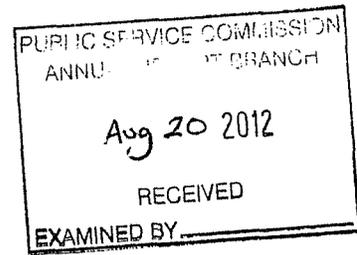


UNION COUNTY WATER DISTRICT

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REPORT ON AUDIT OF FINANCIAL STATEMENTS

For the years ended December 31, 2011 and 2010



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# MC<sub>E</sub>ELROY, MITCHELL & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS  
BUSINESS CONSULTANTS

## INDEPENDENT AUDITORS' REPORT

### PARTNERS

S. MARTIN MC<sub>E</sub>ELROY, JR., CPA  
ROBERT E. MITCHELL, CPA

### ASSOCIATES

TODD BOWLEY  
ERIC SUDDOTH

Board of Commissioners  
Union County Water District  
Morganfield, Kentucky

We have audited the accompanying financial statements of the business-type activities of the Union County Water District as of and for the years ended December 31, 2011 and 2010, which comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Union County 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 opinions.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Union County Water District as of December 31, 2011 and 2010 and the respective 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 August 3, 2012 on our consideration of the Union County 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 the 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 audit.

M = Ely, Mitchell & Associates, LLP

Morganfield, Kentucky  
August 3, 2012

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## LIABILITIES AND NET ASSETS

	2011	2010
Current liabilities:		
Current portion of long-term debt	\$ 80,000	\$ 47,500
Current portion of obligation under capital lease	-	34,000
Accounts payable	10,704	8,166
Other accrued liabilities	61,870	55,111
	152,574	144,777
Current liabilities payable from restricted assets:		
Accrued interest payable	4,750	13,346
Current portion of long-term debt	17,000	16,000
	21,750	29,346
Non-current liabilities:		
Long-term debt, net of current portion	189,000	500,000
Customer advances in aid of construction	980	1,197
Total non-current liabilities	189,980	501,197
Total liabilities	364,304	675,320
Net Assets:		
Invested in capital assets, net of related debt	5,655,625	5,478,040
Restricted for debt service	26,780	18,520
Unrestricted	312,418	527,813
Total net assets	5,994,823	6,024,373
Total liabilities and net assets	\$ 6,359,127	\$ 6,699,693

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT  
Statement of Revenues, Expenses, and Changes in Net Assets  
For the years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>Operating revenues:</b>		
Water sales	\$ 1,271,090	\$ 1,195,306
Other revenues	87,167	75,508
	<u>1,358,257</u>	<u>1,270,814</u>
<b>Operating expenses:</b>		
Water purchased	491,165	443,149
Fuel and power purchased for pumping	58,501	53,270
Water transmission and distribution	121,310	99,852
Customer account expense	32,269	26,581
General and administrative	488,605	461,528
Depreciation and amortization	242,203	244,224
	<u>1,434,053</u>	<u>1,328,604</u>
Total operating expenses	<u>1,434,053</u>	<u>1,328,604</u>
Operating loss	<u>(75,796)</u>	<u>(57,790)</u>
<b>Non-operating revenues (expenses):</b>		
Interest income	405	9,340
Interest expense	(22,108)	(44,896)
	<u>(21,703)</u>	<u>(35,556)</u>
Total non-operating expenses	<u>(21,703)</u>	<u>(35,556)</u>
Loss before contributions	(97,499)	(93,346)
Capital contributions	67,949	88,217
Change in net assets	(29,550)	(5,129)
Total net assets- beginning of year	<u>6,024,373</u>	<u>6,029,502</u>
Total net assets- end of year	<u>\$ 5,994,823</u>	<u>\$ 6,024,373</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT  
Statement of Cash Flows  
For the years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>Cash flows from operating activities:</b>		
Receipts from customers	\$ 1,362,083	\$ 1,256,338
Payments to suppliers	(786,996)	(715,493)
Payments to employees	(401,267)	(364,169)
	<u>173,820</u>	<u>176,676</u>
<b>Cash flows from non-capital financing activities:</b>	<u>-</u>	<u>-</u>
<b>Cash flows from capital and related financing activities:</b>		
Acquisition and construction of capital assets	(102,050)	(171,760)
Principal payments on bond indebtedness	(277,500)	(647,000)
Principal payments on capital lease	(34,000)	(32,000)
Interest payments on bond indebtedness	(30,564)	(54,933)
Interest payments on capital lease	(118)	(1,808)
Proceeds from contributed capital	89,342	66,824
Proceeds (payments) on customer advances	(217)	(437)
	<u>(355,107)</u>	<u>(841,114)</u>
Net cash used by capital and related financing activities		
<b>Cash flows from investing activities:</b>		
Purchase of investment securities	(100,400)	(175,000)
Proceeds from sale and maturity of investment securities	275,400	388,000
Investment income	405	15,218
	<u>175,405</u>	<u>228,218</u>
Net cash provided by investing activities		
Net decrease in cash and cash equivalents	(5,882)	(436,220)
Cash and cash equivalents, beginning of year	<u>241,896</u>	<u>678,116</u>
Cash and cash equivalents, end of year	<u>\$ 236,014</u>	<u>\$ 241,896</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT  
Statement of Cash Flows, Continued  
For the years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating loss	\$ (75,796)	\$ (57,790)
Items to reconcile net operating income to net cash provided by operations:		
Depreciation and amortization	242,203	244,224
Changes in operation assets and liabilities:		
Accounts receivable- consumers	3,826	(14,476)
Other assets	2,886	692
Accounts payable	2,538	6,586
Accrued interest payable	(8,596)	(11,845)
Other accrued liabilities	<u>6,759</u>	<u>9,285</u>
Net cash provided by operating activities	<u><u>173,820</u></u>	<u><u>176,676</u></u>

**Reconciliation of cash and cash equivalents:**

Unrestricted cash and cash equivalents	\$ 187,484	\$ 194,030
Restricted cash and cash equivalents	<u>48,530</u>	<u>47,866</u>
Total cash and cash equivalents	<u><u>\$ 236,014</u></u>	<u><u>\$ 241,896</u></u>

The accompanying notes are an integral part of the financial statements

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

1. **Summary of Significant Accounting Policies**

The accounting policies of the Union County Water District (“District”) conform to generally accepted accounting principles (GAAP) applicable to governmental enterprise units. The following summary of the more significant accounting policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

a. **Reporting Entity**

In evaluating how to define the entity for financial reporting purposes, management considered whether the District is a component unit of another primary government and all potential component units of the District. The District is a special-purpose district organized to construct, operate, and maintain water service facilities and supply water to customers in Union County, Kentucky. The District is governed by three appointed Commissioners who are nominated and approved by the Union County Fiscal Court. The District purchases its water supply from the City of Morganfield, Kentucky. All of the water purchased by the District has been filtered and treated. The District operates and maintains the distribution system that supplies its end users. The District’s basic financial statements include the financial position and the results of operations of the District. A review of other units of local government, using the criteria set forth in generally accepted accounting principles, indicates there are no additional entities or funds for which the District has reporting responsibilities. Management has determined the District should not be considered a part of any unit of local government for reporting purposes for the following reasons:

1. The District has separate legal standing from all other units of government.
2. A primary government appoints the voting majority of the District’s Board of Commissioners. However, the primary government is not able to impose its will on the District and there is no potential for the District to provide benefits to or burdens on the primary government.
3. The District is fiscally independent of all other units of local government. The District’s Board of Commissioners has the sole authority to determine financial programs, establish rates (subject to Public Service Commission approval) and issue bonded debt.
4. The financial statements of other units of local government would not be misleading or incomplete without the inclusion of the District’s financial statements.

b. **Basis of Accounting and Presentation**

The District is a single-enterprise proprietary fund and uses the accrual basis of accounting. Proprietary funds are used to account for operations that are financed in a manner similar to private business enterprise and that a periodic determination of revenues earned, expenses incurred and/or change in net assets is appropriate for capital maintenance, public policy, management control, accountability or other purposes. Under this method, revenues are recorded when earned, and expenses are recognized as soon as they result in liabilities for the benefits provided.

1. **Summary of Significant Accounting Policies, Continued**

b. **Basis of Accounting and Presentation, Continued**

The financial statements are prepared on the basis of Governmental Accounting Standards Board (GASB), Statement Number 34, Basic Financial Statements, Management Discussion and Analysis for State and Local Governments and related standards.

The District applies all Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the proprietary funds principle ongoing operations. The principle operating revenues of the District are charges to customers for water usage. Operating expenses include the cost of providing water service, administrative expenses and depreciation on capital assets. Other revenues and expenses are reported as non-operating in the financial statements.

Charges for services include revenues based on exchange or exchange-like transactions, namely water and sewer use. Program-specific grants and contributions (operating and capital), include revenues arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program, are accrued when all related eligibility requirements have been met.

c. **Measurement Focus**

The District's cost of services or "capital maintenance" measurement focus is all financial and economic resources. All assets and liabilities associated with the District's operations are included on the Statement of Net Assets. Depreciation is reported as a cost of operations.

d. **Cash and Cash Equivalents**

The District's cost of services or considers all highly liquid investments with an original maturity of ninety days or less to be cash equivalents.

e. **Investments**

KRS 66.480 permits the District to invest in U.S. Treasury obligations, U.S. Agency obligations, certain Federal instruments, repurchase agreements, commercial bank certificates of deposit, savings and loan deposits, and the Commonwealth of Kentucky investment pool. Investments are recorded at fair market value. Certificates of deposit are reported at cost since the redemption terms do not consider market rates. These investments are required to be fully collateralized in accordance with provisions of KRS 66.480.

1. Summary of Significant Accounting Policies, Continued

f. Restricted Assets

Restricted assets are cash and cash equivalents whose use is limited by legal requirements. Restricted cash and cash equivalents represent amounts required by debt covenants to be segregated for future debt payments and accrued interest on long-term debt obligations.

g. Capital Assets

Capital assets are stated at cost. All materials for capital improvements are capitalized when purchased. Construction in progress is not depreciated until completed and placed into service. Interest expense incurred during a construction period is capitalized. Depreciation is provided for by using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows:

Structures, lines, mains and accessories, and system improvements	50 years
Equipment, including hydrants and meters	5-20 years
Transportation equipment	5 years

h. Debt Issue Cost

Issue costs on bonds payable are being amortized using the outstanding bonds method.

i. Deferred Revenues

The District reports deferred revenue on its statement of net assets. Deferred revenues arise when potential revenue does not meet both the “measurable” and “available” criteria for recognition in the current period. Deferred revenues also arise when resources are received by the District before it has legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the District has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized.

j. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. A liability for compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the District and its employees is accrued as employees earn the rights to the benefits. The District’s policy is to accrue up to 30 days of unused vacation, which is payable upon termination of employment. Employees can accrue up to 60 days of sick leave, which upon termination of employment has no monetary value.

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

1. Summary of Significant Accounting Policies, Continued

k. Net Assets

Net assets present the difference between assets and liabilities in the statement of net assets. Proprietary fund net assets are divided into three components:

- Invested in capital assets, net of related debt- consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
- Restricted net assets- consist of net assets that are restricted by the District's creditors (for example, through debt covenants), by state enabling legislation (through restrictions on shared revenues), by grantors (both federal and state), and by other contributors.
- Unrestricted- all other net assets are reported in this category.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, restricted resources are applied first.

2. Deposits

At December 31, 2011, the Union County Water District maintained deposits of \$247,797 at two financial institutions. All of these bank balances were covered by federal depository insurance.

3. Restricted Assets

The Union County Water District had certain assets and corresponding retained earnings reserved for debt service which were restricted due to its outstanding debt. These consisted of a cash reserve and sinking fund for the United States Department of Agriculture note.

<u>Restricted Assets:</u>	<u>2011</u>	<u>2010</u>
Sinking Fund	\$ 28,455	\$ 34,511
Reserve Fund	20,075	13,355
Total restricted assets	<u>48,530</u>	<u>47,866</u>
Less: Accrued current liabilities payable from restricted assets:		
Principal	17,000	16,000
Interest	4,750	13,346
	<u>21,750</u>	<u>29,346</u>
Net assets restricted for debt service	<u>\$ 26,780</u>	<u>\$ 18,520</u>

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

4. Capital Assets

Capital asset activity consisted of the following for the year ended December 31, 2011:

	December 31, 2010	Additions	Disposals	December 31, 2011
Capital assets not depreciated:				
Land and land rights	\$ 10,175	\$ -	\$ -	\$ 10,175
Capital assets depreciated:				
Transport and distribution mains	4,099,754	15,651	-	4,115,405
Other transport and distribution plant	25,354	-	-	25,354
Distribution reservoirs and standpipe	4,554,883	47,925	-	4,602,808
Meters	1,011,136	33,569	-	1,044,705
Hydrants	34,523	-	-	34,523
Electric pumping equipment	688,553	-	-	688,553
Structures and improvements	20,202	-	-	20,202
Equipment	114,540	4,710	-	119,250
Transportation equipment	64,795	-	-	64,795
Office equipment and software	17,753	4,101	-	21,854
Other tangible property	10,900	-	-	10,900
	<u>10,642,393</u>	<u>105,956</u>	<u>-</u>	<u>10,748,349</u>
Total assets at historical cost	10,652,568	105,956	-	10,758,524
Less accumulated depreciation	<u>(4,593,028)</u>	<u>(240,871)</u>	<u>-</u>	<u>(4,833,899)</u>
Total capital assets, net	<u>\$ 6,059,540</u>	<u>\$ (134,915)</u>	<u>\$ -</u>	<u>\$ 5,924,625</u>

Depreciation expense amounted to \$240,871 and \$242,892 for the years ended December 31, 2011 and 2010, respectively. Amortization expense amounted to \$1,332 for each of the years ended December 31, 2011 and 2010.

5. Long-Term Debt

Long-term debt of the District consisted of the following as of December 31, 2011 and 2010:

	December 31, 2011				
	Balance Dec. 31, 2010	Additions	Deductions	Balance Dec. 31, 2011	Due Within One Year
USDA Loan	\$ 381,000	\$ -	\$ 230,000	\$ 151,000	\$ 17,000
KIA Assistance Agreement	182,500	-	47,500	135,000	80,000
Total long-term debt	<u>563,500</u>	<u>-</u>	<u>277,500</u>	<u>286,000</u>	<u>\$ 97,000</u>

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

5. Long-Term Debt, Continued

Presented on the balance sheet under the following captions:

Current portion long-term debt	\$ 80,000
Current portion long-term debt payable from restricted assets	17,000
Long-term debt, net of current portion	<u>189,000</u>
	<u>\$ 286,000</u>

Principal and interest requirements to retire the District's long-term obligations at December 31, 2011 were as follows:

	Principal	Interest	Total
2012	\$ 97,000	\$ 15,612	\$ 112,612
2013	73,000	9,404	82,404
2014	18,000	5,484	23,484
2015	20,000	4,510	24,510
2016	20,000	3,485	23,485
2016-2019	58,000	3,998	61,998
	<u>\$ 286,000</u>	<u>\$ 42,493</u>	<u>\$ 328,493</u>

Other information on the District's long-term indebtedness is summarized below:

	Interest Rate	Final Maturity	Principal Balance	Security
USDA Loan	5.125%	1/1/2019	\$ 151,000	Utility Revenues
KIA Assistance Agreement	2.5%-5.25%	6/1/2013	\$ 135,000	Utility Revenues

**December 31, 2010**

	Balance Dec. 31, 2009	Additions	Deductions	Balance Dec. 31, 2010	Due Within One Year
USDA Loan	\$ 983,000	\$ -	\$ 602,000	\$ 381,000	\$ 16,000
KIA Assistance Agreement	227,500	-	45,000	182,500	47,500
Total long-term debt	<u>1,210,500</u>	<u>-</u>	<u>647,000</u>	<u>563,500</u>	<u>\$ 63,500</u>

6. Line of Credit

During the year ended December 31, 2011, the District opened a line of credit in the amount of \$300,000 with United Community Bank. The line of credit bears interest at the prime rate minus 0.43% and is unsecured. At December 31, 2011, the outstanding balance was zero.

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

7. Operating Lease

The Union County Water District entered into a lease agreement with the Union County Fiscal Court to lease office space. The lease is for a term of twenty-eight months expiring December 31, 2011 with an option for three annual renewals. The monthly rent expense is \$500.

8. County Employees Retirement System (CERS)

The District has elected to participate in the County Employee Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing, multiple employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute.

Covered employees are required to contribute 5 percent of their salary to the plan. Covered employees who began participation on or after September 1, 2008 are required to contribute 6 percent of their salary to the plan. The District's contribution rate for employees was 18.96 percent.

The District's contributions for the fiscal years ending December 31 were as follows:

Year	Amount
2011	\$ 36,761
2010	32,642
2009	22,196

Benefits fully vest on reaching five years of service for employees. Aspects of benefits for covered employees include retirement after 27 years of service or age 65. Employees who began participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months of service credit.

CERS also provides post-retirement health care coverage as follows:

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

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, nonhazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to maximum dollar amount.

8. **County Employees Retirement System (CERS), Continued**

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502)564-4646.

9. **Deferred Compensation**

The District allows all eligible employees to participate in deferred compensation plans administered by the Kentucky Public Employees' Deferred Compensation Authority. The Kentucky Public Employees' Deferred Compensation Authority is authorized under KRS 18A.230 to 18A.275 to provide administration of tax sheltered supplemental retirement plans for all state, public school and university employees and employees of local political subdivisions that have elected to participate. These deferred compensation plans permit all full-time employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Participation by eligible employees in the deferred compensation plans is voluntary.

Historical trend information showing the Kentucky Public Employees' Deferred Compensation Authority's progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Public Employees' Deferred Compensation Authority's annual financial report. This report may be obtained by writing the Kentucky Public Employees' Deferred Compensation Authority at 101 Sea Hero Road, Suite 110, Frankfort, KY 40601-8862, or by telephone at (502) 573-7925.

10. **Commitments**

On December 19, 1986 the District entered into an agreement with the City of Morganfield, Kentucky whereby the City agrees to sell and deliver to the District and the District agrees to purchase and receive from the City all of the water required by the District up to a maximum of 2,000,000 gallons per day. The District can purchase water from other suppliers only in the event of an emergency. The agreement outlines a specific method of determining the City's cost of water produced during the previous fiscal year which is the rate charged to the District for the next year. The agreement covers a period of 42 years which expires December 19, 2028.

11. **Concentrations of Sales**

For the year ended December 31, 2011, three industrial customers in the coal mining industry accounted for \$419,570 in sales and surcharges for approximately 31% of the District's total operating revenues. For the year ended December 31, 2010, sales attributable to these companies were \$322,163 or approximately 25% of total operating revenues.

12. **Risk Management**

The District is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees, and natural disasters. The District carries commercial insurance for these types of risk of loss, including workers compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

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

**13. Subsequent Events**

In preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through August 3, 2012, the date the financial statements were available to be issued.

# McELROY, MITCHELL & ASSOCIATES, LLP

CERTIFIED PUBLIC ACCOUNTANTS  
BUSINESS CONSULTANTS

## 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*

### PARTNERS

S. MARTIN McELROY, JR., CPA  
ROBERT E. MITCHELL, CPA

### ASSOCIATES

TODD BOWLEY  
ERIC SUDDOTH

To the Commissioners  
Union County Water District  
Morganfield, Kentucky

We have audited the financial statements of the business-type activities of the Union County Water District as of and for the year ended December 31, 2011, which collectively comprise the District's basic financial statements and have issued our report thereon dated August 3, 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**

Management of Union County Water District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Union County Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies in internal control over financial reporting. [A-1 and A-2] A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Union County Water District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with such 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*.

The Union County Water District's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's responses, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management, board of Commissioners, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these parties. However, this report is a matter of public record and its distribution is not limited.

M. E. Ely, Mitchell & Associates, LLP

Morganfield, Kentucky  
August 3, 2012

## Schedule of Findings & Responses

### **A-1 Control Risk Related To Lack Of Segregation Of Duties:**

Due to a limited number of personnel employed at the District, incompatible work functions are often performed by the same individual and a high degree of trust is necessitated.

**Criteria:** Each key step of an accounting system should be segregated among employees. Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition.

**Effect:** The staff size of the District limits the ability to rotate duties and implement some checking procedures. This limitation may affect the ability to record, process, summarize and report financial data.

**Recommendation:** We recommend that management always be mindful of key functions assigned to employees and provide oversight in all steps of the accounting system.

**Response:** Management concurs with the recommendation and has taken steps to separate functions and provide oversight where needed.

### **A-2 Control Risk Due to Lack of Qualifications to Fulfill Assigned Functions**

The auditor, from the District's books of original entry, prepares the financial statements and notes for the Union County Water District.

**Criteria:** Internal controls should be put in place for the District to review and approve generally accepted accounting principles (GAAP) financial statements and notes. The District is to accept full responsibility for the accuracy of the GAAP financial statements and notes.

**Effect:** Based upon the entity's present financial statements, the client's auditor is currently preparing the audit financial statements and disclosures.

**Recommendation:** Procedures should be implemented to allow the District to prepare their own GAAP financial statements and notes.

**Response:** Management is aware of the situation regarding the preparation of GAAP financial statements and is currently looking into the best way to handle the situation.