

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH
MAR 30 2012
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EXAMINED BY _____

HENRY COUNTY WATER DISTRICT #2
BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORTS
At December 31, 2011 and 2010

**HENRY COUNTY WATER DISTRICT #2
BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORTS**

Years Ended December 31, 2011 and 2010

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To the Commissioners of the
Henry County Water District #2
Campbellsburg, Kentucky 40011

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of Henry County Water District #2 as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of Henry County Water District #2'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 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Henry County Water District #2, as of December 31, 2011 and 2010, and the 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 March 23, 2012, on our consideration of the Henry County Water District #2'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 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.

Management has omitted the 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.

Raisor, Zapp & Woods, PSC

RAISOR, ZAPP & WOODS, PSC
Certified Public Accountants

March 23, 2012

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF NET ASSETS
December 31, 2011 and 2010

	2011	2010
ASSETS		
Current Assets:		
Cash, Including Time Deposits	\$ 362,479	\$ 403,702
Accrued Interest Receivable	382	606
Accounts Receivable (Net)	469,827	538,549
Other Receivables	1,365	797
Inventory	140,989	138,939
Prepaid Expense	29,896	15,435
Total Current Assets	\$ 1,004,938	\$ 1,098,028
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 1,758,694	\$ 1,793,299
Accrued Interest Receivable	4,855	5,670
Construction Grants Receivable	-	75,000
Unamortized Bond Issue Costs (Net)	98,041	104,028
Capital Assets (Net)	14,021,055	14,071,492
Total Noncurrent Assets	\$ 15,882,645	\$ 16,049,489
Total Assets	\$ 16,887,583	\$ 17,147,517
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 60,220	\$ 63,199
Accounts Payable - Construction	2,000	-
Accrued Compensated Absences	26,255	22,985
Accrued Salaries, Wages & Benefits	34,170	43,900
Accrued Payroll Taxes/Employee Withholding	16,365	14,031
Utility Tax Payable	7,120	7,299
Sales Tax Payable	594	626
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Customer Deposits	796	1,602
Revenue Bonds Payable	399,000	388,000
Total Current Liabilities	\$ 546,520	\$ 541,642
Noncurrent Liabilities:		
Revenue Bonds Payable (Net of Unamortized Bond Discount & Premium of \$58,903 for 2011 and \$61,552 for 2010)	\$ 7,619,097	\$ 8,015,448
Deferred Loss-Early Debt Retirement	(202,975)	(215,370)
Noncurrent Liabilities Payable from Restricted Assets:		
Customer Deposits Payable	66,040	85,400
Funds Held for Future Lines	29,200	-
Total Noncurrent Liabilities	\$ 7,511,362	\$ 7,885,478
Total Liabilities	\$ 8,057,882	\$ 8,427,120
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	\$ 6,301,974	\$ 5,925,890
Restricted for Capital Projects	382,052	241,362
Restricted for Debt Service	1,202,801	1,380,296
Unrestricted	942,874	1,172,849
Total Net Assets	\$ 8,829,701	\$ 8,720,397

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For the Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 2,989,572	\$ 2,862,764
Wholesale Water Charges	233,237	233,033
Total Charges for Services	\$ 3,222,809	\$ 3,095,797
Other Charges and Miscellaneous:		
Reconnect and Disconnect Charges	\$ 28,370	\$ 26,422
Forfeited Discounts	86,534	77,686
Miscellaneous	37,432	29,108
Total Other Charges and Miscellaneous	\$ 152,336	\$ 133,216
Total Operating Revenues	\$ 3,375,145	\$ 3,229,013
Operating Expenses:		
Accounting and Collecting Labor	\$ 122,478	\$ 111,064
Chemicals	59,392	58,096
Commissioner Salaries	28,800	27,900
Continuing Education	1,575	1,514
Contractual Services-Maintenance of Mains/Distribution System	129,640	124,172
Dues	1,715	2,957
Insurance	43,360	49,230
Maintenance of Mains/Distribution System Expenses	223,136	206,475
Miscellaneous	6,516	4,774
Office Supplies and Expense	59,120	60,317
Operating Labor	531,835	570,238
Other Interest Expense	609	635
Payroll Taxes	54,650	53,060
Professional Services	80,460	79,435
Purchased Power	398,664	404,789
Regulatory Fees	4,967	4,584
Retirement Expense & Employee Benefits	322,478	282,609
Transportation Expense	20,685	19,329
Utilities	26,857	27,265
Depreciation Expense	835,486	833,845
Total Operating Expenses	\$ 2,952,423	\$ 2,922,288
Net Operating Income	\$ 422,722	\$ 306,725
Nonoperating Revenue (Expense):		
Investment Income	\$ 25,215	\$ 40,656
Interest Expense	(349,357)	(409,569)
Amortization Expense	(21,031)	(15,755)
Total Nonoperating Revenue (Expense)	\$ (345,173)	\$ (384,668)
Net Income (Loss) Before Contributions	\$ 77,549	\$ (77,943)
Capital Contributions	31,755	52,245
Net Income (Loss)	\$ 109,304	\$ (25,698)
Net Assets--Beginning of Year	8,720,397	8,746,095
Net Assets--End of Year	\$ 8,829,701	\$ 8,720,397

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 3,423,939	\$ 3,086,679
Payments to Suppliers	(1,478,845)	(1,355,329)
Payments to Employees	(689,573)	(699,687)
Other Receipts (Payments)	29,508	3,612
Net Cash Provided (Used) by Operating Activities	\$ 1,285,029	\$ 1,035,275
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of Capital Assets (Including Work In Process)	\$ (785,709)	\$ (438,977)
Principal Proceeds from Capital Debt	-	5,663,000
Debt Refunding & Issuance Costs	-	(161,903)
Principal Paid on Capital Debt	(388,000)	(6,539,168)
Interest Paid on Capital Debt	(349,357)	(409,569)
Grant Proceeds	75,000	55,000
Capital Contributions	60,955	74,122
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ (1,387,111)	\$ (1,757,495)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds (Purchase) of Investments (Net)	\$ (2,926)	\$ 605,623
Interest Received	26,254	46,276
Net Cash Provided (Used) by Investing Activities	\$ 23,328	\$ 651,899
Net Increase (Decrease) in Cash and Cash Equivalents	\$ (78,754)	\$ (70,321)
Balances-Beginning of the Year	1,089,892	1,160,213
Balances-End of the Year	\$ 1,011,138	\$ 1,089,892

	Balances Per December 31, 2011 Statement of Net Assets	Balances Per December 31, 2011 Statement of Cash Flows
Cash	\$ 52,444	\$ 52,444
Certificates of Deposit	310,035	-
Restricted Cash	958,694	958,694
Restricted Certificates of Deposit	800,000	-
Total Cash and Cash Equivalents, End of Year	\$ 2,121,173	\$ 1,011,138

	Balances Per December 31, 2010 Statement of Net Assets	Balances Per December 31, 2010 Statement of Cash Flows
Cash	\$ 296,593	\$ 296,593
Certificates of Deposit	107,109	-
Restricted Cash	793,299	793,299
Restricted Certificates of Deposit	1,000,000	-
Total Cash and Cash Equivalents, End of Year	\$ 2,197,001	\$ 1,089,892

(Continued)

HENRY COUNTY WATER DISTRICT #2
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2011 and 2010

	2011	2010
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ 422,722	\$ 306,725
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	835,486	833,845
Change in Assets and Liabilities:		
Receivables, Net	68,722	(142,388)
Other Receivables	(568)	54
Inventories	(2,050)	(4,315)
Prepaid Expenses	(14,461)	24,398
Accounts Payable	(319)	3,829
Accrued Expenses	(5,143)	11,470
Customer Meter Deposits Payable	(19,360)	1,657
	\$ 1,285,029	\$ 1,035,275
Net Cash Provided by Operating Activities	\$ 1,285,029	\$ 1,035,275

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

At December 31, 2011, Henry County Water District #2 had \$2,000 of capitalized expenditures for construction in accounts payable on the Statement of Net Assets.

At December 31, 2010, Henry County Water District #2 had \$2,660 of capitalized expenditures for the acquisition of plant assets in accounts payable on the Statement of Net Assets.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES

Description of entity: Henry County Water District #2 is a rural water company serving approximately 6,300 customers in the Kentucky counties of Henry, Trimble, Carroll, Oldham and Shelby, and is regulated by the Public Service Commission of the Commonwealth of Kentucky. The water district was formed under the laws of Henry County through its Fiscal Court and began operations in 1965.

In evaluating how to define Henry County Water District #2 for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The basic -- but not the only -- criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the District is able to exercise oversight responsibilities. Based upon the application of these criteria, the District has no component units.

A summary of the District's significant accounting policies follows:

Basis of presentation and accounting: As stated in Kentucky Revised Statutes (KRS) 278.015, "any water district shall be a public utility and shall be subject to the jurisdiction of the Public Service Commission." In KRS 278.220, it is outlined that the Public Service Commission may establish a system of accounts to be kept by the utilities subject to its jurisdiction, and may prescribe the manner in which such accounts shall be kept. The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

All activities of the District are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted; and unrestricted components.

Revenues and expenses: Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the District. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

The District adheres to the use restrictions established by Bond Agreements when expenses are incurred for which both restricted and unrestricted net assets are available. The District has no policy defining which resources (restricted or unrestricted) to use first.

Property and equipment: Property and equipment purchased or constructed is stated at cost. The District's policy is to capitalize asset purchases exceeding \$500 for office equipment and \$1,000 for service equipment. The cost of meters, including installation, is recorded at the Public Service Commission approved charge of \$1,120. Interest related to costs, and major improvements, renewals and replacements is capitalized as a cost of the project. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. The range of estimated useful lives by type of asset is as follows:

- Structures & Improvements	7-60 years
- Distribution System	7-40 years
- Machinery & Equipment	3-25 years

Construction in process represents costs related to various water line extensions being installed by District employees, as well as system improvements. Expenses for maintenance and repairs that do not increase the useful life of the asset are charged to operations as they are incurred.

Inventory: Inventories of supplies are valued at the lower of cost or market on a first-in, first-out basis.

Bond Discount and Premium: The bond discount and premium are amortized over the life of the bonds.

Compensated Absences: See Note 9 for the District's policy on vacation and sick pay.

Income Taxes: The Henry County Water District #2 is not subject to income taxes.

Contributed Capital: Under the Governmental Accounting Standards Board's (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the District recognizes capital contributions as revenues, in the statement of revenues, expenses, and changes in fund net assets. Capital contributions include donated property, impact fees, tap on fees and grants. Tap on fees and impact fees of \$31,755 and \$37,285 were received by the District for the years ended December 31, 2011 and 2010, respectively. Grant funds of \$75,000 receivable at December 31, 2010 were collected in 2011. \$14,960 was received in 2010 for reimbursement of constructed water lines.

Net assets: Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net assets are classified in the following three components: invested in capital assets, net of related debt; restricted; and unrestricted net assets. Invested in capital assets, net of related debt, consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted net assets consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net assets consist of all other net assets not included in the above categories.

Estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Statement of Cash Flows: For the purpose of the Statement of Cash Flows, Henry County Water District #2 considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

HENRY COUNTY WATER DISTRICT #2
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
 December 31, 2011 and 2010

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS

The Bond and Interest Sinking Account was established with the original bond issue. Under the bond resolution which established this account, it was provided that a minimum balance be maintained in this account as security to the bondholders. In order to attain the minimum balance, the monthly transfer to be made into the account for the outstanding bond issues is as follows:

$$\begin{array}{r}
 \text{one sixth (1/6) of the next semiannual interest payment} \\
 + \quad \text{one twelfth (1/12) of next annual principal payment} \\
 = \quad \text{monthly transfer}
 \end{array}$$

Transfers and/or segregated deposits were sufficient to meet the total obligation outstanding on all issues at December 31, 2011 and 2010.

Upon the issuance of the original bonds, a Depreciation Account was established to provide funds for extraordinary repairs and extensions to the system and/or make up any deficiency in the Bond and Interest Sinking Account. After monthly deposits are made into the Bond and Interest Account, monthly transfers are required to be made to the Depreciation Account. The 1996 Bond Resolution (which was refinanced with the 2003 Bond Issue) required a monthly transfer of \$3,845 to accumulate to a balance of \$461,400. The 2001, 2003, and 2010 Bond Resolutions ratify and confirm the creation of the 1996 Depreciation Fund. At December 31, 2011 and 2010, the Depreciation Account was fully funded.

NOTE 3 – CASH AND INVESTMENTS

KRS 66.480 authorizes the District to invest in obligations of the United States and its agencies and instrumentalities including repurchase agreements, through sources including national and state banks chartered in Kentucky, obligations and contracts for future delivery backed by the full faith of the United States or its Agency, certificates of deposit and interest bearing accounts in institutions insured by the Federal Depository Insurance Corporation and other investments described therein provided that approved securities are pledged to secure those funds on deposit in an amount equal to the amount of those funds. The District may also invest in mutual funds meeting the requirements of the statute.

Henry County Water District #2's policies regarding deposits of cash are discussed above. The table presented below is designed to disclose the level of custody credit risk assumed by the District based upon how its deposits were insured or secured with collateral at December 31, 2011 and 2010. The categories of credit risk are defined as follows:

Category 1 – Insured by FDIC or collateralized with a depository surety bond or securities held by the District (public trust) or by its agent in its name.

Category 2 – Uninsured but collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.

Category 3 – Uninsured and uncollateralized; or collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the District's name; or collateralized with no written or approved collateral agreement.

December 31, 2011

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Checking & Savings Deposits	\$ 1,044,781	\$ 152,195	\$ 892,586	\$ -	\$ 1,010,539
Certificates of Deposit	1,110,035	835,000	215,000	60,035	1,110,034
Total Deposits	\$ 2,154,816	\$ 987,195	\$ 1,107,586	\$ 60,035	\$ 2,120,573

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 3 – CASH AND INVESTMENTS (Continued)

December 31, 2010

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Checking & Savings Deposits	\$ 1,090,743	\$ 52,195	\$ 1,038,548	\$ -	\$ 1,089,392
Certificates of Deposit	1,107,109	1,092,109	15,000	-	1,107,109
Total Deposits	\$ 2,197,852	\$ 1,144,304	\$ 1,053,548	\$ -	\$ 2,196,501

Reconciliation to Statement of Net Assets:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Unrestricted Cash, Including Time Deposits	\$ 362,479	\$ 403,702
Restricted Cash, Including Time Deposits	1,758,694	1,793,299
Less Cash on Hand	(600)	(500)
	<u>\$ 2,120,573</u>	<u>\$ 2,196,501</u>

NOTE 4 – RESTRICTED ASSETS

Restricted cash and time deposits consist of the following:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Bond and Interest Sinking Account	\$ 591,716	\$ 569,038
Depreciation Account	606,230	605,588
Shelby RECC Reserve Account	-	200,000
Customer Deposits & Impact Charge Escrow	178,696	252,311
Construction Account	382,052	166,362
Total	<u>\$ 1,758,694</u>	<u>\$ 1,793,299</u>

Restricted receivables consist of the following:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Interest Receivable	\$ 4,855	\$ 5,670
Construction Grants Receivable	-	75,000
	<u>\$ 4,855</u>	<u>\$ 80,670</u>

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$88,577 and \$81,838 at December 31, 2011 and 2010, respectively. The amount provided for bad debts represents the portion of the total amounts for which collection is unlikely, based on historical collection data.

Estimated unbilled water service revenue of \$178,302 and \$204,757 is included in accounts receivable at December 31, 2011 and 2010, respectively.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 6 – CAPITAL ASSETS

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

	Balance at January 1, 2011	Additions	Disposals	Balance at December 31, 2011
Land & Land Rights	\$ 176,617	\$ -	\$ -	\$ 176,617
Structures & Improvements	23,584,744	287,343	-	23,872,087
Distribution System	2,185,662	308,654	-	2,494,316
Machinery & Equipment	1,026,022	9,215	-	1,035,237
Construction in Process	15,125	456,406	276,569	194,962
Totals at Historical Cost	\$ 26,988,170	\$ 1,061,618	\$ 276,569	\$ 27,773,219
Less: Accumulated Depreciation				
Structures & Improvements	\$ (10,484,839)	\$ (697,400)	\$ -	\$ (11,182,239)
Distribution System	(1,695,168)	(68,958)	-	(1,764,126)
Machinery & Equipment	(736,671)	(69,128)	-	(805,799)
Total Accumulated Depreciation	\$ (12,916,678)	\$ (835,486)	\$ -	\$ (13,752,164)
Capital Assets, Net	\$ 14,071,492	\$ 226,132	\$ (276,569)	\$ 14,021,055

	Balance at January 1, 2010	Additions	Disposals	Balance at December 31, 2010
Land & Land Rights	\$ 176,617	\$ -	\$ -	\$ 176,617
Structures & Improvements	23,561,536	23,208	-	23,584,744
Distribution System	1,923,927	261,735	-	2,185,662
Machinery & Equipment	930,771	99,683	4,432	1,026,022
Construction in Process	-	38,333	23,208	15,125
Totals at Historical Cost	\$ 26,592,851	\$ 422,959	\$ 27,640	\$ 26,988,170
Less: Accumulated Depreciation				
Structures & Improvements	\$ (9,794,846)	\$ (689,993)	\$ -	\$ (10,484,839)
Distribution System	(1,623,984)	(71,184)	-	(1,695,168)
Machinery & Equipment	(668,435)	(72,668)	(4,432)	(736,671)
Total Accumulated Depreciation	\$ (12,087,265)	\$ (833,845)	\$ (4,432)	\$ (12,916,678)
Capital Assets, Net	\$ 14,505,586	\$ (410,886)	\$ 23,208	\$ 14,071,492

Included under the District's capital assets were \$2,954,320 and \$2,700,330 of fully depreciated assets, at December 31, 2011 and 2010, respectively. Land and land rights and construction in process are capital assets not being depreciated.

A \$42,107 550H Case dozer was recorded under a capital lease. This lease was paid off in 2009. Accumulated depreciation of \$14,737 and \$10,527 is associated with this asset at December 31, 2011 and 2010, respectively.

Depreciation expense aggregated \$835,486 and \$833,845 in 2011 and 2010, respectively.

NOTE 7 – CUSTOMER DEPOSITS/ESCROW

Customer deposits are collected upon installation of water service. This amount is to be refunded to the customer upon discontinuation of service (after the customer's bill has been paid in full) or one year pending a

**HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010**

NOTE 7 – CUSTOMER DEPOSITS/ESCROW (Continued)

satisfactory payment record. Deposits received from customers are held in an interest bearing account (which is included in the financial statements as restricted cash). Records are maintained which detail the accrued interest on each customer's deposit based on the current annual rate. Accrued interest is paid annually and when the deposit is refunded.

NOTE 8 – LONG-TERM DEBT

As of December 31, 2011 and 2010, the long-term debt payable consisted of the following:

Bonds Payable:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
2001 Bond Issue, original issue amount of \$900,000, secured by water revenues. Interest is charged 2.4% to 4.75% per annum. Final maturity is January 1, 2018.	\$ 433,000	\$ 493,000
2003 Bond Issue, original issue amount of \$2,978,000, secured by water revenues. Interest is charged 4.06% to 4.81% per annum. Final maturity is January 1, 2033.	2,409,000	2,484,000
2010 B Bond Issue, original issue amount of \$5,663,000, secured by water revenues. Interest is charged 3.20% to 4.33% per annum. Final maturity is January 1, 2028.	5,235,000	5,488,000
Total Bonds Payable	\$ 8,077,000	\$ 8,465,000
Current Portion	\$ 399,000	\$ 388,000
Noncurrent Portion	7,678,000	8,077,000
Total Bonds Payable	\$ 8,077,000	\$ 8,465,000
Unamortized Bond Premium	6,292	6,676
Unamortized Bond Discount	(65,195)	(68,228)
Total Bonds Payable Net of Unamortized Bond Premium and Discount	\$ 8,018,097	\$ 8,403,448

Accrued Compensated Absences:

Accrued Compensated Absences (All Current)	\$ 26,255	\$ 22,985
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Kentucky Rural Water Finance Corporation Flexible Term Finance Program Series 2001D

At original issue, \$900,000 of municipal bonds were outstanding with interest rates that range from 2.4% to 4.75% per annum with maturity dates ranging from 2003-2018. On December 31, 2011, \$433,000 of bonds were outstanding on this issue. On December 31, 2010, \$493,000 of bonds were outstanding on this issue.

Kentucky Rural Water Finance Corporation Flexible Term Finance Program Series 2003

At original issue, \$2,978,000 of municipal bonds were outstanding with interest rates that range from 4.06% to 4.81% per annum with maturity dates ranging from 2003-2033. On December 31, 2011, \$2,409,000 of bonds were outstanding on this issue. On December 31, 2010, \$2,484,000 of bonds were outstanding on this issue.

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 8 – LONG-TERM DEBT (Continued)

Kentucky Rural Water Finance Corporation Public Projects Revenue Bonds, Series 2010 B

On May 13, 2010 Henry County Water District entered into a \$5,663,000 bond agreement with Kentucky Rural Water Finance Corporation. The proceeds of the bonds were used to refund the District's then outstanding Refunding Revenue Bonds, Series 1998 (principal, interest, and 1% redemption premium as required). On December 31, 2011, \$5,235,000 of the 2010B bonds were outstanding. On December 31, 2010, \$5,488,000 of bonds were outstanding on this issue.

In 2010 the total cash flow required to service the (old) 1998 Bonds was \$8,782,499. This exceeded the cash flow required to service the new issue of \$7,935,261 by \$847,238. The economic gain to the District was \$227,732 as calculated on a present value basis.

In 2010 in the Statement of Net Assets, the net costs associated with the early debt retirement of the 1998 Bonds were deferred and amortized over the remaining life of the defeased debt. The amount deferred was reported as a decrease (contra liability) to the book value of the new debt issued to finance the refunding. Total deferred costs were \$223,117. Amortization for the year was \$7,747 and was included as a component of interest expense.

Changes in Long-term Debt

The following is a summary of changes in long-term debt for the years ended December 31, 2011 and 2010.

December 31, 2011

	Balance at January 1, 2011	Additions	Retirements	Balance at December 31, 2011	Current Portion
Bonds Payable	\$ 8,465,000	\$ -	\$ 388,000	\$ 8,077,000	\$ 399,000
Accrued Compensated Absences	22,985	3,270	-	26,255	26,255
Total Enterprise Fund Debt	\$ 8,487,985	\$ 3,270	\$ 388,000	\$ 8,103,255	\$ 425,255

December 31, 2010

	Balance at January 1, 2010	Additions	Retirements	Balance at December 31, 2010	Current Portion
Bonds Payable	\$ 9,210,000	\$ 5,663,000	\$ 6,408,000	\$ 8,465,000	\$ 388,000
Note Payable - 2008 Shelby RECC	131,168	-	131,168	-	-
Accrued Compensated Absences	20,430	2,555	-	22,985	22,985
Total Enterprise Fund Debt	\$ 9,361,598	\$ 5,665,555	\$ 6,539,168	\$ 8,487,985	\$ 410,985

The annual requirements for all long-term debt outstanding at December 31, 2011, are as follows:

Due	Bonds	Bond Interest	Total Principal and Interest
2012	\$ 399,000	\$ 335,128	\$ 734,128
2013	418,000	320,476	738,476
2014	428,000	305,096	733,096
2015	445,000	289,324	734,324
2016	463,000	272,900	735,900
2017-2021	2,244,000	670,370	2,914,370
2022-2026	2,592,000	301,953	2,893,953
2027-2031	1,068,000	12,575	1,080,575
2032	20,000	350	20,350
	\$ 8,077,000	\$ 2,508,172	\$ 10,585,172

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 8 – LONG-TERM DEBT (Continued)

The annual requirements for all long-term debt outstanding at December 31, 2010, are as follows:

Due	Bonds	Bond Interest	Total Principal & Interest
2011	\$ 388,000	\$ 349,358	\$ 737,358
2012	399,000	335,128	734,128
2013	418,000	320,476	738,476
2014	428,000	305,096	733,096
2015	445,000	289,324	734,324
2016-2020	2,235,000	1,190,605	3,425,605
2021-2025	2,533,000	710,603	3,243,603
2026-2030	1,420,000	204,508	1,624,508
2031-2032	199,000	11,234	210,234
	<u>\$ 8,465,000</u>	<u>\$ 3,716,332</u>	<u>\$ 12,181,332</u>

NOTE 9 – COMPENSATED ABSENCES

Vacation and sick pay are considered expenditures in the year earned.

Vacation Days

All full time employees earn one week of vacation time and one additional day per year up to the maximum of four weeks. Only two weeks of unused vacation time may be carried over to the next year. If there is still any vacation leave remaining, the employee will be paid straight time for that portion not carried over in January of the following year. If an employee has accumulated vacation leave at time of retirement or resigning, he may have the option to use the leave time or receive payment at his/her regular rate. A terminated employee will be compensated for any accrued vacation time.

At December 31, 2011 and 2010, a liability for accrued vacation was recorded in the amount of \$26,255 and \$22,985, respectively.

Sick and Personal Days

All full time employees earn 1 sick day per month. An employee may carry over any sick leave accrued during the year that was not used, without limit. If and when the employee retires or resigns, there will be no pay for unused sick leave. Full time personnel earn 4 personal days per year with no carry-over or pay for any unused time.

At December 31, 2011 and 2010, the District had an unrecorded sick pay liability to its employees of \$113,711 and \$111,185, respectively. The estimated liabilities include required salary related payments.

NOTE 10 – FUND EQUITY- RESTRICTED NET ASSETS

	December 31, 2011	December 31, 2010
Restricted for Capital Projects:		
Monies Reserved for Future System Improvements	\$ 382,052	\$ 166,362
Construction Grants Receivable	-	75,000
Total Restricted for Capital Projects	<u>\$ 382,052</u>	<u>\$ 241,362</u>
Restricted for Debt Service:		
1998, 2001, 2003 and 2010 Bond Issues		
Cash	\$ 1,197,946	\$ 1,374,626
Add: Accrued Interest Receivable	4,855	5,670
Total Restricted for Debt Service	<u>\$ 1,202,801</u>	<u>\$ 1,380,296</u>

HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 11 – BAD DEBT EXPENSE

Water revenue charges have been netted with an estimated bad debt expense of \$8,266 and \$19,327 at December 31, 2011 and 2010, respectively.

NOTE 12 – INTEREST EXPENSE

Interest expense incurred for the years ended December 31, 2011 and 2010 was \$349,966 and \$410,204, respectively. No interest was capitalized in 2011 or 2010.

NOTE 13 – INSURANCE AND RELATED ACTIVITIES

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risks is covered through the purchase of commercial insurance. The District is also subject to the risks associated with employee injury. These risks are covered through premiums paid to Kentucky Employers' Mutual Insurance, a commercial insurance company.

NOTE 14 – THE COUNTY EMPLOYEES' RETIREMENT SYSTEM

Henry County Water District #2 participates in the Commonwealth of Kentucky's County Employees' Retirement System (CERS). Electing employees and all new employees of the District may participate in the System. The most recent financial report on CERS is included in the Kentucky Retirement System's annual report, June 30, 2011 and 2010. Copies of this report will be distributed to each participating employer in the Kentucky Employees Retirement System, County Employees Retirement System, and State Police Retirement System. Copies will also be available to Legislative personnel and state libraries.

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each participating county, city and school board, and any additional eligible local agencies electing to participate in CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the plan documents. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Contributions - For the fiscal years ended June 30, 2011 and 2010, plan members were required to contribute 5% of their annual creditable compensation. 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 of Trustees of the Kentucky Retirement Systems (Board) on the basis of an annual valuation last preceding 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 bases adopted by the Board. For the fiscal years ended June 30, 2011 and 2010, participating employers contributed 16.93% and 16.16% respectively, of each employee's creditable compensation (17.93% and 17.16% for new members after September 1, 2008). The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010 were 16.93% and 20.91%, respectively. Administrative costs of the Kentucky Retirement System are financed through employer contributions and investment earnings.

The District's total payroll for the year ended December 31, 2011 was \$739,944. Contributions were based on \$701,585 (eligible gross wages). The total pension expense for the year ended December 31, 2011 was \$125,638 and \$35,385 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2011.

**HENRY COUNTY WATER DISTRICT #2
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010**

NOTE 14 – THE COUNTY EMPLOYEES' RETIREMENT SYSTEM (Continued)

The District's total payroll for the year ended December 31, 2010 was \$739,889. Contributions were based on \$702,431 (eligible gross wages). The total pension expense for the year ended December 31, 2010 was \$116,167 and \$35,237 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2010.

The District's contribution for the year ended June 30, 2011 and 2010, was .029% and .026%, respectively, of the System's total contribution requirements for all employers.

For non-hazardous duty, the required contributions to the plan were as follows:

	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributions
June 30, 2011	432,414,052	435,404,150	-	100.7%
June 30, 2010	453,055,709	373,682,939	9,156,991	84.5%
June 30, 2009	425,830,683	303,046,162	7,623,628	73.0%

The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from CERS. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance for current beneficiaries.

NOTE 15 – ECONOMIC DEPENDENCY

Henry County Water District #2 provides water services to residential and commercial customers in the Kentucky counties of Henry, Trimble, Carroll, Oldham and Shelby. The District also supplies water for resale to the cities of Eminence and New Castle located in Henry County. It should be noted that 7.2% and 7.4% of the total water charges for services revenue was received from these cities for the years ended December 31, 2011 and 2010, respectively. The wholesale rate charged to the cities of Eminence and New Castle was \$2.20 per 1,000 gallons until September 30, 2010. On October 1, 2010, the wholesale rate increased to \$2.58 per 1,000 gallons. Also, the District supplies water for resale to West Carroll Water District at the same wholesale rate.

NOTE 16 – FUNDS HELD FOR FUTURE LINES AND CONTRIBUTED CAPITAL – IMPACT FEES

The District collects funds from developers for their allocable cost of line extensions. The amount is calculated based on the size of the line and the number of estimated hook-ups. As others pay to hook-up to the line, portions of these funds are refunded to the developer. Once a line has been completed, the developer's cost of the line is recorded as capital contributions from customers.

NOTE 17 – COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS

During 2009, the District completed line extensions at Pennywinkle, Highway 389, and Upper Middle Creek. The District had obtained state funding grants through Kentucky Infrastructure Authority for these projects. At December 31, 2009, the District had accrued \$130,000 of construction grants receivable regarding such projects. As of December 31, 2010, \$75,000 was still to be received for these projects. These grants were all received by December 31, 2011.

The District is currently in the process of obtaining financing for a \$5 million water project. The Morton Ridge and US 42 tank project involves a 20 inch line upgrade from the treatment plant to the Highway 42 tank. The Highway 42 tank will be replaced with a 1 million gallon tank. The District is seeking funding from Rural Development and/or Kentucky Infrastructure Authority.

\$163,123 of construction costs and engineering fees relating to the Highway 193 and 202 line upsize project have been capitalized as construction in process.

The District is the subject of pending claims or lawsuits. The ultimate disposition of any settlement or other legal decision is not determined at the present time.

To the Commissioners of the
Henry County Water District #2
Campbellsburg, KY 40011

**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**

We have audited the financial statements of Henry County Water District #2, as of and for the year ended December 31, 2011, and have issued our report thereon dated March 23, 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 Henry County Water District #2's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Henry County Water District #2's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Henry County Water District #2'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 and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or 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 (Items 11-1 and 11-2).

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. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency (Item 11-3).

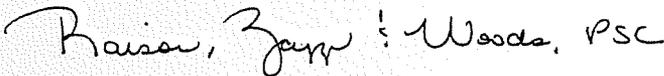
COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether Henry County Water District #2'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 an instance of noncompliance or other matters that is required to be reported under Government Auditing Standards, and which is described in the accompanying schedule of findings and responses as Item 11-4.

We noted certain matters that we reported to management of Henry County Water District #2 in a separate letter dated March 23, 2012.

Henry County Water District #2's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit Henry County Water District 2's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, lending agencies, and the Public Service Commission, and is not intended to be and should not be used by anyone other than these specified parties.



RAISOR, ZAPP, & WOODS P.S.C
Certified Public Accountants

March 23, 2012

**HENRY COUNTY WATER DISTRICT #2
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2011**

A. SUMMARY OF AUDITOR'S RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of Henry County Water District #2.
2. Three deficiencies in internal control related to the audit of the financial statements are reported in the 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. Items 11-1 and 11-2 were reported as material weaknesses. Item 11-3 was reported as a significant deficiency.
3. One instance of noncompliance material to the financial statements of Henry County Water District #2, which would be required to be reported in accordance with Government Auditing Standards, was disclosed during the audit.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

GOVERNMENT AUDITING STANDARDS

DEFICIENCIES IN INTERNAL CONTROL

11-1 SIZE OF ENTITY, CROSS-TRAINING, CHECKING PROCEDURES AND DOCUMENTATION

CONDITION:

Due to the size of the entity, cross-training and checking procedures are not in place for certain administrative positions. This limits internal control. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2010 as 10-1.

CRITERIA:

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, and allow timely preparation of financial data consistent with management assertions.

CAUSE:

Responsibilities associated with individual positions limit the availability of individuals to rotate duties and implement checking procedures.

EFFECT:

This limitation may affect the ability to timely record, process, summarize and report financial data.

RECOMMENDATION:

Management should strive to provide cross-training for administrative staff and implement checking processes.

RESPONSE:

We concur with the recommendation. Management believes adequate resources have been expended and control procedures implemented, that are commensurate with the staff size and responsibility of financial personnel. Efforts will be made to maintain appropriate documentation for all transactions.

HENRY COUNTY WATER DISTRICT #2
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2011

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

11-2 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED NOTE DISCLOSURES

CONDITION:

District financial statements, including the required disclosures, are prepared as part of the annual audit. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2010 as 10-2.

CRITERIA:

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that financial statements and required notes are prepared in accordance with generally accepted accounting principles.

CAUSE:

The draft accrual basis financial statements and disclosures are prepared during the audit process. The entries are entered into the District's general ledger/financial reports.

EFFECT:

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

RECOMMENDATION:

District management should continue to enhance its knowledge of reporting requirements in providing oversight of this service.

RESPONSE:

The outsourcing of this service is a result of management's cost benefit decision to use others' accounting expertise rather than incur internal resource costs. District staff have been and will continue to be educated on appropriate accounting. We concur with the recommendation and will continue to improve our overall accounting knowledge in performing our oversight responsibilities.

11-3 RECONCILIATION OF CUSTOMER DEPOSITS

CONDITION:

The general ledger customer deposits payable account was not reconciled to the customer deposit subsidiary ledger at year-end. This condition was also cited as a significant deficiency in the schedule of findings and responses for the year ended December 31, 2010 as 10-3.

CRITERIA:

Significant accounts in the general ledger, such customer deposits payable, should be reconciled to subsidiary ledgers in a timely manner.

HENRY COUNTY WATER DISTRICT #2
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2011

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

11-3 RECONCILIATION OF ACCOUNTS RECEIVABLE AND CUSTOMER DEPOSITS (Continued)

CAUSE:

A proper reconciliation was not performed.

EFFECT:

The general ledger customer deposits payable balance was adjusted to subsidiary balance upon completion of the annual audit.

RECOMMENDATION:

On a monthly basis, the general ledger customer deposits payable balance should be reconciled to the subsidiary ledger.

RESPONSE:

We concur with the recommendation.

COMPLIANCE AND OTHER MATTERS

11-4 VIOLATION OF KRS 91A.060 AND KRS 66.480

CONDITION

The District failed to adequately insure and fully collateralize its deposits as required by Kentucky Revised Statutes.

CRITERIA

Procedures should be in place to provide reasonable assurance that deposits are properly insured or fully collateralized.

CAUSE

Deposits were not reviewed at regular intervals to insure proper collateral amounts.

EFFECT

Because of the lack of collateral, District deposits were not insured and/or collateralized by \$60,035.

RECOMMENDATION

Procedures should be implemented to verify that adequate collateral has been pledged to cover all deposits.

RESPONSE

We concur with the recommendation. Such a procedure will be implemented immediately.