

Knox County Utility Commission
Artemus, Kentucky

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


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Artemus, Kentucky

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Knox County Utility Commission
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Independent Auditors' Report

To the Commissioners
Knox County Utility Commission
Artemus, Kentucky

We have audited the accompanying financial statements of the business-type activities of the Knox County Utility Commission the (Commission) 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 the Commission'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 the Knox County Utility Commission 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 this missing information.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2012 on our consideration of the Knox County Utility Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Commission's financial statements as a whole. The accompanying departmental statements for the water and sewer departments are presented separately for the purpose of additional analysis and are not a required part of the financial statements. The accompanying departmental statements for the water and sewer departments are the responsibility of management and were derived from and relate 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 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

Knox County Utility Commission
 Statements of Net Assets
 December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 586,193	\$ 778,492
Investments	107,279	105,823
Receivables, less allowance	80,544	90,699
Unbilled accounts receivable	42,645	61,000
Other receivables	3,013	-
Inventories	31,902	22,348
Other current assets	100	143
Total Current Assets	851,676	1,058,505
Noncurrent assets		
Restricted assets		
Restricted cash and cash equivalents	87,433	82,754
Capital Assets		
Land and improvements	44,619	44,619
Structures and improvements	497,407	497,407
Pumping equipment	108,133	106,102
Meters and meter installation	683,078	659,421
Hydrants	53,816	48,901
Storage tanks	1,148,102	741,318
Transmission and distribution plant	10,104,183	9,065,295
Vehicles and other equipment	377,617	372,978
Office equipment	41,790	41,790
Lift stations	344,195	344,195
Construction in progress	-	1,203,738
	13,402,940	13,125,764
Accumulated depreciation	(4,601,968)	(4,132,172)
Net Capital Assets	8,800,972	8,993,592
Other Assets		
Bond issue costs, net of amortization	10,752	11,305
Total Other Assets	10,752	11,305
Total Noncurrent Assets	8,899,157	9,087,651
Total Assets	9,750,833	10,146,156

	<u>2011</u>	<u>2010</u>
Liabilities		
Current Liabilities		
Current portion of long-term debt	53,000	50,000
Accounts payable	47,406	281,608
Accrued interest payable	47	47
Accrued salaries and taxes payable	18,448	18,128
Total Current Liabilities	<u>118,901</u>	<u>349,783</u>
Noncurrent Liabilities		
Customer deposits	28,254	27,386
Long-term debt	2,645,000	2,698,000
Total Noncurrent Liabilities	<u>2,673,254</u>	<u>2,725,386</u>
Total Liabilities	<u>2,792,155</u>	<u>3,075,169</u>
Net Assets		
Invested in capital assets, net of related debt	6,102,972	6,245,592
Restricted	87,433	82,754
Unrestricted	768,273	742,641
Total Net Assets	<u>\$ 6,958,678</u>	<u>\$ 7,070,987</u>

Knox County Utility Commission
 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	\$ 1,068,913	\$ 1,118,892
Sewer sales	21,324	16,454
Service charges	15,675	14,130
Tap fees	24,000	30,013
Penalties	30,104	30,006
Other revenues	6,385	8,795
Total Operating Revenues	<u>1,166,401</u>	<u>1,218,290</u>
Operating Expenses		
Salaries and wages	255,857	251,015
Employee benefits	161,332	153,848
Purchased power	221,996	194,655
Utilities	56,247	52,819
Chemicals	73,079	58,995
Repairs and maintenance	61,344	25,747
Contracted services	24,351	23,232
Vehicle and equipment expenses	27,248	19,826
Insurance	33,737	32,881
Sewer treatment	16,493	17,156
Amortization	553	553
Depreciation	469,796	442,264
Bad debt expense, net of recoveries	14,814	14,548
Other operating expenses	48,616	55,112
Total Operating Expenses	<u>1,465,463</u>	<u>1,342,651</u>
Operating Loss	<u>(299,062)</u>	<u>(124,361)</u>
Nonoperating Revenues (Expenses)		
Interest income	19,907	18,303
Federal and state grants	291,258	1,156,973
Other income	59,882	2,052
Other expense	(59,770)	-
Interest expense	(124,524)	(126,685)
Total Nonoperating Revenues (Expenses)	<u>186,753</u>	<u>1,050,643</u>
Change in Net Assets	<u>(112,309)</u>	<u>926,282</u>
Net Assets, Beginning of Year	<u>7,070,987</u>	<u>6,144,705</u>
Net Assets, End of Year	<u>\$ 6,958,678</u>	<u>\$ 7,070,987</u>

Knox County Utility Commission
 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	\$ 1,186,381	\$ 1,200,170
Receipts from other activities	6,385	8,795
Payments to employees	(255,537)	(247,456)
Payments to suppliers	<u>(982,970)</u>	<u>(404,272)</u>
Net Cash Provided (Used) by Operating Activities	<u>(45,741)</u>	<u>557,237</u>
 Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(277,176)	(1,239,979)
Principal payments on debt	(50,000)	(49,000)
Interest payments on debt	(124,524)	(126,722)
Federal, state and local grants	291,258	1,156,973
Miscellaneous non-operating	59,882	2,052
Miscellaneous non-operating expense	<u>(59,770)</u>	<u>-</u>
Net Cash Used by Capital and Related Financing Activities	<u>(160,330)</u>	<u>(256,676)</u>
 Cash Flows From Investing Activities		
Interest on cash and investments	<u>18,451</u>	<u>16,768</u>
Net Cash Provided by Investing Activities	<u>18,451</u>	<u>16,768</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	(187,620)	317,329
 Cash and Cash Equivalents at Beginning of Year	<u>861,246</u>	<u>543,917</u>
Cash and Cash Equivalents at End of Year	<u>\$ 673,626</u>	<u>\$ 861,246</u>
 Reconciliation of Cash at End of Year		
Cash and Cash Equivalents	\$ 586,193	\$ 778,492
Restricted Cash and Cash Equivalents	<u>87,433</u>	<u>82,754</u>
Total Cash at End of Year	<u>\$ 673,626</u>	<u>\$ 861,246</u>

See accompanying notes to financial statements.

Knox County Utility Commission
Statements of Cash Flows (Continued)
For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of Operating Loss to Net Cash		
Provided (Used) by Operating Activities:		
Operating loss	\$ (299,062)	\$ (124,361)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities		
Depreciation	469,796	442,264
Amortization	553	553
(Increase) Decrease in:		
Accounts receivable	10,155	(14,391)
Unbilled accounts receivable	18,355	4,500
Other receivables	(3,013)	-
Inventory	(9,554)	6,373
Prepaid expenses and other assets	43	112
Increase (Decrease) in:		
Accounts payable	(234,202)	238,062
Customer deposits	868	566
Accrued expenses	320	3,559
	<u>\$ (45,741)</u>	<u>\$ 557,237</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ (45,741)</u>	<u>\$ 557,237</u>

See accompanying notes to financial statements.

Knox County Utility Commission
Notes to the Financial Statements
December 31, 2011 and 2010

Note 1 – Summary of Significant Accounting Policies

Reporting Entity

The Knox County Utility Commission, of Knox County, Kentucky the (“Commission”) was created in 2001 from a merger of the East Knox Water District and the Dewitt Water District. Water Districts are organized under Chapter 74 of the Kentucky Revised Statutes. The Commission is governed by a five person board of Commissioners which is appointed by the Knox County Fiscal Court. The Commission is regulated by the Kentucky Public Service Commission.

The Commission 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 a portion of Knox County, Kentucky. The Commission’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 Commission 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 Commission 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 Commission 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 Commission as a whole. These statements include all funds of the Commission. The statements distinguish between governmental and business-type activities. The Commission does not have any governmental activities.

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

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies (Continued)

Investments

The Commission is authorized by state statute to invest in: 1) Obligations of the United States and of its agencies and instrumentalities; 2) Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities; 3) Shares of any savings and loan insured by an agency of the government of the United States up to the amount so insured; 4) Interest bearing deposits in nationally chartered or state banks chartered in Kentucky and insured by an agency of the government of the United States up to the amount so insured, and in larger amounts provided such bank shall pledge as security obligations of the United States government, its agencies and instrumentalities.

The Commission's investments consist of 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.

Accounts Receivable

Receivables include amounts due from customers for water and sewer services. These receivables are due at the time the services are billed. Billing is completed monthly and accounts are considered past due on the twenty first day after the end of each billing period. Accounts receivable are presented net of uncollectible accounts. The allowance amount is estimated using a percentage of accounts past due more than 90 days. At December 31, 2011 and 2010, the Allowance for Doubtful Accounts totaled \$10,500 and \$10,500, respectively.

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 Commission'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:

<u>Asset Classification</u>	<u>Range of Lives</u>
Structures and improvements	10-40 years
Transmission distribution mains	50 years
Meters and services	20 years
Other equipment and vehicles	5-10 years

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 1 – Significant Accounting Policies (Continued)

Customer Deposits

The Commission collects and holds in escrow a \$40 deposit from customers to insure collection of its water charges. Interest at an annual rate of 2.53% 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.

Net Assets

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

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

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

Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”.

Note 2 – Restricted Assets

Under the terms of all loan resolutions, the Commission is required to maintain certain accounts and funds for the benefit and protection of the creditors. In addition, the Commission 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 Commission 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 \$87,433 and \$82,754.

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 3 – Kentucky Revised Statute

At December 31, 2011 and 2010, all of the cash of the Commission was covered by federal depository insurance and securities pledged as collateral on behalf of the Commission. 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 91A.060, the Commission 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.

Note 4 – Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of December 31, 2011 and 2010, \$645,512 and \$831,274 of the Commission's total deposits at banks of \$895,512 and \$1,081,274, respectively, were exposed to custodial credit risk as follows:

	<u>2011</u>	<u>2010</u>
Uninsured and uncollateralized	\$ -	\$ -
Uninsured and collateral held by pledging bank	645,512	831,274
Uninsured and collateral held by pledging bank's trust		
Department not in the District's name	-	-
Total	<u>\$ 645,512</u>	<u>\$ 831,274</u>

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 5 – 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 land improvements	\$ 44,619	\$ -	\$ -	\$ 44,619
Structures and improvements	497,407	-	-	497,407
Pumping equipment	106,103	2,030	-	108,133
Meters and meter installation	659,421	23,657	-	683,078
Hydrants	48,901	4,915	-	53,816
Storage tanks	741,318	406,784	-	1,148,102
Transmission and distribution plant	9,065,295	1,038,889	-	10,104,184
Vehicles and other equipment	372,977	4,639	-	377,616
Office equipment	41,790	-	-	41,790
Lift stations	344,195	-	-	344,195
Construction in process	1,203,738	246,849	1,450,587	-
Totals at historical cost	<u>13,125,764</u>	<u>1,727,763</u>	<u>1,450,587</u>	<u>13,402,940</u>
Less accumulated depreciation for:				
Structures and improvements	346,647	21,956	-	368,603
Pumping equipment	56,616	7,315	-	63,931
Meters and meter installation	361,738	30,516	-	392,254
Hydrants	24,113	3,067	-	27,180
Storage tanks	311,884	49,113	-	360,997
Transmission and distribution plant	2,644,433	320,935	-	2,965,368
Vehicles and other equipment	283,393	22,725	-	306,118
Office equipment	39,202	382	-	39,584
Lift stations	64,146	13,787	-	77,933
Total accumulated depreciation	<u>4,132,172</u>	<u>469,796</u>	<u>-</u>	<u>4,601,968</u>
Capital assets - net	<u>\$ 8,993,592</u>	<u>\$ 1,257,967</u>	<u>\$ 1,450,587</u>	<u>\$ 8,800,972</u>

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 5 – Capital Assets (Continued)

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 land improvements	\$ 44,619	\$ -	\$ -	\$ 44,619
Structures and improvements	487,747	9,660	-	497,407
Pumping equipment	100,721	5,382	-	106,103
Meters and meter installation	633,253	26,168	-	659,421
Hydrants	48,901	-	-	48,901
Storage tanks	741,318	-	-	741,318
Transmission and distribution plant	9,065,295	-	-	9,065,295
Vehicles and other equipment	366,092	6,885	-	372,977
Office equipment	41,430	360	-	41,790
Lift stations	344,195	-	-	344,195
Construction in process	12,215	1,191,523	-	1,203,738
Totals at historical cost	<u>11,885,786</u>	<u>1,239,978</u>	<u>-</u>	<u>13,125,764</u>
Less accumulated depreciation for:				
Structures and improvements	324,115	22,532	-	346,647
Pumping equipment	49,636	6,980	-	56,616
Meters and meter installation	332,028	29,710	-	361,738
Hydrants	21,182	2,931	-	24,113
Storage tanks	272,093	39,791	-	311,884
Transmission and distribution plant	2,347,026	297,407	-	2,644,433
Vehicles and other equipment	255,633	27,760	-	283,393
Office equipment	37,837	1,365	-	39,202
Lift stations	50,358	13,788	-	64,146
Total accumulated depreciation	<u>3,689,908</u>	<u>442,264</u>	<u>-</u>	<u>4,132,172</u>
Capital assets - net	<u>\$ 8,195,878</u>	<u>\$ 797,714</u>	<u>\$ -</u>	<u>\$ 8,993,592</u>

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 6 – 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>	<u>Due Within</u> <u>One Year</u>
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2034; interest payable on a semi-annual basis at the rate of 4.5%	\$ 343,000	\$ -	\$ 8,000	\$ 335,000	\$ 9,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2029; interest payable on a semi-annual basis at the rate of 5.0%	64,000	-	2,000	62,000	2,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2040; interest payable on a semi-annual basis at the rate of 5.0%	2,021,000	-	35,000	1,986,000	37,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2042; interest payable on a semi-annual basis at the rate of 4.5%	<u>320,000</u>	<u>-</u>	<u>5,000</u>	<u>315,000</u>	<u>5,000</u>
	<u>\$ 2,748,000</u>	<u>\$ -</u>	<u>\$ 50,000</u>	<u>\$ 2,698,000</u>	<u>\$ 53,000</u>

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 6 – 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>	<u>Due Within</u> <u>One Year</u>
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2034; interest payable on a semi-annual basis at the rate of 4.5%	\$ 351,000	\$ -	\$ 8,000	\$ 343,000	\$ 8,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2029; interest payable on a semi-annual basis at the rate of 5.0%	66,000	-	2,000	64,000	2,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2040; interest payable on a semi-annual basis at the rate of 5.0%	2,055,000	-	34,000	2,021,000	35,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2042; interest payable on a semi-annual basis at the rate of 4.5%	325,000	-	5,000	320,000	5,000
	<u>\$ 2,797,000</u>	<u>\$ -</u>	<u>\$ 49,000</u>	<u>\$ 2,748,000</u>	<u>\$ 50,000</u>

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 6 – Long-Term Debt (Continued)

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

<u>Year ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 53,000	\$ 120,522	\$ 173,522
2013	54,000	118,105	172,105
2014	58,000	115,575	173,575
2015	61,000	113,045	174,045
2016	64,000	110,515	174,515
2017-2021	283,000	419,245	702,245
2022-2026	436,000	435,110	871,110
2027-2031	540,000	329,250	869,250
2032-2036	596,000	142,466	738,466
2037-2041	553,000	81,742	634,742
	<u>\$ 2,698,000</u>	<u>\$ 1,985,575</u>	<u>\$ 4,683,575</u>

Note 7 – Retirement Plan

The Commission's full time employees are covered under the County Employee's Retirement System (CERS), a cost sharing, multiple-employer, public employers retirement system. Funding for the plan is provided through payroll withholdings and contributions by the Commission. Employees hired before September 1, 2008 are withheld at the rate of 5% of the employee's total compensation subject to contribution. Employees hired on or after September 1, 2008 are withheld at the rate of 6% of the employees total compensation subject to contribution. The Commission's contribution rate for the years ended December 31, 2011 and 2010 were 18.96% and 16.93%, respectively.

The Commission's payroll for the years ended December 31, 2011, 2010, and 2009 that was covered by CERS was \$240,261, \$235,465, and \$222,127, respectively.

The Commission's contribution requirement for CERS for the years ended December 31, 2011, 2010, and 2009 was \$43,230, \$39,007, and \$49,099, respectively.

Benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the Plan documents.

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

Note 8 – Risk Management

The Commission 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 Commission 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.

Knox County Utility Commission
Notes to the Financial Statements (Continued)
December 31, 2011 and 2010

Note 9 - Subsequent Events

Management of the Commission 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.

Knox County Utility Commission
 Departmental Statements of Net Assets - Water Department
 December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 574,732	\$ 768,142
Investments	107,279	105,823
Receivables, less allowance	79,494	89,558
Unbilled accounts receivable	42,645	61,000
Other receivables	3,013	-
Inventories	31,902	22,348
Other current assets	100	143
Total Current Assets	839,165	1,047,014
Noncurrent assets		
Restricted assets		
Restricted cash and cash equivalents	87,433	82,754
Capital Assets		
Land and improvements	44,619	44,619
Structures and improvements	497,407	497,407
Pumping equipment	97,515	95,484
Meters and meter installation	682,983	659,326
Hydrants	53,816	48,901
Storage tanks	1,148,102	741,318
Transmission and distribution plant	9,574,333	8,535,445
Vehicles and other equipment	376,903	372,264
Office equipment	41,790	41,790
Construction in progress	-	1,203,738
	12,517,468	12,240,292
Accumulated depreciation	(4,461,139)	(4,016,832)
Net Capital Assets	8,056,329	8,223,460
Other Assets		
Bond issue costs, net of amortization	10,752	11,305
Total Other Assets	10,752	11,305
Total Noncurrent Assets	8,154,514	8,317,519
Total Assets	8,993,679	9,364,533

	<u>2011</u>	<u>2010</u>
Liabilities		
Current Liabilities		
Current portion of long-term debt	53,000	50,000
Accounts payable	46,791	278,777
Accrued interest payable	47	47
Accrued salaries and taxes payable	18,448	18,128
Total Current Liabilities	<u>118,286</u>	<u>346,952</u>
Noncurrent Liabilities		
Customer deposits	28,254	27,386
Long-term debt	2,645,000	2,698,000
Total Noncurrent Liabilities	<u>2,673,254</u>	<u>2,725,386</u>
Total Liabilities	<u>2,791,540</u>	<u>3,072,338</u>
Net Assets		
Invested in capital assets, net of related debt	5,358,329	5,475,460
Restricted	87,433	82,754
Unrestricted	756,377	733,981
Total Net Assets	<u>\$ 6,202,139</u>	<u>\$ 6,292,195</u>

Knox County Utility Commission
 Departmental Statements of Revenues, Expenses and Changes in Net Assets - Water Department
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Water sales	\$ 1,068,913	\$ 1,118,892
Service charges	15,675	14,130
Tap fees	24,000	30,013
Penalties	30,104	30,006
Other revenues	6,385	8,795
Total Operating Revenues	<u>1,145,077</u>	<u>1,201,836</u>
Operating Expenses		
Salaries and wages	255,308	250,349
Employee benefits	161,292	153,799
Purchased power	221,996	194,655
Utilities	55,267	51,933
Chemicals	73,079	58,995
Repairs and maintenance	61,344	25,747
Contracted services	24,351	23,232
Vehicle and equipment expenses	27,248	19,826
Insurance	33,737	32,881
Amortization	553	553
Depreciation	444,307	416,775
Bad debt expense, net of recoveries	14,814	14,510
Other operating expenses	48,590	55,062
Total Operating Expenses	<u>1,421,886</u>	<u>1,298,317</u>
Operating Loss	<u>(276,809)</u>	<u>(96,481)</u>
Nonoperating Revenues (Expenses)		
Interest income	19,907	18,303
Federal and state grants	291,258	1,156,973
Other income	59,882	2,052
Other expense	(59,770)	-
Interest expense	<u>(124,524)</u>	<u>(126,685)</u>
Total Nonoperating Revenues (Expenses)	<u>186,753</u>	<u>1,050,643</u>
Change in Net Assets	<u>(90,056)</u>	<u>954,162</u>
Net Assets, Beginning of Year	<u>6,292,195</u>	<u>5,338,033</u>
Net Assets, End of Year	<u>\$ 6,202,139</u>	<u>\$ 6,292,195</u>

Knox County Utility Commission
 Departmental Statements of Cash Flows - Water Department
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities		
Receipts from customers	\$ 1,164,966	\$ 1,184,340
Receipts from other activities	6,385	8,795
Payments to employees	(254,988)	(246,790)
Payments to suppliers	<u>(963,215)</u>	<u>(387,738)</u>
Net Cash Provided (Used) by Operating Activities	<u>(46,852)</u>	<u>558,607</u>
 Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(277,176)	(1,239,978)
Principal payments on debt	(50,000)	(49,000)
Interest payments on debt	(124,524)	(126,722)
Federal, state and local grants	291,258	1,156,973
Miscellaneous non-operating	59,882	2,052
Miscellaneous non-operating expense	<u>(59,770)</u>	<u>-</u>
Net Cash Used by Capital and Related Financing Activities	<u>(160,330)</u>	<u>(256,675)</u>
 Cash Flows From Investing Activities		
Interest on cash and investments	<u>18,451</u>	<u>16,767</u>
Net Cash Provided by Investing Activities	<u>18,451</u>	<u>16,767</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	(188,731)	318,699
 Cash and Cash Equivalents at Beginning of Year	<u>850,896</u>	<u>532,197</u>
 Cash and Cash Equivalents at End of Year	<u><u>\$ 662,165</u></u>	<u><u>\$ 850,896</u></u>
 Reconciliation of Cash at End of Year		
Cash and Cash Equivalents	\$ 574,732	\$ 768,142
Restricted Cash and Cash Equivalents	<u>87,433</u>	<u>82,754</u>
Total Cash at End of Year	<u><u>\$ 662,165</u></u>	<u><u>\$ 850,896</u></u>

Knox County Utility Commission
 Departmental Statements of Cash Flows - Water Department (Continued)
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of Operating Loss to Net Cash		
Provided (Used) by Operating Activities:		
Operating loss	\$ (276,809)	\$ (96,481)
Adjustments to reconcile operating loss		
to net cash provided (used) by operating activities		
Depreciation	444,307	416,775
Amortization	553	553
(Increase) Decrease in:		
Accounts receivable	10,064	(13,767)
Unbilled accounts receivable	18,355	4,500
Other receivables	(3,013)	-
Inventory	(9,554)	6,373
Prepaid expenses and other assets	43	112
Increase (Decrease) in:		
Accounts payable	(231,986)	236,417
Customer deposits	868	566
Accrued expenses	320	3,559
	<u>\$ (46,852)</u>	<u>\$ 558,607</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ (46,852)</u>	<u>\$ 558,607</u>

Knox County Utility Commission
 Departmental Statements of Net Assets - Sewer Department
 December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 11,461	\$ 10,350
Receivables, less allowance	1,050	1,141
Total Current Assets	<u>12,511</u>	<u>11,491</u>
Noncurrent assets		
Capital Assets		
Pumping equipment	10,618	10,618
Meters and meter installation	95	95
Transmission and distribution plant	529,850	529,850
Vehicles and other equipment	714	714
Lift stations	<u>344,195</u>	<u>344,195</u>
	885,472	885,472
Accumulated depreciation	<u>(140,829)</u>	<u>(115,340)</u>
Net Capital Assets	<u>744,643</u>	<u>770,132</u>
Total Noncurrent Assets	<u>744,643</u>	<u>770,132</u>
Total Assets	<u>757,154</u>	<u>781,623</u>
Liabilities and Net Assets		
Liabilities		
Current Liabilities		
Accounts payable	<u>615</u>	<u>2,831</u>
Total Liabilities	<u>615</u>	<u>2,831</u>
Net Assets		
Invested in capital assets, net of related debt	744,643	770,132
Unrestricted	<u>11,896</u>	<u>8,660</u>
Total Net Assets	<u>\$ 756,539</u>	<u>\$ 778,792</u>

Knox County Utility Commission
 Departmental Statements of Revenues, Expenses and Changes in Net Assets - Sewer Department
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Sewer sales	\$ 21,324	\$ 16,454
Total Operating Revenues	<u>21,324</u>	<u>16,454</u>
Operating Expenses		
Salaries and wages	549	666
Employee benefits	40	49
Utilities	980	886
Sewer treatment	16,493	17,156
Depreciation	25,489	25,489
Bad debt expense, net of recoveries	-	38
Other operating expenses	<u>26</u>	<u>50</u>
Total Operating Expenses	<u>43,577</u>	<u>44,334</u>
Operating Loss	<u>(22,253)</u>	<u>(27,880)</u>
Change in Net Assets	<u>(22,253)</u>	<u>(27,880)</u>
Net Assets, Beginning of Year	<u>778,792</u>	<u>806,672</u>
Net Assets, End of Year	<u>\$ 756,539</u>	<u>\$ 778,792</u>

Knox County Utility Commission
 Departmental Statements of Cash Flows - Sewer Department
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities		
Receipts from customers	\$ 21,415	\$ 15,830
Payments to employees	(549)	(666)
Payments to suppliers	<u>(19,755)</u>	<u>(16,534)</u>
Net Cash Provided (Used) by Operating Activities	<u>1,111</u>	<u>(1,370)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	1,111	(1,370)
Cash and Cash Equivalents at Beginning of Year	<u>10,350</u>	<u>11,720</u>
Cash and Cash Equivalents at End of Year	<u>\$ 11,461</u>	<u>\$ 10,350</u>
Reconciliation of Operating Loss to Net Cash Provided (Used) by Operating Activities:		
Operating loss	\$ (22,253)	\$ (27,880)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities		
Depreciation	25,489	25,489
(Increase) Decrease in:		
Accounts receivable	91	(624)
Increase (Decrease) in:		
Accounts payable	<u>(2,216)</u>	<u>1,645</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ 1,111</u>	<u>\$ (1,370)</u>

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

To the Commissioners
Knox County Utility Commission
Artemus, Kentucky

We have audited the financial statements of the business-type activities of Knox County Utility Commission, 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 Knox County Utility Commission'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 Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission'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 questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect 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 responses to be material weaknesses. (See 2011-1 and 2011-2)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Knox County Utility Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Knox County Utility Commission's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit Knox County Utility Commission'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, 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

Knox County Utility Commission
Schedule of Findings and Responses
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 Commission's limited internal resources prevents the preparation of financial statements and related note disclosures in accordance with Generally Accepted Accounting Principles.

Effect:

The Commission 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 Commission 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 Commission's office staff does not allow proper segregation of duties with regard to cash handling, billing, and accounts receivable bookkeeping; and payroll processing.

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