

PENDLETON COUNTY WATER DISTRICT

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Deaf, Hard-of-Hearing or Speech Impaired, call 711

June 4, 2012



Public Service Commission
P.O. Box 615
Frankfort, KY 40602

RE: 2011 Audit Report

To Whom It May Concern:

Please find enclosed a copy of our 2011 Audit Report.

If you have any questions, please feel free to contact me.

Sincerely,

William Jones
Manager

WJ/cbw

EQUAL OPPORTUNITY PROVIDER

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH
JUN 6 2012
RECEIVED
EXAMINED BY _____

PENDLETON COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

For the Years Ended December 31, 2011 and 2010

PENDLETON COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

December 31, 2011 and 2010

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PENDLETON COUNTY WATER DISTRICT
FINANCIAL STATEMENTS
December 31, 2011 and 2010

Board of Commissioners

L.R. Faulkner, Jr., Chairman

Dave Boden, Vice-Chairman

Dr. J.C. Crowley, Treasurer

Larry "Rick" Adams, Secretary

Brent Moore, Commissioner

Of Counsel

Jeff Dean, Pendleton County Attorney

Administration

William Jones, General Manager



Van Gorder, Walker & Co., Inc.
Certified Public Accountants

Charles A. Van Gorder, CPA
John P. Walker, CPA, MBA
Lori A. Owen, CPA
John R. Chamberlin, CPA, MBA
Members of AICPA & KyCPA
Licensed in Kentucky & Ohio

Independent Auditor's Report

To the Board of Commissioners Pendleton County Water District

We have audited the accompanying balance sheets of the Pendleton County Water District (District) as of December 31, 2011 and 2010 and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pendleton County Water District as of December 31, 2011 and 2010, and the results of its operations and cash flows 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 a report dated April 12, 2012 on our consideration of the Pendleton County Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

The management's discussion and analysis on pages 3-7 and the supplementary schedules on page 21 are not required parts of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Van Gorder, Walker & Company, Inc.
Erlanger, Kentucky
April 12, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Our discussion and analysis of the District's financial performance provides an overview of the District's financial activities for the year ended December 31, 2011. The information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The assets of the District exceeded its liabilities at the close of the most recent year by \$8,525,857 (net assets). This was a decrease of \$127,219 in comparison to the prior year. This change is mainly attributable to a decrease in water revenue due to an unusually wet year coupled with an increase in operating revenues because a section of water line had to be replaced when the excessive rainfall caused it to slip and leak.
- At the end of the current year, unrestricted net assets were \$1,249,060.

USING THIS ANNUAL REPORT

The financial statements presented herein include all of the activities of the District as prescribed in GASB Statements No. 34. The financial statements include a balance sheet, statement of revenues, expenses and changes in net assets and statement of cash flows, notes to the financial statements and a supplemental schedule. These statements show the condition of the District's finances and the sources of income and the funds expended.

Basis of Accounting

The District's financial statements are prepared using the accrual basis of accounting.

The Statements of Net Assets and Revenues, Expenses and Changes in Net Assets

In the Statements of Net Assets and the Statements of Revenues, Expenses and Changes in Net Assets, we report the District's activities.

- The District charges rates for water consumption to customers to cover all or most of the cost of certain services it provides.

SUMMARY OF NET ASSETS

Table 1 provides a summary of the District's net assets at December 31, 2011 and 2010.

	<u>2011</u>	<u>2010</u>
Current Assets	\$ 391,203	\$ 304,135
Restricted Assets	1,146,696	1,224,225
Noncurrent Assets	<u>9,058,875</u>	<u>9,255,647</u>
 Total Assets	 <u>10,596,774</u>	 <u>10,784,007</u>
Current Liabilities	74,706	82,002
Liabilities Payable from Restricted Assets	124,696	121,255
Long Term Liabilities	<u>1,871,515</u>	<u>1,927,674</u>
 Total Liabilities	 <u>2,070,917</u>	 <u>2,130,931</u>
Net Assets:		
Invested in Capital Assets, Net of Related Debt	7,121,974	7,269,969
Restricted	154,823	150,874
Unrestricted	<u>1,249,060</u>	<u>1,232,233</u>
 Total Net Assets	 <u>\$ 8,525,857</u>	 <u>\$ 8,653,076</u>

The District's net assets for 2011 decreased 1.47% or \$127,219 as compared to a 19.5% or \$1,413,074 increase in the previous year. This decrease is primarily due to a decrease in water revenues caused by a year of excessive rainfall coupled with an increase in operating expenses because a section of water line began to slip and leak as a result of the excessive rainfall and had to be redone. During 2010 there was a large donation of lines that was not repeated during 2011.

The largest portion of the District's net assets (83.5%) reflects its investment in capital assets (e.g. land, buildings, infrastructure, machinery and equipment), less any related debt used to acquire those assets still outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investments in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate the debt.

An additional portion of the District's net assets (1.8%) is considered to be restricted. This amount represents resources that are subject to external restrictions on how they may be used.

The unrestricted net assets may be used to meet the District's ongoing obligations to customers and creditors.

SUMMARY OF CHANGES IN NET ASSETS

Revenues

Water revenues decreased \$36,964 or 3% from 2010 to 2011. The decrease was a result of excessive rain during 2011 compared to 2010 which had insufficient rainfall during the late summer and early fall.

Water Costs

Water Costs decreased \$33,124 or 7.6% from 2010 to 2011. This was caused by a decrease in customer consumption due to the excessive rainfall noted above in combination with decreased water loss from construction usage.

Operation and Maintenance Expense

Operation and maintenance expense increased \$55,262 or 9.25% from 2010 to 2011. This increase was primarily due to increases in employee salaries and benefits, and the cost of replacing a section of water line that began to slip and leak due to the excessive rainfall.

Investment Income

Investment income decreased \$4,268 from 2010 to 2011. This number reflects the decrease in interest rates at financial institutions as well as the use of District funds to provide interim financing for a construction project until the bonds were sold to fund the project.

Capital Contributions

Capital contributions decreased \$1,403,847 from 2010 to 2011. This decrease is primarily due to the fact that a large capital contribution of 1,165,451 from the State of Kentucky comprised of relocated lines was not repeated during 2011. In addition grants related to the construction of 7 miles in of water lines and pump station renovation declined \$181,073. Customer contributions declined \$57,323 because there was no construction project that added new customers during 2011 and the 2010 donation of lines from a developer subdivision was not repeated.

The following schedule compares the revenues and expenses for the current year and the previous year.

Table 2
Changes in Net Assets

	<u>2011</u>	<u>2010</u>
Operating Revenues:		
Water Sales	\$1,202,509	\$1,239,473
Forfeited Discounts	22,282	21,812
Miscellaneous Services Revenues	<u>15,258</u>	<u>15,919</u>
Total Operating Revenues	<u>1,240,049</u>	<u>1,277,204</u>
Operating Expenses:		
Water Purchased	403,943	437,067
Operation and Maintenance Expense	652,508	597,246
Depreciation	<u>348,712</u>	<u>327,533</u>
Total Operating Expenses	<u>1,405,163</u>	<u>1,361,846</u>
Net Operating Loss	<u>(165,114)</u>	<u>(84,642)</u>
Non-Operating Income(Expenses)		
Investment Income	9,463	13,731
Loss on Disposition of Assets	(50,498)	-0-
Interest on Long-Term Debt	(88,553)	(87,345)
Amortization of Bond Discount and Expenses	<u>(887)</u>	<u>(887)</u>
Net Non-Operating Expenses	<u>(130,475)</u>	<u>(74,501)</u>
Income/(Loss) Before Capital Contributions	(295,589)	(159,143)
Capital Contributions	<u>168,370</u>	<u>1,572,217</u>
Change in Net Assets	(127,219)	1,413,074
Net Assets – January 1	<u>8,653,076</u>	<u>7,240,002</u>
Net Assets – December 31	<u><u>\$8,525,857</u></u>	<u><u>\$8,653,076</u></u>

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At December 31, 2011, the District had \$9,043,260 invested in capital assets including land, buildings, water systems, equipment, and vehicles, as reflected in the following schedule. This represents a net decrease (additions less retirements and depreciation) of \$195,884. During 2011 the District did not add a large amount of new assets and depreciation increased because of the sizeable addition of new lines, hydrants and meters in connection with the U.S. 27 relocation project and a construction project completed by the District during 2010.

Table 3 Summarizes the District's capital assets at the end of 2011 as compared to 2010.

Table 3
Capital Assets at Year End

	<u>2011</u>	<u>2010</u>
Land	\$ 63,176	\$ 63,176
Construction in Progress	0	22,112
Transmission Lines & Equipment	12,106,366	11,945,063
Furniture & Fixtures	71,194	71,194
Machinery & Equipment	303,146	312,110
Buildings & Improvements	<u>270,232</u>	<u>384,579</u>
Subtotal	12,814,114	12,798,234
Accumulated Depreciation	<u>(3,770,854)</u>	<u>(3,559,090)</u>
Total Capital Assets	<u>\$ 9,043,260</u>	<u>\$ 9,239,144</u>

Debt Outstanding

Table 4 illustrates the District's outstanding debt at the end of 2011 compared to 2010.

Table 4
Outstanding Debt at Year End

	<u>2011</u>	<u>2010</u>
Bond Payable Obligations	\$ 1,791,500	\$ 1,832,500
Capitalized Lease	47,000	53,000
Developer Refunds	<u>99,288</u>	<u>100,174</u>
Total	<u>\$ 1,937,788</u>	<u>\$ 1,985,674</u>

At year-end, the District had \$1,937,788 in outstanding notes and bonds compared to \$1,985,674 last year. This is a decrease of 2.4%. This decrease is due to the timely repayment of \$47,886 of long term debt during 2011.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The District's budget for 2012 calls for a 2.9% increase in operating revenues due to the expectation of more normal weather conditions during 2012. Although the District expects operating expenses to decrease because they do not expect to have to replace a water line during 2012, increased water costs, employee wages, and the related benefits are expected to offset the savings so that the total operating expenses are expected to increase by 2.3%. Another operating loss, although slightly lower, is expected during 2012. This combination of a fairly consistent revenue stream offset by increasing expenses resulting in a net operating loss is a pattern that is expected to continue into the future.

FINANCIAL CONTACT

This financial report is designed to provide our customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District Administrative Office at 331 Highway 330 West, Falmouth, Kentucky 41040.

A handwritten signature in black ink, appearing to read "William Jones", with a long horizontal flourish extending to the right.

William Jones, General Manager
Pendleton County Water District

PENDLETON COUNTY WATER DISTRICT BALANCE SHEETS December 31, 2011 and 2010
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ASSETS	2011	2010
Current Assets		
Cash and cash equivalents	\$ 220,833	\$ 123,257
Accounts receivable	117,223	126,595
Inventories	33,343	34,457
Prepays	18,642	18,466
Accrued interest income	275	473
Unamortized issue costs	887	887
Total Current Assets	<u>391,203</u>	<u>304,135</u>
Restricted Assets		
Improvement, repair, and replacement	898,613	709,691
Depreciation reserve	151,587	149,594
Bond sinking fund	60,546	50,205
Customer deposits	35,950	38,829
Fishing Creek Road	-	275,906
Total Restricted Assets	<u>1,146,696</u>	<u>1,224,225</u>
Noncurrent Assets		
Unamortized issue costs	15,615	16,503
Capital Assets		
Construction in progress	-	22,112
Land, building, transmission system, equipment, and vehicles	12,814,114	12,776,122
Less: accumulated depreciation	<u>(3,770,854)</u>	<u>(3,559,090)</u>
Total Capital Assets, net of depreciation	<u>9,043,260</u>	<u>9,239,144</u>
TOTAL ASSETS	<u><u>\$ 10,596,774</u></u>	<u><u>\$ 10,784,007</u></u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Current Liabilities		
Accounts payable	\$ 53,453	\$ 60,308
Accrued and withheld liabilities	19,480	20,807
Developer refunds - current portion	1,773	887
Total Current Liabilities	<u>74,706</u>	<u>82,002</u>
Current Liabilities Payable From Restricted Assets		
Revenue bonds - current portion	57,500	52,000
Lease obligation - current portion	7,000	6,000
Customer deposits	33,758	36,571
Accrued interest payable	26,438	26,684
Total Current Liabilities Payable From Restricted Assets	<u>124,696</u>	<u>121,255</u>
Long-Term Liabilities		
Bonds	1,734,000	1,780,500
Developer refunds	97,515	100,174
Capital lease payable	40,000	47,000
Total Long-Term Liabilities	<u>1,871,515</u>	<u>1,927,674</u>
TOTAL LIABILITIES	<u>2,070,917</u>	<u>2,130,931</u>
NET ASSETS		
Invested in capital assets, net of related debt	7,121,974	7,269,969
Restricted	154,823	150,874
Unrestricted	<u>1,249,060</u>	<u>1,232,233</u>
TOTAL NET ASSETS	<u>8,525,857</u>	<u>8,653,076</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 10,596,774</u></u>	<u><u>\$ 10,784,007</u></u>

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

PENDLETON COUNTY WATER DISTRICT STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES		
Water revenue	\$ 1,224,791	\$ 1,261,285
Other service revenues	15,258	15,919
TOTAL OPERATING REVENUES	<u>1,240,049</u>	<u>1,277,204</u>
OPERATING EXPENSES		
Water purchased	403,943	437,067
Operation and maintenance expense	629,717	575,410
Dépreciation	348,712	327,533
Taxes	22,791	21,836
TOTAL OPERATING EXPENSES	<u>1,405,163</u>	<u>1,361,846</u>
OPERATING LOSS	<u>(165,114)</u>	<u>(84,642)</u>
NON-OPERATING INCOME (EXPENSE)		
Investment income	9,463	13,731
Loss on disposal of assets	(50,498)	-
Interest on long-term obligations	(88,553)	(87,345)
Amortization of bond discounts and expenses	(887)	(887)
NET NON-OPERATING EXPENSES	<u>(130,475)</u>	<u>(74,501)</u>
NET LOSS	<u>(295,589)</u>	<u>(159,143)</u>
CAPITAL CONTRIBUTIONS	<u>168,370</u>	<u>1,572,217</u>
CHANGE IN NET ASSETS	<u>(127,219)</u>	<u>1,413,074</u>
NET ASSETS, JANUARY 1	<u>8,653,076</u>	<u>7,240,002</u>
NET ASSETS, DECEMBER 31	<u>\$ 8,525,857</u>	<u>\$ 8,653,076</u>

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

PENDLETON COUNTY WATER DISTRICT STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2011 and 2010
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	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from customers	\$ 1,249,421	\$ 1,274,951
Paid to suppliers for goods and services	(648,371)	(665,457)
Paid to or on behalf of employees for services	(415,324)	(389,687)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>185,726</u>	<u>219,807</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition and construction of fixed assets	(207,881)	(648,066)
Proceeds from sale of fixed assets	4,556	-
Interest received on investments	9,661	13,978
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>(193,664)</u>	<u>(634,088)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on long term debt	(48,773)	(45,387)
Interest paid on long term debt	(88,799)	(84,696)
Proceeds from issuance of long-term debt	-	220,000
Contributed capital received	16,287	46,036
Grant proceeds	152,083	396,697
(Increase)/Decrease in restricted cash	77,529	(99,831)
Increase/(Decrease) in customer deposits	(2,813)	1,127
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>105,514</u>	<u>433,946</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	97,576	19,665
CASH AND CASH EQUIVALENTS-BEGINNING OF YEAR	<u>123,257</u>	<u>103,592</u>
CASH AND CASH EQUIVALENTS-END OF YEAR	<u>\$ 220,833</u>	<u>\$ 123,257</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income (loss)	\$ (165,114)	\$ (84,642)
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	348,712	327,533
Change in operating assets and liabilities		
Decrease (Increase) in receivables	9,372	(2,253)
Decrease (Increase) in inventories	1,114	2,012
Decrease (Increase) in prepaid assets	(176)	(2,625)
Increase (Decrease) in accounts payable	(6,855)	(21,804)
Increase (Decrease) in other accrued liabilities	(1,327)	1,586
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 185,726</u>	<u>\$ 219,807</u>
NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital assets (transmission mains, hydrants, etc.) contributed to the District	<u>\$ -</u>	<u>\$ 1,129,481</u>
SUPPLEMENTAL INFORMATION		
Interest paid	<u>\$ (88,799)</u>	<u>\$ (84,696)</u>

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

PENDLETON COUNTY WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2011 and 2010

NOTE 1 – GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES

The Pendleton County Water District (District) is a water utility, which provides service to residential and commercial customers in Pendleton County, Kentucky. The District was created by the Pendleton County Fiscal Court under the provisions of chapter 74 of the Kentucky Revised Statutes (“KRS”) in 1958. The District’s current service area includes parts of Pendleton, Campbell, and Grant Counties.

Regulatory Requirements

The District is subject to the regulatory authority of the Kentucky Public Service Commission (“PSC”) pursuant to KRS 278.040.

Basis of Accounting

The District’s financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. The District applies all Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) Opinions of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The District has adopted, as applicable, GASB Statements 33 through 49 and related interpretations issued through December 31, 2011. Statement No. 33 required capital contributions to be recorded in the statement of revenues, expenses and changes in net assets. Statement 34 and subsequent statements and interpretations required certain other changes in terminology, format and content, as well as inclusion of the management’s discussion and analysis as required supplementary information.

All activities of the District are accounted for within a single proprietary (enterprise) reporting entity. Proprietary entities are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expense, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. 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 associated with the operations are included on the balance sheet. Net assets (i.e., total assets net of total liabilities) are segregated into “invested in capital assets, net of related liabilities”; “restricted”; and “unrestricted” components.

<p>PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010</p>
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Cash Equivalents

For purposes of the balance sheets and statements of cash flows, the District considers all unrestricted highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Budgets

In accordance with Kentucky Revised Statute 65.065, the District is required to submit a balanced budget to the Pendleton County Fiscal Court prior to December 1. The budget includes proposed expenditures and the means of financing them for the upcoming year. Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. Expenditures may not legally exceed budgeted appropriations at the fund level. All appropriations lapse at fiscal year end.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined under the First-In, First-Out (FIFO) method. Market is determined on the basis of estimated realizable market values.

Distribution System, Building, and Equipment

Property, plant, transmission lines and equipment are recorded at cost and depreciated over their estimated useful lives using the straight line method. Upon sale or retirement, the cost and related accumulated depreciation are removed from the respective accounts and the resulting gain or loss is included in the "Non-Operating Income (Expense)" portion of the Statements of Revenues, Expenses, and Changes in Net Assets.

Construction in Progress

Capitalizable costs incurred on projects which are not in use or ready for use at year end are held as "Construction in Progress". When the related asset is ready for use, related costs are transferred to the related asset account. The Construction in Progress account was \$0 and \$22,112 at December 31, 2011 and 2010, respectively.

Miscellaneous Deferred Charges

The costs of issuance of the District's Revenue Bonds are deferred and recorded as unamortized issue costs and are amortized over the life of the bond issues.

Capital Contributions

In conformity with the provisions of Governmental Accounting Standards Board Statement No. 33 – *Accounting and Financial Reporting for Non-Exchange Transactions*, amounts related to customer contributions in aid of construction have been reported as other income in the District's income statement. These contributions represent customer tap-in fees and other contributions to recover the costs of extensions of the distribution system. The District also includes estimated cost figures for those lines contributed by outside contractors.

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

During 2011 and 2010 these contributions consisted of the following:

<u>Source</u>	<u>2011</u>	<u>2010</u>
Tap in fees and construction costs paid by new customers	\$ 16,287	\$ 73,609
Construction funding from Pendleton County Fiscal Court	-	40,000
State funding from the Kentucky Highway Department	152,083	1,458,608
Total	<u>\$ 168,370</u>	<u>\$ 1,572,217</u>

Income Tax Status

The District is exempt from federal and state income taxes since it is a governmental entity. Accordingly, the financial statements include no provision for income taxes.

Use of Estimates

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Operating Revenues and Non-operating Revenues

Revenues have been classified as operating and non-operating. Operating revenues are those revenues that are directly generated from the sale of water to customers. Non-operating revenues are those revenues that arise from the overall function of the entity. Examples of non-operating revenues are grant revenues, sales of fixed assets and interest income.

NOTE 2 – DEPOSITS AND INVESTMENTS

Deposits consist of checking and savings accounts. They are carried at cost, which approximates market value. The carrying amount of deposits is separately displayed on the balance sheet as “Cash and Cash Equivalents” and “Restricted Assets”. At December 31, 2011 and 2010, the bank balances were \$220,833 and \$123,257, respectively, which were the same as the carrying amount. The District has amounts on deposit with one bank in excess of FDIC insured amounts. The bank has pledged collateral to cover such excess amounts.

Funds in excess of current expenses or obligations of the District are invested in certificates of deposit issued by, or other interest bearing accounts of, banks that are insured by the Federal Deposit Insurance Corporation.

Effective January 1, 1998, investments are reported at fair value which is determined using the selected basis. Short term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair market value.

The District’s investments are categorized to give an indication of the level of risk assumed by the District at December 31, 2011.

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

The categories are described as follows:

Category 1 - Insured and registered, with securities held by the entity or its agent in the entity's name;

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name;

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name.

	Category 1	Category 2	Category 3	Fair Value/ Carrying Cost	Cost
Deposits	\$ 220,833	\$ -	\$ -	\$ 220,833	\$ 220,833
Investments	1,124,326	-	22,370	1,146,696	1,146,696
Total	<u>\$ 1,345,159</u>	<u>\$ -</u>	<u>\$ 22,370</u>	<u>\$ 1,367,529</u>	<u>\$ 1,367,529</u>

In accordance with GASB 40, the District has \$22,370 in bond sinking funds held in investments in federally backed US Treasury Obligations rated AAA/Aaa. The market risk on these investments is negligible.

NOTE 3 – RESTRICTED NET ASSETS

Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net assets are classified in the following three components: invested in capital assets, net of related debt; restricted; and unrestricted net assets. Invested in capital assets, net of related debt consists of all capital assets net of accumulated depreciation and reduced by outstanding debts, that is attributable to the acquisition, construction and improvement of those assets. Restricted net assets consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net assets consist of all other net assets not included in the above categories.

Included in restricted net assets at December 31,

	2011	2010
Depreciation Reserve Fund	\$ 104,000	\$ 104,000
Bond Sinking Fund	50,823	46,874
Total Restricted Net Assets	<u>\$ 154,823</u>	<u>\$ 150,874</u>

NOTE 4 – UTILITY PLANT IN SERVICE

All property, plant and equipment, including infrastructure assets, are recorded at cost and depreciated over their estimated useful lives, using the straight-line method. Upon sale or retirement, the cost and related accumulated depreciation are eliminated from the respective

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

accounts and the resulting gain or loss included in the results of operations. Repair and maintenance charges, which do not increase the useful lives of the assets, are charged to income as incurred. Interest incurred on construction funding during the period of construction is capitalized and is added to the item under construction rather than charged to expense as incurred.

The property, plant and equipment accounts are summarized as follows:

Asset Type	December 31, 2010	Additions	Retirements	December 31, 2011
Land	\$ 63,176	\$ -	\$ -	\$ 63,176
Buildings and improvements	384,579	-	(114,347)	270,232
Construction in progress	22,112	164,714	(186,826)	-
Distribution reservoirs and standpipes	786,103	-	-	786,103
Furniture and fixtures	71,194	-	-	71,194
Hydrants	176,754	-	-	176,754
Meter system and installation	568,502	-	-	568,502
Other plant and misc. equipment	112,922	950	-	113,872
Pumping equipment	288,032	186,826	(34,784)	440,074
Services	664,144	9,261	-	673,405
Tools and equipment	15,720	2,979	-	18,699
Transmission mains	9,461,528	-	-	9,461,528
Transportation equipment	183,468	29,978	(42,871)	170,575
Subtotal	12,798,234	394,708	(378,828)	12,814,114
Accumulated depreciation	(3,559,090)	(348,712)	136,948	(3,770,854)
Capital Assets, net	<u>\$ 9,239,144</u>	<u>\$ 45,996</u>	<u>\$ (241,880)</u>	<u>\$ 9,043,260</u>

NOTE 5 – BONDED INDEBTEDNESS

Water Works System Revenue Bonds, U.S. Department of Agriculture 1977

On May 26, 1978, the District sold \$263,000 of revenue bonds for the purpose of financing the costs of major water system facilities. All bonds mature on December 1st of each year beginning in 1980, ending in 2017. Interest is payable on June 1st and December 1st and principal is due in annual installments on December 1st through 2017.

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2012	5.00%	\$ 12,000	\$ 3,950	\$ 15,950
2013	5.00%	12,000	3,350	15,350
2014	5.00%	13,000	2,750	15,750
2015	5.00%	13,000	2,100	15,100
2016	5.00%	14,000	1,450	15,450
2017	5.00%	15,000	750	15,750
Totals		<u>\$ 79,000</u>	<u>\$ 14,350</u>	<u>\$ 93,350</u>

Water Works System Revenue Bonds, U.S. Department of Agriculture 1997

On April 2, 1998, the District sold \$747,000 of revenue bonds for the purpose of financing the costs of major water system facilities. All bonds mature on December 1st of each year beginning in 2000 and ending in 2037. Interest is payable on June 1st and December 1st of each year and principal is due in annual installments on December 1st through 2037. The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2012	5.125%	\$ 9,500	\$ 34,414	\$ 43,914
2013	5.125%	10,500	33,928	44,428
2014	5.125%	11,000	33,389	44,389
2015	5.125%	12,000	32,826	44,826
2016	5.125%	12,500	32,211	44,711
2017-2037	5.125%	616,000	424,272	1,040,272
Totals		<u>\$ 671,500</u>	<u>\$ 591,040</u>	<u>\$ 1,262,540</u>

Kentucky Rural Water Finance Corporation Revenue Bonds, Series 2001A

On June 27, 2001, the District participated in the Kentucky Rural Water Finance Corporation's first Flexible Term Finance Program Remarketing wherein the proceeds of the revenue bonds issued were used to provide refunding and new money for twelve water systems throughout Kentucky. The District's share of the bond proceeds was \$374,000. All bonds mature on January 1st of each year beginning in 2003 and ending in 2024. Interest is payable on January 1st and July 1st of each year and principal is due in annual installments on January 1st through 2024.

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2012	5.099%	\$ 14,000	\$ 13,514	\$ 27,514
2013	5.099%	16,000	12,742	28,742
2014	5.099%	17,000	11,860	28,860
2015	5.099%	18,000	10,893	28,893
2016	5.099%	19,000	9,873	28,873
2017-2024	5.099%	175,000	36,516	211,516
Totals		\$ 259,000	\$ 95,398	\$ 354,398

Water Works System Revenue Bonds, U.S. Department of Agriculture 2004

On January 29, 2005, the District sold \$596,000 of revenue bonds for the purpose of financing the costs of major water system facilities. All bonds mature on January 1st of each year beginning in 2007, with debt service requirements beginning in 2006, and ending in 2044. Interest is payable on January 1st and July 1st of each year and principal is due in annual installments on January 1st through 2044. The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2012	4.50%	\$ 8,000	\$ 25,290	\$ 33,290
2013	4.50%	8,000	24,930	32,930
2014	4.50%	8,000	24,570	32,570
2015	4.50%	9,000	24,210	33,210
2016	4.50%	9,000	23,805	32,805
2017-2044	4.50%	520,000	402,525	922,525
Totals		\$ 562,000	\$ 525,330	\$ 1,087,330

Water Works System Revenue Bonds, U.S. Department of Agriculture 2010

On July 30, 2010, the District sold \$220,000 of revenue bonds for the purpose of financing the costs of major water system facilities. All bonds mature on January 1st of each year beginning in 2012, with debt service requirements beginning in 2010, and ending in 2049. Interest and principal are due in annual installments on January 1st through 2049.

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2012	3.50%	\$ 3,000	\$ 7,700	\$ 10,700
2013	3.50%	3,000	7,595	10,595
2014	3.50%	3,000	7,490	10,490
2015	3.50%	3,000	7,385	10,385
2016	3.50%	3,500	7,280	10,780
2017-2049	3.50%	204,500	150,331	354,831
Totals		<u>\$ 220,000</u>	<u>\$ 187,781</u>	<u>\$ 407,781</u>

NOTE 6 – CAPITAL LEASE

In 1997, the District signed a capital sublease agreement for its office and storage facilities. The leased property of \$137,718 is included in buildings and improvements on the fixed asset summary in Note 4. Amortization of the lease is included in depreciation expense. Accumulated amortization amounted to \$50,497 and \$47,054 at December 31, 2011 and 2010, respectively. Future minimum lease payments are as follows:

Year	Rent Amount	Interest Amount	Total Lease Payment
2012	\$ 7,000	\$ 2,588	\$ 9,588
2013	7,000	2,141	9,141
2014	7,000	1,695	8,695
2015	8,000	1,190	9,190
2016	8,000	680	8,680
2017	10,000	53	10,053
Totals	<u>\$ 47,000</u>	<u>\$ 8,347</u>	<u>\$ 55,347</u>

NOTE 7 – DEVELOPER REFUNDS

During 2000, a developer installed waterlines within a subdivision that he owns. Per the requirements of the Public Service Commission, the District will refund \$279 to this developer for each customer that buys a lot and connects to the waterline within ten years of the line's completion. The total refund could be \$27,850. As of December 31, 2010, only one customer had tapped into this line, leaving a balance of \$27,571. The refund period expired in December 2010; the remaining balance of \$27,571 was therefore recognized as income during the year, decreasing the liability to \$0.

During 2003, a second developer installed waterlines within a subdivision that he owns. The District will refund \$887 to this developer (the actual cost of 50 feet of waterline) for each customer that buys a lot and connects to the waterline within ten years as of December 1, 2004. The total refund could be \$115,245. As of December 31, 2011, eighteen customers had tapped

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

into this line, leaving a balance of \$99,288. The District estimates that two additional customers will tap on during 2012 for a current portion of refund payable of \$1,773.

The total Developer Refund payable is \$99,288, of which \$1,773 is due currently and \$97,515 is a long-term obligation.

NOTE 8 – INDEBTEDNESS SUMMARY

The changes in long-term indebtedness are as follows:

Debt Instrument	Balance at December 31, 2010	Additions	Retirements	Balance at December 31, 2011
Revenue bonds of 1977	\$ 90,000	\$ -	\$ (11,000)	\$ 79,000
Revenue bonds of 1997	680,500	-	(9,000)	671,500
Series 2001A bonds	273,000	-	(14,000)	259,000
Revenue bonds of 2004	569,000	-	(7,000)	562,000
Revenue bonds of 2010	220,000	-	-	220,000
Capitalized lease	53,000	-	(6,000)	47,000
Developer refunds	101,061	-	(1,773)	99,288
Subtotal	1,986,561	\$ -	\$ (48,773)	1,937,788
Less: current portion of long-term debt	(58,887)			(66,273)
Total Long-Term Indebtedness	\$ 1,927,674			\$ 1,871,515

NOTE 9 – OPERATING LEASE

The District leases a copier under an operating lease that began in July 2008 and will remain in force until June 2013. Rental payments under this lease were \$2,425 and \$2,104 for 2011 and 2010, respectively. Future minimum lease payments are as follows:

Year	Lease Payments
2012	\$ 2,202
2013	734
Totals	\$ 2,936

NOTE 10 – EMPLOYEE RETIREMENT SYSTEM

County Employees Retirement System

Employees who work an average of 100 hours per month participate in the County Employees Retirement System (CERS) of Kentucky. It is a cost sharing multiple-employer defined benefit pension plan created by and operated under Kentucky law. CERS covers substantially all regular full-time employees of each county and school board, and any additional local agencies electing to participate in the system. The plan provides for retirement, disability and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments are provided at the discretion of the State Legislature. For the years ended December 31, 2011 and 2010, plan members were required to contribute

PENDLETON COUNTY WATER DISTRICT NOTES TO THE FINANCIAL STATEMENTS December 31, 2011 and 2010

5% of their annual creditable compensation. Members hired on or after September 1, 2008 are required to contribute 6%. The additional 1% is considered a health insurance contribution. Employer contribution rates are actuarially determined. Such contribution rates are determined by the Board of Trustees of the Kentucky Retirement System. They may amend contribution rates as of the first day of July, if it is determined necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. From January until July 2011 the employer contribution rates were 16.93%. From July until December 2011, the employer rates were 18.96%. From January until July 2010 the employer contribution rates were 16.16%. From July until December 2010, the employer rates were 16.93%.

The District has made 100% of all required contributions for each of the years ended December 31, 2011, 2010, 2009, 2008, and 2007. Information about the contributions made by the District and the employees, as well as gross payroll and covered payroll follows:

	2011	2010	2009	2008	2007
Gross Payroll - All Employees	\$ 323,777	\$ 314,299	\$ 296,050	\$ 286,209	\$ 264,994
Gross Payroll - Covered Employees	300,177	291,099	261,530	251,989	235,765
Employee Contribution	15,242	14,555	13,077	12,599	11,788
Employer Contribution (expense)	53,817	48,244	38,892	37,298	34,707

NOTE 11 – ECONOMIC DEPENDENCY/CREDIT RISK

Pendleton County Water District is a government agency operating with one office in Falmouth, Kentucky. It grants credit to customers who are primarily local residents and businesses. The District receives all of its operating revenues from customers in Pendleton, Campbell, and Grant Counties in Kentucky.

NOTE 12 – CONCENTRATIONS

The District has agreements to purchase water from the City of Falmouth, Kentucky and the Northern Kentucky Water District through the year 2047. In June 2001, the District signed an agreement to purchase water on an “as needed” basis from the City of Williamstown, Kentucky. This contract is in force until June 2021.

PENDLETON COUNTY WATER DISTRICT SCHEDULES OF OPERATIONS, MAINTENANCE AND ADMINISTRATIVE EXPENSES For the Years Ended December 31, 2011 and 2010
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	<u>2011</u>	<u>2010</u>
Operations, Maintenance and Administrative Expenses		
Salaries and wages - employees	\$ 297,298	\$ 284,801
Employee pension and benefits	93,099	83,272
Advertising	1,166	993
Bad debt expense	4,632	4,935
Commissioners' fees	23,600	23,200
Contractual services - accounting	18,600	18,050
Contractual services - other	22,304	17,167
Insurance - general and vehicle	16,269	14,024
Insurance - other	1,209	858
Insurance - workers' compensation	4,618	5,361
Maintenance	2,397	807
Materials and supplies	82,809	56,350
Miscellaneous	3,757	6,530
Purchased power	15,553	18,095
Regulatory commission	1,953	1,881
Rental of equipment	2,425	2,104
Transportation	21,877	21,462
Utilities	16,151	15,520
	<u> </u>	<u> </u>
Total Operations, Maintenance and Administrative Expenses	<u>\$ 629,717</u>	<u>\$ 575,410</u>



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING
STANDARDS**

**To the Board of Commissioners
Pendleton County Water District**

We have audited the financial statements of the Pendleton County Water District as of and for the years ended December 31, 2011 and 2010, and have issued our report thereon dated April 12, 2012. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audits, we considered the Pendleton County Water District's internal control over financial reporting as a basis for designing our audit 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 the Pendleton County Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Pendleton County Water District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Pendleton County Water District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Pendleton County Water District's financial statements that is more than inconsequential will not be prevented or detected by the Pendleton County Water District's internal control. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

Lack of Segregation of Duties

Condition: We noted that due to the size of the District and financial considerations, some of the executing and recording of transactions are performed by the same person.

Criteria: Segregation of duties is a necessary part of any system of internal control. Segregating the processes of authorizing, executing and recording transactions is essential.

Effect: Lack of segregation of duties could allow for receipts to be diverted away from the District and expenses not attributed to the District could be paid for from the District's cash account. The District has determined that the cost of mitigation is not justified when compared to the risk of the related transactions.

Recommendation: Due to the size of the District and other financial considerations, internal controls should be implemented, to the highest appropriate level, to segregate the duties of the personnel. Controls should then be monitored to ascertain that they are sufficient to reduce the risk of material misstatement to an acceptable level.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Pendleton County Water District's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Pendleton County Water District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. Noncompliance 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 audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.



Van Gorder, Walker & Co., Inc.
Certified Public Accountants

This report is intended solely for the information and use of the audit committee, management, others within the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Van Gorder, Walker & Co., Inc.

Van Gorder, Walker & Co., Inc.
Erlanger, Kentucky
April 12, 2012