

REPORT OF

NORTH HOPKINS WATER DISTRICT
MADISONVILLE, KENTUCKY

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

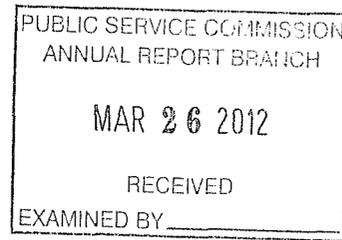


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INDEPENDENT AUDITORS' REPORT

To the Commissioners
North Hopkins Water District
Madisonville, Kentucky

We have audited the accompanying financial statements of North Hopkins Water District as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of North Hopkins Water District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 above present fairly, in all material respects, the financial position of North Hopkins Water District as of December 31, 2011 and 2010, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 13, 2012, on our consideration of North Hopkins Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and 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 3 through 7 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.

Alexander, Toney : Knight PLLC

Madisonville, Kentucky
March 13, 2012

NORTH HOPKINS WATER DISTRICT
Management's Discussion and Analysis
December 31, 2011 and 2010

The discussion and analysis of the North Hopkins Water District's financial performance provides an overview and analysis of the District's financial activities for the years ended December 31, 2011 and 2010. It should be read in conjunction with the accompanying basic financial statements.

Financial Highlights for the Year 2011

- * The District's net assets increased \$93.0 thousand or 4.5% from \$2.077 million to \$2.170 million.

Overview Of The Financial Statements

This report consists of this management's discussion and analysis, basic financial statements, and notes to the financial statements. The basic financial statements are reported using the full accrual basis of accounting.

Basic financial statements:

The Statement of Net Assets include information on the District's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). In simple terms, this statement presents a snap-shot view of the assets the District owns, the liabilities it owes and the net difference. The net difference is further separated into amounts restricted for specific purposes and unrestricted amounts.

The Statement of Revenues, Expenses, and Changes in Fund Net Assets include the District's revenues and expenses for the years ended December 31, 2011 and 2010. This statement provides information on the District's operations and can be used to determine whether the District has recovered all of its actual and projected costs through user fees and other charges.

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.

The notes to the financial statements provide additional disclosures required by governmental accounting standards and provide information to assist the reader in understanding the District's financial condition.

District Financial Analysis

A summary of the District's Statement of Net Assets is presented below.

Table 1
Condensed Statement of Net Assets
(in thousands)

	<u>2011</u>	<u>2010</u>	<u>dollar change</u>	<u>percent change</u>	<u>2009</u>	<u>dollar change</u>	<u>percent change</u>
Current assets	\$ 134.7	\$ 187.9	(\$ 53.2)	(28.3%)	\$ 133.7	\$ 54.2	40.5%
Capital assets	2,882.0	2,947.7	(65.7)	(2.2%)	2,934.4	13.3	0.5%
Other noncurrent assets	<u>366.4</u>	<u>192.3</u>	174.1	90.5%	<u>476.7</u>	(284.4)	(59.7%)
Total assets	<u>3,383.1</u>	<u>3,327.9</u>	55.2	1.7%	<u>3,544.8</u>	(216.9)	(6.1%)
Current liabilities	120.2	73.4	46.8	63.8%	161.9	(88.5)	(54.7%)
Long-term liabilities	<u>1,092.6</u>	<u>1,177.2</u>	(84.6)	(7.2%)	<u>1,422.1</u>	(244.9)	(17.2%)
Total liabilities	<u>1,212.8</u>	<u>1,250.6</u>	(37.8)	(3.0%)	<u>1,584.0</u>	(333.4)	(21.0%)
Net assets invested in capital assets, net of related debt	1,711.0	1,762.3	(51.3)	(2.9%)	1,443.6	318.7	22.1%
Net assets restricted for debt service	76.0	17.8	58.2	327.0%	239.2	(221.4)	(92.6%)
Net assets restricted for capital projects	261.7	136.7	125.0	91.4%	165.4	(28.7)	(17.4%)
Unrestricted net assets	<u>121.6</u>	<u>160.5</u>	(38.9)	(24.2%)	<u>112.6</u>	47.9	42.5%
Total net assets	<u>\$2,170.3</u>	<u>\$2,077.3</u>	\$ 93.0	4.5%	<u>\$1,960.8</u>	\$ 116.5	5.9%

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 \$2.17 million at the close of the current year.

2010 to 2011

As shown in table 1, the District's total assets increased \$55,200 from \$3,327,900 to \$3,383,100. Current assets decreased \$53,200. The current assets decrease primarily results from a decrease of \$60,000 in unrestricted cash. While cash overall increased, unrestricted cash decreased as the District moved more money into restricted cash. Capital assets decreased \$65,700 as depreciation expense outpaced new capital additions. Other noncurrent assets increased \$174,100 due to the \$176,700 increased in restricted cash.

The District's total liabilities decreased \$37,800. Current liabilities increased \$46,800 due to an increase primarily of \$53,000 in current bonds payable. Noncurrent liabilities decreased \$84,600 as the District made debt service payments as scheduled.

The District's total net assets increased \$93,000, due to the net effect of the increase in total assets and decrease in total liabilities referred to above. Net assets restricted for capital projects increased \$125,000 as the District funded its depreciation reserve account.

2009 to 2010

As shown in table 1, the District's total assets decreased by \$216,900 from \$3,544,800 to \$3,327,900. Current assets increased \$54,200. The current assets increase primarily results from an increase of \$57,000 in unrestricted cash. Cash provided by operating activities increased in 2010 as can be seen on the District's Statement of Cash Flow. Other noncurrent assets decreased \$284,400. The District used \$275,000 of restricted cash from debt service and debt service reserve funds when refunding the 1998 Refunding Revenue Bonds in 2010.

The District's total liabilities decreased \$333,400. Current liabilities decreased \$88,500 due to a decrease of \$62,000 in current bonds payable and a decrease of \$33,000 in accrued interest on bonds. Noncurrent liabilities decreased \$244,900 as the District realized a significant future debt service decrease upon refunding of bonds during the year.

The District's total net assets increased \$116,500, due to the net effect of the decrease in total assets and decrease in total liabilities referred to above. Net assets invested in capital assets, net of related debt, a component unit of total net assets, increased \$318,700 from the result of the additions of capital assets and the reduction in long-term debt. Net assets restricted for debt service, also a component of total net assets, decreased \$221,400 because of decreases in sinking fund amounts and debt service reserve requirements.

A summary of the District's Statement of Revenues, Expenses and Changes in Fund Net Assets is presented below.

Table 2
Condensed Statements of Revenues, Expenses and Changes in Fund Net Assets
(in thousands)

	<u>2011</u>	<u>2010</u>	<u>dollar</u> <u>change</u>	<u>percent</u> <u>change</u>	<u>2009</u>	<u>dollar</u> <u>change</u>	<u>percent</u> <u>change</u>
Operating revenues	\$ 743.8	\$ 742.2	\$ 1.6	0.2%	\$ 697.2	\$ 45.0	6.5%
Nonoperating revenues	<u>0.0</u>	<u>12.7</u>	(12.7)	(100.0%)	<u>39.2</u>	(26.5)	(67.6%)
Total revenues	<u>743.8</u>	<u>754.9</u>	(11.1)	(1.5%)	<u>736.4</u>	18.5	2.5%
Operating expenses	615.8	649.4	(33.6)	(5.2%)	607.2	42.2	6.9%
Nonoperating expenses	<u>42.3</u>	<u>79.2</u>	(36.9)	(46.6%)	<u>85.8</u>	(6.6)	(7.7%)
Total expenses	<u>658.1</u>	<u>728.6</u>	(70.5)	(9.7%)	<u>693.0</u>	35.6	5.1%
Income before capital contributions	85.7	26.3	59.4	225.9%	43.4	(17.1)	(39.4%)
Capital contributions	<u>7.3</u>	<u>90.2</u>	(82.9)	(91.9%)	<u>87.9</u>	2.3	2.6%
Changes in net assets	93.0	116.5	(23.5)	(20.2%)	131.3	(14.8)	(11.3%)
Beginning net assets	<u>2,077.3</u>	<u>1,960.8</u>	116.5	5.9%	<u>1,829.5</u>	131.3	7.2%
Ending net assets	<u>\$2,170.3</u>	<u>\$2,077.3</u>	\$ 93.0	4.5%	<u>\$1,960.8</u>	\$ 116.5	5.9%

2010 to 2011

The District's total revenues decreased \$11,100. Operating revenues remained similar to prior year increasing \$1,600. Nonoperating revenues decreased \$12,700. The District cashed in a large certificate of deposit (CD) in the prior year as part of the 2010 bond refunding. The majority of the District's interest income came from this CD.

The District's total expenses decreased \$70,500. Operating expenses decreased \$33,600 as the District found and repaired several leaks in the prior year which resulted in purchased water decreasing \$25,000. The District also incurred less repair work in 2011 which is seen in a \$23,000 decrease in materials and supplies. Nonoperating expenses decreased \$36,900. This decrease is primarily seen in interest expense which decreased \$37,000 as a result of the 2010 bond refunding.

Capital contributions decreased \$82,900 as the District received coal severance grants in 2010 but not in 2011.

Changes in net assets, which increased 20.2% less than the prior year, resulted from the above decreases.

2009 to 2010

The District's total revenues increased \$18,500. Operating revenues increased \$45,000 primarily due to increased water rates adjusted when the District's supplier increased rates at the beginning of the year. Since the District applies to the Kentucky Public Service Commission for a purchased water adjustment each year when the District's supplier increases or decreases water cost, the increase/decrease in water sales should be similar to the increase/decrease in purchased water cost. As seen in the following paragraph, purchased water cost increased \$38,000. Nonoperating revenues decreased \$26,500 as non-capital grant monies received for ice storm damages in the prior year were not received in the current year.

The District's total expenses increased \$35,600. The one significant change in operating expenses was purchased water which increased \$38,000 due to change in rates charged by the City of Madisonville, the District's water supplier.

Changes in net assets, which increased 11.3% less than the prior year, resulted from the above increases.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2011 the District had \$2,881,979 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net decrease (additions, retirements, depreciation) of \$65,784 from the prior year. The increase is due to depreciation expense of \$96,365 outpacing capital asset additions in 2011.

Significant additions during the year included \$18,066 in meters and taps and \$12,515 in office computers and a new billing system.

At December 31, 2010 the District had \$2,947,763 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net increase (additions, retirements, depreciation) of \$13,351 from the prior year. The increase is due to capital asset additions out pacing depreciation expense of \$92,707 in 2010.

Significant additions during the year included \$51,773 of line expenditures, \$11,630 in tank painting, and \$14,534 generator hookup expenditures.

A comparison of the District's capital assets over the past three years is presented in Note E of the financial statements.

Long-Term Debt

At December 31, 2011, the District had \$1,177,139 in revenue bonds and revenue refunding bonds outstanding, which was a decrease of \$31,314 from the prior year balance of \$1,208,453. The District's two bond issues were paid as scheduled and there were no new borrowings.

At December 31, 2010, the District had \$1,208,453 in revenue bonds and revenue refunding bonds outstanding, which was a decrease of \$307,247 from the prior year balance of \$1,515,700. The District's 2001 bond issue was paid as scheduled. The District refunded the 1998 refunding revenue bonds during 2010 with issuance of the 2010 refunding revenue bonds.

Additional information on the District's long-term debt can be found in Note G of the financial statements.

Currently Known Facts, Decisions, or Conditions

There are no currently known facts, decisions, or conditions that District management expects to have a significant effect on financial position or results of operations.

Requests For Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the North Hopkins Water District, 1580 Neelie Webb Road, Madisonville, Kentucky 42431.

North Hopkins Water District
Statement of Net Assets
December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<u>Assets</u>		
Current assets		
Cash and cash equivalents	\$ 44,822	\$ 104,640
Accounts receivable	58,485	50,336
Material and parts inventory	25,466	26,942
Prepaid expenses	<u>5,946</u>	<u>5,994</u>
Total current assets	<u>134,719</u>	<u>187,912</u>
Noncurrent assets		
Restricted cash and cash equivalents	345,871	169,147
Capital assets:		
Nondepreciable	14,237	14,237
Depreciable, net of accumulated depreciation	2,867,742	2,933,526
Bond issue costs, net of accumulated amortization	20,437	23,007
Refundable deposit	<u>100</u>	<u>100</u>
Total noncurrent assets	<u>3,248,387</u>	<u>3,140,017</u>
Total assets	<u>3,383,106</u>	<u>3,327,929</u>
<u>Liabilities</u>		
Current liabilities payable from current assets		
Accounts payable	17,732	32,221
Accrued taxes and other payables	<u>2,756</u>	<u>2,693</u>
	<u>20,488</u>	<u>34,914</u>
Current liabilities payable from restricted assets		
Customer meter deposits	1,400	1,800
Accrued interest-meter deposits	23	24
Bonds payable	84,520	31,231
Accrued interest-bonds	<u>13,763</u>	<u>5,476</u>
	<u>99,706</u>	<u>38,531</u>
Total current liabilities	<u>120,194</u>	<u>73,445</u>
Long-term liabilities		
Bonds payable	<u>1,092,619</u>	<u>1,177,222</u>
Total long-term liabilities	<u>1,092,619</u>	<u>1,177,222</u>
Total liabilities	<u>1,212,813</u>	<u>1,250,667</u>
<u>Net assets</u>		
Invested in capital assets, net of related debt	1,711,040	1,762,317
Restricted for:		
Debt service	76,039	17,801
Capital projects	261,706	136,685
Unrestricted	<u>121,508</u>	<u>160,459</u>
Total net assets	<u>\$2,170,293</u>	<u>\$2,077,262</u>

The accompanying notes are an integral part of these statements.

North Hopkins Water District
Statement of Revenues, Expenses and Changes in Fund Net Assets
Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues		
Water sales	\$ 740,384	\$ 738,577
Other operating revenues	<u>3,417</u>	<u>3,595</u>
Total operating revenues	<u>743,801</u>	<u>742,172</u>
Operating expenses		
Purchased water	303,366	328,438
Salaries-employees	86,655	80,745
Salaries-officers	10,800	10,800
Depreciation	96,365	92,707
Transportation	9,468	10,630
Contract services	19,480	18,079
Taxes	7,465	7,350
Purchased power	10,672	8,659
Materials and supplies	49,166	72,529
Insurance	8,414	7,184
Miscellaneous	4,395	1,359
Regulatory commission expense	1,135	1,104
Rent	5,485	5,185
Advertising	569	2,119
Uncollectible accounts	<u>2,340</u>	<u>2,549</u>
Total operating expenses	<u>615,775</u>	<u>649,437</u>
Operating income (loss)	128,026	92,735
Non-operating revenues (expenses)		
Interest income	31	12,653
Amortization of bond issue cost	(2,570)	(2,590)
Interest expense	<u>(39,756)</u>	<u>(76,523)</u>
Total non-operating revenues (expenses)	(42,295)	(66,460)
Income (loss) before contributions	85,731	26,275
Capital contributions-tap fees	7,300	12,600
Capital contributions-customers/developers	0	6,051
Capital contributions-county	<u>0</u>	<u>71,493</u>
Change in net assets	93,031	116,419
Net assets at beginning of year	<u>2,077,262</u>	<u>1,960,843</u>
Net assets at end of year	<u>\$2,170,293</u>	<u>\$2,077,262</u>
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The accompanying notes are an integral part of these statements.

North Hopkins Water District
Statement of Cash Flows
Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<u>Cash flows from operating activities</u>		
Cash received from customers	\$ 729,895	\$ 738,335
Cash payments to suppliers for goods and services	(431,827)	(455,231)
Cash payments to employees for services	(97,455)	(91,545)
Other operating revenues	<u>3,417</u>	<u>3,595</u>
Net cash provided (used) by operating activities	204,030	195,154
<u>Cash flows from capital and related financing activities</u>		
Acquisition and construction of capital assets	(31,271)	(105,367)
Principal paid on revenue bonds	(37,000)	(1,516,000)
Proceeds from bond issue	0	1,227,570
Payment of bond issue costs	0	(22,420)
Interest paid on revenue bonds	(25,773)	(107,000)
Interest paid on customer deposits	(11)	(14)
Capital contributions received from customers/developers	7,300	18,651
Capital contributions received from state/county government	0	71,493
Customer deposits collected	3,450	4,250
Customer deposits repaid	<u>(3,850)</u>	<u>(4,550)</u>
Net cash provided (used) by capital and related financing activities	(87,155)	(433,387)
<u>Cash flows from investing activities</u>		
Interest earned on bank deposits	<u>31</u>	<u>12,653</u>
Net cash provided (used) by investing activities	31	12,653
Net increase (decrease) in cash and cash equivalents	116,906	(225,580)
Cash and cash equivalents at beginning of year	<u>273,787</u>	<u>499,367</u>
Cash and cash equivalents at end of year	<u>\$ 390,693</u>	<u>\$ 273,787</u>
	=====	=====
<u>Reconciliation of operating income to net cash provided (used) by operating activities</u>		
Operating income	\$ 128,026	\$ 92,735
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	96,365	92,707
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	(8,149)	2,307
(Increase) decrease in inventory	1,476	(1,038)
(Increase) decrease in prepaid expenses	48	1,566
Increase (decrease) in accounts payable	(13,799)	6,748
Increase (decrease) in accrued taxes and other payables	<u>63</u>	<u>129</u>
Total adjustments	<u>76,004</u>	<u>102,419</u>
Net cash provided (used) by operating activities	<u>\$ 204,030</u>	<u>\$ 195,154</u>
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The accompanying notes are an integral part of these statements.

NOTE A - SUMMARY OF ACCOUNTING POLICIES

The accounting policies of the North Hopkins Water District conform to Generally Accepted Accounting Principles (GAAP) as applicable to governments. The District applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989 unless those pronouncements conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements, in which case, GASB prevails. The following is a summary of the more significant policies:

1. The Financial Reporting Entity

North Hopkins Water District (the "District") was created on June 3, 1965, under the provisions of chapter 74 of the Kentucky Revised Statutes of the Commonwealth of Kentucky. The principal office of the District is located at 1580 Neelie Webb Road, Madisonville, Kentucky. The District is composed of three commissioners who are appointed by the Hopkins County Judge Executive and provides water to its customers in and around northern Hopkins County, Kentucky.

In evaluating how to define the government, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GASB Statement No. 14 - *The Financial Reporting Entity*.

2. Basis of Presentation, Measurement Focus, and Basis of Accounting

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 activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the District's assets, liabilities, net assets, revenues, and expenses. Enterprise Funds account for activities 1) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or 2) that are required by laws or regulations that the activities costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or 3) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statements of net assets. Net assets are required to be displayed in three components: 1) invested in capital assets, net of related debt, 2) restricted, and 3) unrestricted. Invested in capital assets, net of related debt is capital assets net of accumulated depreciation and reduced by outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Restricted net assets are those with constraints placed on their use by either: 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation. All net assets not otherwise classified as restricted, are shown as unrestricted. The statements of revenue, expenses, and changes in fund net assets present increases (revenues) and decreases (expenses) in net assets.

North Hopkins Water District
Notes to Financial Statements
December 31, 2011 and 2010

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The accounts of the District are maintained on the accrual basis of accounting. Its revenues are recognized when they are earned, and its expenses are recognized when they are incurred.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues and expenses of the District's enterprise fund are charges to customers for sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Unbilled water receivables for utility services provided through December 31 are included in the financial statements.

When both restricted and unrestricted resources are available for use, the District generally first uses restricted resources, then unrestricted resources as they are needed.

3. Cash and Cash Equivalents

All cash except for a small amount kept "on hand" is deposited in financial institutions. Deposits are interest bearing checking accounts and a certificate of deposit. Unrestricted cash is available to be expended for normal operating expenses. Restricted cash is limited to payments of bond principal and interest, emergency capital improvements, and other designated purposes. Cash and cash equivalents are defined as being all monies on deposit in banks and investments with a maturity of 90 days or less.

4. Inventory

Inventory consists primarily of replacement parts and supplies. Inventory is stated at the lower of cost or market. Cost is determined primarily by the first-in, first-out method.

5. Capital Assets

Capital assets, which include property, plant, and equipment, are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. No interest was capitalized during the years ended December 31, 2011 and 2010.

North Hopkins Water District
 Notes to Financial Statements
December 31, 2011 and 2010

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Capital assets of the District are depreciated using a straight-line method over the following estimated useful lives:

Structures, improvements and water system	5 to 65 years
Furniture, machinery and equipment	3 to 7 years

6. Restricted Net Assets

Restricted net assets are cash set aside for the repayment of debt in compliance with bond covenants and cash restricted for future operations in compliance with escrow reserve agreements.

7. Long-Term Liabilities

Long-term debt is reported as liabilities in the statement of net assets. Long-term debt is reported at face value plus applicable issuance premiums and net of applicable discounts and deferred amounts on refunding. Costs related to issuance of debt are deferred and amortized over the lives of the various debt issues. Discounts on debt issuances and amounts deferred on refunding are deferred and amortized as interest expense over the remaining life of the old bonds, or the life of the new bonds, whichever is shorter. Premiums on debt issuances are deferred and amortized as a reduction of interest expense over the life of the bonds.

8. Uncollectible Accounts

All accounts receivable are considered by management to be collectible, therefore no provision for uncollectible accounts has been established. Uncollectible accounts are expensed using the direct write-off method.

9. Use of Estimates

The preparation of financial statements in accordance with accounting principals generally accepted in the United States requires management to make estimates that affect amounts reported in the financial statements during the reporting period. Actual results could differ from those estimates.

NOTE B - DEPOSITS

The District maintains deposits with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to law, the depository institution should pledge sufficient securities as collateral which, together with FDIC insurance, equals or exceeds the amount on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge of securities should be evidenced by an agreement that is (1) in writing, (2) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (3) an official record of the depository institution. This agreement, signed by both parties, must be sufficient to create an enforceable and perfected security interest in the collateral under Kentucky law.

North Hopkins Water District
 Notes to Financial Statements
December 31, 2011 and 2010

NOTE B - DEPOSITS continued

Deposits are categorized to give an indication of risk assumed by the District at the end of the year. Category 1 includes deposits that are insured, Category 2 includes collateralized deposits held by the pledging institution's trust department or agent in the District's name, and Category 3 includes uncollateralized and uninsured deposits.

On December 31, 2011, the reconciled balance of the District's deposits totaled \$390,663 and the bank balances were \$395,961. Of the bank balances \$326,039 was covered by federal depository insurance (category 1) and \$69,922 remained uncollateralized (category 3).

On December 31, 2010, the reconciled balance of the District's deposits totaled \$273,757 and the bank balances were \$277,539. Of the bank balances \$273,277 was covered by federal depository insurance (category 1) and \$4,262 remained uncollateralized (category 3).

NOTE C - PREPAID EXPENSES

Prepaid expenses include prepaid insurance which represents the amount of unexpired insurance which the District had previously paid for at the balance sheet date and prepaid interest which represents the amount of interest expense paid prior to scheduled debt service.

At December 31, 2011, the District's prepaid expenses consisted of \$5,725 of insurance and \$221 of interest. At December 31, 2010, the District's prepaid expenses consisted of \$5,773 of insurance and \$221 of interest.

NOTE D - RESTRICTED CASH AND CASH EQUIVALENTS

The District has cash set aside for the repayment of debt in compliance with bond covenants, cash restricted for future operations in compliance with escrow reserve agreements, cash set aside for future capital assets, and cash set aside for repayment of customer deposits.

Restricted balances as of December 31 are as follows:

	<u>2011</u>	<u>2010</u>
Bond and interest redemption fund	\$ 76,039	\$ 23,277
Bond depreciation fund	261,706	136,685
Meter deposit fund	<u>8,126</u>	<u>9,185</u>
Totals	<u>\$ 345,871</u>	<u>\$ 169,147</u>

North Hopkins Water District
Notes to Financial Statements
December 31, 2011 and 2010

NOTE E - CAPITAL ASSETS

Capital asset activities for the years ended December 31, 2011 and 2010, were as follows:

	<u>Balances</u> <u>12/31/09</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>Balances</u> <u>12/31/10</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>Balances</u> <u>12/31/11</u>
Business-type activities:							
Capital assets not being depreciated							
Land & land rights	\$ 14,237	\$ 0	\$ 0	\$ 14,237	\$ 0	\$ 0	\$ 14,237
Construction in progress	7,181	50,421	57,602	0	0	0	0
Total	<u>21,418</u>	<u>50,421</u>	<u>57,602</u>	<u>14,237</u>	<u>0</u>	<u>0</u>	<u>14,237</u>
Capital assets being depreciated							
Structures, improvements, & water system	4,565,799	90,359	0	4,656,158	18,066	0	4,674,224
Office furniture & equipment	90,796	22,880	0	113,676	12,515	5,085	121,106
Total	<u>4,656,595</u>	<u>113,239</u>	<u>0</u>	<u>4,769,834</u>	<u>30,581</u>	<u>5,085</u>	<u>4,795,330</u>
Total capital assets	<u>4,678,013</u>	<u>163,660</u>	<u>57,602</u>	<u>4,784,071</u>	<u>30,581</u>	<u>5,085</u>	<u>4,809,567</u>
Less accumulated depreciation for:							
Structures, improvements, & water system	1,721,414	87,171	0	1,808,585	87,988	0	1,896,573
Office furniture & equipment	22,187	5,536	0	27,723	8,377	5,085	31,015
Total accumulated depreciation	<u>1,743,601</u>	<u>92,707</u>	<u>0</u>	<u>1,836,308</u>	<u>96,365</u>	<u>5,085</u>	<u>1,927,588</u>
Total business-type activities capital assets, net	<u>\$2,934,412</u>	<u>\$ 70,953</u>	<u>\$ 57,602</u>	<u>\$2,947,763</u>	<u>(\$ 65,784)</u>	<u>\$ 0</u>	<u>\$2,881,979</u>

NOTE F - UNAMORTIZED BOND ISSUE COST

Series 1998

\$44,576 of proceeds from the Series 1998 bonds were capitalized as bond issue cost and was being amortized using the straight line method over the term of the bonds. Bond issue cost of \$0 during 2011 and \$1,486 during 2010 were amortized. The Series 1998 bonds were refunded in 2010 and the remaining unamortized balance of \$21,694 was adjusted into deferred amount of refunding on the new issue.

Series 2001

\$8,207 of proceeds from the Series 2001 bonds were capitalized as bond issue cost and are being amortized using the straight line method over the term of the bonds. Bond issue cost of \$811 during 2011 and \$811 during 2010 were amortized.

Series 2010

\$22,420 of proceeds from the Series 2001 bonds were capitalized as bond issue cost and are being amortized using the straight line method over the term of the bonds. Bond issue cost of \$1,758 during 2011 and \$293 during 2010 were amortized.

North Hopkins Water District
Notes to Financial Statements
December 31, 2011 and 2010

NOTE G - LONG-TERM LIABILITIES

Long-term liability activity

Long-term liability activity for the years ended December 31, 2011 and 2010, were as follows:

	Balances			Balances			Balances			Amounts
	<u>12/31/09</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/10</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/11</u>		<u>Due Within</u>	
									<u>One Year</u>	
Revenue Bonds:										
Series 1998	\$1,495,000	\$ 0	\$1,495,000	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	
Series 2001	43,167	0	21,000	22,167	0	22,000	167	167	167	
Series 2010	<u>0</u>	<u>1,245,000</u>	<u>0</u>	<u>1,245,000</u>	<u>0</u>	<u>15,000</u>	<u>1,230,000</u>	<u>90,000</u>	<u>90,000</u>	
Total	1,538,167	1,245,000	1,516,000	1,267,167	0	37,000	1,230,167	90,167	90,167	
Less/Add Deferred Amounts:										
Issuance Discount	(14,088)	(14,088)	(14,474)	(17,044)	0	(2,303)	(14,741)	(2,217)	(2,217)	
On Refunding	(8,688)	(8,688)	(9,269)	(41,829)	0	(3,486)	(38,343)	(3,486)	(3,486)	
Issuance Premium	<u>309</u>	<u>309</u>	<u>150</u>	<u>159</u>	<u>0</u>	<u>103</u>	<u>56</u>	<u>56</u>	<u>56</u>	
Total Bonds and Business-Type Activities Long-Term Liabilities	<u>\$1,515,700</u>	<u>\$1,222,533</u>	<u>\$1,492,407</u>	<u>\$1,208,453</u>	<u>\$ 0</u>	<u>\$ 31,314</u>	<u>\$1,177,139</u>	<u>\$ 84,520</u>	<u>\$ 84,520</u>	

Description of debt

Waterworks Refunding Revenue Bonds, Series 1998

On March 1, 1998, the District authorized and provided for the issuance of \$2,090,000 of Waterworks Refunding Revenue Bonds, Series 1998 (the "1998 Refunding Bonds") for the current refunding of Waterworks Revenue Bonds, Series 1988A, Series 1988B, and Series 1994. Due to the decline in interest rates, the District determined that by issuing the refunding bonds, the District could realize savings in annual debt service payments. Total debt service payments would be reduced over the next twenty-five years by \$1,314,875 and resulted in an economic gain of \$348,649. The refunding was accomplished by selling the \$2,090,000 1998 bonds at a two percent discount of \$41,800 which provided net proceeds of \$2,053,444, including accrued interest of \$5,244. The discount on bonds will be amortized as interest expense using the bonds outstanding/straight line method over the term of the bonds. The difference between the reacquisition price and the net carrying amount of the old bonds was \$16,714 (the deferred amount of refunding). The deferred amount of refunding will be amortized as interest expense using the straight line method over the term of the bonds.

The \$1,420,000 outstanding balance of the "1998 Refunding Bonds" were refunded in November 2010 with issuance of \$1,245,000 of 2010 Revenue Refunding Bonds and use of \$243,963 in debt service and debt service reserve funds.

The "1998 Refunding Bonds" mature in annual installments through the year 2023. Interest is payable semi-annually on January 1 and July 1. The interest rate varies over the term of maturity from 4.10% to 5.30%. \$44,576 of proceeds from the issue was capitalized as bond issue cost and is being amortized using the straight line method over the term of the bonds. \$156,793 of proceeds from the issue was deposited into a special fund with a trustee to provide for a debt service reserve fund. Interest earned by the fund is credited to interest income.

North Hopkins Water District
Notes to Financial Statements
December 31, 2011 and 2010

NOTE G - LONG-TERM LIABILITIES continued

The "1998 Refunding Bonds" were presented on the financial statements net of unamortized deferred amount of refunding which was \$0 and \$0 as of December 31, 2011 and 2010, respectively, and net of unamortized discount on bonds which was \$0 and \$0 as of December 31, 2011 and 2010, respectively. In 2010, deferred amount of refunding of \$557 and discount on bonds of \$1,504 were amortized as interest expense. Upon refunding of the "1998 Refunding Bonds" in 2010, the remaining \$8,134 unamortized balance of deferred amount of refunding and the remaining \$12,582 unamortized balance of discount on bonds was adjusted into deferred amount on refunding on the new issue.

Waterworks Revenue Bonds, Series 2001

In November 2001, the District entered into an assistance agreement with Kentucky Rural Water Finance Corporation authorizing issuance of \$183,000 of revenue bonds as part of the Kentucky Rural Water Finance Corporation Multimodal Public Projects Revenue Bonds (Flexible Term Program), Series 2001. The 2001 bonds were sold at a 1.64% premium of \$3,003 which provided total proceeds of \$186,003. The premium on bonds will be amortized as a reduction of interest expense using the bonds outstanding/straight line method over the term of the bonds.

The 2001 bonds mature in annual installments through the year 2012. Interest and principal is payable monthly by the District to the bond trustee. The interest rate varies over the term of maturity from 4.15% to 5.15%. \$8,207 of proceeds from the issue was capitalized as bond issue cost and is being amortized using the straight line method over the term of the bonds.

The 2001 bonds are presented on the financial statements to include unamortized premium on bonds which was \$57 and \$159 as of December 31, 2011 and 2010, respectively. In 2011, premium on bonds of \$103 was amortized as a reduction to interest expense. In 2010, premium on bonds of \$150 was amortized as a reduction to interest expense.

Waterworks Refunding Revenue Bonds, Series 2010

In November 2010, the District entered into an assistance agreement with Kentucky Rural Water Finance Corporation authorizing issuance of \$1,245,000 of revenue refunding bonds as part of the Kentucky Rural Water Finance Corporation Public Projects Revenue and Refunding Bonds (Flexible Term Program), Series 2010D for the current refunding of the Waterworks Refunding Revenue Bonds, Series 1998. Due to the decline in interest rates, the District determined that by issuing the refunding bonds, the District could realize savings in annual debt service payments. Total debt service payments would be reduced over the next thirteen years by \$316,859 and resulted in an economic gain of \$100,354. The refunding was accomplished by selling the \$1,245,000 2010 bonds at a discount of \$17,430 which provided net proceeds of \$1,227,570. The discount on bonds will be amortized as interest expense using the bonds outstanding/straight line method over the term of the bonds. The difference between the reacquisition price and the net carrying amount of the old bonds was \$42,410 (the deferred amount of refunding). The deferred amount of refunding will be amortized as interest expense using the straight line method over the term of the bonds.

North Hopkins Water District
Notes to Financial Statements
December 31, 2011 and 2010

NOTE G – LONG-TERM LIABILITIES continued

The 2010 bonds mature in annual installments through the year 2023. Interest is payable semi-annually on February 1 and August 1. The interest rate varies over the term of maturity from 0.80% to 3.40%. \$22,420 of proceeds from the issue was capitalized as bond issue cost and is being amortized using the straight line method over the term of the bonds.

The 2010 bonds are presented on the financial statements net of unamortized deferred amount of refunding which was \$38,343 as of December 31, 2011 and \$41,829 as of December 31, 2010 and net of unamortized discount on bonds which was \$14,740 as of December 31, 2011 and \$17,044 as of December 31, 2010. In 2011, deferred amount of refunding of \$3,486 and discount on bonds of \$2,303 were amortized as interest expense. In 2010, deferred amount of refunding of \$581 and discount on bonds of \$386 were amortized as interest expense.

Debt Maturity

Annual debt service requirements at December 31, 2011 are as follows:

<u>Year Ended</u> <u>December 31</u>	<u>Business-type Activities</u>	
	<u>Principal</u>	<u>Interest</u>
2012	\$ 90,167	\$ 33,197
2013	90,000	32,023
2014	90,000	30,763
2015	95,000	29,143
2016	95,000	27,053
2017-2021	530,000	92,600
2022-2023	<u>240,000</u>	<u>12,120</u>
Totals	<u>\$1,230,167</u>	<u>\$ 256,899</u>

NOTE H - RISK MANAGEMENT

The District is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. The District purchases commercial insurance for all risks of losses. Settlements resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

North Hopkins Water District
Notes to Financial Statements
December 31, 2011 and 2010

NOTE I - RELATED PARTY TRANSACTIONS

The District rents office space from Betsy Sellers, the billing clerk for the District. Rent for 2011 totaled \$5,400 and rent for 2010 totaled \$5,100.

Prior to his appointment as commissioner in January 2007, James D. Ashby performed mowing services for the District. Mr. Ashby continues to perform mowing services for the District. Mowing services for 2011 totaled \$3,500 and mowing services for 2010 totaled \$3,000.

NOTE J - CONSTRUCTION IN PROGRESS AND CAPITAL CONTRIBUTIONS

During 2010, the District received \$62,713 from the Hopkins County Fiscal Court to assist in waterline extensions and interior painting of a tank. The Hopkins County Fiscal Court provided the funds from a coal severance grant received from the Commonwealth of Kentucky. The cost of both projects were capitalized in 2010 upon completion. The District also received \$8,780 of remaining funds from the Commonwealth of Kentucky, Transportation Cabinet, Department of Highways to reimburse the District for costs involved with line relocations.

NOTE K - MAJOR SUPPLIER

The District purchases 100% of water resold from the City of Madisonville, Kentucky.

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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 Commissioners
North Hopkins Water District
Madisonville, Kentucky

We have audited the financial statements of North Hopkins Water District as of and for the years ended December 31, 2011 and 2010, and have issued our report thereon dated March 13, 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 North Hopkins Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of North Hopkins Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of North Hopkins Water 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, as discussed below, that we consider to be significant deficiencies in internal control over financial reporting. 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.

2011-1 Segregation of Duties

Condition: The internal control relating to receipts and disbursements is inadequate due to a lack of segregation of duties.

Criteria: Adequate segregation of duties is essential to an adequate internal control over financial reporting by allocating various duties among employees.

Effect: The lack of proper segregation of duties may permit errors or irregularities to go undetected.

Cause: There is a small number of accounting personnel. The cost versus benefit relationship prevents the District from hiring enough accounting personnel to properly segregate key accounting functions.

Recommendation: While the small number of employees that exist will never provide proper segregation of duties, the District should continually review job responsibilities for better accounting controls.

Response: The District concurs with the recommendation and will continually review job responsibilities to improve accounting controls when possible.

2011-2 Lack of Controls over Preparation of Financial Statements

Condition: The District outsources drafting of financial statements to the auditors. Management lacks the knowledge to apply generally accepted accounting principles in preparing the District's financial statements, including required disclosures.

Criteria: A proper control environment would be to employ or outsource an individual with the necessary accounting expertise to prevent, detect, and correct a potential misstatement in the financial statements and disclosures drafted by the auditor, or to internally prepare such financial statements and disclosures.

Effect: The absence of such controls may allow errors to go undetected.

Cause: Lack of personnel who possess the required knowledge to detect material misstatement in auditor drafted financial statements.

Recommendation: We recommend the District consider additional training for staff in charge of accounting and financial statement presentation. The District may consider adding manuals and disclosure checklists regarding preparation of financial statements to the control environment.

Response: We concur and will explore our options.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether North Hopkins 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 or other matters that are required to be reported under *Governmental Auditing Standards*.

We noted certain matters that we reported to management of North Hopkins Water District in a separate letter dated March 13, 2012.

North Hopkins Water District's response to the findings identified in our audit is described above. We did not audit North Hopkins Water District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the District's management and is not intended to be and should not be used by anyone other than these specified parties.

Alexander, Toney : Knight PLLC

Madisonville, Kentucky
March 13, 2012