

*Muhlenberg County Water District*

P. O. BOX 348  
GREENVILLE, KENTUCKY 42345

March 20, 2012

Jeff Cline  
Filing Division  
Kentucky Public Service Commission  
211 Sower Boulevard  
PO Box 615  
Frankfort, KY 40602

Dear Mr. Cline:

I have talked with our accountant, Shellie Utley of Berry & Kington, and she requested that I contact you and ask for an extension of time for filing our annual report. Outside accounting has been unable to prepare the financial statement due to other commitments.

If you have any questions, please contact me at 270-338-1300.

Sincerely,



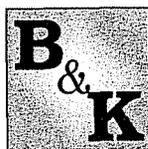
Ronda Hearld  
Office Manager

PUBLIC SERVICE COMMISSION  
ANNUAL REPORT BRANCH  
JUL 23 2012  
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EXAMINED BY \_\_\_\_\_

**MUHLENBERG COUNTY WATER DISTRICT**

**FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2011**



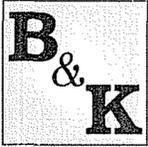
**BERRY & KINGTON, PSC**  
**CERTIFIED PUBLIC ACCOUNTANTS**



**MUHLENBERG COUNTY WATER DISTRICT**  
**FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2011**

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**BERRY & KINGDON, PSC**  
**CERTIFIED PUBLIC ACCOUNTANTS**

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Madisonville, KY 42431  
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**INDEPENDENT AUDITORS' REPORT**

To the Board of Commissioners  
Muhlenberg County Water District  
Greenville, Kentucky

We have audited the accompanying financial statements of the Muhlenberg County Water District as of and for the year ended December 31, 2011 which comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Muhlenberg County Water District's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the District's December 31, 2010 financial statements and, in our report dated May 6, 2011 we expressed an unqualified opinion on the respective financial statements.

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. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Muhlenberg County Water District as of December 31, 2011 and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 15, 2012, on our consideration of the Muhlenberg County Water District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 6 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

  
Madisonville, Kentucky  
May 15, 2012

**MUHLENBERG COUNTY WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2011  
(UNAUDITED)**

As management of the Muhlenberg County Water District we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the years ended December 31, 2011 and 2010. For the years ended December 31, 2011 and 2010, the Muhlenberg County Water District has prepared the financial statements based on the guidelines provided in Governmental Accounting Standards Board (GASB) Statement No. 34.

**FINANCIAL HIGHLIGHTS**

- The assets of the Muhlenberg County Water District exceeded its liabilities at the close of the 2011 year by \$5,425,243 (Net assets). Of this amount, \$421,248 (unrestricted net assets) may be used to meet the district's ongoing obligations to citizens and creditors in accordance with the District's fund designation and fiscal policies.
- The District's total net assets decreased by \$82,793. Normal operating and nonoperating activities decreased the District's net assets by \$106,120. Capital contributions of \$23,327 increased net assets.
- The District's total long-term bond and notes payable decreased by \$274,637 from the prior year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of 1) the basic financial statements, and 2) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Basic financial statements** – The basic financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to private-sector business.

The Statement of Net Assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the District's net assets changed during the year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in the future fiscal periods (e.g., earned but unused compensated absences).

The Statement of Cash Flows includes information on the District's cash receipts and payments and the changes in cash balances resulting from operating activities, investing activities and financing activities.

**Notes to the Financial Statements** – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 10 - 21.

### DISTRICT FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$5,425,243 as of December 31, 2011.

#### MUHLENBERG COUNTY WATER DISTRICT'S NET ASSETS

	2011	2010
Current and other assets	\$ 1,486,311	\$ 1,477,572
Capital assets	7,733,121	8,088,828
Total Assets	9,219,432	9,566,400
Current and other liabilities	737,871	720,206
Long-term liabilities	3,056,318	3,338,158
Total Liabilities	3,794,189	4,058,364
Net Assets:		
Invested in capital assets net of related debt	4,464,632	4,565,202
Restricted	539,363	551,823
Unrestricted	421,248	391,011
Total Net Assets	\$ 5,425,243	\$ 5,508,036

The largest portion of the District's net assets (82%) reflects its investments in capital assets (e.g., land and construction in progress, buildings, plants and facilities, machinery and equipment, system studies and mapping and infrastructure), less any debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the District's net assets (10%) represents resources that are subject to external restriction on how they may be used. The remaining balance of unrestricted net assets \$421,248 may be used to meet the District's ongoing obligations to citizens and creditors.

As of December 31, 2011, the District is able to report positive balances in all three categories of net assets.

**Analysis of the District's Operations** – Overall the District had a decrease in net assets of

\$82,793. Total revenues decreased \$263,142 mainly due to a decrease in capital grants and contributions of \$232,564. There was a decrease in operating revenues of \$30,555.

The following table provides a summary of the District's operations for the year ended December 31, 2011 and 2010.

**MUHLENBERG COUNTY WATER DISTRICT  
CHANGES IN NET ASSETS**

	<u>2011</u>	<u>2010</u>
<b>Revenues</b>		
Metered water sales	\$ 2,624,222	\$ 2,702,328
Other sales	282,458	229,529
Other operating revenues	96,451	101,829
Investment income	12,301	12,324
Capital grants and contributions	<u>23,327</u>	<u>255,891</u>
Total revenues	<u>3,038,759</u>	<u>3,301,901</u>
<b>Expenses</b>		
Administrative and general expenses	984,767	1,003,225
Source of supply purchases	792,189	854,129
Transmission and distribution expenses	478,040	540,523
Depreciation and amortization	413,057	411,744
Interest on debt and other	156,167	165,069
Customer accounts expenses	102,893	146,183
Pumping expenses	101,777	91,312
Payroll and other taxes	53,216	62,874
Water treatment	16,544	16,081
Bad debts	18,750	11,549
(Gain) loss on equipment disposal	<u>4,152</u>	<u>(12,479)</u>
Total Expenses	<u>3,121,552</u>	<u>3,290,210</u>
Change in net assets	(82,793)	11,691
Net assets - January 1	<u>5,508,036</u>	<u>5,496,345</u>
Net assets - December 31	<u><u>\$ 5,425,243</u></u>	<u><u>\$ 5,508,036</u></u>

**FINANCIAL ANALYSIS OF THE DISTRICT'S OPERATIONS**

The following provides an explanation of revenues by source that changed significantly from the prior year:

- Capital grants and contributions decreased by \$232,564 or 91%.
- Other sales increased by \$52,929 or 23%.

The following provides an explanation of expenditures by function that changed significantly from the prior year:

- Source of supply purchases decreased by \$61,940 due to a decrease in demand by the District's customers.

- Transmission and distribution expenses decreased by \$62,483 due to a decrease in payroll expenditures.
- Customer accounts expenses decreased by \$43,290 due to decreases in payroll expenditures.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital assets

The District's investment in capital assets for business-type activities as of December 31, 2011, amounts to \$7,733,121 (net of accumulated depreciation). This investment in capital assets includes land, buildings, plants and facilities, machinery and equipment, and infrastructure. The total decrease in the District's net investment in capital assets for the fiscal year was 4%.

	2011	2010
<b>Business-type activities:</b>		
Capital assets, not being depreciated:		
Land	\$ <u>35,752</u>	\$ <u>35,752</u>
Total capital assets, not being depreciated	<u>35,752</u>	<u>35,752</u>
Capital assets, being depreciated:		
Plants and facilities	7,002,366	7,311,895
Buildings	284,134	309,533
Vehicles and equipment	218,335	213,729
Office furniture and equipment	<u>192,534</u>	<u>217,919</u>
Total capital assets, being depreciated	<u>7,697,369</u>	<u>8,053,076</u>
Business-type activities capital assets, net	<u>\$ 7,733,121</u>	<u>\$ 8,088,828</u>

Major capital asset transactions/events during the fiscal year included:

- Purchase of vehicles and related equipment for \$44,662.

Additional information on the District's capital assets can be found in Note 4 of this report.

### Long-term and other debt

At the end of the current year, the Muhlenberg County Water District had total debt of \$3,425,055. New debt of \$13,833 was incurred during the year for the purchase of additional vehicles.

	2011	2010
Revenue bonds payable	\$ 3,430,000	\$ 3,706,000
Notes payable	76,598	70,000
Capital lease obligation	12,000	23,000
Less deferred charges	<u>(93,543)</u>	<u>(103,842)</u>
Total	<u>\$ 3,425,055</u>	<u>\$ 3,695,158</u>

Additional information on the District's long-term debt can be found in Note 6 of this report.

## **REQUEST FOR INFORMATION**

The financial report is designed to provide our citizens, customers, investors and creditors with a general overview of the District's finances. If you have any questions about this report or need any additional information, contact the Office Manager, at P.O. Box 348, Greenville, Kentucky 42345 or call (270) 338-1300.

**Muhlenberg County Water District**  
**Statement of Net Assets**  
**December 31, 2011 and 2010**

<u>Assets</u>	<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Cash equivalents		\$ 166,225	\$ 99,004
Customer accounts receivable (less allowance for uncollectible accounts of \$10,513 and \$12,085)		209,552	220,877
Unbilled revenue		138,861	156,295
Other receivables		29,585	39,368
Prepayments		26,341	23,507
Inventory		48,197	51,957
Restricted assets:			
Cash equivalents		262,480	277,244
Investments, at fair value		512,739	507,788
Capital assets, net of depreciation		7,733,121	8,088,828
Deferred charges		<u>92,331</u>	<u>101,532</u>
Total Assets		<u>9,219,432</u>	<u>9,566,400</u>
 <u>LIABILITIES</u> 			
<u>Liabilities</u>			
Trade accounts payable		76,760	84,629
Accrued liabilities		56,518	44,409
Accrued interest on debt		67,776	69,308
Customers' deposits		168,080	164,860
Short-term debt		64,235	70,000
Long-term debt due in one year		304,502	287,000
Noncurrent liabilities:			
Long-term debt due after one year		<u>3,056,318</u>	<u>3,338,158</u>
Total Liabilities		<u>3,794,189</u>	<u>4,058,364</u>
 <u>NET ASSETS</u> 			
<u>Net Assets</u>			
Invested in capital assets, net of related debt		4,464,632	4,565,202
Restricted for:			
Debt Service and Customer Deposits		539,363	551,823
Unrestricted		<u>421,248</u>	<u>391,011</u>
Total Net Assets		<u>\$ 5,425,243</u>	<u>\$ 5,508,036</u>

See notes to financial statements.

**Muhlenberg County Water District**  
**Statement of Revenues, Expenses, and Changes in Net Assets**  
**For the Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b><u>Operating Revenue</u></b>		
Water revenues	\$ 2,906,680	\$ 2,931,857
Other	<u>96,451</u>	<u>101,829</u>
Total Operating Revenues	<u>3,003,131</u>	<u>3,033,686</u>
 <b><u>Operating Expenses</u></b>		
Administrative and general expenses	984,767	1,003,225
Source of supply purchases	792,189	854,129
Transmission and distribution expenses	478,040	540,523
Depreciation	403,855	402,542
Customer accounts expenses	102,893	146,183
Pumping expenses	101,777	91,312
Payroll and other taxes	53,216	62,874
Bad debts	18,750	11,549
Water treatment	<u>16,544</u>	<u>16,081</u>
Total Operating Expenses	<u>2,952,031</u>	<u>3,128,418</u>
 <b><u>Operating Income (Loss)</u></b>	 <u>51,100</u>	 <u>(94,732)</u>
 <b><u>Nonoperating Revenues (Expenses)</u></b>		
Investment income	12,301	12,324
Gain (loss) on capital asset disposals	(4,152)	12,479
Interest on debt	(154,506)	(164,953)
Amortization of deferred charges related to debt	(9,202)	(9,202)
Other interest expense	<u>(1,661)</u>	<u>(116)</u>
Total Nonoperating Revenue (Expenses)	<u>(157,220)</u>	<u>(149,468)</u>
 <b><u>Net Income before Capital Contributions</u></b>	 <u>(106,120)</u>	 <u>(244,200)</u>
 <b><u>Capital Contributions</u></b>	 <u>23,327</u>	 <u>255,891</u>
 <b><u>Change in Net Assets</u></b>	 <u>(82,793)</u>	 <u>11,691</u>
 <b><u>Net Assets-Beginning of Year</u></b>	 <u>5,508,036</u>	 <u>5,496,345</u>
 <b><u>Net Assets-End of Year</u></b>	 <u>\$ 5,425,243</u>	 <u>\$ 5,508,036</u>

See notes to financial statements.

**Muhlenberg County Water District**  
**Statement of Cash Flows**  
**For the Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b><u>Cash Flows from Operating Activities</u></b>		
Cash received from customers	\$ 3,041,673	\$ 3,037,960
Cash payments to suppliers for goods and services	(1,299,962)	(1,305,953)
Cash payments to employees for services	(1,239,827)	(1,429,054)
Net Cash Provided By Operating Activities	501,884	302,953
<b><u>Cash Flows From Capital and Related Financing Activities</u></b>		
Net increase (decrease) in line of credit obligation	(5,765)	70,000
Principal paid on capital debt	(288,470)	(275,125)
Contributed capital	13,110	24,665
Acquisition of property, plant, and equipment	(52,301)	(344,993)
Proceeds from equipment disposal	-	13,527
Grants received	10,217	231,226
Proceeds from capital debt	13,833	-
Interest paid on debt	(147,401)	(156,840)
Net Cash Used by Capital and Related Financing Activities	(456,777)	(437,540)
<b><u>Cash Flows From Investing Activities</u></b>		
Income received on investments	12,301	12,324
Purchase of investment securities	(4,951)	(4,243)
Net Cash Provided (Used) By Investing Activities	7,350	8,081
<b><u>Net Increase (Decrease) in Cash Equivalents</u></b>	52,457	(126,506)
<b><u>Cash Equivalents-Beginning of Year</u></b>	376,248	502,754
<b><u>Cash Equivalents-End of Year</u></b>	\$ 428,705	\$ 376,248
<b><u>Reconciliation of Operating Income to Net Cash Provided</u></b>		
<b><u>By Operating Activities</u></b>		
Operating Income (Loss)	\$ 51,100	\$ (94,732)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	403,855	402,542
Provision for uncollectible accounts	(1,572)	(143)
Change in assets and liabilities		
Decrease (increase) in accounts receivable	40,114	4,417
Decrease (increase) in inventory	3,760	10,274
Decrease (increase) in prepayments	(2,834)	(1,333)
Increase (decrease) in accounts payable	(7,869)	(8,790)
Increase (decrease) in customer deposits	3,220	2,625
Increase (decrease) in accrued liabilities	12,110	(11,907)
Net Cash Provided By Operating Activities	\$ 501,884	\$ 302,953
<b><u>Reconciliation of Total Cash</u></b>		
Current Assets - Cash	\$ 166,225	\$ 99,004
Restricted Assets - Cash	262,480	277,244
Total Cash	\$ 428,705	\$ 376,248

**Non-cash Investing, Capital and Related Financing Activities - None**

See notes to financial statements.

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Muhlenberg County Water District, (the District), was established under the provisions of Chapter 74 of the Kentucky Revised Statutes in July 1962. Actual operations began in December 1967. The Muhlenberg County Judge Executive appoints a three member commission that oversees the District's Water System which renders services based on user charges.

The financial statements of the District are prepared in accordance with Generally Accepted Accounting Principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental and financial reporting principles. The District has elected to implement the provisions of GASB Statement 20 with regard to the application of Financial Accounting Standards Board (FASB) pronouncements to its proprietary fund. In accordance with the provisions of GASB Statement 20, the District has elected to not apply those FASB statements and interpretations issued after November 30, 1989. The more significant of the government's accounting policies are described below.

**Reporting Entity**

The District, for financial purposes, includes all of the accounts relevant to the operations of the Muhlenberg County Water District owned water system in accordance with generally accepted accounting principles.

**Basis of Presentation**

The accounts of the District are organized in accordance with the uniform system of accounts adopted by the Public Service Commission of Kentucky. Those accounts are organized on the basis of a proprietary fund type, specifically an enterprise fund. The operations of each fund are summarized by providing a separate set of self balancing accounts which include its assets, liabilities, fund equity, revenues and expenses. The following funds are used by the District:

*Proprietary Fund Types*

Proprietary funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. The accounting objectives are determinations of net income, financial position and cash flow. All assets and liabilities are included on the Statement of Net Assets.

**Measurement Focus/Basis of Accounting**

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied. The accounting and financial statements for a proprietary fund are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and all liabilities (whether current or non-current) are included on the statement of net assets and the operating statements present increases (revenues) and decreases (expenses) in net total assets. Under the accrual basis of accounting, revenues are recognized when earned, including unbilled water services which are accrued. Expenses are recognized at the time the liability is incurred.

**Budgets**

The District adopted a fixed budget for the fiscal year ended December 31, 2011. Flexible budgets prepared for several levels of possible activity are better for proprietary fund planning,

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

control, and evaluation purposes than are fixed budgets. For this reason, actual comparison of the fixed operating budget adopted by the District and the actual operating revenues and expenses are not shown in these financial statements.

The District is required to follow budgetary guidelines established by the Public Service Commission and the Department of Rural Development. Those guidelines require:

- 1) The District to submit a proposed budget for the fiscal year commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them for the upcoming year.
- 2) The District is required to submit a budget to the Department of Rural Development for each fiscal year as stipulated in the bond agreement.

For the year ended December 31, 2011, the District has complied with budgetary guidelines.

**Cash Equivalents/ Investments**

Cash and cash equivalents are deposited with Old National Bank. District ordinances authorize the District to invest in obligations of the U.S. Government and its instrumentalities, mutual funds, repurchase agreements, and demand deposits. All investments must be purchased through brokers/dealers or deposited with local financial institutions.

For the purpose of the statement of cash flows, the District considers all cash in banks and certificates of deposit with stated maturities of three months or less or available for withdrawal by management to be cash and cash equivalents.

**Compensated Absences**

The District recognizes a liability for unpaid compensated absences arising from unpaid sick time in accordance with Governmental Accounting Standards Board (GASB) Statement 16. GASB Statement 16 requires employers to accrue a liability for future vacation; sick and other leave benefits that meet the following conditions:

- 1) The employer's obligation relating to employees' rights to receive compensation for future absences is attributable to employees' services already rendered.
- 2) The obligation relates to rights that vest or accumulate.
- 3) Payment of the compensation is probable.
- 4) The amount can be reasonably estimated.

Employees earn vacation leave on their hire date anniversary of each year. Employees hired during the first 6 months of any year will receive 5 days of vacation during the first year of employment and 10 days of vacation during the second year. Persons hired during the last 6 months of any year receive days on a prorated basis during the first year of employment. Vacation days after the second year of employment are earned as 10 days in the third to the fifth year, 15 days in the sixth through tenth year and 20 days after year ten. Vacation leave may not be carried forward from one year to the next. Each year employees receive 12 sick and/or personal days. Sick

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

days may be carried forward into the next year if not used. Payment is made for any unused sick and personal leave upon resignation or retirement. Sick and personal leave benefits are limited to a maximum carryover of 50 days.

**Prepaid Items**

Payments made to vendors for services that will benefit periods beyond December 31, 2011 are recorded as prepaid items.

**Post Employment Benefits**

Post employment benefits are those received by employees after termination of employment. The District provides no such benefits.

**Capital Assets**

Capital assets, which include property, plant and equipment, are stated at historical cost. Donated capital assets are stated at their fair market value on the date donated. Proprietary fund capital assets are recorded in the respective funds and depreciated using the straight line method. Repairs and maintenance are recorded as expenses. Estimated useful lives, in years, for depreciable assets are as follows:

Utility System	20 to 65 years
Furniture, Machinery and Equipment	5 to 10 years
Improvements	5 to 10 years
Vehicles	3 to 5 years

**Allowance for Uncollectible Accounts**

An allowance for uncollectible accounts has been provided based on prior years' loss experiences as a percentage of revenues billed. Based on past experience, management considers the allowance adequate to provide for any losses on collection of the December 31, 2011 accounts receivable.

**Inventory**

Inventories are stated at cost using the first-in first-out (FIFO) method. Inventory consists primarily of replacement parts and supplies.

**Restricted Assets**

The restricted assets have been handled in accordance with the provisions of the various enterprise fund revenue bond resolutions, loan resolutions, loan agreements, or by state or federal laws and regulations. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as needed. See Note 3 for information describing restricted assets.

**Estimates**

The preparation of the District's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Risk Management**

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disaster. During the year ended

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

December 31, 2011, the District contracted with commercial insurance carriers for coverage of all risks mentioned above. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years. There were no significant reductions in coverage during the past three years.

**Bond Discounts/Issuance Costs**

Bond discounts and issuance costs on long-term debt are deferred and charged to interest expense over the terms of the related issues.

**Net Assets**

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any borrowing used for the acquisition, construction or improvements of those assets, and adding back unspent debt proceeds. Net assets are reported as restricted when there are limitations imposed on their use either through enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

**Subsequent Events**

The District has evaluated subsequent events through May 15, 2012, the date which the financial statements were available to be issued.

**2. DEPOSITS AND INVESTMENTS**

**1. Net Assets**

The captions on the statement of net assets for cash, investments and restricted assets enumerated as to deposits and investments and the amounts in total are as follows:

	<u>Deposits</u>	<u>Investments</u>	<u>Total</u>
Cash equivalents	\$ 166,225	\$ -	\$ 166,225
Restricted assets:			
Cash equivalents	262,480	-	262,480
Investments	<u>180,000</u>	<u>332,739</u>	<u>512,739</u>
Total	<u>\$ 608,705</u>	<u>\$ 332,739</u>	<u>\$ 941,444</u>

**2. Deposits**

At year-end, the carrying amount of the District's deposits in financial institutions was \$608,705 and the bank balances were \$662,825. Of the bank balances, \$250,000 was covered by federal depository insurance, with \$412,825 covered by collateral held by the pledging financial institution's agent or trust department in the District's name.

**3. Investments**

*Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

increasing interest rates.

*Credit Risk*

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The custodial credit risk for investments is the risk that a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party if the counterparty to the transaction fails.

Investments in corporate bonds have been limited to US Government Agency obligations that carry a superior credit rating. The value of the District's investment in external investment pools are not regulated by an oversight agency. The other investments of the District are collateralized certificates of deposit (Section B above) or with mutual funds invested in direct obligations of the US Government and its instrumentalities.

*Concentration of Credit Risk*

Concentration of credit risk is the risk of loss attributed to the magnitude of the District's investment in a single issuer. The District does not place any limit on the amount that may be invested with one issuer. At December 31, 2011, the District had 35% of its investments in fully collateralized certificates of deposit and 65% were in mutual funds invested in direct obligations of the US Government and its instrumentalities.

*Identification*

At December 31, 2011, the District had the following investments:

Investment	Maturities	Fair Value
Certificates of Deposit:		
Old National Bank	1/1/2021	\$ 180,000
Mutual Funds:		
Federated Securities Trust Obligations	23 Days Average	332,739
Total Investments		<u>\$ 512,739</u>

**3. RESTRICTED NET ASSETS**

	Depreciation Fund	Payment/ Escrow Fund	Customer Meter Deposits	Total
Cash equivalents	\$ 49,854	\$ 36,476	\$ 176,150	\$ 262,480
Investments:				
Certificates of deposit	180,000	-	-	180,000
Mutual funds	-	332,739	-	332,739
Totals	<u>\$ 229,854</u>	<u>\$ 369,215</u>	<u>\$ 176,150</u>	<u>\$ 775,219</u>

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

**Net Assets Restricted for Debt Retirement and Customer Meter Deposits**

A portion of the net assets are reserved for debt retirement and customer meter deposits. The reserved portion is calculated as follows:

<u>Debt Requirement Restricted Assets</u>			
Depreciation Fund	\$	229,854	
Payment and Escrow Funds		369,215	
Customer Deposit Cash		<u>176,150</u>	
Total			\$ 775,219
 <u>Current Portion of Debt Requirements and Customer Meter Deposits</u>			
Customer meter deposits	\$	168,080	
Accrued interest payable		<u>67,776</u>	
Total			<u>235,856</u>
<u>Net Assets Restricted for Debt Retirement and Customer Meter Deposits</u>			<u>\$ 539,363</u>

**Customer Meter Deposits**

Customer deposits for utility services are segregated and invested on a short-term basis. At December 31, 2011, customer deposits of \$176,150 were deposited in an interest bearing account in Old National Bank for the purpose of refunding customer deposits.

**4. CAPITAL ASSETS**

A summary of proprietary fund property, plant and equipment at December 31, 2011 for business-type activities follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
<b>Business-type activities:</b>				
Capital assets, not being depreciated:				
Land	\$ <u>35,752</u>	\$ -	\$ -	\$ <u>35,752</u>
Total capital assets, not being depreciated	<u>35,752</u>	<u>-</u>	<u>-</u>	<u>35,752</u>
Capital assets, being depreciated:				
Plants and facilities	12,812,499	7,639	-	12,820,138
Buildings	720,448	-	(13,288)	707,160
Vehicles and equipment	714,993	44,662	-	759,655
Office furniture and equipment	<u>275,350</u>	<u>-</u>	<u>-</u>	<u>275,350</u>
Total capital assets, being depreciated	<u>14,523,290</u>	<u>52,301</u>	<u>(13,288)</u>	<u>14,562,303</u>
Less accumulated depreciation for:				
Plants and facilities	(5,500,604)	(317,168)	-	(5,817,772)
Buildings	(410,915)	(21,246)	9,135	(423,026)
Vehicles and equipment	(501,264)	(40,056)	-	(541,320)
Office furniture and equipment	<u>(57,431)</u>	<u>(25,385)</u>	<u>-</u>	<u>(82,816)</u>
Total accumulated depreciation	<u>(6,470,214)</u>	<u>(403,855)</u>	<u>9,135</u>	<u>(6,864,934)</u>
Total capital assets, being depreciated, net	<u>8,053,076</u>	<u>(351,554)</u>	<u>(4,153)</u>	<u>7,697,369</u>
Business-type activities capital assets, net	<u>\$ 8,088,828</u>	<u>\$ (351,554)</u>	<u>\$ (4,153)</u>	<u>\$ 7,733,121</u>

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

5. **EMPLOYEES' RETIREMENT PLAN**  
**County Employees' Retirement System**

1. **Plan Description and Provisions**

The District is a participant in the Commonwealth of Kentucky's County Employees' Retirement System (CERS). CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each participating county, city and school board and any additional eligible local agencies electing to participate in the CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Prior to July 1, 2009, cost of living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands. CERS is administered by Kentucky Retirement Systems Board of Trustees pursuant to KRS 78.510-78.852.

2. **Contributions**

Covered employees are required by state statute to contribute 5 percent of their annual creditable compensation to CERS. Participating employers are required by state statute (KRS 61.565) to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the year ended December 31, 2011, the employer contribution rate was 16.93% from January 1, through June 30, 2011 and 18.96% from July 1, through December 31, 2011, respectively, of members' compensation. Total contributions for the year ended December 31, 2011 of \$151,224 was 100% of the required contributions for the year. Total payroll for the year was \$696,250 and total covered payroll was \$654,367. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member's account while the 1% was deposited to an account created under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 5% of their annual creditable compensation.

An Annual Financial Report is prepared by the Kentucky Retirement Systems and contains financial statements and required supplementary information for the County Employees Retirement System. *The financial report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601 or on their website at <http://kyret.ky.gov>.*

**3. Post-retirement Healthcare Benefits**

In addition to the pension benefits described above, the Kentucky Retirement Systems (KRS) provides post-retirement healthcare benefits, in accordance with Kentucky Revised Statutes. The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System (KERS), the County Employees Retirement System (CERS), and the State Police Retirement System (SPRS). The Fund and members receiving benefits pay prescribed portions of the aggregate premiums paid by the Fund. For the fiscal year ended June 30, 2011, (the date of the latest available information), insurance premiums withheld from benefit payments to members of the CERS approximated \$29,219,273. As of June 30, 2011, the Fund had 92,989 retirees and beneficiaries for whom benefits were available. The allocation of insurance premiums paid by the Fund and amounts withheld from member benefits is based on years of service. For members participating prior to July 1, 2003, years of service and respective percentage of the maximum contribution are as follows:

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>
20 or more	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less than 4	0%

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for members who began participating on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is updated annually due to changes in the Consumer Price Index for all urban consumers. This benefit is not protected under the inviolable contract provision of Kentucky Revised Statute 16.652, 61.692 and 78.852. The Kentucky General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

In prior years, the employers' required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20 year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996,

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

**6. DEBT OBLIGATIONS**

**Revenue Bonds Payable**

<u>Description</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Balance 12/31/2011</u>	<u>Due in One Year</u>
Waterworks Refunding Bonds Series 2004-A	2.00% - 3.75%	2017	\$ 596,000	\$ 100,000
Waterworks Refunding Bonds Series 2004-D	3.00%- 4.55%	2021	1,199,000	113,000
Waterworks Refunding Bonds Series 2007-D	4.13%-4.55%	2027	<u>1,635,000</u>	<u>75,000</u>
Total			3,430,000	<u>\$ 288,000</u>
Less current portion			(288,000)	
Less deferred loss on early retirement of debt			<u>(93,543)</u>	
Long-term portion			<u>\$ 3,048,457</u>	

*Series 2004-A*

A bond issue dated March 24, 2004, authorized issuance of \$1,234,000 of refunding revenue bonds maturing in annual installment through 2017. Interest is paid semi-annually on February 1, and August 1, from 2.0% to 3.75% per annum and principal is payable annually on February 1.

*Series 2004-D*

A bond resolution dated October 19, 2004, authorized issuance of \$1,820,000 of refunding revenue bonds maturing in annual installments through 2021. Interest is paid semi-annually on February 1, and August 1, from 3.0% to 4.13% per annum and principal is payable annually on February 1. This issue refinanced the 1995 Series outstanding bonds.

*Series 2007-D*

A bond resolution dated July 1, 2007, authorized issuance of \$1,895,000 of refunding revenue bonds maturing in annual installments through 2027. Interest is paid semi-annually on January 1, and July 1, from 4.175% to 4.55% per annum and principal is payable annually on July 1.

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

Principal and interest requirements of the revenue bonds payable as of December 31, 2011 are:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest &amp; Fees</u>	<u>Total</u>
2012	\$ 288,000	\$ 137,293	\$ 425,293
2013	298,000	126,984	424,984
2014	313,000	115,659	428,659
2015	324,000	103,321	427,321
2016	338,000	90,247	428,247
2017	295,000	77,220	372,220
2018	246,000	66,290	312,290
2019	241,000	56,365	297,365
2020	168,000	47,760	215,760
2021	174,000	40,550	214,550
2022	110,000	34,348	144,348
2023	115,000	29,343	144,343
2024	120,000	24,110	144,110
2025	125,000	18,650	143,650
2026	135,000	12,963	147,963
2027	140,000	6,370	146,370
Total	<u>\$ 3,430,000</u>	<u>\$ 987,473</u>	<u>\$ 4,417,473</u>

**KACO Capital Lease Obligation**

During 1992, the District entered into a phase of construction to service an area known as "Forest Oak." The District received a Community Block Grant in the amount of \$153,770 and borrowed \$147,000 from the Kentucky Association of Counties Leasing Trust (KACO). These monies were remitted through the Muhlenberg County Fiscal Court. The interest rate on this obligation is 5.55% over a 20 year term.

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest &amp; Fees</u>	<u>Total</u>
2012	<u>\$ 12,000</u>	<u>\$ 65</u>	<u>\$ 12,065</u>

**First National Bank Obligations**

On August 19, 2010, the District obligated itself for a line of credit with First National Bank in the amount of \$70,000. The loan bears interest at 3.75% and is unsecured. The District renewed the line of credit on August 25, 2011 for \$64,235. A balloon payment of \$64,235 is due August 25, 2012. The outstanding principal balance as of December 31, 2011 and 2010 was \$64,235 and \$70,000, respectively. No interest had been paid for the year ended December 31, 2011 or 2010, respectively. Total interest incurred as of December 31, 2011 and 2010 was \$3,479 and \$958, respectively.

**Old National Bank Obligation**

On September 2, 2011, the District obligated itself for a note with Old National Bank in the amount of \$13,833 for the purchase of a vehicle. The loan bears interest at 3.55% and is secured by a vehicle.

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

Year Ending December 31,	Principal	Interest & Fees	Total
2012	\$ 4,502	\$ 366	\$ 4,868
2013	4,668	204	4,872
2014	3,193	43	3,236
Total	<u>\$ 12,363</u>	<u>\$ 613</u>	<u>\$ 12,976</u>

**Changes in Business-Type Activities Debt**

A summary of changes in the business-type activities debt for the year ended December 31, 2011 follows:

	Balance 12/31/2010	Loans Incurred	Principal Payments	Balance 12/31/2011	Due Within One Year
<b><u>Business-Type Activities:</u></b>					
Revenue Bonds Payable	\$ 3,706,000	\$ -	\$ 276,000	\$ 3,430,000	\$ 288,000
Old National Bank	-	13,833	1,470	12,363	4,502
KACO Capital Lease Obligation	23,000	-	11,000	12,000	12,000
Total Business-Type Activities	<u>\$ 3,729,000</u>	<u>\$ 13,833</u>	<u>\$ 288,470</u>	<u>\$ 3,454,363</u>	<u>\$ 304,502</u>

**7. COMMITMENTS**

**Purchase Contracts**

**Central City Municipal Water and Sewer**

The District has a long-term contract with Central City Municipal Water and Sewer for the purchase of treated water. The contract for water was amended September 9, 1981, and is for a period of 50 years. There are no minimum payments required under the contract except for actual delivery and the rates are adjusted periodically. The District purchased \$787,941 from Central City during the year ended December 31, 2011.

On June 20, 2011, the District entered into a new agreement with the City of Central City, Kentucky to continue to purchase treated water from the City's new water treatment plant. The new pricing structure stated in the contract will become effective upon 30 days written notice after all three of the following events occur: 1). Kentucky Rural Development acknowledges the contract between the parties; 2). Kentucky Public Service Commission (PSC) reviews and accepts the contract for filing and 3). the City shall have substantially completed the water treatment plant expansion. Once effective, the contract is for a period of 50 years and states that the initial rate will be \$2.63 per 1,000 gallons of water purchased. As of the date of these financials, the new contract is not yet in effect.

**Todd County Water District**

On May 1, 2006, the District entered into a long-term contract with Todd County Water District for the purchase of treated water. The contract for water is for a period of 25 years and calls for water sales not to exceed 800,000 gallons per month at a rate of \$4.85 per 1,000 gallons. Water rate increases imposed by Todd County Water District will be passed onto the District as they occur. The District purchased \$1,504 from Todd County Water District during the year ended December 31, 2011.

**Wholesale Contract**

**Muhlenberg County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended December 31, 2011**

The District sells water on a wholesale basis to the City of Drakesboro, Kentucky. The original October 1967 contract was amended in May 1997, to extend water sales to October 2047. The District has the authority by the Public Service Commission of Kentucky, to periodically adjust the rates charged to the City of Drakesboro. Total sales to the City of Drakesboro during the year ended December 31, 2011 were \$68,882.

**8. PUBLIC SERVICE COMMISSION REGULATIONS**

The District is required to file with the Public Service Commission (PSC) a report of its gross earnings or receipts derived from intra-state business for the preceding calendar year. The District has satisfied this requirement. The District has also filed the 2011 annual PSC Report as required. Further, the PSC requires that all customer deposit refunds be paid with interest. This requirement has been fulfilled.

**9. LITIGATION**

The District is not aware of any pending or threatened litigation in which it is involved which would have a material effect on these financial statements.



**BERRY & KINGTON, PSC**  
**CERTIFIED PUBLIC ACCOUNTANTS**

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**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 Board of Commissioners  
Muhlenberg County Water District  
Greenville, Kentucky

We have audited the financial statements of the Muhlenberg County Water District, as of and for the year ended December 31, 2011 and have issued our report thereon dated May 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

*Internal Control Over Financial Reporting*

In planning and performing our audit, we considered the Muhlenberg 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.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies in internal control over financial reporting (2011-1). A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

*Compliance and Other Matters*

As part of obtaining reasonable assurance about whether the Muhlenberg 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We also noted certain matters that we have reported to management of the Muhlenberg County Water District, in a separate letter dated May 15, 2012.

This report is intended solely for the information of the District commission and management. However, this report is a matter of public record and its distribution is not limited.

  
Madisonville, Kentucky  
May 15, 2012

**Muhlenberg County Water District**  
**Schedule of Findings and Responses**  
**For The Year Ended December 31, 2011**

**2011-1 Segregation of Duties**

Condition

There is an absence of appropriate segregation of duties consistent with appropriate control objectives.

Criteria

A prudent control environment requires various functions of internal control be allocated among various employees.

Effect

Although no instances were noted, lack of segregation of duties can create situations where assets are not properly safeguarded and errors and irregularities may go undetected.

Cause

Lack of personnel.

Recommendation

We recommend that management review its financial operation for opportunities to separate incompatible functions. Where segregation of duties cannot be achieved due to the size of the staff, management should maintain its awareness of the weakness and compensate with other controls.

Response

We concur with the finding.