

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

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Laurel County Water District No. 2
London, Kentucky

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

Laurel County Water District No. 2
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Independent Auditor's Report

Commissioners
Laurel County Water District No. 2
London, Kentucky

We have audited the accompanying financial statements of the business-type activities of Laurel County Water District No. 2 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 Laurel County Water District No. 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.

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 Laurel County Water District No. 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 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 opinions on the financial statements that collectively comprise the Laurel County Water District No. 2's financial statements as a whole. The accompanying 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 also not a required part of the 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 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

Laurel County Water District No. 2
 Statements of Net Assets
 December 31, 2011 and 2010

Assets	<u>2011</u>	<u>2010</u>
Current Assets		
Cash and cash equivalents	\$ 1,359,130	\$ 747,353
Receivables, less allowance for doubtful accounts of \$10,000 and \$10,000	192,551	195,111
Unbilled accounts receivable	111,314	115,005
Inventories	100,707	107,204
Other current assets	104	100
Total Current Assets	<u>1,763,806</u>	<u>1,164,773</u>
Noncurrent Assets		
Restricted Assets		
Customer deposits	63,454	58,114
Depreciation reserves - cash	352,592	351,245
Depreciation reserves - certificates of deposit	125,100	125,100
Bond and interest funds	14,089	14,335
Total Restricted Assets	<u>555,235</u>	<u>548,794</u>
Capital Assets		
Land and improvements	496,336	471,288
Buildings and improvements	485,153	482,386
Source of supply and pumping	3,503,559	251,353
Water treatment equipment	123,333	123,333
Transmission and distribution plant	6,081,232	5,738,183
Vehicles and other equipment	530,917	523,585
Construction in progress	6,110,041	4,908,660
Less: accumulated depreciation	<u>(4,612,574)</u>	<u>(4,330,664)</u>
Net Capital Assets	<u>12,717,997</u>	<u>8,168,124</u>
Other Assets		
Bond issuance costs, net of amortization	<u>17,298</u>	<u>19,316</u>
Total Noncurrent Assets	<u>13,290,530</u>	<u>8,736,234</u>
Total Assets	<u>15,054,336</u>	<u>9,901,007</u>

See accompanying notes to financial statements.

Liabilities	<u>2011</u>	<u>2010</u>
Current Liabilities		
Accounts payable	37,806	23,397
Accounts payable - construction	677,397	244,824
Accrued interest payable	1,625	3,204
Accrued salaries and taxes payable	15,967	17,844
Current portion of long-term debt	127,056	128,858
Other current liabilities	23,320	18,804
Total Current Liabilities	<u>883,171</u>	<u>436,931</u>
Noncurrent Liabilities		
Currents deposits	65,800	60,940
Long-term debt, less current portion included in current liabilities	<u>8,871,468</u>	<u>4,712,304</u>
Total Noncurrent liabilities	<u>8,937,268</u>	<u>4,773,244</u>
Total Liabilities	<u>9,820,439</u>	<u>5,210,175</u>
Net Assets		
Invested in capital assets, net of related debt	3,042,076	3,326,962
Restricted	555,235	548,794
Unrestricted	1,636,586	815,076
Total Net Assets	<u>\$ 5,233,897</u>	<u>\$ 4,690,832</u>

Laurel County Water District No. 2
 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	\$ 2,034,168	\$ 1,919,012
Service charges	82,452	84,848
Tap fees	22,727	27,124
Penalties	48,529	40,494
Other revenues	7,070	11,138
	<hr/>	<hr/>
Total Operating Revenues	2,194,946	2,082,616
	<hr/>	<hr/>
Operating Expenses		
Salaries and wages	493,130	490,062
Employee benefits	275,555	254,965
Purchased water	50,197	58,599
Purchased power	127,576	75,376
Utilities	18,458	16,619
Chemicals	93,150	133,953
Materials and supplies	95,699	71,068
Contracted services	66,339	54,802
Vehicle and equipment expenses	37,154	35,081
Insurance	17,796	19,647
Bad debt expense, net of recoveries	23,817	13,825
Depreciation	281,910	246,459
Amortization	2,018	2,018
Other operating expenses	36,880	26,913
	<hr/>	<hr/>
Total Operating Expenses	1,619,679	1,499,387
	<hr/>	<hr/>
Operating Income	575,267	583,229
	<hr/>	<hr/>
Non-operating Revenues (Expenses)		
Interest income	2,658	2,873
Grant revenue	10,000	862,507
Rental income	5,500	4,250
Gain (loss) on disposition of equipment	-	1,592
Interest expense	(50,360)	(55,728)
	<hr/>	<hr/>
Total Non-operating Revenues (Expenses)	(32,202)	815,494
	<hr/>	<hr/>
Change in Net Assets	543,065	1,398,723
Net Assets, Beginning of Year	4,690,832	3,491,556
Restatement note 10	-	(199,447)
	<hr/>	<hr/>
Net Assets, Beginning of Year	4,690,832	3,292,109
	<hr/>	<hr/>
Net Assets, End of Year	<u>\$ 5,233,897</u>	<u>\$ 4,690,832</u>

See accompanying notes to financial statements.

Laurel County Water District No. 2
Statement 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	\$ 2,194,127	\$ 1,935,593
Receipts from other activities	7,070	11,138
Payments to employees	(495,007)	(472,489)
Payments to suppliers	(775,459)	(490,379)
Payments for other activities	<u>(36,880)</u>	<u>(26,913)</u>
Net Cash Provided by Operating Activities	<u>893,851</u>	<u>956,950</u>
Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(4,399,210)	(4,470,715)
Principal payments on debt	(98,899)	(135,123)
Proceeds from debt	4,256,261	3,605,497
Interest payments on debt	(51,939)	(55,728)
State grants	10,000	862,507
Proceeds from sale of assets	-	8,844
Other receipts/(payments)	<u>5,500</u>	<u>4,250</u>
Net Cash Used by Capital and Related Financing Activities	<u>(278,287)</u>	<u>(180,468)</u>
Cash Flows From Investing Activities		
Interest on certificates of deposits	<u>2,654</u>	<u>2,873</u>
Net Cash Provided by Investing Activities	<u>2,654</u>	<u>2,873</u>
Net Increase in Cash and Cash Equivalents	618,218	779,355
Cash and Cash Equivalents at the Beginning of Year	<u>1,171,047</u>	<u>391,692</u>
Cash and Cash Equivalents at the End of Year	<u>\$ 1,789,265</u>	<u>\$ 1,171,047</u>
Reconciliation of cash per Statements of Net Assets to cash per Statements of Cash Flows:		
Cash and cash equivalents	\$ 1,359,130	\$ 747,353
Restricted cash and cash equivalents:		
Customer deposits	63,454	58,114
Depreciation reserves-cash	352,592	351,245
Bond and interest funds	<u>14,089</u>	<u>14,335</u>
Cash and Equivalents per Statements of Cash Flows	<u>\$ 1,789,265</u>	<u>\$ 1,171,047</u>

See accompanying notes to financial statements.

Laurel County Water District No. 2
 Statements of Cash Flows (Continued)
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of Operation Income to Net Cash Provided by Operating Activities:		
Operating income	\$ 575,267	\$ 583,229
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	283,928	248,477
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	6,251	(135,885)
Decrease (increase) in inventory	6,497	(4,001)
Decrease (increase) in prepaid expenses	-	467
Increase (decrease) in accounts payable	14,409	247,090
Increase (decrease) in accrued expenses	7,499	17,573
	<u>\$ 893,851</u>	<u>\$ 956,950</u>
Net Cash Provided by Operating Activities	<u>\$ 893,851</u>	<u>\$ 956,950</u>

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies

Reporting Entity

Laurel County Water District No. 2, of Laurel County, Kentucky ("District") was created in 1963 under Chapter 74 of the Kentucky Revised Statutes. The District is governed by a five person board of Commissioners which is appointed by the Laurel County Fiscal Court. The District is regulated by the Kentucky Public Service Commission.

Laurel County Water District No. 2's financial statements include the operations of all entities for which the District exercises oversight responsibility. Oversight responsibility includes, but is not limited to, financial interdependency, selection of the governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters. The entities included in the financial statements are the general operations of the District. There are no other entities that are subject to the District's oversight responsibility as indicated above.

Basis of Accounting, 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 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 the funds of the District. The statements distinguish between governmental and business-type activities. The District 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 District includes revenue 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 deposits with maturities of 90 days or less to be cash equivalents.

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 expenditure 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.

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies (Continued)

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	25 years
Meters and services	20 years
Other equipment and vehicles	5-10 years

Accounts Receivable

Receivables include amounts due from customers for water services. These receivables are due at the time the services are billed. Billing is completed monthly and accounts are considered past due on the sixteenth 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.

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.

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 \$491,781 and \$490,680, respectively.

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010

Note 3 - Kentucky Revised Statute

At December 31, 2011 and 2010 all 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 91A.060, 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.

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 \$1,446,954 and \$796,675 of the District's total deposits at banks of \$1,946,954 and \$1,319,043, respectively, were exposed to custodial credit as follows:

	<u>2011</u>	<u>2010</u>
Uninsured and uncollateralized	\$ -	\$ -
Uninsured and collateral held by pledging bank	1,446,954	796,675
Uninsured and collateral held by pledging bank's trust Department not in the District's name	-	-
Total	<u>\$ 1,446,954</u>	<u>\$ 796,675</u>

Laurel Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010 (Continued)

Note 5 - Capital Assets (Continued)

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	\$ 471,288.00	\$ 25,048	\$ -	\$ 496,336
Building and improvements	482,386	2,767	-	485,153
Source of supply and pumping	251,353	3,252,206	-	3,503,559
Water treatment equipment	123,333	-	-	123,333
Transmission and distribution plant	5,738,183	343,049	-	6,081,232
Vehicles and other equipment	523,585	7,332	-	530,917
Construction in progress	4,908,660	4,754,058	3,552,677	6,110,041
Totals at historical cost	<u>12,498,788</u>	<u>8,384,460</u>	<u>3,552,677</u>	<u>17,330,571</u>
Less accumulated depreciation for:				
Land and improvements	1,000	1,000	-	2,000
Building and improvements	390,744	8,431	-	399,175
Source of supply and pumping	162,304	58,519	-	220,823
Water treatment equipment	68,568	4,823	-	73,391
Transmission and distribution plant	3,286,723	182,986	-	3,469,709
Vehicles and other equipment	421,325	26,151	-	447,476
Total accumulated depreciation	<u>4,330,664</u>	<u>281,910</u>	<u>-</u>	<u>4,612,574</u>
Capital assets - net	<u>\$ 8,168,124</u>	<u>\$ 8,102,550</u>	<u>\$ 3,552,677</u>	<u>\$ 12,717,997</u>

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010 (Continued)

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 improvements	\$ 471,288	\$ -	\$ -	\$ 471,288
Building and improvements	480,636	1,750	-	482,386
Source of supply and pumping	248,757	2,596	-	251,353
Water treatment equipment	123,333	-	-	123,333
Transmission and distribution plant	5,668,617	76,910	7,344	5,738,183
Vehicles and other equipment	530,092	8,058	14,565	523,585
Construction in progress	527,259	4,381,401	-	4,908,660
Totals at historical cost	<u>8,049,982</u>	<u>4,470,715</u>	<u>21,909</u>	<u>12,498,788</u>
**Less accumulated depreciation for:				
Land and improvements	-	1,000	-	1,000
Building and improvements	377,232	13,512	-	390,744
Source of supply and pumping	158,010	4,294	-	162,304
Water treatment equipment	61,789	6,779	-	68,568
Transmission and distribution plant	3,094,154	192,661	92	3,286,723
Vehicles and other equipment	407,677	28,213	14,565	421,325
Total accumulated depreciation	<u>4,098,862</u>	<u>246,459</u>	<u>14,657</u>	<u>4,330,664</u>
Capital assets - net	<u>\$ 3,951,120</u>	<u>\$ 4,224,256</u>	<u>\$ 7,252</u>	<u>\$ 8,168,124</u>

**Balance of accumulated depreciation at Dec. 31, 2009 and 2010 was adjusted by the prior period adjustment. (See Note 10)

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010 (Continued)

Note 6 - Long-Term Debt

The following is a summary of long-term transactions for the year end 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 Kentucky Infrastructure Authority, principal and interest at the rate of 1.6%, payable on a semi-annual basis with the final payment due December 1, 2026	\$ 259,165	\$ -	\$ 14,858	\$ 244,307	\$ 15,097
Loan payable to Kentucky Infrastructure Authority, payable monthly in varying principal amounts, with final payment due June 1, 2017; interest payable on a semi-annual basis at rates graduated from 3.75% to 5.325% over the life of the loan	352,500	-	47,500	305,000	50,000
Loan payable to GMAC Commercial Mortgage Corporation, payable annually in varying principal amounts, with final payment due January 1, 2019; interest payable on a semi-annual basis at the rate of 5.0%	170,000	-	21,000	149,000	22,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2036; interest payable on a semi-annual basis at the rate of 4.5%	458,000	-	9,500	448,500	10,000

Note 6 – Long-Term Debt (Continued)

Line of credit payable to the First National Bank of London, payable monthly at a rate of 66% of the Wall Street prime rate, maturing March 15, 2011.	36,000	-	6,041	29,959	29,959
Interim financing loan payable to Kentucky Rural Water Finance Corporation. Total loan amount is \$8,385,000. Interest at the rate of 2.5% and principal is due October 1, 2012.	<u>3,565,497</u>	<u>4,256,261</u>	<u>-</u>	<u>7,821,758</u>	<u>-</u>
	<u>\$ 4,841,162</u>	<u>\$ 4,256,261</u>	<u>\$ 98,899</u>	<u>\$ 8,998,524</u>	<u>\$ 127,056</u>

During 2010, the District entered into a loan agreement with Kentucky Rural Water Finance Corporation. The total loan amount is \$8,385,000. Total draws outstanding against this loan at December 31, 2010 were \$3,565,497. The purpose of this loan is to construct a raw water line and upgrade the water treatment plant. At the completion of the project this loan will be repaid with proceeds from debt that will be issued by the United States Department of Agriculture acting through Rural Development. Repayment of the loan to Rural Development will begin January 2012 over a period of forty years. As of December 31, 2011 the interest rate has not been determined but will range from 3.25% to 4.5%.

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010 (Continued)

Note 6 - Long-Term Debt (Continued)

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

	Balance Dec. 31, 2009	Additions	Payments	Balance Dec. 31, 2010	Due Within One Year
Loan payable to Kentucky Infrastructure Authority, principal and interest at the rate of 1.6%, payable on a semi-annual basis with the final payment due December 1, 2026	\$ 273,788	\$ -	\$ 14,623	\$ 259,165	\$ 14,858
Loan payment to Kentucky Infrastructure Authority, payable monthly in varying principal amounts, with final payment due June 1, 2017; interest payable on a semi-annual basis at rates graduated from 3.75% to 5.325% over the life of the loan	397,500	-	45,000	352,500	47,500
Loan payable to GMAC Commercial Mortgage Corporation, payable annually in varying principal amounts, with final payment due January 1, 2019; interest payable on a semi-annual basis at the rate of 5.0%	190,000	-	20,000	170,000	21,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2036; interest payable on a semi-annual basis at the rate of 4.5%	467,500	-	9,500	458,000	9,500
Line of credit payable to First National Bank of London, payable monthly at a rate of 66% of the Wall Street prime rate, maturing March 14, 2011.	-	40,000	4,000	36,000	36,000
Interim financing loan payable to Kentucky Rural Water Finance Corporation. Total loan amount is \$8,385,000. Interest at the rate of 2.5% and principal is due October 1, 2012.	-	3,565,497	-	3,565,497	-
	<u>\$ 1,328,788</u>	<u>\$ 3,605,497</u>	<u>\$ 93,123</u>	<u>\$4,841,162</u>	<u>\$ 128,858</u>

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010 (Continued)

Note 6 – Long-Term Debt (Continued)

All revenues from water are pledged as collateral on the loans payable to the Kentucky Infrastructure Authority.

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

Due the year ending <u>December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 127,056	\$ 47,292	\$ 174,348
2013	101,339	42,675	144,014
2014	200,586	354,137	554,723
2015	208,836	345,793	554,629
2016	218,091	337,421	555,512
2017-2021	791,914	1,576,732	2,368,646
2022-2026	877,943	1,425,026	2,302,969
2027-2031	976,000	1,248,200	2,224,200
2032-2036	1,198,500	1,035,068	2,233,568
2037-2041	1,305,500	786,598	2,092,098
2042-2046	1,601,000	503,794	2,104,794
2047-2051	1,391,759	139,924	1,531,683
	<u>\$ 8,998,524</u>	<u>\$ 7,842,660</u>	<u>\$ 16,841,184</u>

Note 7 – Retirement Plan

The District's full time employees are covered under the County Employee's Retirement System (CERS), a cost sharing, multiple-employer, public employer's retirement system. Funding for the plan is provided through payroll withholdings and contributions by the District. 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 employee's total compensation subject to contribution. The District's contribution rate for the years ended December 31, 2011 and 2010 were 18.96% and 16.93%, respectively.

The District's payroll for the years ended December 31, 2011, 2010, and 2009 that was covered by CERS was \$469,032, \$472,139 and \$439,330, respectively.

The District's contribution requirement for CERS for the years ended December 31, 2011, 2010, and 2009 was \$84,145, \$78,234, and \$64,217, 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.

Laurel County Water District No. 2
Notes to Financial Statements
December 31, 2011 and 2010 (Continued)

Note 8 – 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 9 - Subsequent Events

Date of Management Evaluation

Management of the District has evaluated subsequent events through March 29, 2011, 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 10 – Prior Period Adjustment

Net assets and accumulated depreciation were restated at January 1, 2010 to correct the amount of prior year's depreciation which had been cumulatively understated by \$199,447. The beginning balance of Net Assets for the 2010 year has been restated from \$3,491,556 to \$3,292,109.

Laurel County Water District No. 2
 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 Rural Development Direct Loan:		
Water and Waste Disposal System for Rural Communities	10.760	<u>\$ 4,256,261</u>
Total		<u><u>\$ 4,256,261</u></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
Laurel County Water District No. 2
London, Kentucky

We have audited the financial statements of the business-type activities of Laurel County Water District No. 2, 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 Laurel County Water District No. 2's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect 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.

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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Laurel County Water District No. 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Commissioners, management, others within the organization and federal awarding agencies 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
Laurel Water District No. 2
London, Kentucky

Compliance

We have audited Laurel Water District No. 2'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 Laurel Water No. 2's major federal programs for the year ended December 31, 2011. Laurel Water District No. 2'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 Laurel Water District No. 2's management. Our responsibility is to express an opinion on Laurel Water District No. 2'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 Laurel Water District No. 2'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 Laurel Water District's compliance with those requirements.

In our opinion, Laurel Water District No. 2 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 Laurel Water District No. 2 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 Laurel Water District No. 2'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 Laurel Water District No. 2'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 Board of Commissioners, Management, 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

Laurel County Water District No. 2
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 Laurel Water District No. 2.
2. There were no significant deficiencies related to the audit of financial statements which were required to be 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 were no instances of noncompliance material to the financial statements of Laurel Water District No. 2.
4. There were no significant deficiencies related to the audit of major program disclosed in the Independent Auditor's 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 awards program for Laurel County Water District No. 2 expresses an unqualified opinion.
6. There were no audit findings relative to the major federal award program for Laurel County Water District No. 2.
7. The program tested as major was: CFDA #
10.760
Water and Waste Disposal System to Rural Communities
8. The threshold for distinguishing Type A and B Programs was \$300,000.
9. Laurel County Water District No. 2 did not qualify as a low-risk auditee.

B. Findings – Financial Statements

None

Laurel County Water District No. 2
Summary of Prior Year Audit Findings
December 31, 2011

Status of Prior Year Audit Findings

No audit findings in the prior year.