

Hyden–Leslie County Water District
Hyden, Kentucky

Independent Auditors' Report
And Financial Statements
For the Years Ended
December 31, 2011 and 2010

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Hyden-Leslie County Water District
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Independent Auditors' Report

To the Commissioners
Hyden-Leslie County Water District
Hyden, Kentucky

We have audited the accompanying financial statements of the business-type activities of Hyden-Leslie 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 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 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 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 business-type activities of Hyden-Leslie County Water District 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.

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 the missing information.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2012, on our consideration of Hyden-Leslie 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 important for assessing the results of our audit.

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Baldwin CPAs, PLLC

Baldwin CPAs, PLLC
March 29, 2012

Hyden-Leslie County Water District
 Statements of Net Assets
 December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 790,865	\$ 1,483,188
Investments	1,299,643	1,274,647
Receivables, less allowance for doubtful accounts of \$5,000	180,975	176,990
Unbilled accounts receivable	33,000	33,000
Grant receivables	628,836	707,278
Inventories	25,092	30,731
Other current assets	25,435	24,586
Total Current Assets	<u>2,983,846</u>	<u>3,730,420</u>
Noncurrent Assets		
Restricted Assets		
Customer deposits	80,088	77,964
Depreciation reserves	296,880	296,880
Debt and interest funds	149,825	142,676
Total Restricted Assets	<u>526,793</u>	<u>517,520</u>
Capital Assets		
Land and improvements	32,169	32,169
Buildings and improvements	1,759,544	1,759,544
Source of supply and pumping	772,440	772,440
Water treatment equipment	364,494	361,419
Transmission and distribution plant	12,169,503	12,151,821
Vehicles and other equipment	825,571	818,088
Construction in progress	11,016,319	3,879,579
Less: accumulated depreciation	(6,209,004)	(5,760,433)
Net Capital Assets	<u>20,731,036</u>	<u>14,014,627</u>
Total Noncurrent Assets	<u>21,257,829</u>	<u>14,532,147</u>
Total Assets	<u>\$ 24,241,675</u>	<u>\$ 18,262,567</u>

	<u>2011</u>	<u>2010</u>
Liabilities		
Current Liabilities		
Accounts payable	\$ 650,947	\$ 731,495
Accrued interest payable	38,546	5,076
Current portion of long-term debt	146,092	142,392
Other current liabilities	11,786	11,791
Total Current Liabilities	<u>847,371</u>	<u>890,754</u>
Noncurrent Liabilities		
Customer deposits	35,769	33,644
Expansion deposits	44,320	44,320
Compensated absences	47,606	59,394
Long-term debt, less current portion included in current liabilities	4,154,643	1,310,735
Total Noncurrent Liabilities	<u>4,282,338</u>	<u>1,448,093</u>
Total Liabilities	<u>5,129,709</u>	<u>2,338,847</u>
Net Assets		
Invested in capital assets, net of related debt	16,430,301	12,561,500
Restricted	526,793	517,520
Unrestricted	2,154,872	2,844,700
Total Net Assets	<u>\$ 19,111,966</u>	<u>\$ 15,923,720</u>

Hyden-Leslie County Water District
 Statements of Revenues, Expenses and Changes in Net Assets
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Water sales	\$ 1,460,618	\$ 1,276,149
Service charges	5,972	3,715
Tap fees	83,400	21,578
Penalties	42,508	35,031
Other revenues	<u>1,712</u>	<u>1,863</u>
Total Operating Revenues	<u>1,594,210</u>	<u>1,338,336</u>
Operating Expenses		
Salaries and wages	384,719	339,907
Employee benefits	197,834	167,163
Purchased water	14,615	14,832
Utilities	162,960	140,908
Chemicals	65,449	54,672
Materials and supplies	69,510	43,788
Contracted services	22,477	20,351
Vehicle and equipment expenses	28,947	28,411
Insurance	33,355	32,155
Bad debt expense, net of recoveries	14,209	9,921
Depreciation	448,571	455,920
Other operating expenses	<u>42,172</u>	<u>38,832</u>
Total Operating Expenses	<u>1,484,818</u>	<u>1,346,860</u>
Operating Income (Loss)	<u>109,392</u>	<u>(8,524)</u>
Non-operating Revenues (Expenses)		
Interest income	27,020	71,812
Grant revenue	3,113,530	1,938,778
Interest expense	<u>(61,696)</u>	<u>(65,930)</u>
Total Non-operating Revenues	<u>3,078,854</u>	<u>1,944,660</u>
Change in Net Assets	3,188,246	1,936,136
Net Assets, Beginning of Year	15,923,720	13,734,734
Restatement note 11	-	<u>252,850</u>
Net Assets, Beginning of Year	<u>15,923,720</u>	<u>13,987,584</u>
Net Assets, End of Year	<u>\$ 19,111,966</u>	<u>\$ 15,923,720</u>

See accompanying notes to financial statements.

Hyden-Leslie County Water District
 Statements of Cash Flows
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities		
Receipts from customers	\$ 1,590,633	\$ 1,321,630
Receipts from other activities	1,712	1,863
Payments to employees	(396,507)	(357,326)
Payments to suppliers	(685,114)	(107,018)
Payments for other activities	<u>(42,172)</u>	<u>(38,832)</u>
Net Cash Provided by Operating Activities	<u>468,552</u>	<u>820,317</u>
Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(7,133,370)	(1,810,465)
Principal payments on debt	(142,392)	(137,795)
Interest payments on debt	(59,836)	(66,345)
Proceeds from debt	2,990,000	-
Grants	<u>3,191,973</u>	<u>1,231,500</u>
Net Cash Used by Capital and Related Financing Activities	<u>(1,153,625)</u>	<u>(783,105)</u>
Cash Flows From Investing Activities		
Purchases of investments	(24,997)	(75,054)
Interest on investments	<u>27,020</u>	<u>78,660</u>
Net Cash Provided by Investing Activities	<u>2,023</u>	<u>3,606</u>
Net (Decrease) Increase in Cash and Cash Equivalents	(683,050)	40,818
Cash and Cash Equivalents at Beginning of Year	<u>2,000,708</u>	<u>1,959,890</u>
Cash and Cash Equivalents at End of Year	<u>\$ 1,317,658</u>	<u>\$ 2,000,708</u>
Reconciliation of cash per Statements of Net Assets to cash per Statements of Cash Flows:		
Cash and cash equivalents	\$ 790,865	\$ 1,483,188
Customer deposits	80,088	77,964
Depreciation reserves	296,880	296,880
Debt and interest funds	<u>149,825</u>	<u>142,676</u>
Cash and equivalents per Statements of Cash Flows	<u>\$ 1,317,658</u>	<u>\$ 2,000,708</u>

Hyden-Leslie County Water District
 Statements of Cash Flows
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:		
Operating Income (Loss)	\$ 109,392	\$ (8,524)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities		
Depreciation	448,571	455,920
(Increase) Decrease in operating assets		
Accounts receivable	(3,985)	(17,277)
Unbilled receivables	-	-
Inventory	5,639	(1,167)
Other current assets	(849)	411
Increase (Decrease) in operating liabilities		
Accounts payable	(80,548)	421,812
Accrued expenses	(9,668)	(30,858)
 Net Cash Provided by Operating Activities	 <u>\$ 468,552</u>	 <u>\$ 820,317</u>

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 1 – Summary of Significant Accounting Policies

Reporting Entity

Hyden-Leslie County Water District, of Leslie County, Kentucky (“District”) was created in 1968 under Chapter 74 of the Kentucky Revised Statutes and is exempt from income taxes under Section 501(c)(4) of the Internal Revenue Code. The District is governed by a five person board of Commissioners which is appointed by the Leslie County Fiscal Court. The District is regulated by the Kentucky Public Service Commission.

The District is a rural water utility system whose purpose is to establish, develop and operate a water supply and distribution system for its members and customers in Leslie County, Kentucky. The District’s primary source of revenue is from water sales to its customers, including public bodies and local businesses in its service area.

Basis of Accounting, Financial Presentation and Measurement Focus

The basic financial statements of the District have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) as applied to governmental units. The Governmental Accounting Standards Board (“GASB”) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

The District applies all relevant Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements, in which case, GASB prevails. In addition, the District applies all applicable FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements to its business-type activities.

The Statement of Net Assets and Statement of Revenues, Expenses and Changes in Net Assets display information about the District as a whole. These statements include all funds of the District.

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating income reported by the District includes revenues and expenses related to the continuing operation of water service for its customers. Principal operating revenues are charges to customers for services. Principal operating expenses are the costs of providing the services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

Cash and Cash Equivalents

The District considers demand deposits and certificates of deposit with maturities of less than three months to be cash equivalents.

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies (Continued)

Investments

Investments include certificates of deposits with maturity dates of three months or more. Certificates of deposit in excess of FDIC insurance coverage are collateralized by securities held by the pledging institution.

The District also invests in mutual funds, which are recorded at their fair market value. Securities are traded on a national exchange and valued at the last reported sales price at current exchange rates and investments that do not have an established market are reported at an estimated fair value.

Accounts Receivable

Receivables include amounts due from customers for water services. These receivables are due at the time the services are billed and are considered past due on the first day of the following month. Accounts receivable are presented net of uncollectible accounts. The allowance amount is estimated using a percentage of accounts past due more than 30 days. At December 31, 2011 and 2010, the allowance for doubtful accounts was \$5,000.

Unbilled Accounts Receivable

Estimated unbilled revenues from water sales are recognized at the end of each fiscal year on a pro rata basis. The estimated amount is based on billing during the month following the close of the fiscal year.

Inventories and Prepaid Expenses

Inventories consist of expendable supplies held for consumption stated on a first-in, first-out basis. They are reported at cost and are recorded as an expense at the time individual items are used. Prepaid expenses record payments to vendors that benefit future reporting periods and are reported on the consumption basis.

Property, Plant and Equipment

The District's property, plant and equipment with useful lives of more than one year are stated at historical cost. The costs of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized. Capital assets are depreciated using the straight-line method. When assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in operations.

Estimated useful lives for depreciable assets are as follows:

Asset Classification	Range of Lives
Structures and improvements	40 years
Transmission distribution mains	40 years
Plant equipment	15 years
Meters and services	35 years
Other equipment and vehicles	5-10 years

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies (Continued)

Customer Deposits

The District collects and holds in escrow a \$30 deposit from customers to insure collection of its water charges. Interest at an annual rate of .12% is paid on these deposits.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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.

Note 2 – Restricted Assets

Under the terms of all loan resolutions, the District is required to maintain certain accounts and funds for the benefit and protection of the creditors. In addition, the District is also required to collect reasonable and sufficient rates and charges for services rendered, prohibited from selling, leasing or mortgaging any part of the system without prior approval, required to maintain the operating system in good condition and to carry adequate insurance on all properties to protect against loss or damage.

The resolutions require the District to establish a depreciation fund or reserve to be used to finance the cost of unusual repairs, renewals and replacements not included in the annual budget and to pay for future system extensions. The balance of these accounts at December 31, 2011 and 2010 was \$296,880.

Note 3 – Kentucky Revised Statute

At December 31, 2011 and 2010 \$2,530,937 and \$2,479,682 of the cash of the District was covered by federal depository insurance and securities pledged as collateral on behalf of the District. In accordance with Kentucky Revised Statute (KRS) 91A.060, the deposits are to be insured by the Federal Depository Insurance Corporation or collateralized to the extent uninsured by any obligations permitted by KRS 41.240(4). According to KRS 41.240(4), it shall either pledge or provide as collateral securities or other obligations having an aggregate current face value or current quoted market value at least equal to the deposits. According to KRS 66.480, the District is allowed to invest in obligations of the U.S. Treasury and U.S. agencies, repurchase agreements, obligations of the Commonwealth of Kentucky and its agencies, insured savings and loans, or interest bearing deposits of insured national or state banks. For additional cash descriptive information, see Note 1.

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 4 – Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk. As of December 31, 2011 and 2010, \$1,006,954 and \$1,745,272 of the District's total deposits at banks of \$2,536,442 and \$2,518,347, respectively, were exposed to custodial credit risk as follows:

	<u>2011</u>	<u>2010</u>
Uninsured and uncollateralized	\$ 5,505	\$ 38,665
Uninsured and collateral held by pledging bank	1,001,449	1,706,607
Uninsured and collateral held by pledging bank's trust Department not in the District's name	-	-
Total	<u>\$ 1,006,954</u>	<u>\$ 1,745,272</u>

Note 5 – Investments

As of December 31, 2011 and 2010, the District had the following investments:

	<u>Rating</u>	<u>Fair Value</u> <u>2011</u>	<u>Fair Value</u> <u>2010</u>
Federated Capital Reserves	Not Rated	\$ 113,179	\$ 783,897
Certificate of Deposit	Not Rated	1,186,464	490,750
Total		<u>\$ 1,299,643</u>	<u>\$ 1,274,647</u>

Mutual Funds are liquid assets; therefore, they do not have a maturity date and are classified as current assets.

Interest Rate Risk – Investments. The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value arising from increasing interest rates.

Concentration of Credit Risk – Investments. The District places no limit on the amount the District may invest in any one fund. Less than 10% of the District's investments are in Federated Capital Reserves. This investment is 8.7% of the District's total investments.

Risks and Uncertainties – Investments. The District invests in various mutual funds. Mutual funds are exposed to various risks, such as interest rate, credit, and market risks. Due to the level of risks associated with certain mutual funds, it is at least reasonably possible that changes in the values of mutual funds will occur in the near term and that such changes could materially affect the account balances and the amounts reported in the financial statements.

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 6 – Capital Assets

The following is a summary of capital asset transactions for the year ended December 31, 2011:

	Balance Dec. 31, 2010	Additions	Dispositions	Balance Dec. 31, 2011
Land and improvements	\$ 32,169	\$ -	\$ -	\$ 32,169
Building and improvements	1,759,544	-	-	1,759,544
Source of supply and pumping	772,440	-	-	772,440
Water treatment equipment	361,419	3,075	-	364,494
Transmission and distribution plant	12,151,821	17,682	-	12,169,503
Vehicles and other equipment	818,088	7,483	-	825,571
Construction in process	3,879,579	7,136,740	-	11,016,319
Totals at historical cost	<u>19,775,060</u>	<u>7,164,980</u>	<u>-</u>	<u>26,940,040</u>
Less accumulated depreciation for:				
Building and improvements	587,305	41,820	-	629,125
Source of supply and pumping	382,032	20,011	-	402,043
Water treatment equipment	352,855	5,558	-	358,413
Transmission and distribution plant	3,781,608	348,444	-	4,130,052
Vehicles and other equipment	656,633	32,738	-	689,371
Total accumulated depreciation	<u>5,760,433</u>	<u>448,571</u>	<u>-</u>	<u>6,209,004</u>
Capital assets - net	<u>\$ 14,014,627</u>	<u>\$ 6,716,409</u>	<u>\$ -</u>	<u>\$ 20,731,036</u>

The following is a summary of capital asset transactions for the year ended December 31, 2010:

	Balance Dec. 31, 2009	Additions	Dispositions	Balance Dec. 31, 2010
Land and improvements	\$ 32,169		\$ -	\$ 32,169
Building and improvements	1,759,544	-	-	1,759,544
Source of supply and pumping	772,440		-	772,440
Water treatment equipment	361,419		-	361,419
Transmission and distribution plant	12,126,051	25,770	-	12,151,821
Vehicles and other equipment	804,052	14,036	-	818,088
Construction in process	2,108,921	1,770,658	-	3,879,579
Totals at historical cost	<u>17,964,596</u>	<u>1,810,464</u>	<u>-</u>	<u>19,775,060</u>
Less accumulated depreciation for:				
Building and improvements	545,485	41,820	-	587,305
Source of supply and pumping	361,501	20,531	-	382,032
Water treatment equipment	343,577	9,278	-	352,855
Transmission and distribution plant	3,429,110	352,498	-	3,781,608
Vehicles and other equipment	624,840	31,793	-	656,633
Total accumulated depreciation	<u>5,304,513</u>	<u>455,920</u>	<u>-</u>	<u>5,760,433</u>
Capital assets - net	<u>\$ 12,660,083</u>	<u>\$ 1,354,544</u>	<u>\$ -</u>	<u>\$ 14,014,627</u>

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 7 -- Long-Term Debt

The following is a summary of long-term debt transactions for the year ended December 31, 2011:

	<u>Balance</u> <u>Dec. 31, 2010</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2011</u>
Loan payable to Kentucky Infrastructure Authority, principal and interest, at the rate of 3%, payable on a semi-annual basis, with final payment due June 1, 2015	\$ 549,327	\$ -	\$ 115,792	\$ 433,535
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2028; interest payable on a semi-annual basis at the rate of 5.0%	624,000	-	22,000	602,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2040; interest payable on a semi-annual basis at the rate of 4.5%	279,800	-	4,600	275,200
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2051; interest payable on a semi-annual basis	<u>2,990,000</u>	<u>2,990,000</u>	<u>2,990,000</u>	<u>2,990,000</u>
	<u>\$ 1,453,127</u>	<u>\$ 2,990,000</u>	<u>\$ 142,392</u>	<u>\$ 4,300,735</u>

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 7 – Long-Term Debt (Continued)

The following is a summary of long-term debt transactions for the year ended December 31, 2010:

	<u>Balance</u> <u>Dec. 31, 2009</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2010</u>
Loan payable to Kentucky Infrastructure Authority, principal and interest, at the rate of 3%, payable on a semi-annual basis, with final payment due June 1, 2015	\$ 661,722	\$ -	\$ 112,395	\$ 549,327
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2028; interest payable on a semi-annual basis at the rate of 5.0%	645,000	-	21,000	624,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2040; interest payable on a semi-annual basis at the rate of 4.5%	284,200	-	4,400	279,800
	<u>\$ 1,590,922</u>	<u>\$ -</u>	<u>\$ 137,795</u>	<u>\$ 1,453,127</u>

The aggregate annual principal repayments on long-term debt are summarized as follows:

<u>Year Ending</u> <u>December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 146,092	\$ 123,594	\$ 269,686
2013	151,897	133,240	285,137
2014	201,812	127,409	329,221
2015	142,234	120,808	263,042
2016	80,200	117,193	197,393
2017-2021	451,100	537,197	988,297
2022-2026	544,200	444,347	988,547
2027-2031	490,700	346,348	837,048
2032-2036	459,200	280,442	739,642
2037-2041	524,800	204,867	729,667
2042-2046	538,500	129,964	668,464
2047-2051	570,000	46,699	616,699
	<u>\$ 4,300,735</u>	<u>\$ 2,612,108</u>	<u>\$ 6,912,843</u>

Hyden-Leslie County Water District
Notes to Financial Statements
December 31, 2011 and 2010

Note 8 – Retirement Plan

In 1999 the District adopted a 401(k) deferred compensation pension plan. Under this plan the District matches employee contributions up to a maximum of 5% of gross salaries. This plan covers all full-time employees. Pension expense for 2011, 2010 and 2009 was \$19,274, \$18,775 and \$17,601, respectively.

Note 9 – Risk Management

The District is exposed to various risks of loss related to limited torts; theft of, damage to and destruction of assets; errors and omissions and natural disasters for which the District carries commercial insurance. There have been no significant reductions in coverage for the year and settlements have not exceeded coverage in the past three years.

Note 10 - Subsequent Events

Date of Management Evaluation

Management of the District has evaluated subsequent events through March 29, 2012, the date on which the financial statements were available to be issued. No events have occurred subsequent to the date of the financial statements that would require adjustment to or disclosure in the financial statements.

Note 11 - Restatement

Net assets as of January 1, 2010, have been restated for grant income not recorded prior to the beginning of January 1, 2010. Net assets have increased by \$252,850, the beginning balance for the 2010 year has been restated from \$13,734,734 to \$13,987,584. The grant income received was related to costs on the water treatment plant project, therefore construction in progress has also been restated and increased from \$3,626,729 to \$3,879,579.

Hyden-Leslie County Water District
 Schedule of Expenditures of Federal Awards
 For the Year Ended December 31, 2011

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Agriculture		
ARRA Water and Waste Disposal Systems Grant	10.760	\$ 797,253
Direct Loan:		
ARRA Water and Waste Disposal Systems	10.760	<u>2,990,000</u>
Total U.S. Department of Agriculture		<u>3,787,253</u>
U.S. Department of Housing and Urban Development		
Passed through Leslie County Fiscal Court:		
Community Development Block Grant/ States Program	14.228	<u>\$ 985,000</u>
Total		<u>\$ 4,772,253</u>

Footnote to Schedule of Expenditures of Federal Awards

- (1) Expenditures on this schedule are reflected on the accounting basis as reported in the financial statements.

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*

Commissioners
Hyden-Leslie County Water District
Hyden, Kentucky

We have audited the financial statements of the business-type activities of Hyden-Leslie County Water District, as of and for the year ended December 31, 2011, and have issued our report thereon dated March 29, 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 Hyden-Leslie County Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and 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 schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting 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 misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses. (See items 2011-1 and 2011-2)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hyden-Leslie 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 one instance of noncompliance or other matter that are required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs. (See item 2011-3)

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

This report is intended solely for the information and use of management, the commissioners, others within the organization, the Public Service Commission, 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.

Baldwin CPAs, PLLC

Baldwin CPAs, PLLC
March 29, 2012

Independent Auditors' Report on Compliance With Requirements
That Could Have A Direct And Material Effect On Each Major Program And On Internal
Control Over Compliance In Accordance
With OMB Circular A-133

Commissioners
Hyden-Leslie County Water District
Hyden, Kentucky

Compliance

We have audited Hyden-Leslie County Water District's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Hyden-Leslie County Water District's major federal programs for the year ended December 31, 2011. Hyden-Leslie County Water District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Hyden-Leslie County Water District's management. Our responsibility is to express an opinion on Hyden-Leslie County Water District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Hyden-Leslie County Water District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Hyden-Leslie County Water District's compliance with those requirements.

In our opinion, Hyden-Leslie County Water District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2011. The results of our auditing procedures did not disclose any instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133.

Internal Control Over Compliance

Management of Hyden-Leslie County Water District is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Hyden-Leslie County Water District's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Hyden-Leslie County Water District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance 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 compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the commissioners, others within the entity, the Public Service Commission, 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.

Baldwin CPAs, PLLC

Baldwin CPAs, PLLC
March 29, 2012

Hyden-Leslie County Water District
Schedule of Findings And Questioned Costs
December 31, 2011

A. Summary of Audit Results

1. The auditors' report expresses an unqualified opinion on the financial statements of Hyden-Leslie County Water District.
2. Two material weaknesses related to the audit of the financial statements were 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*.
3. There was one instance of noncompliance material to the financial statements of Hyden-Leslie County Water District.
4. There were no significant deficiencies related to the audit of the major program discussed in the Independent Auditors' Report on Compliance with Requirements that Could have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133.
5. The auditors' report on compliance for the major federal award program for Hyden-Leslie County Water District expresses an unqualified opinion.
6. There were no audit findings relative to the major federal award program for Hyden-Leslie County Water District.
7. The programs tested as major were:

	<u>CFDA#</u>
Water and Waste Disposal Loans and Grants	10.760
Community Development Block Grant	14.228
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Hyden-Leslie County Water District did not qualify as a low-risk auditee.

Hyden-Leslie County Water District
Schedule of Findings And Questioned Costs
December 31, 2011

2011-1

Criteria:

As discussed in *Standards for Internal Control in the Federal Government* published by the General Accounting Office of the United States, internal control is an integral component of an organization's management that provides reasonable assurance that an objective of reliable financial reporting is being achieved. Organizations should implement procedures to ensure this objective is achieved.

Condition:

During the audit procedures performed, instances of this objective not being completely achieved were noted.

Cause:

The District's limited internal resources prevents the preparation of financial statements and related note disclosures in accordance with Generally Accepted Accounting Principles.

Effect:

The District was unable to prepare their financial statements and related note disclosures in accordance with Generally Accepted Accounting Principles.

Views of responsible officials and planned corrective actions:

The District feels that it would not be cost beneficial to hire the personnel required to complete these tasks.

2011-2

Criteria:

As discussed in *Standards for Internal Control in the Federal Government* published by the General Accounting Office of the United States, internal control is an integral component of an organization's management that provides reasonable assurance that an objective of reliable financial reporting is being achieved. Organizations should implement procedures to ensure this objective is achieved.

Condition:

During the audit procedures performed, instances of this objective not being completely achieved were noted.

Cause:

The size of the Water District's office staff does not allow proper segregation of duties.

Effect:

This condition creates a weakness in internal controls which could result in unauthorized transactions being processed.

Views of responsible officials and planned corrective actions:

The District feels that it would not be cost beneficial to hire the personnel required to complete these tasks.

Hyden-Leslie County Water District
Schedule of Findings And Questioned Costs
December 31, 2011

2011-3

Criteria:

As discussed in KRS 66.480, public funds must be invested in accordance with guidance set forth therein.

Condition:

During the audit procedures performed, instances of this objective not being completely achieved were noted.

Cause:

The District held investments that did not meet the criteria as required by KRS 66.480. More specifically, the District held shares in a mutual fund which consisted of certain assets that are not allowed for investment of public funds.

Effect:

The District was not in compliance with KRS 66.480.

Recommendation to Management:

We recommend that Management contact their financial representative and correct this issue.

Views of responsible officials and planned corrective actions:

Management agrees with this finding and will contact their financial representative as soon as possible.

Hyden-Leslie County Water District
Summary of Prior Year Audit Findings
December 31, 2011

Status of Prior Year Audit Findings

No audit findings in the prior year.