEFFREY G. SPROWLES, CPA

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners of
Adair County Water District

We have audited the accompanying financial statements of the business-type activities of Adair County Water District, as of and for the years ended December 31, 2011 and 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Adair County Water District's management. Our responsibility is to express opinions 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 the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities Adair County Water District, as of December 31, 2011 and 2010, and the respective changes in financial position, and, where applicable, 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 May 31, 2012, on our consideration of the Adair 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 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 considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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 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.

301 E. MAIN STREET • P.O. BOX 1083 • CAMPBELLSVILLE, KY 42719-1083 • (270) 465-6842 • FAX (270) 465-7703
E-Mail: wbscpa@windstream.net • www.wbscpas.com

MEMBERS: AICPA • KYCPA

Board of Commissioners of
Adair County Water District
Page 2

This report is intended solely for the information and use of management, the Board of Commissioners, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Wise, Buckner, Sprowles & Associates, PLLC

Wise, Buckner, Sprowles & Associates, PLLC
Campbellsville, KY

May 31, 2012



ADAIR COUNTY WATER DISTRICT Management's Discussion and Analysis

The management of the Adair County Water District's offers all persons interested in the financial position of the Utility this narrative overview and analysis of the Utility's financial performance during the years ending December 31, 2011 and 2010. It provides an introduction to the District's 2011 financial statements. Information in this overview and analysis has been prepared by the District's CPA and should be considered in conjunction with the financial statements and notes.

Financial Highlights

Overview of the Financial Statements

The financial section of this annual report consists of the following three parts: Management's Discussion and Analysis, Basic Financial Statements and the notes to the financial statements. The basic financial statements include: the statements of net assets, the statements of revenues, expenses, and changes in net assets, and the statement of cash flows.

The MD&A is intended to explain the significant changes in financial position and differences in operation between the current and prior years. Understanding the financial trend of the District begins with understanding the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets. Looking at these two reports, you should be able to determine if the District is better off financially this year than it was in the past.

Required Financial Statements

The Financial Statements of the District report information utilizing the full accrual basis of accounting. The Financial Statements conform to accounting principles which are generally accepted in the United States of America. The statements of Net Assets include information on the District's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to Districts creditors (liabilities). The Statement of Revenues, Expense and Changes in Net Assets identify the District's revenues and expenses for the fiscal year ended December 31, 2011. This statement normally provides information on the District's operations over the past two fiscal years and can be used to determine whether the District has recovered all of its actual and projected costs through user fees and other charges. The third financial statement is the Statements of Cash Flows. This statement provides information on the District's cash receipts, cash payments and changes in cash resulting from operations, investments and financing activities. From the Statements of Cash Flows, the reader can obtain comparative information on the source and use of cash and the change in the cash and cash equivalents balance for each of the last two fiscal years.

Financial Analysis of the District

Net Assets

A summary of the District's Statements of Net Assets is presented below.

Condensed Statement of Net Assets

| | 2011 | 2010 |
|--|----------------------|----------------------|
| Cash and Investments | \$ 925,627 | \$ 676,431 |
| Other Assets | 493,074 | 1,101,333 |
| Capital Assets | <u>33,586,816</u> | <u>18,921,509</u> |
| Total Assets | 35,005,517 | 20,699,273 |
| Current Liabilities | 3,574,855 | 1,467,810 |
| Other Liabilities | 224,098 | 184,745 |
| Long-Term Outstanding | <u>8,526,676</u> | <u>6,744,917</u> |
| Total Liabilities | <u>12,325,629</u> | <u>8,397,472</u> |
| Net Assets: | | |
| Invested in Capital Assets (Net of Related Debt) | 22,010,673 | 10,956,946 |
| Restricted | 735,412 | 571,664 |
| Unrestricted | <u>(66,197)</u> | <u>773,191</u> |
| Total Net Assets | <u>\$ 22,679,888</u> | <u>\$ 12,301,801</u> |

A summarized comparison of the District's statements of revenues, expenses and changes in net assets for the years December 31, 2011, and 2010 follows:

Statement of Revenues, Expenses and Changes in Net Assets

Condensed Statement of Revenues, Expenses & Changes in Net Assets Years Ended December 31, 2011 and 2010

| | 2011 | 2010 | Dollar Change | Percent Change |
|---|------------------|------------------|------------------|-------------------|
| Operating Revenues | \$ 2,809,514 | \$ 2,366,106 | \$ 443,408 | 18.74% |
| Operating Expenses | (2,301,655) | (2,111,937) | (189,718) | 8.98% |
| Depreciation Expense | <u>(928,365)</u> | <u>(624,893)</u> | <u>(303,472)</u> | <u>48.56%</u> |
| Operating Income/(Loss) | (420,506) | (370,724) | (49,782) | 13.43% |
| Non-Operating Revenues/(Expenses) | | | | |
| Non-Utility Income | 30,824 | 13,783 | 17,041 | 123.64% |
| Operating Lease Agreement | (540,990) | 28,570 | (569,560) | -1993.56% |
| Interest Income | 3,197 | 3,512 | (315) | -8.97% |
| Miscellaneous Nonutility Expenses | (2,563) | - | (2,563) | |
| Interest Expense & Fiscal Charges | <u>(313,772)</u> | <u>(280,708)</u> | <u>(33,064)</u> | <u>11.78%</u> |
| Total Non-Operating Revenues/(Expenses) | (823,304) | (234,843) | (588,461) | 250.58% |

Statement of Revenues, Expenses and Changes in Net Assets, Continued

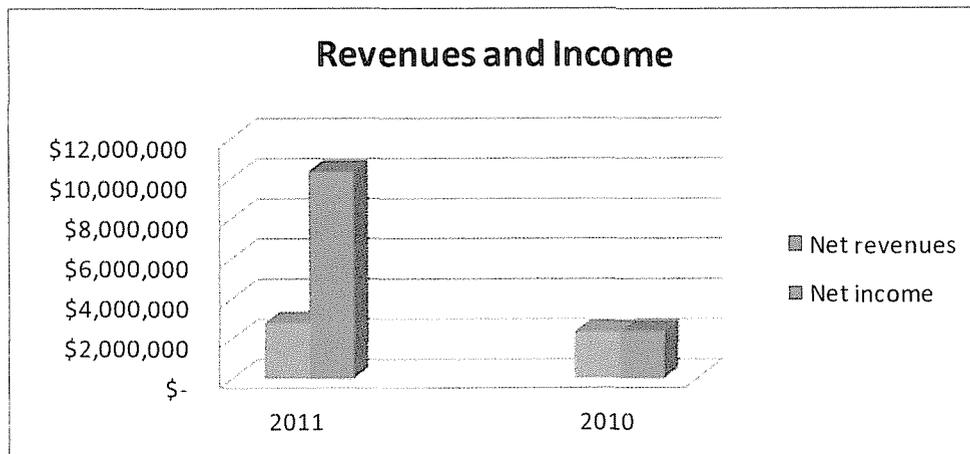
| | 2011 | 2010 | Dollar Change | Percent Change |
|--|----------------------|----------------------|----------------------|-------------------|
| Income/(Loss) Before Capital Contributions | \$ (1,243,810) | \$ (605,567) | \$ (638,243) | 105.40% |
| Capital Contributions | 11,621,897 | 2,990,310 | 8,631,587 | 288.65% |
| Increase/(Decrease) in Net Assets | 10,378,087 | 2,384,743 | 7,993,344 | 335.19% |
| Beginning of Year, Restated | 12,301,801 | 9,917,058 | 2,384,743 | 24.05% |
| End of Year | <u>\$ 22,679,888</u> | <u>\$ 12,301,801</u> | <u>\$ 10,378,087</u> | <u>84.36%</u> |

Operating revenues

A comparison of the District's revenues and net income for the years ended December 31, 2011 and 2010 is as follows:

| | 2011 | 2010 | Dollar Change | Percentage Change |
|--------------|---------------|--------------|------------------|----------------------|
| Net revenues | \$ 2,809,514 | \$ 2,366,106 | \$ 443,408 | 18.74% |
| Net income | \$ 10,378,087 | \$ 2,384,743 | \$ 7,993,344 | 335.19% |

The following graph shows the District's 2010 revenues and income in comparison to the District's 2011 revenues and income.



Operating revenues increased by \$443,408 from 2010 to 2011. The primary reasons for the increase in revenues are a combination of growth in customer base and greater water usage in 2011.

Net income increased by \$7,993,344 from 2010 to 2011. Several factors are the cause for this increase. However, the most significant reason for this increase is the increased capital contributions of \$8,631,587 and increase of operating expenses.

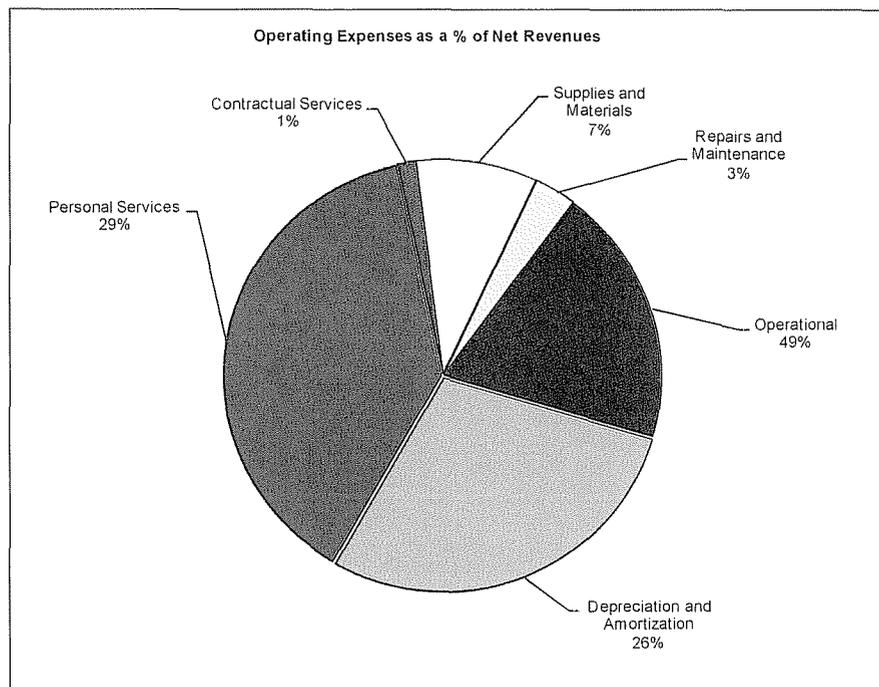
Expenses

Total operating expenses increased by \$493,190 from 2010 to 2011. The increase is primarily due to current economic conditions and the increased cost of doing business.

| Operating Expenses | 2011 | 2010 | Dollar Change | Percent Change |
|-------------------------------|---------------------|---------------------|-------------------|----------------|
| Personal Services | \$ 1,237,875 | \$ 681,858 | \$ 556,017 | 44.92% |
| Contractual Service | 44,794 | 30,063 | 14,731 | 32.89% |
| Supplies and Materials | 291,213 | 174,619 | 116,594 | 40.04% |
| Repairs and Maintenance | 100,286 | 60,030 | 40,256 | 40.14% |
| Operational | 627,487 | 1,165,367 | (537,880) | -85.72% |
| Depreciation and Amortization | 928,365 | 624,893 | 303,472 | 32.69% |
| | <u>\$ 3,230,020</u> | <u>\$ 2,736,830</u> | <u>\$ 493,190</u> | <u>15.27%</u> |

Expenses as a Percentage of Revenues

The following pie chart shows the District's expenses as a percentage of revenues.



Debt Outstanding

At December 31, 2011, the District had \$11,352,045 in debt outstanding versus \$7,597,266 for December 31, 2010.

Economic Factors and Future Planning

The primary service area of the Utility is located in Adair County; we completed a merger with the City of Columbia in July of 2011 and are now the sole provider of water and sewer in all of Adair County including the City of Columbia. The population growth for the Utility's service area has averaged 140-180

persons annually over the past ten years, and this growth rate is expected to continue into the near future. In conjunction with its master plan the Utility has maintained project and financial planning to keep pace with this growth. Rate structures are also reviewed on a consistent basis to ensure that water services are provided to customers at the best value. A rate increase has been sent to the approving agencies and should be approved in early 2012.

Our water has been purchased from four sources the Columbia/Adair County Water Commission, Russell Springs, Jamestown and Campbellsville as an emergency source.

Several projects are planned to build up our infrastructure to serve the needs of our current customer base as well as plan for future growth. One of those projects which are under construction at this time is Phase 12 which includes a new high service distribution main and a composite tank in the Southern end of Adair County. When finished we will be able to distribute more water and help increase pressure to the southern part of our service area. Since the merger with the City of Columbia has been completed we are continuing to map meters, lines and other utilities in the City of Columbia where we are planning on replacing old lines and meters in the City system that have not been updated since their first installation. This will be a two part construction project to be completed when funding is available. We have completed a small project to replace lines on three city streets and install a metering system at the city fire department.

Our next major project will be to install a high service distribution main from Highway East 80 to Hwy South 55. When this project is complete we will be able to eliminate our supply from Jamestown. Management has also planned to continue to replace our smaller distribution mains with more high service distribution mains to serve the growth in customer base and serve our existing customers better. All of this is planned along side of continuing to build our customer base with new lines and continued service to our existing customer base.

Financial Contact

The District's financial statements are designed to provide the District's customers, commissioners, creditors and other interested parties with a general overview of the District's financial operations and financial condition. If you have questions about the report or need additional financial information, please contact the District's Manager, Lennon Stone at (270) 384-2181 or P.O. Box 567, 109 Grant Lane, Columbia, KY 42728

General information relating to Adair County Water District can be found at the Utility's web site www.caud.net

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
STATEMENT OF NET ASSETS
December 31, 2011 and 2010

| | 2011 | 2010 |
|--|---------------|---------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and Cash Equivalents | \$ 190,215 | \$ 104,767 |
| Customer Accounts Receivable | 294,509 | 378,776 |
| Accounts Receivable - Other | 9,990 | 519,500 |
| Inventory | 179,916 | 160,239 |
| Prepaid Expenses | 8,659 | 42,818 |
| Total Unrestricted Current Assets | 683,289 | 1,206,100 |
| Restricted Cash and Investments | 735,412 | 571,664 |
| Total Current Assets | 1,418,701 | 1,777,764 |
| NON-CURRENT ASSETS | | |
| Capital Assets: | | |
| Land and Construction in Progress | 2,726,557 | 384,224 |
| Other Capital Assets (net of accumulated depreciation) | 30,860,259 | 18,537,285 |
| Total Non-Current Assets | 33,586,816 | 18,921,509 |
| TOTAL ASSETS | 35,005,517 | 20,699,273 |
| LIABILITIES | | |
| CURRENT LIABILITIES | | |
| Accounts Payable - Trade | 249,009 | 123,429 |
| Accounts Payable - Construction in Progress | - | 182,552 |
| Accrued and Withheld Taxes | 55,860 | 14,450 |
| Customer Deposits | 34,586 | 22,467 |
| Accrued Payroll | 11,440 | 8,523 |
| Deferred Credit | 398,593 | 264,040 |
| Liabilities Payable from Restricted Assets: | | |
| Interest Payable | 224,096 | 184,745 |
| Current Portion of Revenue Bonds Payable | 268,884 | 165,319 |
| Current Portion of Notes Payable | 2,556,485 | 687,030 |
| Total Current Liabilities | 3,798,953 | 1,652,555 |
| NON-CURRENT LIABILITIES | | |
| Long-term Liabilities (Excluding Current Portion): | | |
| Non-Current Portion of Revenue Bonds Payable | 8,526,676 | 6,744,917 |
| Total Non-Current Liabilities | 8,526,676 | 6,744,917 |
| TOTAL LIABILITIES | 12,325,629 | 8,397,472 |
| NET ASSETS | | |
| Invested in Capital Assets, Net of Related Debt | 22,010,673 | 10,956,946 |
| Restricted | 735,412 | 571,664 |
| Unrestricted | (66,197) | 773,191 |
| TOTAL NET ASSETS | \$ 22,679,888 | \$ 12,301,801 |

ADAIR COUNTY WATER DISTRICT
 DBA COLUMBIA/ADAIR UTILITIES DISTRICT
 STATEMENTS OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS
 Years Ended December 31, 2011 and 2010

| | County Water | City Water | Sewer | Total 2011 | 2010 |
|--|-----------------|---------------|------------|----------------------|----------------------|
| OPERATING REVENUES | | | | | |
| Water Sales | \$ 2,123,095 | \$ 261,756 | \$ 295,995 | \$ 2,680,846 | \$ 2,175,021 |
| Service Charges and Other | 126,898 | 1,770 | - | 128,668 | 191,085 |
| Total Operating Revenues | 2,249,993 | 263,526 | 295,995 | 2,809,514 | 2,366,106 |
| OPERATING EXPENSES | | | | | |
| Personal Service | 777,927 | 260,664 | 199,284 | 1,237,875 | 681,858 |
| Contractual Services | 33,061 | 4,436 | 7,297 | 44,794 | 30,063 |
| Supplies and Materials | 207,641 | 72,126 | 11,446 | 291,213 | 174,619 |
| Repairs and Maintenance | 62,701 | 15,697 | 21,888 | 100,286 | 60,030 |
| Operational | 442,714 | 107,306 | 77,467 | 627,487 | 1,165,367 |
| Depreciation and Amortization | 665,813 | 48,931 | 213,621 | 928,365 | 624,893 |
| Total Operating Expenses | 2,189,857 | 509,160 | 531,003 | 3,230,020 | 2,736,830 |
| OPERATING INCOME/(LOSS) | 60,136 | (245,634) | (235,008) | (420,506) | (370,724) |
| NON-OPERATING REVENUES (EXPENSES) | | | | | |
| Other Non-Utility Income | 30,824 | - | - | 30,824 | 13,783 |
| Operating Lease - City | 174,336 | - | - | 174,336 | 28,570 |
| Operating Lease -Water Plant | (715,326) | - | - | (715,326) | - |
| Interest Income | 3,197 | - | - | 3,197 | 3,512 |
| Miscellaneous Nonutility Expenses | (1,167) | (773) | (623) | (2,563) | - |
| Interest Expenses and Fiscal Charges | (263,795) | (10,542) | (39,435) | (313,772) | (280,708) |
| Total Non-Operating Revenues (Expenses) | (771,931) | (11,315) | (40,058) | (823,304) | (234,843) |
| INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS | (711,795) | (256,949) | (275,066) | (1,243,810) | (605,567) |
| Capital Contributions | 1,782,754 | 3,000 | 9,836,143 | 11,621,897 | 2,990,310 |
| Grants | - | - | - | - | - |
| INCREASE (DECREASE) IN NET ASSETS | 1,070,959 | (253,949) | 9,561,077 | 10,378,087 | 2,384,743 |
| NET ASSETS | | | | | |
| Beginning of Year, Restated | | | | 12,301,801 | 9,917,058 |
| End of Year | | | | <u>\$ 22,679,888</u> | <u>\$ 12,301,801</u> |

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
STATEMENT OF CASH FLOWS
Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|--|--------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash Received From Customers | \$ 2,908,321 | \$ 2,279,771 |
| Cash Payments to Employees for Services | (1,193,547) | (671,093) |
| Cash Payments to Suppliers for Goods and Services | (938,199) | (1,446,303) |
| Customer Deposits Received | 35,575 | 20,600 |
| Customer Deposits Returned | (23,515) | (14,740) |
| | 788,635 | 168,235 |
| Net Cash Provided/(Used) By Operating Activities | | |
| | | |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Principal Paid on Debt | (258,919) | (2,109,861) |
| Interest Paid on Debt | (318,066) | (248,183) |
| Loan Proceeds | 1,869,455 | 1,233,390 |
| Bond Proceeds | - | 1,100,000 |
| Acquisition of Capital Assets | (2,706,047) | (2,812,359) |
| Contributed Capital | 870,940 | 2,554,262 |
| | (542,637) | (282,751) |
| Net Cash Provided/(Used) By Investing Activities Related Financing Activities | | |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest | 3,198 | 3,513 |
| | 3,198 | 3,513 |
| Net Cash Provided/(Used) By Investing Activities | | |
| | | |
| Net Increase/(Decrease) In Cash and Cash Equivalents | 249,196 | (111,003) |
| Cash and Cash Equivalents - Beginning of Year | 676,431 | 787,434 |
| Cash and Cash Equivalents - End of Year | \$ 925,627 | \$ 676,431 |
| | | |
| RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET ASSETS | | |
| Cash and Cash Equivalents | \$ 190,215 | \$ 104,767 |
| Short-Term Investments | - | - |
| Restricted Cash | 735,412 | 571,664 |
| | \$ 925,627 | \$ 676,431 |
| TOTAL CASH AND CASH EQUIVALENTS | | |
| | | |
| NONCASH ITEMS: | | |
| Contributed Capital from City Water & Sewer Assets | \$10,751,457 | |

ADAIR COUNTY WATER DISTRICT
 DBA COLUMBIA/ADAIR UTILITIES DISTRICT
 STATEMENT OF CASH FLOWS (CONTINUED)
 Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|---|--------------|--------------|
| RECONCILIATION OF OPERATING INCOME/(LOSS) TO NET CASH PROVIDED/(USED) FOR OPERATING ACTIVITIES | | |
| Operating Margin | \$ (420,506) | \$ (370,724) |
| ADJUSTMENTS TO RECONCILE OPERATING INCOME/(LOSS) TO NET CASH PROVIDED/(USED) FOR OPERATING ACTIVITIES | | |
| Depreciation | 928,365 | 624,893 |
| Change in Assets and Liabilities: | | |
| (Increase)/Decrease in Accounts Receivable | 84,267 | (169,096) |
| (Increase)/Decrease in Inventory | (19,677) | 14,830 |
| (Increase)/Decrease in Prepaid Expenses | 34,159 | 12,416 |
| Increase/(Decrease) in Accounts Payable | 125,581 | 27,273 |
| Increase/(Decrease) in Salaries and Wages Payable | 2,917 | 8,523 |
| Increase/(Decrease) in Customer Deposits | 12,119 | 5,670 |
| Increase/(Decrease) in Accrued and Withheld Taxes | 41,410 | 14,450 |
| Total Reconciling Adjustments | 1,209,141 | 538,959 |
| NET CASH PROVIDED/(USED) BY OPERATING ACTIVITIES | \$ 788,635 | \$ 168,235 |

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 1: DESCRIPTION OF ENTITY

Reporting Entity - The Adair County Water District Commissioners have financial accountability and control over all activities related to the water district. The district's primary source of income is derived from water sales. The district also receives funding from federal government sources and must comply with the requirements of those funding source entities.

The District operates under rules established by the Public Service Commission (PSC) of Kentucky. Accounting records of the District are maintained in accordance with the Uniform System of Accounts prescribed by the PSC.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The accounts of Adair County Water District are maintained in accordance with the principles of fund accounting. Under fund accounting, resources for various purposes are classified for accounting and reporting purposes into funds established according to their nature and purpose. Separate accounts are maintained for each fund; however, the district uses only one fund type known as a proprietary fund type.

The proprietary fund type is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of this fund are included on the statement of net assets. Net assets (i.e., net of total liabilities) is segregated into invested in capital assets, net of related debt; restricted and unrestricted.

FASB Pronouncements - Since the District uses a proprietary fund, it applies all applicable Financial Accounting Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins (ARB's) of the Committee on Accounting Procedures. The only exception in use of the aforementioned pronouncements is those that conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements.

Cash, Cash Equivalents and Investments - The District considers all highly liquid investments with a remaining maturity of 90 days or less when purchased to be cash equivalents. Investments are presented at fair value. Short-term investments generally mature or are otherwise available for withdrawal in less than one year.

Inventory - Inventories are generally used for construction, operation and maintenance work rather than for resale. Materials and supplies inventory consists principally of spare parts that are recorded when purchased and expensed when used. Inventory is stated at the lower of cost or market value. Cost is generally determined on a first-in, first-out basis.

Restricted Assets

Certain proceeds from revenue bonds and funds set aside for their repayment are classified as restricted on the statement of net assets because their use is limited to applicable bond covenants. Current liabilities payable from these restricted assets are classified as such. When both restricted and unrestricted assets will be used for a project, it is the District's policy to use restricted assets first, then finish with unrestricted.

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets and Related Depreciation – The utility plant and equipment was recorded at cost. Depreciation is computed using the straight-line method over the plant's estimated useful life of 40 years. The office building is depreciated on a straight-line basis over an estimated useful life of 20 years. Machinery, office equipment and service vehicles are depreciated on a straight-line basis over their estimated useful life ranging from 5 to 10 years.

Long-Term Obligations

Long-term debt and other obligations are reported as district liabilities. Bond Issue Costs are being amortized and charged to expense over the term of the outstanding revenue bonds by use of the straight-line method.

Revenues and Expenses

Revenues and expenses are distinguished between operating and non-operating items. Operating revenues generally result from providing services and producing, and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Charges for Services

District billings are rendered and recorded monthly based on metered usage.

Capital Contributions

Cash and capital assets are contributed to the District by external parties. The value of property contributed to the District is reported as revenue on the statement of revenues, expenses and changes in net assets.

Net Assets

Net assets comprise the various net earnings from operating income, non-operating revenues and expenses, and capital contributions. Net assets are classified in the following three components:

Invested in capital assets, net of related debt—This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted—This component of net assets consists of constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets—this component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

ADAIR COUNTY WATER DISTRICT
 DBA COLUMBIA/ADAIR UTILITIES DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 For the Years Ended December 31, 2011 and 2010

NOTE 3: CASH AND CASH EQUIVALENTS AND INVESTMENTS

A comparison of the District's cash and investments is shown below:

| | December 31, 2011 | December 31, 2010 |
|-------------------------------------|----------------------|----------------------|
| Unrestricted: | | |
| Cash | \$ 190,215 | \$ 104,767 |
| Certificates of Deposit and Savings | - | - |
| Total Unrestricted | 190,215 | 104,767 |
| Restricted: | | |
| Cash | 517,636 | 408,675 |
| Certificates of Deposit and Savings | 217,776 | 162,989 |
| Total Restricted | 735,412 | 571,664 |
| Total Cash and Cash Equivalents | \$ 925,627 | \$ 676,431 |

There are three categories of credit risk that apply to the government's bank balance:

1. Insured or collateralized with securities held by the government or by the government's agent in the government's name.
2. Collateralized with securities held by the pledging financial institution's trust department or the government's agent in the government's name.
3. Uncollateralized.

| | 2011 | 2010 |
|---|------------------|------------------|
| Insured (FDIC) or Collateral Held by Pledging Bank Securities in District's Name | \$ 2,457,045 | \$ 2,711,527 |
| Uninsured or Uncollateralized | - | - |
| Total (Memorandum Only) | \$ 2,457,045 | \$ 2,711,527 |

The District investment policy is conservative.

Deposits

The carrying amount of the District's deposits at December 31, 2011 was \$925,627 and the bank balance was \$925,153. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. Of the bank balance, \$500,000 was insured by federal depository insurance and the rest was collateralized by the pledging financial institutions.

Restricted Assets

These assets consist of cash restricted in a sinking fund and depreciation reserve fund as required by the revenue bonds plus cash received from the United States Fidelity and Guaranty Company for repairs to the system constructed by Roy Brothers.

ADAIR COUNTY WATER DISTRICT
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NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 4: CUSTOMER AND OTHER ACCOUNTS RECEIVABLES

Customer and other accounts receivables were as follows:

| | 2011 | 2010 |
|---------------------------------|------------|------------|
| Accounts Receivable - Trade | \$ 485,154 | \$ 515,888 |
| Allowance for Doubtful Accounts | (190,645) | (137,112) |
| Net | \$ 294,509 | \$ 378,776 |

NOTE 5: CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2011 and 2010 was as follows:

| | Balance 12/31/10 | Additions | Deletions | Balance 12/31/11 |
|---|---------------------|---------------|-----------|---------------------|
| Capital Assets Not Being Depreciated | | | | |
| Land and Land Rights | \$ 384,224 | \$ 41,700 | \$ - | \$ 425,924 |
| Construction in Progress | - | 2,300,633 | - | 2,300,633 |
| Total Assets Not Being Depreciated | 384,224 | 2,342,333 | - | 2,726,557 |
| Capital Assets Being Depreciated | | | | |
| Office Equipment | 173,147 | 680 | - | 173,827 |
| Service Equipment | 471,510 | 122,776 | - | 594,286 |
| Building | 364,434 | - | - | 364,434 |
| Plant and Equipment | 24,734,285 | 18,758,723 | - | 43,493,008 |
| Total Assets Being Depreciated | 25,743,376 | 18,882,179 | - | 44,625,555 |
| Total Capital Assets | \$ 26,127,600 | \$ 21,224,512 | \$ - | \$ 47,352,112 |
| Less: Accumulated Depreciation | | | | |
| Office Equipment | \$ 151,439 | \$ 18,778 | \$ - | \$ 170,217 |
| Service Equipment | 362,206 | 42,233 | - | 404,439 |
| Plant and Equipment | 6,692,446 | 6,498,194 | - | 13,190,640 |
| Total Accumulated Depreciation | 7,206,091 | 6,559,205 | - | 13,765,296 |
| Net Capital Assets | \$ 18,921,509 | \$ 14,665,307 | \$ - | \$ 33,586,816 |

Depreciation expense for the year ended December 31, 2011 was \$928,365.

NOTE 6: SHORT-TERM DEBT

The District has interim financing through a local bank of \$2,281,485 for a project in progress (interest rate 2.6%) and short-term loans of \$225,000 (interest 5%) and \$50,000 (interest 3.5%) to purchase land.

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 7: LONG-TERM OBLIGATIONS

Revenue Bonds and Debt with principal payments due annually on January 1 are detailed as follows:

| | <u>2011</u> | <u>2010</u> |
|---|-------------|-------------|
| 1974 Waterworks Revenue Bond, original amount \$80,000 maturing January 1, 2014, with interest payments due semi-annually on January 1, and July 1, at a rate of 5% | \$ 12,000 | \$ 15,500 |
| 1975 Utilities Revenue Bond, original amount \$96,000 maturing October 1, 2015 with interest payments due semi-annual on April 1, October 1 at a rate of 5% | 22,000 | - |
| 1977 Utilities Revenue Bond, original amount \$998,000 maturing October 1, 2016 with interest payments due semi-annual on April 1, October 1 at a rate of 5% | 250,000 | - |
| 1978 Waterworks Revenue Bond, original amount \$363,000 maturing January 1, 2018 with interest payments due semi-annually on January 1, July 1, at a rate of 5% | 138,000 | 152,000 |
| 1985 Water District Water Revenue Bond, original amount \$1,155,000 maturing January 1, 2025, with interest payments due annually on January 1 at a rate of 5% | 790,000 | 821,000 |
| Series A of 1988 Utilities Revenue Bond, original amount \$750,000 maturing October 1, 2028, with interest payments due semi-annual April 1, October 1, at a rate of 5% | 530,955 | - |
| Series B of 1988 Utilities Revenue Bond, original amount \$200,000 maturing October 1, 2028, with interest payments due semi-annual April 1, October 1, at a rate of 5% | 131,788 | - |
| 1989 Water District Water Revenue Bond, original amount \$200,000 maturing January 1, 2022, with interest payments due annually on January 1 at a rate of 6% | 115,000 | 122,000 |
| 1992 Water District Water Revenue Bond, original amount \$745,000 maturing January 1, 2032, with interest payments due annually on January 1 at a rate of 5% | 567,000 | 582,000 |
| 1995 Water District Water Revenue Bond, original amount \$428,000 maturing January 1, 2035, with interest payments due annually on January 1 at a rate of 4.5% | 344,000 | 353,000 |
| 1995 Utilities Revenue Bond, original amount \$125,000 maturing October 1, 2034, with interest payments due semi-annual on April 1, October 1, at a rate of 4.50% | 99,900 | - |
| 1998 Water District Water Revenue Bond, original amount \$427,000 maturing January 1, 2035, with interest payments due annually on January 1 at a rate of 4.5% | 364,000 | 370,000 |
| 2000 Utilities Revenue Bond, original amount \$501,000 maturing October 1, 2040, with interest payments due semi-annual on April 1, October 1 at a rate of 4.50% | 444,700 | - |

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 7: LONG-TERM OBLIGATIONS (CONTINUED)

| | <u>2011</u> | <u>2010</u> |
|---|---------------------|---------------------|
| 2003 Water District Water Revenue Bond, original amount \$627,000 maturing January 1, 2042, with interest payments due annually on January 1 at a rate of 4.5% | \$ 574,500 | \$ 583,000 |
| 2004 Utilities Revenue Bond, original amount \$495,000 maturing October 1, 2043, with interest payments due semi-annual on April 1, October 1 at a rate of 4.25% | 459,000 | - |
| 2005 Water District Water Revenue Bond, original amount \$1,238,000 maturing January 1, 2045, with interest payments due annually on January 1 at a rate of 4.25% | 1,152,000 | 1,168,000 |
| 2007 Water District Water Revenue Bond, original amount \$752,000 maturing January, 2046, with interest payments due annually on January 1 at a rate of 4.25% | 726,000 | 735,000 |
| 2008 Utilities Revenue Bond, original amount \$115,000 maturing October 1, 2047 with interest payments due semi-annual on April 1, October 1 at a rate of 4.125% | 112,300 | - |
| 2008 Kentucky Infrastructure Authority Loan, original amount \$1,000,000 maturing December 2028, at a rate of 1% | 862,417 | 908,736 |
| 2009 Water District Water Revenue Bond, original amount \$1,100,000 maturing January 2050, with interest payments due semi-annually on January and July 1, at a rate of 2.38% | <u>1,100,000</u> | <u>1,100,000</u> |
| Total Debt | 8,795,560 | 6,910,236 |
| Payments Due in Less Than One Year | <u>(268,884)</u> | <u>(165,319)</u> |
| Total Long-Term Obligations | <u>\$ 8,526,676</u> | <u>\$ 6,744,917</u> |

The annual requirements to amortize all bonded debt outstanding as of December 31, 2011 are as follows:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-----------|---------------------|---------------------|----------------------|
| 2012 | \$ 268,884 | \$ 351,892 | \$ 620,776 |
| 2013 | 282,353 | 340,466 | 622,819 |
| 2014 | 307,226 | 328,292 | 635,518 |
| 2015 | 317,105 | 315,486 | 632,591 |
| 2016 | 325,288 | 302,182 | 627,470 |
| 2017-2021 | 1,502,160 | 1,322,352 | 2,824,512 |
| 2022-2026 | 1,662,389 | 1,000,290 | 2,662,679 |
| 2027-2031 | 1,261,013 | 692,898 | 1,953,911 |
| 2032-2036 | 1,111,442 | 423,740 | 1,535,182 |
| 2037-2041 | 964,100 | 236,725 | 1,200,825 |
| 2042-2046 | 612,400 | 64,500 | 676,900 |
| 2047-2051 | 181,200 | 9,257 | 190,457 |
| | <u>\$ 8,795,560</u> | <u>\$ 5,388,080</u> | <u>\$ 14,183,640</u> |

ADAIR COUNTY WATER DISTRICT
 DBA COLUMBIA/ADAIR UTILITIES DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 For the Years Ended December 31, 2011 and 2010

NOTE 8: BONDING COMPANY SETTLEMENT

A summary of the guaranteed payments from the United States Fidelity and Guaranty Company resulting from the settlement with the district regarding leakage of lines and repairs to those lines.

| | Total |
|--|------------|
| Repairs: \$8,000 per year, starting November 1, 1984, for a period of 15 years | \$ 120,000 |
| Leakage: \$5,280 per year, starting November 1, 1984, for a period of 37 years | \$ 195,360 |

LUMP SUM PAYMENTS

| | |
|---------------------------|-------------------|
| November 1, 1994 | \$ 50,000 |
| November 1, 2000 | 50,000 |
| November 1, 2004 | 50,000 |
| November 1, 2009 | 50,000 |
| November 1, 2014 | 100,000 |
| November 1, 2019 | <u>100,000</u> |
| Total Guaranteed Payments | <u>\$ 715,360</u> |

NOTE 9: RISK MANAGEMENT

The Adair County Water District is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; injuries to employees; errors and omissions and natural disasters. The District purchases commercial insurance to cover any of these instances. The District did not have settled claims that exceeded the District's commercial insurance coverage in any of the past three years.

NOTE 10: PENSION PLAN

Substantially all employees are covered under the County Employees Retirement System (CERS). Funding for the Plan is provided through payroll withholdings of 5% and a District contribution for the years ended June 30, 2011, 2010 and 2009 of 18.96%, 16.93% and 13.55% for Non Hazardous Employee's. The contribution rate is actuarially determined. The District's contribution requirement for CERS for the years ended June 30, 2011, 2010 and 2009 was \$183,753, \$99,399 and \$68,019 from the District and \$50,816, \$29,836 and \$22,723 from employees. The total covered payroll for CERS during the years ended June 30, 2011, 2010 and 2009 was \$957,752, \$596,710 and \$455,068.

The County Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

NOTE 11: BASIS FOR EXISTING RATES

Current water rates were approved by the PSC on June 14, 2007 and became effective with the November 2007 billing period. In January 2012 the District received the approval from PSC for a rate increase.

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 12: OPERATING LEASE AGREEMENT

Effective July 30, 2010, the City of Columbia and the Adair County Water District entered into an operating agreement where the City turned over the operation of their water distribution system, waste water collection and treatment system.

The operation agreement is recorded as an operating lease agreement in the financial statements until the Asset Purchase Agreement was completed in July, 2011.

On December 14, 2010 the District and the Columbia/Adair County Water Commission ("Water Commission") executed a statement of intent whereby the Water Commission stated its intent to transfer to the District through an Asset Purchase Agreement all ownership of assets and assumption of debt obligations. The transfer cannot be completed until the Kentucky Public Service Commission ("the PSC") has entered a final order authorizing the transfer of assets and debt from the Water Commission to the District.

Effective January 1, 2011 the District entered into an operating agreement with the Water Commission where the District shall manage, operate, repair, and maintain the Water Commission's water treatment plant. They would also make the required monthly transfers to the Sinking Fund and Reserve Fund accounts commencing February 10, 2011 in the amount of \$56,720, the lease is in effect until the completion of the Asset Purchase Agreement. The required transfer and assumption of all operating would take the place of the District paying for water consumption. The District paid the Water Commission \$889,000 for water in 2010.

NOTE 13: PRIOR PERIOD ADJUSTMENTS

During the year, the District became aware of not recording the reserve for subdivision refund correctly on their books. Accordingly, beginning Capital Assets (\$527,766), Accumulated Depreciation (\$120,036), Reserve (\$264,040) and Net Assets (\$143,695) were restated on the Statement of Net Assets by the amount shown.

NOTE 14: ASSET PURCHASE AGREEMENT

In July, 2011, the Asset Purchase Agreement with the City of Columbia and Adair County Water District was completed after approval was received from the PSC and USDA which resulted in the following changes to the Statement of Net Assets:

Capital Assets net of Accumulated Depreciation for the water increased \$2,024,946; Capital Assets net of Accumulated Depreciation for the sewer increased \$10,870,754; Restricted Cash increased \$391,317; Long-term Debt for the water increased \$491,500; and Long-term Debt for the sewer increased \$1,652,743.

Additionally, Contributed Capital increased \$11,142,774 on the Statement of Revenues and Expenditures.

NOTE 15: SUBSEQUENT EVENTS

The District's management has evaluated subsequent events through May 31, 2012.

ADAIR COUNTY WATER DISTRICT
DBA COLUMBIA/ADAIR UTILITIES DISTRICT
SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
For the Year Ended December 31, 2011

The audit of Adair County Water District for the year ended December 31, 2010, revealed no audit findings requiring corrective action.



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*

To the Board of Commissioners of
Adair County Water District

We have audited the financial statements of the business-type activities of Adair County Water District, as of and for the year ended December 31, 2011, which collectively comprise the Adair County Water District's basic financial statements and have issued our report thereon dated May 31, 2012. 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.

Internal Control Over Financial Reporting

Management of Adair County Water District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we consider Adair 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 Adair County Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Adair County Water 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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 a 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 consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses. 2011-1

A significant deficiency is a deficiency, or 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 Adair 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 those 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Adair County Water District, in a separate letter dated May 31, 2012.

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

This report is intended solely for the information and use of management, the Board of Commissioners, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Wise, Buckner, Sprowles & Associates, PLLC

Wise, Buckner, Sprowles & Associates, PLLC
Campbellsville, KY

May 31, 2012

ADAIR COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2011

Internal Control Over Financial Reporting

2011-1 - Preparation of Financial Statements

- Condition: Personnel at the District do not have sufficient expertise in selecting and applying accounting principles to prepare financial statements in accordance with generally accepted accounting principles. They also have not been recording developer refunds according to 807 KAR 5:066.
- Criteria: Management needs to exercise control over the preparation of its financial statements. To exercise control, management must possess the necessary accounting expertise to prevent, detect and correct a potential misstatement in its financial statements.
- Effect: Management may not be able to detect and correct potential misstatements in its financial statements.
- Recommendation: The Board of Directors should be aware that this condition is a material weakness and will be in future years unless management is able to prepare their financial statements in accordance with the generally accepted accounting principles.
- Management's Response: While management understands the importance of correcting this deficiency, the cost of correcting the deficiency by hiring independent or in-house accounting staff would be prohibitive, especially under current budget and revenue constraints. Staff is working to correct this deficiency in-house by seeking additional training.