



Report

of

**South Hopkins Water District
Dawson Springs, Kentucky**

For The Years Ended December 31, 2011 and 2010



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INDEPENDENT AUDITORS' REPORT

To the Commissioners
South Hopkins Water District
Dawson Springs, Kentucky

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

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated January 31, 2012, on our consideration of South Hopkins Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Alexander, Toney & Knight PLLC

Madisonville, Kentucky
January 31, 2012

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

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

Financial Highlights for the Year 2011

- The District's net assets decreased \$45 thousand from \$1.978 million to \$1.933 million.
- The District's water sales increased \$58,000 over the prior year.

Overview Of The Financial Statements

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

Basic financial statements:

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

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

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

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

District Financial Analysis

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

Table 1
Condensed Statements of Net Assets
(in thousands)

	<u>2011</u>	<u>2010</u>	<u>dollar change</u>	<u>percent change</u>	<u>2009</u>	<u>dollar change</u>	<u>percent change</u>
Current assets	\$ 308.3	\$ 336.5	(\$ 28.2)	(8.4%)	\$ 368.0	(\$ 31.5)	(8.6%)
Capital assets	2,124.6	2,182.0	(57.4)	(2.6%)	2,223.3	(41.3)	(1.9%)
Other noncurrent assets	<u>380.5</u>	<u>366.6</u>	13.9	3.8%	<u>349.5</u>	17.1	4.9%
Total assets	<u>2,813.4</u>	<u>2,885.1</u>	(71.7)	(2.5%)	<u>2,940.8</u>	(55.7)	(1.9%)
Current liabilities	134.1	102.4	31.7	31.0%	111.8	(9.4)	(8.4%)
Long-term liabilities	<u>746.2</u>	<u>805.0</u>	(58.8)	(7.3%)	<u>837.3</u>	(32.3)	(3.9%)
Total liabilities	<u>880.3</u>	<u>907.4</u>	(27.1)	(3.0%)	<u>949.1</u>	(41.7)	(4.4%)
Net assets invested in capital assets, net of related debt	1,433.8	1,460.1	(26.3)	(1.8%)	1,462.0	(1.9)	(0.1%)
Net assets restricted for debt service	48.4	48.4	0.0	0.0%	48.2	0.2	0.4%
Net assets restricted for capital projects	215.0	198.5	16.5	8.3%	184.9	13.6	7.4%
Unrestricted net assets	<u>235.9</u>	<u>270.7</u>	(34.8)	(12.9%)	<u>296.6</u>	(25.9)	(8.7%)
Total net assets	<u>\$1,933.1</u>	<u>\$1,977.7</u>	(\$ 44.6)	(2.3%)	<u>\$1,991.7</u>	(\$ 14.0)	(0.7%)

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$1.93 million at the close of the current year.

2010 to 2011

As shown in table 1, the District's total assets decreased \$71,700 when compared to the prior year. Current assets decreased \$28,200 or 8.4% primarily due to a \$40,300 decrease in unrestricted cash and a \$14,200 increase in accounts receivable. Unrestricted cash decreased as the District's annual water cost adjustment increased significantly. Accounts receivable increased as higher water rates over the prior year provided a larger receivable balance. Capital assets decreased \$57,400 as depreciation expense outpaced new additions. Other noncurrent assets increased \$13,900 due to the District funding restricted cash primarily bond depreciation funds.

The District's total liabilities decreased \$27,100. Current liabilities increased \$31,700 or 31.0% primarily due to bond payments as scheduled are larger in the upcoming year than scheduled payments have been in past years. Current bonds payable are \$19,400 higher. Accounts payable are also higher at the end of the current year as water cost payable is \$5,400 higher and pensions payable is \$900 higher. The long-term liabilities decrease is a reflection of a \$38,900 reduction in revenue bonds payable as bond payments were made as scheduled and also a higher balance of current bonds payable.

The District's total net assets decreased \$44,600, which results from the net effect of the decreases in total assets and decreases in total liabilities referred to above. Net assets invested in capital assets, net of related debt,

decreased \$26,300 as depreciation expense outpaced new capital additions. Net assets restricted for capital projects, a component of total net assets, increased \$16,500 as depreciation funds were funded as required by bond covenants.

2009 to 2010

As shown in table 1, the District's total assets decreased \$55,700 when compared to the prior year. Current assets decreased \$31,500 or 8.6% primarily due to a \$71,000 decrease in unrestricted cash, a \$27,000 increase in accounts receivable, a \$5,500 increase in inventory, and a \$9,000 increase in prepaid expenses. Unrestricted cash decreased as the District's water cost increased significantly. In future years, the District will be able to recoup water cost increases. Accounts receivable increased as higher water rates over the prior year provided a larger receivable balance. Prepaid expenses increased because in the prior year a large insurance payment normally made each December was made subsequent to year end. Capital assets decreased \$41,300 as depreciation expense outpaced new additions. Other noncurrent assets increased \$17,000 due to the District funding restricted cash primarily bond depreciation funds.

The District's total liabilities decreased \$41,700. Current liabilities decreased \$9,400 or 8.4% primarily due to small decreases in accounts payable, accrued taxes and other payables, and current accumulated compensated absences. The long-term liabilities decrease is a reflection of a \$39,700 reduction in revenue bonds payable as bond payments were made as scheduled.

The District's total net assets decreased \$14,000, which results from the net effect of the decreases in total assets and decreases in total liabilities referred to above. Net assets restricted for capital projects, a component of total net assets, increased \$13,600 as depreciation funds were funded as required by bond covenants.

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

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

	<u>2011</u>	<u>2010</u>	<u>dollar change</u>	<u>percent change</u>	<u>2009</u>	<u>dollar change</u>	<u>percent change</u>
Operating revenues	\$1,332.7	\$1,274.1	\$ 58.6	4.6%	\$1,131.8	\$ 142.3	12.6%
Nonoperating revenues	<u>7.4</u>	<u>15.8</u>	(8.4)	(53.2%)	<u>109.3</u>	(93.5)	(85.5%)
Total revenues	<u>1,340.1</u>	<u>1,289.9</u>	50.2	3.9%	<u>1,241.1</u>	48.8	3.9%
Operating expenses	1,359.1	1,285.5	73.6	5.7%	1,236.1	49.4	4.0%
Nonoperating expenses	<u>36.2</u>	<u>37.3</u>	(1.1)	(2.9%)	<u>37.9</u>	(0.6)	(1.6%)
Total expenses	<u>1,395.3</u>	<u>1,322.8</u>	72.5	5.5%	<u>1,274.0</u>	48.8	3.8%
Income before capital contributions	(55.2)	(32.9)	(22.3)	(67.8%)	(32.9)	0.0	0.0%
Capital contributions	<u>10.6</u>	<u>18.9</u>	(8.3)	(43.9%)	<u>39.7</u>	(20.8)	(52.4%)
Changes in net assets	(44.6)	(14.0)	(30.6)	(218.6%)	6.8	(20.8)	(306.9%)
Beginning net assets	<u>1,977.7</u>	<u>1,991.7</u>	(14.0)	(0.7%)	<u>1,984.9</u>	6.8	0.3%
Ending net assets	<u>\$1,933.1</u>	<u>\$1,977.7</u>	(\$ 44.6)	(2.3%)	<u>\$1,991.7</u>	(\$ 14.0)	(0.7%)

2010 to 2011

The District's total revenues increased \$50,200 or 3.9%. Water sales increased \$58,000 as the District had a purchased water adjustment rate increase in 2011. Nonoperating revenues decreased \$8,400. In the prior year, the District received an additional \$2,000 in interest income and \$6,400 in various gains on disposition of assets.

The District's operating expenses increased \$73,600. The District's purchased water cost increased \$76,000 due to a significantly higher once a year underpayment paid to the District's water supplier. The District's contract with the City of Dawson Springs, Kentucky (the City) provides for a once a year underpayment or overpayment based on a water cost calculation from the City. The current year underpayment was \$80,967 while the average for the prior five years was \$38,345. The District is now allowed to recover this additional cost through wholesale customer contracts and a water audit recovery charge but a portion of the recovery will not be made until subsequent to the year end. Salaries and wages decreased \$6,200 as turnover to new employees provides a lower wage scale and transportation expense increased \$6,700 as higher fuel prices and repairs were incurred.

Capital contributions decreased \$8,300 due to less capital contributions from customers.

Changes in net assets decreased \$30,600 due to the net effect of the increased total revenues and increased total expenses mentioned above.

2009 to 2010

The District's total revenues increased \$48,800 or 3.9%. Operating revenues increased \$142,300. Water sales increased \$140,000 as the District had a general rate increase in April 2010 and a purchased water adjustment rate increase in December 2010. Nonoperating revenues decreased \$93,500. In the prior year, the District received approximately \$100,000 in federal and state noncapital grants to assist with a ice storm in early 2009.

The District's operating expenses increased \$49,400. The District's purchased water cost increased \$69,600 due to a 10% increase in water cost from the City of Dawson Springs, Kentucky. Materials and supplies decreased \$18,000. Materials and supplies had increased in the prior year due to storm damage recovery.

Capital contributions decreased \$20,800 due to less capital contributions from customers. The District had very little line extensions during the year.

Changes in net assets decreased \$20,800 due to the net effect of the increased total revenues and increased total expenses mentioned above.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2011 the District had \$2,124,626 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, office furniture and equipment, vehicles, and machinery and equipment. This amount represents a net decrease (additions, retirements, depreciation) of \$57,383 from the prior year. The decrease includes additions of capital assets less \$78,896 of depreciation expense in 2011.

Significant additions during the year included \$16,412 of expenditures in meters.

At December 31, 2010 the District had \$2,182,009 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, office furniture and equipment, vehicles, and machinery and equipment. This amount represents a net decrease (additions, retirements, depreciation) of \$41,253 from the prior year. The decrease includes additions of capital assets less \$81,303 of depreciation expense in 2010.

Significant additions during the year included \$20,396 of expenditures in rebuilt pumps, pumping equipment and motors. The District also expended \$9,865 for meters.

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

Long-Term Debt

At December 31, 2011, the District had \$690,857 in revenue bonds and revenue refunding bonds outstanding which was a decrease of \$39,337 from the prior year balance of \$730,194. All three of the District's bond issues were paid as scheduled and there were no new borrowings.

At December 31, 2010, the District had \$730,194 in revenue bonds and revenue refunding bonds outstanding which was a decrease of \$39,668 from the prior year balance of \$769,862. All three of the District's bond issues were paid as scheduled and there were no new borrowings.

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

Currently Known Facts, Decisions, or Conditions

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

Requests For Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the South Hopkins Water District, 129 South Main Street, Dawson Springs, Kentucky 42408.

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

	<u>2011</u>	<u>2010</u>
<u>Assets</u>		
Current assets		
Cash and cash equivalents	\$ 77,790	\$ 118,047
Accounts receivable	150,847	136,613
Other receivables	30	460
Material and parts inventory	53,068	52,518
Prepaid expenses	<u>26,566</u>	<u>28,811</u>
Total current assets	<u>308,301</u>	<u>336,449</u>
Noncurrent assets		
Restricted cash and cash equivalents	372,568	358,322
Capital assets:		
Nondepreciable	35,333	35,975
Depreciable, net of accumulated depreciation	<u>2,089,293</u>	<u>2,146,034</u>
Bond issue costs, net of accumulated amortization	<u>7,937</u>	<u>8,282</u>
Total noncurrent assets	<u>2,505,131</u>	<u>2,548,613</u>
Total assets	<u>2,813,432</u>	<u>2,885,062</u>
<u>Liabilities</u>		
Current liabilities payable from current assets		
Accounts payable	60,118	52,411
Accrued taxes and other payables	8,969	8,083
Accumulated compensated absences	<u>12,845</u>	<u>12,551</u>
	<u>81,932</u>	<u>73,045</u>
Current liabilities payable from restricted assets		
Accrued bond interest payable	389	467
Bonds payable	44,840	25,437
Customer deposits	<u>6,892</u>	<u>3,483</u>
	<u>52,121</u>	<u>29,387</u>
Total current liabilities	<u>134,053</u>	<u>102,432</u>
Long-term liabilities		
Bonds payable	646,017	704,759
Customer deposits	83,831	86,260
Accumulated compensated absences	<u>16,381</u>	<u>13,943</u>
Total long-term liabilities	<u>746,229</u>	<u>804,962</u>
Total liabilities	<u>880,282</u>	<u>907,394</u>
<u>Net Assets</u>		
Invested in capital assets, net of related debt	1,433,769	1,460,095
Restricted for:		
Debt service	48,444	48,408
Capital projects	214,980	198,517
Unrestricted	<u>235,957</u>	<u>270,648</u>
Total net assets	<u>\$1,933,150</u>	<u>\$1,977,668</u>

The accompanying notes are an integral part of these statements.

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

	<u>2011</u>	<u>2010</u>
Operating revenues		
Water sales	\$1,275,939	\$1,218,040
Other operating revenues	<u>56,784</u>	<u>56,052</u>
Total operating revenues	<u>1,332,723</u>	<u>1,274,092</u>
Operating expenses		
Purchased water	704,240	627,820
Salaries and wages	257,557	263,788
Depreciation	78,897	81,303
Employee benefits	106,435	108,017
Transportation	30,664	23,984
Contract services	17,168	16,665
Taxes	21,639	22,060
Purchased power	41,184	37,312
Materials and supplies	65,398	65,004
Insurance	27,263	28,405
Miscellaneous	8,043	9,991
Chemicals	<u>605</u>	<u>1,152</u>
Total operating expenses	<u>1,359,093</u>	<u>1,285,501</u>
Operating income (loss)	(26,370)	(11,409)
Nonoperating revenues (expenses)		
Interest income	7,410	9,438
Amortization of bond issue cost	(345)	(345)
Interest expense	(35,736)	(37,002)
Gain (loss) on involuntary conversion	0	1,405
Gain (loss) on disposition of capital assets	<u>(77)</u>	<u>4,992</u>
Total nonoperating revenues (expenses)	(28,748)	(21,512)
Income (loss) before contributions	(55,118)	(32,921)
Capital contributions-tap fees	9,600	18,400
Capital contributions-customers	<u>1,000</u>	<u>525</u>
Change in net assets	(44,518)	(13,996)
Net assets at beginning of year	<u>1,977,668</u>	<u>1,991,664</u>
Net assets at end of year	<u><u>\$1,933,150</u></u>	<u><u>\$1,977,668</u></u>

The accompanying notes are an integral part of these statements.

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

	<u>2011</u>	<u>2010</u>
<u>Cash flows from operating activities</u>		
Cash received from customers	\$1,261,705	\$1,190,684
Cash payments to suppliers for goods and services	(1,009,190)	(956,523)
Cash payments to employees for services	(257,557)	(263,788)
Other operating revenues	<u>56,784</u>	<u>56,052</u>
Net cash provided (used) by operating activities	51,742	26,425
<u>Cash flows from capital and related financing activities</u>		
Acquisition and construction of capital assets	(21,592)	(40,383)
Principal paid on bond maturities	(38,900)	(38,900)
Interest paid on bonds	(33,369)	(34,901)
Interest paid on customer deposits	(2,882)	(2,942)
Deposits collected from customers	9,450	9,140
Deposits repaid to customers	(8,470)	(6,762)
Proceeds from involuntary conversion of capital assets	0	1,405
Proceeds from disposition of capital assets	0	4,992
Capital contributions received from customers	<u>10,600</u>	<u>18,925</u>
Net cash provided (used) for capital and related financing activities	(85,163)	(89,426)
<u>Cash flows from investing activities</u>		
Interest earned on bank deposits	<u>7,410</u>	<u>9,438</u>
Net cash provided (used) by investing activities	7,410	9,438
Net increase (decrease) in cash and cash equivalents	(26,011)	(53,563)
Cash and cash equivalents at beginning of year	<u>476,369</u>	<u>529,932</u>
Cash and cash equivalents at end of year	<u>\$ 450,358</u>	<u>\$ 476,369</u>
	=====	=====
<u>Reconciliation of operating income to net cash provided (used) by operating activities</u>		
Operating income (loss)	(\$ 26,370)	(\$ 11,409)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	78,897	81,303
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	(14,234)	(27,356)
(Increase) decrease in other receivables	430	2,601
(Increase) decrease in inventory	(550)	(5,552)
(Increase) decrease in prepaid expenses	2,244	(9,143)
Increase (decrease) in accounts payable	7,707	(2,912)
Increase (decrease) in taxes and other payables	886	(3,547)
Increase (decrease) in compensated absences	<u>2,732</u>	<u>2,440</u>
Total adjustments	<u>78,112</u>	<u>37,834</u>
Net cash provided (used) by operating activities	<u>\$ 51,742</u>	<u>\$ 26,425</u>
	=====	=====

The accompanying notes are an integral part of these statements.

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

NOTE A - SUMMARY OF ACCOUNTING POLICIES

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

1. The Financial Reporting Entity

South Hopkins Water District (the "District") was created on May 6, 1965, under the provisions of chapter 74 of the Kentucky Revised Statutes of the Commonwealth of Kentucky. The principal office of the District is located at 129 South Main Street, Dawson Springs, Kentucky. The District is composed of three commissioners who are appointed by the Hopkins County Judge Executive and provides water to its members in and around southern Hopkins County, Kentucky.

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

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

The accounts of the District are organized in accordance with the uniform system of accounts adopted by the Public Service Commission of Kentucky. Those accounts are organized on the basis of a proprietary fund type, specifically an enterprise fund. The activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the District's assets, liabilities, net assets, revenues, and expenses. Enterprise Funds account for activities 1) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or 2) that are required by laws or regulations that the activities costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or 3) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

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

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

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

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

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

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

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

3. Cash and Cash Equivalents

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

4. Inventory

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

5. Capital Assets

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

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

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

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

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

Structures, improvements and water system	10 to 65 years
Furniture, machinery and equipment	3 to 20 years
Vehicles	5 years

6. Restricted Net Assets

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

7. Long-Term Liabilities

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

8. Uncollectible Accounts

Accounts receivable are presented net of noncollectible accounts. The allowance for uncollectible accounts was \$7,939 at December 31, 2011 and \$7,190 at December 31, 2010.

9. Use of Estimates

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

NOTE B - DEPOSITS

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

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

NOTE B - DEPOSITS continued

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

On December 31, 2011 the reconciled balance of the District's deposits totaled \$449,158 and the bank balances were \$456,952. Of the bank balances \$456,952 was covered by federal depository insurance (category 1).

On December 31, 2010 the reconciled balance of the District's deposits totaled \$476,369 and the bank balances were \$482,908. Of the bank balances \$482,908 was covered by federal depository insurance (category 1).

NOTE C - PREPAID EXPENSES

Prepaid expenses include prepaid insurance which represents the amount of unexpired insurance which the District had previously paid for at the balance sheet date and prepaid employee benefits which represents the amount of employee health insurance for the one month subsequent to the balance sheet date but paid by the District as of the balance sheet date.

At December 31, 2011, the District's prepaid expenses consisted of \$22,331 of insurance and \$4,235 of employee benefits. At December 31, 2010, the District's prepaid expenses consisted of \$23,705 of insurance and \$5,106 of employee benefits.

NOTE D - RESTRICTED CASH AND CASH EQUIVALENTS

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

Restricted balances as of December 31 are as follows:

	<u>2011</u>	<u>2010</u>
Bond and interest redemption fund	\$ 48,444	\$ 48,408
Bond depreciation fund	212,258	198,517
Meter deposit fund	109,144	108,677
Construction fund	<u>2,722</u>	<u>2,720</u>
Totals	<u>\$ 372,568</u>	<u>\$ 358,322</u>
	=====	=====

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

NOTE E - CAPITAL ASSETS

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

	<u>Balances</u> <u>12/31/09</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>Balances</u> <u>12/13/10</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>Balances</u> <u>12/31/11</u>
Business-type activities:							
Capital assets not being depreciated							
Land & land rights	\$ 29,875	\$ 0	\$ 0	\$ 29,875	\$ 0	\$ 0	\$ 29,875
Construction in progress	<u>0</u>	<u>6,100</u>	<u>0</u>	<u>6,100</u>	<u>5,458</u>	<u>6,100</u>	<u>5,458</u>
Total	<u>29,875</u>	<u>6,100</u>	<u>0</u>	<u>35,975</u>	<u>5,458</u>	<u>6,100</u>	<u>35,333</u>
Capital assets being depreciated							
Structures, improvements, & water system	4,921,945	32,657	72,205	4,882,397	20,153	19,588	4,882,962
Office furniture & equipment	45,665	408	967	45,106	499	1,536	44,069
Vehicles & equipment	123,586	0	0	123,586	0	0	123,586
Machinery & equipment	<u>107,674</u>	<u>885</u>	<u>0</u>	<u>108,559</u>	<u>1,580</u>	<u>0</u>	<u>110,139</u>
Total	<u>5,198,870</u>	<u>33,950</u>	<u>73,172</u>	<u>5,159,648</u>	<u>22,232</u>	<u>21,124</u>	<u>5,160,756</u>
Total capital assets	<u>5,228,745</u>	<u>40,050</u>	<u>73,172</u>	<u>5,195,623</u>	<u>27,690</u>	<u>27,224</u>	<u>5,196,089</u>
Less accumulated depreciation for:							
Structures, improvements, & water system	2,806,406	60,082	72,205	2,794,283	59,771	19,588	2,834,466
Office furniture & equipment	39,285	861	967	39,179	956	1,459	38,676
Vehicles & equipment	73,913	14,370	0	88,283	12,147	0	100,430
Machinery & equipment	<u>85,879</u>	<u>5,990</u>	<u>0</u>	<u>91,869</u>	<u>6,022</u>	<u>0</u>	<u>97,891</u>
Total accumulated depreciation	<u>3,005,483</u>	<u>81,303</u>	<u>73,172</u>	<u>3,013,614</u>	<u>78,896</u>	<u>21,047</u>	<u>3,071,463</u>
Total business-type activities capital assets, net	<u>\$2,223,262</u>	<u>(\$ 41,253)</u>	<u>\$ 0</u>	<u>\$2,182,009</u>	<u>(\$ 51,206)</u>	<u>\$ 6,177</u>	<u>\$2,124,626</u>

NOTE F - UNAMORTIZED BOND ISSUE COST

Series 1994A and B

\$13,114 of proceeds from the Series 1994A and B bonds were capitalized as bond issue cost and are being amortized using the straight line method over the term of the bonds. Bond issue cost of \$345 during 2011 and \$345 during 2010 was amortized.

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

NOTE G - LONG-TERM LIABILITIES

Long-term liability activity

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

	Balances			Balances			Balances		Amounts
	<u>12/31/09</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/10</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/11</u>	<u>Due Within</u>	
								<u>One Year</u>	
Revenue Bonds:									
Series 1994A	\$ 559,000	\$ 0	\$ 12,000	\$ 547,000	\$ 0	\$ 12,000	\$ 535,000	\$ 0	
Series 1994B	82,400	0	1,900	80,500	0	1,900	78,600	0	
Series 2004A/B	<u>127,500</u>	<u>0</u>	<u>25,000</u>	<u>102,500</u>	<u>0</u>	<u>25,000</u>	<u>77,500</u>	<u>45,000</u>	
Total	768,900	0	38,900	730,000	0	38,900	691,100	45,000	
Less/Add Deferred									
Amounts:									
On Refunding	(2,072)	0	(591)	(1,481)	0	(591)	(890)	(591)	
Issuance Premium	<u>3,034</u>	<u>0</u>	<u>1,359</u>	<u>1,675</u>	<u>0</u>	<u>1,028</u>	<u>647</u>	<u>431</u>	
Total Bonds	769,862	0	39,668	730,194	0	39,337	690,857	44,840	
Customer Deposits	87,365	9,140	6,762	89,743	9,450	8,470	90,723	6,892	
Accumulated									
Compensated									
Absences	<u>24,053</u>	<u>12,393</u>	<u>9,952</u>	<u>26,494</u>	<u>11,502</u>	<u>8,770</u>	<u>29,226</u>	<u>12,845</u>	
Business-type									
Activities Long-									
Term Liabilities	<u>\$ 881,280</u>	<u>\$ 21,533</u>	<u>\$ 56,382</u>	<u>\$ 846,431</u>	<u>\$ 20,952</u>	<u>\$ 56,577</u>	<u>\$ 810,806</u>	<u>\$ 64,577</u>	

Description of debt

Revenue Refunding Bonds, 1993 Series E and 2004 Series A/B

An assistance agreement (Farmers Home Administration Refunding Program) dated June 1, 1988 was entered into between Kentucky Infrastructure Authority and the District authorizing issuance of \$853,052 of refunding bonds. The bonds were to mature in annual installments through the year 2013. Interest was payable semi-annually on January 1 and July 1. The interest rate varied over the term of maturity from 5.25% to 7.85%. \$30,515 of proceeds from the issue was capitalized as bond issue cost and was to be amortized using the straight-line method over the term of the bonds. \$75,836 of proceeds from the issue was deposited in a special fund with the bond trustee to provide the District's portion of a debt service reserve fund required by the indenture. Payments for retirement of the debt were subject to adjustment for the amortization of the reserve fund. Interest earned by the reserve fund was credited to interest income.

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

NOTE G - LONG-TERM LIABILITIES continued

On April 1, 1993 the Kentucky Infrastructure Authority (KIA) issued Revenue Refunding Bonds, 1993 Series E, dated April 1, 1993 (the "Refunding Bonds") in order to provide funds to advance refund the issue referred to in the previous paragraph. Due to the decline in interest rates KIA determined that by issuing the refunding bonds the District could realize savings in annual debt service payments. The net present value to the District of this savings would be equal to \$42,506. The loss on extinguishment of debt had been accounted for under APB Opinion No. 26 as amended by Statement of Financial Accounting Standards No. 76. The loss had been classified as extraordinary under Statement of Financial Accounting Standards 4 as amended by Statement of Financial Accounting Standards 64. The loss had no material bearing on cash flow for the reporting periods.

The "Refunding Bonds" were to mature in annual installments through the year 2013. Interest was payable semi-annually on January 1 and July 1. The interest rate varied over the term of maturity from 2.50% to 5.75%. \$12,167 of proceeds from the issue was capitalized as bond issue cost and was being amortized using the straight-line method over the term of the bonds. \$67,590 of proceeds from the issue was deposited in a special fund with the bond trustee to provide the District's portion of a debt service reserve fund required by the indenture. Payments for retirement of the debt were subject to adjustment for the amortization of the reserve fund. Interest earned by the fund was credited to interest income.

An assistance agreement dated July 28, 2004 was entered into between KIA and the District authorizing issuance of \$345,000 of refunding bonds (the Revenue Refunding Bonds, Series 2004 A/B) to provide funds to refund the issue referred to in the previous paragraph. Due to the decline in interest rates KIA determined that by issuing the refunding bonds the District could realize savings in annual debt service payments. Total debt service payments would be reduced over the next nine years by \$69,025. The remaining \$53,582 balance in the District's debt service reserve fund referred to in the previous paragraph was used to pay down the principal on the old issue. The 2004 refunding bonds were sold with a premium of \$17,900, which will be amortized as a reduction of interest expense using the bonds outstanding/straight line method over the term of the new bonds. The difference between the reacquisition price and the net carrying amount of the old bonds was \$5,323 (the deferred amount on refunding). The deferred amount on refunding will be amortized as interest expense using the straight-line method over the term of the bonds.

The "Refunding Bonds 2004" mature in monthly installments through the year 2013. Interest and principal is payable monthly by the District. The interest rate varies over the term of maturity from 2.25% to 5.25%.

The "Refunding Bonds 2004" are presented on the financial statements net of unamortized deferred amount of refunding and include unamortized premium on bonds.

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

NOTE G - LONG-TERM LIABILITIES continued

Waterworks Revenue Bonds, 1994 Series A and B

A bond resolution dated November 29, 1994 authorized issuance of \$670,000 (Series A) and \$100,000 (Series B) of waterworks revenue bonds maturing in annual installments through year 2035. Interest is payable semi-annually on January 1 and July 1 at 4.5% per annum and principal is payable annually on January 1.

The 1994 Series Bonds were issued and sold to the United States Department of Agriculture/Rural Development (formerly Rural Economic and Community Development). The bond resolutions provide for all revenue receipts to be deposited into a Water Revenue Fund with transfers to the following funds:

- a) Waterworks Bond and Interest Sinking Fund - Prorata monthly transfers of an amount equal to the next principal and/or interest payments.
- b) Depreciation Fund - Monthly transfers of \$380 until the fund equals at least \$45,600.
- c) Operation and Maintenance Fund - Monthly transfers of an amount equal to the monthly expense disbursement of the District.
- d) After meeting all the requirements of a) through c) above, the balance remaining in the Revenue Fund is to be transferred to the Depreciation Fund.

Withdrawals from the Depreciation Fund can be authorized by the commissioners for the cost of unusual or extraordinary maintenance, repairs, renewals, and replacements, including extensions and additions, not included in the annual budget of current expenses.

Debt Maturity

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

<u>Year Ended</u> <u>December 31</u>	<u>Business-type Activities</u>	
	<u>Principal</u>	<u>Interest</u>
2012	\$ 45,000	\$ 14,844
2013	47,500	28,981
2014	16,100	26,575
2015	16,200	25,848
2016	17,300	25,094
2017-2021	100,100	112,678
2022-2026	127,400	87,278
2027-2031	161,400	54,941
2032-2035	<u>160,100</u>	<u>14,794</u>
Totals	<u>\$ 691,100</u>	<u>\$ 391,033</u>

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

NOTE H - ACCUMULATED COMPENSATED ABSENCES

It is the District's policy to permit employees to accumulate a limited amount of earned but unused sick leave.

NOTE I - EMPLOYEES' PENSION PLAN

Plan description

The District and covered employees contribute to the County Employers Retirement System (CERS), a cost-sharing, multiple-employer defined benefit plan administered by the Board of Trustees of the Kentucky Retirement Systems.

The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living adjustments are provided at the discretion of the State legislature. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of the Kentucky Retirement Systems.

The CERS financial statements and other supplementary information are contained in the publicly available annual financial report of the Kentucky Retirement Systems. Copies of the report are sent to each participating employer as well as distributed to legislative personnel, state libraries and other interested parties. Copies may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West 1260 Louisville Road, Frankfort, Kentucky 40601 or by calling 1-502-564-4646 or on the internet at www.kyret.com.

Funding policy

Per Kentucky Revised Statute 61.565, normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board.

For the year ended December 31, 2011, plan members hired prior to September 1, 2008 were required to contribute 5% of their annual creditable compensation. Plan members hired subsequent to September 1, 2008 were required to contribute 6% of their annual creditable compensation.

The District is required to contribute at an actuarially determined rate. The District was required to contribute 18.96% of each employee's creditable compensation for the last six months of the year ended December 31, 2011. The District was required to contribute 16.93% of each employee's creditable compensation for the first six months of the year ended December 31, 2011 and for the final six months of the year ended December 31, 2010. The District was required to contribute 16.16% of each employee's creditable compensation for the first six months of the year ended December 31, 2010 and for the final six months of the year ended December 31, 2009. The District was required to contribute 13.50% of each employee's creditable compensation for the first six months of the year ended December 31, 2009. The District's contributions to CERS for the years ended December 31, 2011, 2010, and 2009 were \$44,361, \$41,818, and \$38,368, respectively.

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

NOTE J - RISK MANAGEMENT

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

NOTE K - MAJOR SUPPLIER

The District purchases 98% of water resold from the City of Dawson Springs, Kentucky.

NOTE L - GAIN AND LOSS ON DISPOSITION OF CAPITAL ASSETS

During 2011, the District scrapped office furnishings with a remaining basis of \$77. During 2010, the District scrapped fully depreciated meters for \$4,992.

NOTE M - CONSTRUCTION IN PROGRESS

2011

The District has purchased meters to be installed subsequent to year end. The \$5,458 cost will be capitalized when place in service.

2010

The District has purchased meters to be installed subsequent to year end. The \$6,100 cost will be capitalized when place in service.

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

To The Commissioners
South Hopkins Water District
Dawson Springs, Kentucky

We have audited the financial statements of South Hopkins Water District as of and for the years ended December 31, 2011 and 2010, and have issued our report thereon dated January 31, 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 South Hopkins Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of South Hopkins Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of South Hopkins Water District's internal control over financial reporting.

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

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

2011-1 Segregation of Duties

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

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

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

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

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

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

Compliance and Other Matters

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

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

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

Alexander, Toney & Knight PLLC

Madisonville, Kentucky
January 31, 2012