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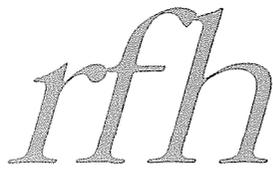
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**EAST PENDLETON COUNTY
WATER DISTRICT
Falmouth, Kentucky**

**FINANCIAL STATEMENTS
December 31, 2011 and 2010**

CONTENTS

Independent Auditors' Report.....	1
Financial Statements	
Balance Sheets.....	2
Statements of Revenues, Expenses and Changes in Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	5-10
Independent Auditors' Report on Compliance and Internal Control in Accordance with Governmental Auditing Standards	11-12



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INDEPENDENT AUDITORS' REPORT

Board of Commissioners
East Pendleton County Water District
Falmouth, Kentucky

J. Carroll Luby, CPA

We have audited the accompanying balance sheets of East Pendleton County Water District as of December 31, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the 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 general purpose 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.

East Pendleton County Water District has not presented the Management Discussion and Analysis, that accounting principles generally accepted in the United States of America 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 financial position of East Pendleton County Water District as of December 31, 2011 and 2010 and the results of its operations and its cash flows 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 a report dated March 21, 2012 on our consideration of East Pendleton County Water District's internal control over financial reporting and 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 read in conjunction with this report in considering the results of our audit.

Ray, Foley, Hensley & Company
RAY, FOLEY, HENSLEY & COMPANY, PLLC
March 21, 2012

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EAST PENDLETON COUNTY WATER DISTRICT
BALANCE SHEETS
December 31,

ASSETS	2011	2010
Current assets		
Cash	\$ 128,070	\$ 179,897
Accounts receivable customers, net	62,180	82,932
Other receivables	<u>-</u>	<u>9,750</u>
Total current assets	<u>190,250</u>	<u>272,579</u>
Restricted assets		
Cash	236,225	245,894
Cash - construction	219,008	252,946
Certificates of deposit	<u>247,349</u>	<u>243,943</u>
Total restricted assets	<u>702,582</u>	<u>742,783</u>
Capital assets		
Property, plant and equipment- Water	6,681,889	6,620,745
Less: accumulated depreciation- Water	(2,823,734)	(2,655,647)
Property, plant and equipment- Sewer	34,197	31,122
Less: accumulated depreciation- Sewer	<u>(23,050)</u>	<u>(21,676)</u>
Total capital assets	<u>3,869,302</u>	<u>3,974,544</u>
Other assets		
Inventory	15,728	15,468
Bond closing costs	<u>41,961</u>	<u>45,286</u>
Total other assets	<u>57,689</u>	<u>60,754</u>
Total assets	<u>\$ 4,819,823</u>	<u>\$ 5,050,660</u>
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable	\$ 29,310	\$ 30,292
Taxes payable	3,345	4,627
Customer deposits	30,715	29,215
Accrued interest payable	20,723	22,421
Current portion of debt	<u>58,400</u>	<u>74,800</u>
Total current liabilities	<u>142,493</u>	<u>161,355</u>
Long-term debt		
KIA note payable	67,500	80,000
Bonds payable, net	<u>1,356,700</u>	<u>1,402,600</u>
Total long-term debt	<u>1,424,200</u>	<u>1,482,600</u>
Net assets		
Invested in capital assets, net of related debt	2,386,702	2,417,144
Restricted for debt service	259,900	269,206
Restricted for depreciation	223,674	220,631
Unrestricted	<u>382,854</u>	<u>499,724</u>
Total net assets	<u>3,253,130</u>	<u>3,406,705</u>
Total liabilities and net assets	<u>\$ 4,819,823</u>	<u>\$ 5,050,660</u>

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

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES AND CHANGES
IN NET ASSETS
for the years ended December 31,

	2011	2010
OPERATING INCOME		
Water sales	\$ 838,285	\$ 911,160
Sewer sales	21,197	22,410
Other revenue	<u>26,352</u>	<u>28,050</u>
Total operating income	<u>885,834</u>	<u>961,620</u>
OPERATING EXPENSES		
Water purchases	207,352	226,422
Pumping	34,287	36,645
Operation	240,662	228,432
Maintenance	18,043	9,957
General and administrative	<u>305,368</u>	<u>298,946</u>
Total operating expense	<u>805,712</u>	<u>800,402</u>
Operating income before depreciation	80,122	161,218
Depreciation expense	(178,689)	(175,713)
Amortization expense	<u>(3,325)</u>	<u>(3,325)</u>
Total depreciation and amortization expense	<u>(182,014)</u>	<u>(179,038)</u>
OPERATING INCOME (LOSS)	(101,892)	(17,820)
Non-operating income (expenses)		
Interest income	5,787	8,730
Gain on asset disposition	4,728	-
Interest expense related to debt	(77,370)	(73,615)
Fees	<u>(180)</u>	<u>(200)</u>
(LOSS) BEFORE CAPITAL CONTRIBUTIONS	(168,927)	(82,905)
Capital contributions		
Grants	-	390,241
Contributed by customers	-	25,000
Tap fees	<u>15,352</u>	<u>37,421</u>
Change in net assets	(153,575)	369,757
Net assets, beginning of year	<u>3,406,705</u>	<u>3,036,948</u>
NET ASSETS, END OF YEAR	<u>\$ 3,253,130</u>	<u>\$ 3,406,705</u>

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

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
for the years ended December 31,

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 916,336	\$ 940,355
Payments to suppliers	(374,935)	(381,072)
Payments for employee services and benefits	<u>(431,981)</u>	<u>(416,739)</u>
Net cash provided by operating activities	<u>109,420</u>	<u>142,544</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Retirement of note principal	(74,800)	(72,500)
Proceeds on sale of fixed assets	5,000	-
Interest paid	(79,068)	(73,615)
Construction in progress	-	(49,137)
Tap fee	15,352	37,421
Customer contributions	-	25,000
Purchase of fixed assets	<u>(73,719)</u>	<u>(25,275)</u>
Net cash used by financing activities	<u>(207,235)</u>	<u>(158,106)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in certificates of deposit	(3,406)	(4,414)
Interest income	<u>5,787</u>	<u>8,730</u>
Net cash provided by investing activities	<u>2,381</u>	<u>4,316</u>
NET INCREASE (DECREASE) IN CASH	(95,434)	(11,246)
Cash at beginning of year	<u>678,737</u>	<u>689,983</u>
CASH AT END OF YEAR	<u>\$ 583,303</u>	<u>\$ 678,737</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	\$ (101,892)	\$ (17,820)
Noncash items included in operating income		
Depreciation	178,689	175,713
Amortization	3,325	3,325
Fees	(180)	(200)
Changes in assets and liabilities		
(Increase) decrease in accounts receivables	20,752	(10,658)
(Increase) decrease in other receivables	9,750	(9,750)
(Increase) decrease in inventory	(260)	(1,803)
Increase (decrease) in accounts payable	(982)	(1,039)
Increase (decrease) in other payables	(1,282)	156
Increase (decrease) in customer deposits	<u>1,500</u>	<u>4,560</u>
Net cash provided by operating activities	<u>\$ 109,420</u>	<u>\$ 142,484</u>

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

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2011 and 2010

1. ORGANIZATION AND ACCOUNTING POLICIES

The East Pendleton County Water District was created and organized as a public body corporate in Pendleton County, Kentucky, pursuant to Chapter 74 of the Kentucky Revised Statutes, by the Pendleton Fiscal Court to operate a water distribution system.

Reporting Entity

The East Pendleton County Water District's financial statements include the operations of all entities for which the District exercises oversight responsibility. Oversight responsibility includes, but is not limited to, financial interdependency, selection of the governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters. The entities included in the financial statements are the general operations of the District.

There are no other entities that are subject to the District's oversight responsibility as indicated above.

Basis of Accounting

The District's financial statements are presented in conformity with the provisions of GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*.

The net assets of the District are classified into three categories; invested in capital assets net of related debit, restricted and unrestricted. The restricted net assets consist of reserves for bond retirement and depreciation costs relating to the construction, replacement, extension, additions and/or improvements to the system. These reserves are discussed in note 3.

When both restricted and unrestricted resources are available for use, the District's Board of Commissioners makes a determination as to which resource should be used.

The District applies all applicable Financial FASB and AICPA pronouncements issued on or before November 30, 1989 that are not in conflict with applicable GASB pronouncements.

The accrual basis of accounting is utilized by the District. Under this method, revenues are recognized when earned and expenses are recognized when incurred.

The District reports all revenues and expenses as operating, except interest income, interest expense, amortization, gains and losses on disposal of assets, and capital contributions.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the District defines cash as cash on hand, cash in bank, money market funds in both unrestricted and restricted accounts, and certificates of deposit with a maturity of less than 90 days.

Accounts Receivable

The District's accounts receivable reserve represents its estimate of all uncollectible accounts. The reserves for both 2011 and were \$3,500.

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2011 and 2010**

6. RETIREMENT PLAN , continued

Contributions – For the year ended December 31, 2011, plan members were required to contribute 5.00% of wages for non-hazardous job classifications. Employees hired after September 2008 are required to contribute an additional 1% to cover the cost of medical insurance that is provided through CERS. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended December 31, 2011, participating employers contributed 16.93% through June 30 and 18.96% thereafter, of each hazardous employee's wages, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

The required contribution and the actual percentage contributed for the District for the current and previous two years are as follows:

<u>Year</u>	<u>Required Contribution</u>	<u>Percentage Contributed</u>
2011	\$ 67,176	100%
2010	\$ 58,108	100%
2009	\$ 48,833	100%

7. 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. In addition to its general liability insurance, the district also carries commercial insurance for all other risks of loss such as worker's compensation and employee health and accident coverage. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

8. RECLASSIFICATIONS

Total amounts for 2010 are presented herein for comparative purposes only and in some instances have been reclassified from the amount presented in the prior year's audited financial statements.

9. SUBSEQUENT EVENTS

The District has evaluated and considered the need to recognize or disclose subsequent events through March 21, 2012, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the year ended December 31, 2011, have not been evaluated by the District.

**EAST PENDLETON COUNTY WATER DISTRICT
INDEPENDENT AUDITORS' 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**

Board of Commissioners
East Pendleton County Water District
Falmouth, Kentucky

We have audited the financial statements of East Pendleton County Water District (the "District") as of and for the year ended December 31, 2011, and have issued our report thereon dated March 21, 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

In planning and performing our audit, we considered the 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 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 identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be material weaknesses in internal control over financial reporting. (2011-1).

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We did not identify any deficiencies in internal control that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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**.

This communication is intended solely for the information and use of management, the Board of Directors, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Ray, Foley, Hensley, & Company

Ray, Foley, Hensley & Company, PLLC
March 21, 2012

**EAST PENDLETON WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
DECEMBER 31, 2011**

FINDING:

2011-1

The District is required to have internal controls in place that enable it to prepare complete financial statements, including note disclosures, in compliance with generally accepted accounting principles.

The District lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures and thus, does not have the internal control procedures required to take responsibility for the financial statements in conformity with generally accepted accounting principles.

Management engaged the auditor to prepare draft financial statements, including the related notes to the financial statements. Management reviewed, approved and accepted responsibility for the financial statements prior to their issuance.

We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements or review the financial statements as prepared by the auditor for compliance with generally accepted accounting principles.

RESPONSE:

This is an ongoing finding. Management has determined that it is more cost effective to continue to engage the auditor to draft the financial statements and related notes.