



**NORTH MERCER WATER DISTRICT**  
**REPORT OF AUDIT**  
**FOR THE YEAR ENDED DECEMBER 31, 2011**

**NORTH MERCER WATER DISTRICT  
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YEAR ENDED DECEMBER 31, 2011**

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# INDEPENDENT AUDITOR'S REPORT

**F A R M E R & H U M B L E**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**P. O. BOX 212**  
**LAWRENCEBURG, KENTUCKY 40342**  
**(502) 839-3588**

Chairman and Commissioners  
North Mercer Water District  
Salvisa, KY 40372

We have audited the accompanying financial statements of the North Mercer Water District, as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions 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 the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Mercer Water District, as of December 31, 2011, and the 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 our report dated March 24, 2012, on our consideration of the North Mercer Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 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.

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

*Farmer & Humble*

Farmer & Humble  
Lawrenceburg, Kentucky  
March 24, 2012

## **NORTH MERCER WATER DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS**

Our discussion and analysis of the District's financial performance provide an overview of the District's financial activities for the year ended December 31, 2011. It should be read in conjunction with the financial statements, which follow this section.

### **HIGHLIGHTS**

#### **Financial Highlights**

- The District's net assets decreased by \$147,887, or 3%, as a result of net loss.
- Revenues increased to \$1,845,412, or 2.2% in 2011 while expenses increased more than 9%.
- The District's investment in capital assets increased by \$2,237,090 to \$11,218,270, an increase of 25% from last year. This reflects the 20/20 project of \$2,589,813.

#### **District Highlights**

- North Mercer Water District completed the majority of the 20/20 project temporarily funded through Kentucky Rural Water Association loans.

### **USING THIS ANNUAL REPORT**

This annual report consists of three parts; Management's Discussion and Analysis, Financial Statements, and Required Supplementary Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements.

#### **Required financial statements**

The Financial Statements of the District report information about the District using accounting methods similar to those used by private sector companies. These statements offer short- and long-term financial information about its activities. The Balance Sheet includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and obligations to creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its cost through its user fees and other charges, profitability, and credit worthiness. The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the District's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and capital and noncapital financing activities and provides answers to such questions as "from where did cash come?," "for what was cash used?," and "what was the change in cash balance during the reporting period?"

### **FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE**

One of the most important questions asked about the District's finances is "Is the District, as a whole, better off or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenditures, and Changes in Net Assets report information about the District's activities in a way that will help answer this question. These two statements report the net assets of the District and changes in them. You can think of the District's net assets-the difference between assets and liabilities-as one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. However, you will need to also consider other non-financial factors such as changes in economic conditions, population growth, and new or changed legislation.

The District's total net assets decreased from last year by \$147,887. Our analysis below focuses on the District's net assets (Table 1) and changes in net assets (Table 2) during the year.

Table 1

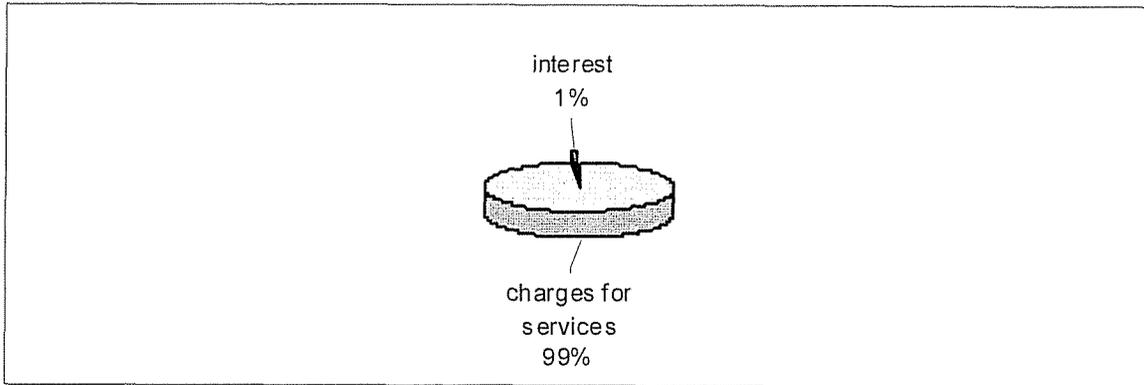
	<u>2011</u>	<u>2010</u>
Capital assets	\$ 11,218,270	\$ 8,981,180
Current and other assets	1,130,416	773,022
Total assets	<u>\$ 12,348,686</u>	<u>\$ 9,754,202</u>
Long-term debt outstanding	\$ 6,711,095	\$ 4,613,403
Other liabilities	827,776	183,097
Total liabilities	<u>\$ 7,538,871</u>	<u>\$ 4,796,500</u>
Net assets:		
Invested in capital assets, net of debt	\$ 3,877,341	\$ 4,311,331
Restricted	330,442	84,441
Unrestricted	602,032	561,930
	<u>\$ 4,809,815</u>	<u>\$ 4,957,702</u>
Total net assets	<u>\$ 4,809,815</u>	<u>\$ 4,957,702</u>

Changes in the District's net assets can be determined by reviewing the following condensed Statement of Revenue, Expenses and Changes in Net Assets for the year.

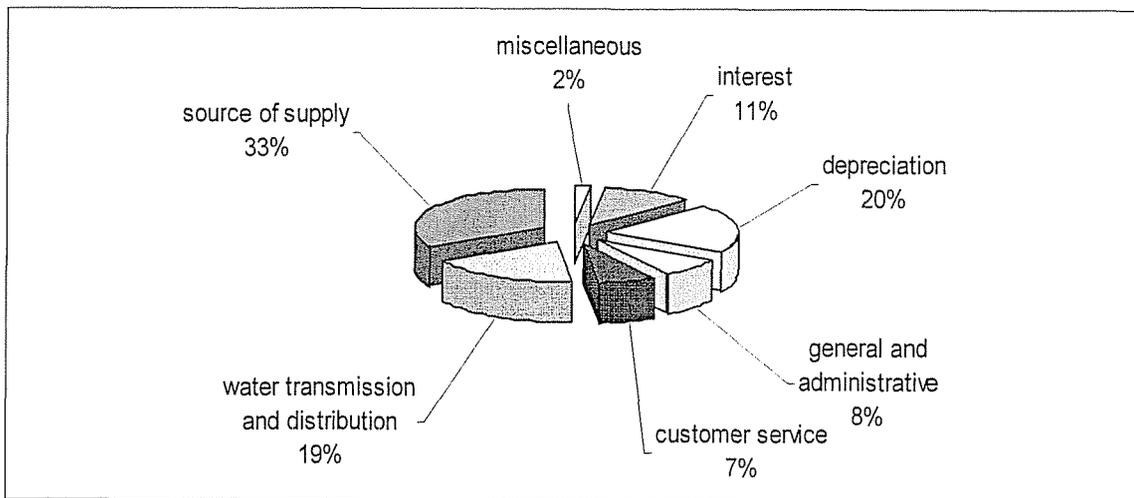
Table 2

	<u>2011</u>	<u>2010</u>
Net operating revenues	\$ 1,830,218	\$ 1,497,194
Interest income	11,860	19,179
Rental	932	
Sale of fixed assets	2,402	354
Total Revenues	<u>1,845,412</u>	<u>1,516,727</u>
Operating expenses	1,793,219	1,644,251
Interest and amortization expenses	224,781	212,038
Total Expenses	<u>2,018,000</u>	<u>1,856,289</u>
Deficit of revenues over expenses	(172,588)	(339,562)
Contributions	24,701	59,638
Change in net assets	<u>(147,887)</u>	<u>(279,924)</u>
Net assets at beginning of year	<u>4,957,702</u>	<u>5,237,626</u>
Net assets at end of year	<u>\$ 4,809,815</u>	<u>\$ 4,957,702</u>

### 2011 Revenues by Source



### 2011 Expenses by Source



Total operating revenues reflect a 22% increase in 2011 compared to 2010.

Operating expenses increased by approximately 9% in 2011 compared to 2010 due primarily to rising costs of water purchased from the City of Harrodsburg.

### THE DISTRICT'S FUND

The District's proprietary fund is the Water Fund. The Water Fund has been established since the District's inception to report charges to water customers for services provided to them.

The changes discussed in the section above provide adequate explanations of the Water Fund's activities during the year.

### Budgetary highlights

Over the course of the year, the District's commissioners approved the original legally adopted Water Fund budget. The Water Fund closed the year with actual expenditures under budget by \$387,180.

### CAPITAL ASSETS AND DEBT ADMINISTRATION

At the end of 2011, the District had \$11.2 million invested in a broad range of capital assets, including its water transmission and distribution mains, water storage facilities, and pump stations. This amount represents a net increase (including additions and deductions) of \$2,237,090, or 25% from last year. These changes are presented in detail in Note 5 to the financial statements.

The following table summarizes the District's capital assets, net of accumulated depreciation, for the years ended December 31, 2011 and 2010.

Table 3

	<u>2011</u>	<u>2010</u>
Land	\$ 48,802	\$ 43,302
Buildings, structures & improvements	55,983	60,895
Equipment, vehicles, furniture, & fixtures	329,847	362,922
Transmission system	7,856,319	5,523,609
Distribution system	1,257,324	1,301,259
Water meters	1,639,748	1,657,209
Hydrants	9,247	9,784
Pump station equipment	21,000	22,200
Net utility plant	<u>\$ 11,218,270</u>	<u>\$ 8,981,180</u>

This year's major additions to utility plant included:

- 20/20 Project \$2,589,813

Water projects will be funded from loans, cash reserves, and excess operating revenue.

#### **Debt**

At year-end, the District had a total of \$6.8 million in bonds and notes outstanding versus \$4.7 million last year, an increase of 6%.

	<u>2011</u>	<u>2010</u>
Water Revenue Refunding Bonds	\$ 1,650,000	\$ 1,740,000
Water Revenue Bonds	2,057,500	2,091,500
Notes due to Kentucky Rural Water Association	2,796,329	
Note due to Mainsource Bank		455,849
Notes due to State of Kentucky	247,500	382,500
Total Outstanding Debt	<u>\$ 6,751,329</u>	<u>\$ 4,669,849</u>

Other obligations include vacation pay. More detailed information about the District's long-term liabilities is presented in Note 6 to the financial statements.

#### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

Water sold decreased by about 17 million gallons, or roughly 6% to a level of 249 million gallons sold. Budgeted revenues for 2012 are projected to be even higher than 2011.

#### **CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our customers, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office manager at North Mercer Water District, P.O. Box 79, Salvisa Kentucky 40372.

## ASSETS

### Current assets:

Cash and cash equivalents	\$	305,700
Cash and cash equivalents-restricted		330,442
Accounts receivable-customers		222,777
Interest receivable		3,509
Materials and supplies		76,022
Prepaid expenses		37,795
<b>Total current assets</b>		<u>976,245</u>

### Non-current assets:

Unamortized Debt Discount		59,131
Investments		95,040

### Utility plant:

Plant in service		16,638,546
Less accumulated depreciation		<u>(5,420,276)</u>

<b>Net utility plant</b>		<u>11,218,270</u>
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<b>Total non-current assets</b>		<u>11,372,441</u>
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<b>Total assets</b>	\$	<u><u>12,348,686</u></u>
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**NORTH MERCER WATER DISTRICT**  
**STATEMENT OF NET ASSETS**  
**December 31, 2011**

**LIABILITIES:**

**Current liabilities:**

**Payable from current assets:**

Accounts payable	\$ 29,137
Accrued liabilities	24,392
Customer deposits	53,841
Advances for construction	354
	<u>107,724</u>

**Payable from restricted assets:**

Accounts payable	489,600
Accrued interest payable	81,452
Current portion of long-term liabilities	149,000
	<u>720,052</u>

**Total current liabilities** 827,776

**Long-term liabilities:**

Accrued compensated absences	8,766
Note due to Kentucky Rural Water Association	2,796,329
Water revenue bonds	3,596,000
Notes due to State of Kentucky	310,000
<b>Total long-term liabilities</b>	<u>6,711,095</u>

**Total liabilities** 7,538,871

**NET ASSETS:**

Invested in capital assets, net of related debt	3,877,341
Restricted:	
Debt service	73,555
Capital projects	256,887
Unrestricted	602,032
<b>TOTAL NET ASSETS</b>	<u>4,809,815</u>

The accompanying notes are an integral part of these financial statements.

**NORTH MERCER WATER DISTRICT**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**YEAR ENDED DECEMBER 31, 2011**

<b>Revenue:</b>	
Water revenues	\$ 1,776,166
Other operating revenues	54,052
<b>Total operating revenues</b>	<u>1,830,218</u>
<b>Operating expenses:</b>	
Source of supply	662,771
Transmission and distribution	374,023
Taxes	27,108
Customer accounts	150,481
General and administrative	167,943
Depreciation	410,893
<b>Total operating expenses</b>	<u>1,793,219</u>
<b>Utility operating income</b>	<u>36,999</u>
<b>Non-operating revenues (expenses):</b>	
Rent	932
Sale of fixed assets	2,402
Interest income	11,860
Interest expense	(221,965)
Amortization	(2,816)
<b>Total non-operating revenues (expenses)</b>	<u>(209,587)</u>
<b>Net loss before contributions</b>	(172,588)
Capital contributions	24,701
Change in net assets	(147,887)
Net assets, beginning of year	<u>4,957,702</u>
Net assets, end of year	<u>\$ 4,809,815</u>

The accompanying notes are an integral part of these financial statements.

**NORTH MERCER WATER DISTRICT  
STATEMENT OF CASH FLOWS  
YEAR ENDED DECEMBER 31, 2011**

**Cash flows from operating activities:**

**Cash inflows:**

Payments received from customers	\$	1,794,177
Deposits received from customers		7,094
<b>Total cash provided:</b>		1,801,271

**Cash outflows:**

Payments for salaries and benefits		484,231
Payments to suppliers for goods and services		889,551
<b>Total cash used:</b>		1,373,782

<b>Net cash provided by operating activities</b>		427,489
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**Cash flows from capital and related financing activities:**

Note issuance		2,796,329
Sale of fixed assets		2,402
System development fees received		24,701
Payments for utility plant		(2,158,383)
Rent		932
Principal payments of bonds		(124,000)
Principal payments of debt		(490,849)
Interest payments of bonds and debt		(181,129)
<b>Net cash used for capital and related financing activities</b>		(129,997)

**Cash flows from investing activities:**

Interest received from investments		8,428
<b>Net cash provided by investing activities</b>		8,428

<b>Net cash flow from all activities</b>		305,920
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Cash and cash equivalents at beginning of period		330,222
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<b>Cash and cash equivalents at end of period</b>	<b>\$</b>	<b>636,142</b>
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**NORTH MERCER WATER DISTRICT  
STATEMENT OF CASH FLOWS  
YEAR ENDED DECEMBER 31, 2011**

**Reconciliation of utility operating income to  
net cash provided by operating activities:**

Utility operating income	\$ 36,999
Depreciation	410,893
(Increase) decrease in:	
Accounts receivable	(36,041)
Materials and supplies	6,770
Prepaid expenses	(21,587)
Increase (decrease) in:	
Accounts payable	327
Accrued liabilities	19,822
Customer deposits	7,094
Accrued compensated absences	3,212
<b>Net cash provided by operating activities:</b>	<u><u>427,489</u></u>

**Schedule of cash and cash equivalents:**

**Beginning of period:**

Unrestricted cash and cash equivalents	245,781
Restricted cash and cash equivalents	84,441
<b>Total cash used:</b>	<u><u>330,222</u></u>

**End of period:**

Unrestricted cash and cash equivalents	305,700
Restricted cash and cash equivalents	330,442
<b>Total cash:</b>	<u><u>636,142</u></u>

Noncash financing activities

Unamortized Debit Discount	\$ 2,816
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The accompanying notes are an integral part of these financial statements.

## **NOTES TO FINANCIAL STATEMENTS**

**NORTH MERCER WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The North Mercer Water District (District) was established in 1959 under KRS 74.010 to provide water service for public health, convenience, fire protection, and comfort to the residents of northern Mercer County, Kentucky. Several expansions of the system have taken place in Mercer, Anderson, Boyle, and Washington Counties since the creation of the District. The commissioners are three regular members, all residents of Mercer County, appointed by the county judge.

North Mercer Water District has been appointed by the Mercer County Fiscal Court as an independent unit. The District selects management staff, sets user charges, establishes budgets and controls all aspects of its daily activities.

The commissioners appoint the Chair(person) from existing members. The Chair responsibilities are to preside at all meetings; be the chief officer of the District; perform all duties commonly incident to the position of presiding officer of a board, commission or business organization and exercise supervision over the business of the District, its officers and employees.

The accompanying statements of the District have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The financial statements include all organizations, activities, and functions that comprise the District. Component units are legally separate entities for which the District (the primary entity) is financially accountable. Financial accountability is defined as the ability to appoint a voting majority of the organization's governing body and either (1) the District's ability to impose its will over the organization or (2) the potential that the organization will provide a financial benefit to, or impose a financial burden on, the District. Using these criteria, the District has no component units.

**A. Basis of Presentation**

The District's fund is an enterprise fund. Enterprise funds are proprietary funds used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

**B. Measurement Focus and Basis of Accounting**

Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus applied.

The proprietary funds utilize and "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net assets.

All proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District's enterprise fund are charged to customers for sales and service. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenue and expenses.

### C. **Assets, Liabilities, and Net Assets**

#### Cash and Investments

For purposes of the statement of cash flows, the District considers all highly liquid investments, including restricted assets, with a maturity of three months or less when purchased, to be cash equivalents.

#### Restricted Assets

Restricted assets and cash and cash equivalents whose use is limited by legal requirements

#### Materials and Supplies

Materials and supplies are stated at the lower of cost (average cost method) or market.

#### Utility Plant

Utility plant is recorded at cost for items purchased or constructed and at estimated fair market value on the date donated for contributed items. The capitalization threshold for utility plant is \$500. Depreciation is computed by the straight-line method based on the estimated useful lives of related asset classifications. It is the District's policy to depreciate assets one-half year in the year of acquisition and one-half year in the year of disposal or retirement.

#### Construction Work in Progress

Construction work in progress represents costs accumulated for the replacement of sections of the District's transmission and distribution systems, plant expansions and rehabilitations, and other projects that were not completed at year end.

#### Compensated Absences

It is the District's policy to permit employees to accumulate earned but unused vacation benefits. Employees may, depending on level and length of service, be paid for various amounts of their total accrued leave upon termination or retirement. The District accrues a liability for leave hours that meet the criteria for payment at the eligible employees' current rates of pay plus retirement benefits and employment taxes. The accrual for compensated absences at December 31, 2011 was \$8,766.

#### Long-Term Obligations

Long-term debt and other long-term obligations are reported as liabilities in the District's balance sheet.

#### Net Assets

Net assets present the differences between assets and liabilities in the statement of net assets. :

- a. Net assets invested in capital assets are reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets.
- b. Net assets are reported as restricted when there are legal limitations imposed on their use by District legislation or external restrictions by creditors, grantors, laws or regulations of other governments.

Budget

In accordance with the District’s enabling legislation, the Commission holds public hearings and subsequently adopts an annual budget for operating expenses and capital outlays. The budget is adopted on a basis consistent with generally accepted accounting principles. It is monitored at various levels of classification detail within the enterprise fund.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results may differ from those estimates.

**NOTE 2. DEPOSITS AND INVESTMENTS**

The following information classifies deposits and investments by categories of risk as defined in GASB Statement 3, *“Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements.”*

A. Deposits

At year-end, the carrying amount of the District’s deposits was \$636,142 and the bank balance was \$728,179. The bank balance covered by federal depository insurance was \$472,661. The remaining deposits were classified as Category 2, collateralized, as defined by GASB (securities are pledged with the financial institution’s trust department or agent in the District’s name).

B. Investments

- Category 1 Insured or registered, with securities held by the District or its agent in the District’s name.
- Category 2 Uninsured and unregistered, with securities held by the counterparty’s trust department or agent in the District’s name.
- Category 3 Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but no in the District’s name.

The District has investments of \$95,040 in Kentucky bank certificates of deposit. The certificates of deposit are covered by federal depository insurance for \$95,040.

C. Reconciliation of Cash, Cash Equivalents and Investments

The classification of cash, cash equivalents and investments on the combined financial statements is based on criteria set forth in GASB Statement No. 9. A reconciliation between classifications of cash and investments on the financial statements and the classifications per GASB Statement No. 3 is as follows:

	Cash and Cash Equivalents	Investments
Cash, Cash Equivalents and Investments	\$ 636,142	\$ 95,040
GASB Statement No. 3	<u>\$ 636,142</u>	<u>\$ 95,040</u>

### NOTE 3. RESTRICTED ASSETS

#### Bond and Interest Repayment Assets

Under bond agreements, the District is required to transfer to the Debt Service Account on or before the last day of each month the following amounts:

- Interest-deposit the sum together with the balance in this account an amount equal the interest on all outstanding bonds accrued and unpaid and to accrue to the end of the then current calendar month.
- Principal-deposit the sum together with the balance in this account and amount equal (a) the principal amount of all outstanding bonds other than term bonds due and unpaid, (b) that portion of the principal amount of the bonds next due which would have accrued on such bonds other than term bonds next due during the ten current calendar month if such principal amount thereof were deemed to accrue monthly in equal installments from a date one year preceding the due date of such bonds next due and (c) the portion of the principal amount of the bonds next due which shall have accrued on such basis in prior months.
- Depreciation-deposit a monthly sum until the depreciation account reaches the balance required by bond agreements.

#### Capital Improvement Assets

The District maintains restricted construction accounts partially funded by grantors.

### NOTE 4. LONG-TERM DEBT

#### Kentucky Infrastructure Loan of 1993 (KIA)

Kentucky Infrastructure Authority has first pledge of gross income and revenues derived from the operation of the system to pay for the District's portion of the debt service requirements of the Kentucky Infrastructure Authority Revenue Bonds, Series 1993 E dated April 7, 1993, which redeemed and retired KIA Bonds Series 1988A and 1988B.

#### Waterworks Revenue Bonds, Series 1994

The District authorized by issuance of \$439,000 in "Waterworks Revenue Bonds" by resolution on June 21, 1994 to finance the cost of construction of extensions, additions and improvements to the system. On February 7, 1995, the U.S. Department of Agriculture Farmers Home Administration purchased the entire issue at 4.5% interest rate. The bonds are payable from and secured by a second pledge of revenues derived from the operation of the System, subject to the priority of a prior obligation to the Kentucky Infrastructure Authority of first pledge revenues.

#### Mainsource Loan of 2010

Mainsource Bank loaned the District \$500,000 to finance capital expenditures. The note dated May 7, 2010 has an interest rate of 4.06%. The note matured on May 1, 2012.

#### Kentucky Rural Water Finance Corporation Loans (Phase I & Phase II)

Kentucky Rural Water Finance Corporation loaned the District \$2,918,946 to provide interim financing on capital expenditures with an interest rate of 3.378. The note matures on January 19, 2012 and will be paid off with U.S. Department of Agriculture bonds of \$3,421,000.

Waterworks Refunding Revenue Loan, Series 2010C

On June 10, 2010, the District issued Waterworks Refunding Revenue Loan, Series 2010C in the amount of \$1,790,000 with an interest rate of 2.2%-4.325% for the purpose of refunding and retiring the outstanding Waterworks Revenue Bonds of 1992 and the Waterworks Refunding Revenue Bonds Series 1996, with interest rates of 5.375%-5.5%. The Waterworks Refunding Revenue Loan, Series 2010C were issued at a par amount of \$1,790,000 and, after paying issuance cost and discount of \$63,590, the net proceeds were \$1,726,410. The refunding met the requirements of an in-substance debt defeasance and the Revenue Bonds were removed from the District's long-term debt.

As a result of the refunding, the District reduced its total debt service requirements by \$488,774, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debt) of \$327,270.

Waterworks Revenue Bonds, Series 1996

On May 7, 1996 the District entered into a loan agreement with the Kentucky Rural Water Finance Corporation, a non-profit corporation, to provide interim financing in the amount of \$433,000 in anticipation of delivery of the Waterworks Revenue Bonds, Series 1996. Permanent financing was obtained from RECD on January 9, 1997, with the issuance of the bonds and draws in the amount of \$368,000 which was repaid from bond proceeds. The bonds sold were in the amount of 443,000 and carry an interest rate of 5.50%.

Waterworks Revenue Bonds, Services 2003

On March 11, 2003, the District entered into a loan agreement with the Kentucky Rural Water Finance Corporation to provide revenue bond anticipation notes in the amount of \$1,450,000 at an interest rate of 3.4% in anticipation of delivery of the Waterworks Revenue Bonds, Series 2004. Permanent financing was obtained from Rural Development in 2004, with the issuance of the bonds and draws in the amount of \$1,059,400 which was repaid from the bond proceeds. The bonds sold were in the amount of \$1,450,000 and carry an interest rate of 4.375%.

	Amount Outstanding 12-31-10	Additions	Deductions	Amount Outstanding 12-31-11	Amounts due within one year
Waterworks refunding loan series 2010C	1,740,000		(90,000)	1,650,000	82,500
Water revenue bonds series 1994	358,000		(8,000)	350,000	9,000
Water revenue bonds series 1996	368,000		(7,000)	361,000	
Water revenue bonds series 2003	1,365,500		(18,500)	1,347,000	20,000
Bonds payable	3,831,500		(123,500)	3,708,000	111,500
Note due to state of Kentucky	382,500		(35,000)	347,500	37,500
Note due to Mainsource Bank	455,849		(445,849)		
Note due to Kentucky Rural Water		2,796,329		2,796,329	
<b>Total long-term debt</b>	<b>4,669,849</b>	<b>2,796,329</b>	<b>(604,349)</b>	<b>6,851,829</b>	<b>149,000</b>

The Waterworks Refunding Loan Series 2010C requires a bond parity of 120% of average annual debt service. The bond parity rating for the year ended December 31, 2011 was 140%.

The future maturity amounts and related interest costs for all long-term debt are as follows:

Year Ended December 31	Bonds		Note Due To State of Kentucky		Total Sinking Fund Requirements	Note Due To Kentucky Rural Water		Total Debt Service
	Principal	Interest	Principal	Interest		Principal	Interest	
2012	111,500	142,998	37,500	15,981	307,979	2,796,329	4,514	3,108,822
2013	127,500	144,136	40,000	14,056	325,692			325,692
2014	133,583	140,528	42,500	11,956	328,567			328,567
2015	141,083	136,604	45,000	10,006	332,693			332,693
2016	143,000	132,149	45,000	8,178	328,327			328,327
2017-2021	808,333	577,654	137,500	8,513	1,532,000			1,532,000
2022-2026	638,333	621,219			1,059,552			1,059,552
2027-thereafter	1,604,168	483,149			2,087,317			2,087,317
Totals	<u>3,707,500</u>	<u>2,178,437</u>	<u>347,500</u>	<u>68,690</u>	<u>6,302,127</u>	<u>2,796,329</u>	<u>4,514</u>	<u>9,102,970</u>

#### **NOTE 5. WATER RATES**

The overall water rate is \$16.30 per thousand gallons for the first 1,000 gallons of water consumed and various amounts per thousand gallons for water in excess of 2,000 gallons. The minimum water bill, which includes 1,000 gallons of water consumption is \$16.30 per month.

The number of customer accounts billed during December 2011 was 4,291.

#### **NOTE 6. OTHER OPERATING REVENUES**

Other operating revenues consisted of the following at December 31, 2011:

Penalty Charges	\$26,854
Service Charges	24,721
Miscellaneous	<u>2,477</u>
Total	<u>\$54,052</u>

#### **NOTE 7. RISK RETENTION**

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 disasters. The District carries commercial insurance for risks of loss. There were not significant reductions in insurance coverage in 2011 from coverage in the prior year. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years. There were no presented claim liabilities at December 31, 2011.

#### **NOTE 8. RETIREMENT**

The District contributes to the Kentucky Retirement System, a cost-sharing multiple-employer public retirement system administered by the State of Kentucky to provide retirement, disability, or death benefits for covered employees. Kentucky statutes establish eligibility and vesting requirements and benefit provisions. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Retirement System, 1260 Louisville Road, Frankfort Kentucky 40601.

The retirement coverage is employee contributory. Employees contribute 5-6% of gross pay and the District contributes 18.96% of gross wages.

The District's contributions to the Kentucky Retirement System for the years ended 2011 and 2010 were \$49,352 and \$48,996 respectively, which are equal to the required contributions for each year.

**NOTE 9. DEFERRED COMPENSATION PLAN**

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. In prior years, the Internal Revenue Code specified that the plan's assets were the property of the District until paid or made available to participants, subject only on an equal basis to the claims of the Authority's creditors. A 1996 federal law now requires all assets and income of Internal Revenue Code Section 457 deferred compensation plans to be held in trust, custodial accounts, or annuity contracts for the exclusive benefit of the participants and their beneficiaries.

Assets of the District's plan are administered by Kentucky Deferred Compensation under contract with the District. The administrator amended the plan as of January 1, 1998, to comply with the new federal law. Consequently, the plan's assets and liabilities are not reflected in the District's financial statements.

**NOTE 10. CONTINGENCIES**

As of December 31, 2011, the District did not have any pending litigation or potential nondisclosed liabilities.

The North Mercer Water District participates in federal loan programs, which are governed by various rules of the grantor agency. Costs charged to the program are subject to audit and adjustment by the grantor agency; therefore, to the extent that the District has not complied with the rules and regulations governing these programs, refunds of any money received may be required. In the opinion of the District, there are no significant contingent liabilities relating to the compliance with the rules and regulations governing the respective programs.

**NORTH MERCER WATER DISTRICT  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

<u>Federal Grantor/Pass-Through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass- Through Entity Identifying Number</u>	<u>Federal Expenditures</u>
U.S. DEPT OF AGRICULTURE			
Passed Through the Office of Rural Development:			
Water and Waste Disposal Systems for Rural Communities	10.760	Series 2011/2011A	2,618,979
TOTAL U.S. DEPT OF AGRICULTURE			<u>2,618,979</u>
TOTAL FEDERAL EXPENDITURES OF AWARDS			<u><u>2,618,979</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**NORTH MERCER WATER DISTRICT  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

**NOTE A-BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the North Mercer Water District and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**NORTH MERCER WATER DISTRICT  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

<b>Section I-Summary of Auditor's Results</b>
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**Financial Statements**

Type of auditor's report issued (unqualified):

Internal control over financial reporting:

- Material weakness(es) identified? \_\_\_\_\_ Yes                            X       No
- Reportable condition(s) identified that are not considered to be material weaknesses? \_\_\_\_\_ Yes                            X       none reported

Noncompliance material to financial statements noted? \_\_\_\_\_ Yes                            X       No

**Federal Awards**

Internal control over major programs:

- Material weakness(es) identified? \_\_\_\_\_ Yes                            X       No
- Reportable condition(s) identified that are not considered to be material weaknesses? \_\_\_\_\_ Yes                            X       none reported

Type of auditor's report issued on compliance for major programs (unqualified):

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? \_\_\_\_\_ Yes                            X       No

Identification of major program:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
10.760	Water and Waste Disposal Systems for Rural Communities

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? \_\_\_\_\_ Yes                            X       No

**Section II-Financial Statement of Findings**

No matters were reported.

**Section III-Federal Award Findings and Questioned Costs**

No matters were reported.

**NORTH MERCER WATER DISTRICT  
SCHEDULE OF PRIOR YEAR AUDIT FINDINGS  
DECEMBER 31, 2011**

There were no prior year audit findings.

**INDEPENDENT AUDITOR'S REPORT  
ON INTERNAL CONTROL  
AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

FARMER & HUMBLE  
CERTIFIED PUBLIC ACCOUNTANTS  
P.O. BOX 212  
LAWRENCEBURG, KENTUCKY 40342  
(502) 839-3588

Chairman and Commissioners  
North Mercer Water District  
Salvisa, KY 40372

We have audited the financial statements of the North Mercer Water District, as of and for the year ended December 31, 2011, and have issued our report thereon dated March 24, 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 Mercer 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 North Mercer Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the North Mercer 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.

**Compliance and Other Matters**

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

This report is intended solely for the information and use of management, Commissioners, others within the entity, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Farmer + Humble*

Farmer & Humble  
Certified Public Accountants  
March 24, 2012

**INDEPENDENT AUDITOR'S REPORT  
ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A  
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE  
WITH OMB CIRCULAR A-133**

**F A R M E R & H U M B L E**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**P.O. BOX 212**  
**LAWRENCEBURG, KENTUCKY 40342**  
**(502) 839-3588**

**INDEPENDENT AUDITOR'S REPORT AND ON COMPLIANCE WITH REQUIREMENTS  
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Chairman and Commissioners  
North Mercer Water District  
Salvisa, KY 40372

Compliance

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

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

In our opinion, North Mercer Water District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2011.

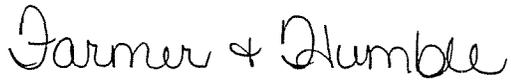
Internal Control Over Compliance

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

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

Our consideration of internal control over compliance was for the limited purposed described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, Commissioners, others within the entity, and federal awarding agencies, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Farmer & Humble".

Farmer & Humble  
Certified Public Accountants  
March 24, 2012