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**GALLATIN COUNTY WATER DISTRICT**  
**BASIC FINANCIAL STATEMENTS,**  
**SUPPLEMENTARY INFORMATION,**  
**AND INDEPENDENT AUDITOR'S REPORTS**

**At December 31, 2012 and 2011**

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**At December 31, 2012 and 2011**

**GALLATIN COUNTY WATER DISTRICT  
BASIC FINANCIAL STATEMENTS  
SUPPLEMENTARY INFORMATION  
AND INDEPENDENT AUDITOR'S REPORTS**

Years Ended December 31, 2012 and 2011

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To the Commissioners of the  
Gallatin County Water District  
Sparta, Kentucky 41086

**INDEPENDENT AUDITOR'S REPORT**

**Report on the Financial Statements**

We have audited the accompanying financial statements of Gallatin County Water District as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Gallatin County Water District's basic financial statements as listed in the table of contents.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Gallatin County Water District, as of December 31, 2012 and 2011, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Other Matters*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 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 general 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 8, 2013, on our consideration of the Gallatin 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 financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Gallatin County Water District's internal control over financial reporting and compliance.

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP & WOODS, PSC  
Certified Public Accountants  
Carrollton, Kentucky

March 8, 2013

**GALLATIN COUNTY WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2012**

Our discussion and analysis of the Gallatin County Water District's financial performance provides an overview of the District's financial activities for the year ended December 31, 2012. Please read it in conjunction with the District's financial statements, which begin on page 7.

**REQUIRED FINANCIAL STATEMENTS**

The financial statements of the District report information about the District's use of accounting methods which are similar to those used by private sector companies. These statements offer short and long-term financial information about its activities.

The Statement of Net Position includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and obligations to District creditors (liabilities). It also provides the basis for evaluating the capital of the District and assessing its liquidity and financial flexibility.

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its costs through its water rates and other fees.

The final required financial statement is its statement of cash flows. The primary purpose of this statement is to provide information about the District's cash receipts and cash payments during the reported period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities, and the change in cash during the reporting period.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the District's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

**FINANCIAL HIGHLIGHTS**

The following are key financial highlights:

- Total assets at year-end were \$7,700,166 and exceeded liabilities in the amount of \$3,825,759 (i.e. net position). Of the total net position, \$857,970 was unrestricted and was available to support short-term operations. Total net assets decreased from year end 2011 to 2012 in the amount of \$105,405.
- Water charges increased \$41,875 during the year.
- Operating expenses increased by \$16,866, attributable mainly to an increase in utilities - pumping, health insurance expense, fuel expense and an increase in line maintenance expense.
- The District was in compliance with all debt covenants required by borrowing agreements.

**Balance Sheet, Statement of Net Position**

Utility Plant decreased by \$124,737, net of depreciation, in 2012. (See diagram below.)

**GALLATIN COUNTY WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2012**

**Condensed Assets**

	<u>2012</u>	<u>2011</u>	<u>Difference</u>
Utility Plant	\$ 6,333,911	\$ 6,458,648	\$ (124,737)
Current Assets	805,162	780,435	24,727
Other Non-current Assets	561,093	603,080	(41,987)
Total Net Assets	<u>\$ 7,700,166</u>	<u>\$ 7,842,163</u>	<u>\$ (141,997)</u>

At the end of December 31, 2012, the District had \$6,333,911 invested in capital assets (net of depreciation) including buildings, equipment, and water lines. (See table below.)

	<u>2012</u>	<u>2011</u>
Land & Rights	\$ 226,229	\$ 226,229
Structures & Improvements	257,506	266,479
Distribution System	5,536,805	5,605,618
Wells	251,006	264,914
Machinery & Equipment	62,365	78,441
Construction in Process	-	16,967
Totals	<u>\$ 6,333,911</u>	<u>\$ 6,458,648</u>

This year's major additions included:

Distribution system additions included the installation of approximately 4,700 feet of 8" distribution main, and 6" meter and vault allowing for more accurate monitoring and recording of water usage by the Kentucky Speedway Facility.

Long-term debt decreased by normal principal payments made during the year. The increase in current and accrued liabilities is attributed to the increase in obligations due on capital projects at December 31, 2012.

**Condensed Liabilities**

	<u>2012</u>	<u>2011</u>	<u>Difference</u>
Long Term Debt	\$ 3,639,060	\$ 3,721,515	\$ (82,455)
Current & Accrued Liabilities	235,347	189,484	\$ 45,863
Total Liabilities	<u>\$ 3,874,407</u>	<u>\$ 3,910,999</u>	<u>\$ (36,592)</u>

**GALLATIN COUNTY WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2012**

**Net Position**

At December 31, 2012, net position decreased \$105,405, as a result of contributions in aid of construction of \$7,996 offset by the District's loss from operations (before contributions) of \$113,401.

**Condensed Net Assets**

	<u>2012</u>	<u>2011</u>	<u>Difference</u>
Net Investment in Capital Assets	\$ 2,671,496	\$ 2,716,436	\$ (44,940)
Restricted for Debt Service	296,293	273,451	22,842
Unrestricted	857,970	941,277	(83,307)
Total	<u>\$ 3,825,759</u>	<u>\$ 3,931,164</u>	<u>\$ (105,405)</u>

**Income Statement**

Operating Revenues for 2012 increased by \$31,335 (1%). Operating expenses increased in 2012 due mainly to increases in utilities-pumping, health insurance expense, fuel expenses and an increase in line maintenance expenses. Depreciation also increased.

**Condensed Statement of Revenues and Expenses**

	<u>2012</u>	<u>2011</u>	<u>Difference</u>
Operating Revenues	\$ 955,720	\$ 924,385	\$ 31,335
Operating Expenses	931,453	914,587	(16,866)
Net-Operating Revenue	<u>\$ 24,267</u>	<u>\$ 9,798</u>	<u>\$ 14,469</u>
Non-Operating Income (Expenses)	(137,668)	(142,242)	4,574
Net Income Before Contributions	<u>\$ (113,401)</u>	<u>\$ (132,444)</u>	<u>\$ 19,043</u>

**Statement of Cash Flows**

Cash from Operating Activities was up \$38,057 in 2012. Cash from capital and related financing activities in 2012 reflect the monies received and used to finance capital improvements and equipment. Cash used in investing activities reflects the District's investment in additional certificates of deposit. Cash is consistent with expectations for the year.

**Condensed Statement of Cash Flows**

	<u>2012</u>	<u>2011</u>	<u>Difference</u>
Cash from Operating Activities	\$ 357,340	\$ 319,283	\$ 38,057
Cash from Capital & Related Financing Activities	(379,140)	(297,304)	(81,836)
Cash from Investing Activities	2,486	(97,486)	99,972
Change in Cash	<u>\$ (19,314)</u>	<u>\$ (75,507)</u>	<u>\$ 56,193</u>
Cash Balance, Beginning of Year	581,789	657,296	(75,507)
Cash Balance, End of Year	<u>\$ 562,475</u>	<u>\$ 581,789</u>	<u>\$ (19,314)</u>

**GALLATIN COUNTY WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2012**

**Debt**

At year-end, the District had \$3,702,886 in notes payable and bonds payable compared to \$3,783,820 last year as shown below. The decrease is attributable to the payment of scheduled principal and interest payments.

	<u>2012</u>	<u>2011</u>
Notes Payable	\$ 492,895	\$ 516,320
Bonds Payable	3,209,700	3,267,500
Accrued Compensated Absences	291	-
Totals	<u>\$ 3,702,886</u>	<u>\$ 3,783,820</u>

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

The District anticipates some minor system upgrades in 2013 which includes expansion of water service to Hwy 1039.

The District anticipates operating income in 2013 to increase in accordance with the rate increase that became effective in June of 2012.

The District anticipates an increase in operating expenses due to the rising cost of health insurance and fuel expenses.

**CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our customers and creditors with a general overview of the District's finances and to 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's office at 4500 Highway 455, Sparta, KY 41086.

Tammy Hendren  
Office Manager

GALLATIN COUNTY WATER DISTRICT  
STATEMENT OF NET POSITION  
December 31, 2012 and 2011

	2012	2011
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash, Including Time Deposits	\$ 659,717	\$ 630,802
Accounts Receivable Trade (Net)	103,142	104,009
Interest Receivable	998	2,567
Inventory	30,699	33,491
Prepaid Expense	10,606	9,566
<b>Total Current Assets</b>	<b>\$ 805,162</b>	<b>\$ 780,435</b>
<b>Noncurrent Assets:</b>		
<b>Restricted Assets:</b>		
Cash, Including Time Deposits	\$ 520,657	\$ 560,919
Interest Receivable	256	553
Bond Issuance Costs, (Net)	40,180	41,608
<b>Capital Assets (Net)</b>	<b>6,333,911</b>	<b>6,458,648</b>
<b>Total Noncurrent Assets</b>	<b>\$ 6,895,004</b>	<b>\$ 7,061,728</b>
<b>Total Assets</b>	<b>\$ 7,700,166</b>	<b>\$ 7,842,163</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts Payable	\$ 10,122	\$ 11,282
Accounts Payable Construction	54,082	3,780
Accrued Wages	5,175	4,846
Accrued Compensated Absences	291	-
Accrued Payroll Taxes/Employee Withholding	6,410	11,817
Utility Tax Payable	2,040	2,151
Sales Tax Payable	356	678
<b>Current Liabilities Payable from Restricted Assets:</b>		
Accrued Interest Payable	72,341	73,705
Revenue Bonds Payable	60,800	57,800
Note Payable - Kentucky Infrastructure Authority	23,730	23,425
<b>Total Current Liabilities</b>	<b>\$ 235,347</b>	<b>\$ 189,484</b>
<b>Noncurrent Liabilities:</b>		
Revenue Bonds Payable	\$ 3,148,900	\$ 3,209,700
Note Payable - Kentucky Infrastructure Authority	469,165	492,895
Escrow - Customer Construction Deposits	1,152	350
<b>Noncurrent Liabilities Payable from Restricted Assets:</b>		
Customer Deposits Payable	19,843	18,570
<b>Total Noncurrent Liabilities</b>	<b>\$ 3,639,060</b>	<b>\$ 3,721,515</b>
<b>Total Liabilities</b>	<b>\$ 3,874,407</b>	<b>\$ 3,910,999</b>
<b>NET POSITION</b>		
Net Investment in Capital Assets	\$ 2,671,496	\$ 2,716,436
Restricted for Debt Service	296,293	273,451
Unrestricted	857,970	941,277
<b>Total Net Position</b>	<b>\$ 3,825,759</b>	<b>\$ 3,931,164</b>

GALLATIN COUNTY WATER DISTRICT  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION  
For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 901,899	\$ 860,024
Total Charges for Services	<u>\$ 901,899</u>	<u>\$ 860,024</u>
Other Charges and Miscellaneous:		
Billing Service Charges	\$ 35,253	\$ 41,324
Reconnect and Disconnect Charges	16,709	20,582
Miscellaneous	1,859	2,455
Total Other Charges and Miscellaneous	<u>\$ 53,821</u>	<u>\$ 64,361</u>
Total Operating Revenues	<u>\$ 955,720</u>	<u>\$ 924,385</u>
Operating Expenses:		
Bank Charges	\$ 6,188	\$ 4,448
Commissioner Fees	7,650	6,300
Contractual Service - Sampling	5,642	14,961
Dues	1,112	1,003
Health Insurance	80,533	69,984
Insurance	20,141	20,150
Labor	210,644	211,709
Maintenance of Mains	41,472	37,507
Office Supplies and Expense	32,254	29,672
Other Interest Expense	107	169
Payroll Taxes	15,057	16,223
Professional Services	11,685	17,914
Purchased Water	8,292	8,307
Regulatory Fees	1,640	1,370
Retirement Expense	40,626	39,402
Travel/Transportation Expense	23,299	20,885
Uniforms	2,270	1,835
Utilities - Office	12,286	11,021
Utilities - Pumping	74,994	68,036
Depreciation Expense	335,561	333,691
Total Operating Expenses	<u>\$ 931,453</u>	<u>\$ 914,587</u>
Operating Income (Loss)	<u>\$ 24,267</u>	<u>\$ 9,798</u>
Nonoperating Revenue (Expense):		
Investment Income	\$ 8,587	\$ 13,268
Interest Expense	(151,078)	(154,079)
Amortization of Bond Issuance Costs	(1,428)	(1,431)
Gain (Loss) on Equipment Sold/Abandoned	6,251	-
Total Nonoperating Revenues (Expense)	<u>\$ (137,668)</u>	<u>\$ (142,242)</u>
Income (Loss) Before Contributions	<u>\$ (113,401)</u>	<u>\$ (132,444)</u>
Capital Contributions	<u>7,996</u>	<u>12,190</u>
Change in Net Position	<u>\$ (105,405)</u>	<u>\$ (120,254)</u>
Net Position--Beginning of Year	<u>3,931,164</u>	<u>4,051,418</u>
Net Position--End of Year	<u>\$ 3,825,759</u>	<u>\$ 3,931,164</u>

**GALLATIN COUNTY WATER DISTRICT  
STATEMENT OF CASH FLOWS  
For the Years Ended December 31, 2012 and 2011**

	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from Customers	\$ 957,427	\$ 919,268
Payments to Suppliers	(49,172)	(54,670)
Payments to Employees	(217,674)	(227,430)
Other Receipts (Payments)	(333,241)	(317,885)
Net Cash Provided (Used) by Operating Activities	\$ 357,340	\$ 319,283
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital Contributions	\$ 8,798	\$ 12,190
Purchases of Capital Assets	(160,522)	(75,262)
Proceeds from Sales of Assets	6,251	-
Principal Paid on Capital Debt	(81,225)	(78,823)
Interest Paid on Capital Debt (including capitalized interest)	(152,442)	(155,409)
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ (379,140)	\$ (297,304)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of Investments	\$ (7,967)	\$ (110,682)
Interest on Investments	10,453	13,196
Net Cash Provided (Used) by Investing Activities	\$ 2,486	\$ (97,486)
Net (Decrease) in Cash and Cash Equivalents	\$ (19,314)	\$ (75,507)
Balances-Beginning of the Year	581,789	657,296
Balances-End of the Year	\$ 562,475	\$ 581,789

	Balances Per December 31, 2012 Statement of Net Position	Balances Per December 31, 2012 Statement of Cash Flows
Cash	\$ 115,503	\$ 115,503
Time Deposits	544,214	-
Restricted Cash	446,972	446,972
Restricted Time Deposits	73,685	-
Total Cash and Cash Equivalents, End of Year	\$ 1,180,374	\$ 562,475

	Balances Per December 31, 2011 Statement of Net Position	Balances Per December 31, 2011 Statement of Cash Flows
Cash	\$ 93,388	\$ 93,388
Time Deposits	537,414	-
Restricted Cash	488,401	488,401
Restricted Time Deposits	72,518	-
Total Cash and Cash Equivalents, End of Year	\$ 1,191,721	\$ 581,789

(Continued)

**GALLATIN COUNTY WATER DISTRICT  
STATEMENT OF CASH FLOWS  
For the Years Ended December 31, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>		
Operating Income (Loss)	\$ 24,267	\$ 9,798
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	335,561	333,692
Change in Assets and Liabilities:		
Receivables, Net	867	(5,663)
Inventories	2,792	(9,109)
Prepaid Expenses	(1,040)	166
Accounts and Other Payables	(1,160)	87
Accrued Expenses	(5,220)	(9,748)
Customer Meter Deposits Payable	1,273	60
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 357,340</b>	<b>\$ 319,283</b>

**SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

At December 31, 2012 and 2011, Gallatin County Water District had incurred \$54,082 and \$3,780 in capital expenditures included in accounts payable - construction, respectively.

GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
December 31, 2012 and 2011

**NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES**

The Gallatin County Water District is a rural water company serving approximately 1,890 customers in Gallatin, Grant and Boone Counties of Kentucky, and regulated by the Public Service Commission of the Commonwealth of Kentucky. The Water District was formed under the laws of Gallatin County in September 1960 through the Fiscal Court (reaffirmed in 1985) and began operations in July 1989.

In evaluating how to define Gallatin County Water District 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 GAAP. The basic -- but not the only -- criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the District is able to exercise oversight responsibilities. Based upon the application of these criteria, the District has no component units.

A summary of the District's significant accounting policies follows:

**Basis of presentation and accounting:** As stated in Kentucky Revised Statutes (KRS) 278.015, "any water district shall be a public utility and shall be subject to the jurisdiction of the Public Service Commission." In KRS 278.220, it is outlined that the Public Service Commission may establish a system of accounts to be kept by the utilities subject to its jurisdiction, and may prescribe the manner in which such accounts shall be kept. The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements.

All activities of the District are accounted for within a single proprietary (enterprise) fund. Proprietary funds 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 (expenses, 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.

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

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. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net position. Net position (i.e., total assets net of total liabilities) is segregated into net investment in capital assets, restricted; and unrestricted components.

**Revenues and expenses:** Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the District. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities.

The District adheres to the use restrictions established by Bond Agreements when expenses are incurred for which both restricted and unrestricted net position is available. The District has no policy defining which resources (restricted or unrestricted) to use first.

GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2012 and 2011

**NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Property and equipment:** Property and equipment purchased or constructed is stated at cost. Interest related to costs, and major improvements, renewals and replacements is capitalized as a cost of the project. Costs associated with hook-up fees are capitalized as meters, installations, and services. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. The range of estimated useful lives by type of asset is as follows:

- Structures & Improvements	40 years
- Distribution System	30-50 years
- Wells	35 years
- Machinery & Equipment	5-20 years

**Inventory:** Inventories are stated at latest cost.

**Compensated Absences:** See Note 9 for the District's policy on vacation and personal days.

**Income Taxes:** The Gallatin County Water District is not subject to income taxes.

**Contributed capital:** Under the Governmental Accounting Standards Board's (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the District recognizes capital contributions as revenues in the statement of revenues, expenses and changes in fund net position. No grant monies were received in the years ended December 31, 2012 and 2011. Tap-on fees of \$7,996 and \$12,190 were received by the District for the years ended December 31, 2012 and 2011.

**Net position:** The District adopted Statement of Governmental Standards (GASB Statement) No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which requires the District to report net position and changes the title of the Statement of Net Assets to the Statement of Net Position (effective for periods beginning after December 15, 2011). Net position comprises the various net earnings from operating and non-operating revenues, expenses, and contributions of capital. Net position is classified in the following three components: net investment in capital assets, restricted, and unrestricted net position. Net investment in capital assets consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted net position consists of net position 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 position consists of all other net position not included in the above categories.

**Estimates:** The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Statement of Cash Flows:** For the purpose of the Statement of Cash Flows, Gallatin County Water District considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

**NOTE 2 – DEBT RESTRICTIONS AND COVENANTS**

The Bond and Interest Sinking Account was established with the original RECD bond issue, and is to be continued to be maintained as long as any of the 1988, 1993, 1996, 2000, 2002 or 2006 issues are outstanding. Under the bond resolution which established this account, it was provided that a minimum balance be maintained in this account as security to the bondholders. In order to attain the minimum balance, a monthly transfer must be made as follows:

$$\begin{array}{l} \text{one sixth (1/6) of the next semiannual interest payment} \\ + \text{ one twelfth (1/12) of next annual principal payment} \\ = \text{monthly transfer} \end{array}$$

GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2012 and 2011

**NOTE 2 – DEBT RESTRICTIONS AND COVENANTS (Continued)**

Transfers sufficient to meet the total obligation outstanding on all issues were made timely during the years ended December 31, 2012 and 2011.

A funded depreciation reserve account was required in accordance with the original RECD Bond issue and was continued with the District's subsequent issues. The cumulative requirement of these issues was a monthly transfer of \$547 into this account until the balance accumulated to \$71,600. The 2000 Bond Resolution required \$240 to be deposited monthly to the depreciation reserve account as long as any bonds payable remain outstanding, until an additional \$28,800 is accumulated. The 2002 Bond Resolution requires an additional transfer of \$65 per month until \$7,800 (additional) is accumulated. The 2006 Bond Resolution requires an additional transfer of \$865 per month until an additional \$103,800 is accumulated in the reserve. This additional transfer began in January, 2008. The deposits must be resumed any time the account(s) fall below the balance indicated.

A funded Maintenance and Replacement Reserve is required by the District's Assistance Agreement (B99-02) with the Kentucky Infrastructure Authority. Under the agreement, the District must deposit into this account an amount equal to 10% of the amount of the loan payment until the amount accumulated on deposit is equal to 5% of the original principal amount of the loan. Assuming all payments are made as required, the account will be fully funded in June, 2013.

Transfers were made as required in 2012 and 2011.

A funded short lived asset account is required under the letter of conditions establishing funding for the 2006 system improvement project. Under this agreement, the District must deposit \$5,535 monthly into the account. This account may be used as needed to replace or add short lived assets in the District's water system. Transfers began in January, 2008. During 2011, \$31,664 was used to finance the acquisition of a new service vehicle and line improvements on Highway 127. During 2012, \$131,546 was used to finance the construction of line improvements and pump maintenance in providing service to Kentucky Speedway.

**NOTE 3 – CASH AND INVESTMENTS**

KRS 66.480 authorizes the District to invest in obligations of the United States and its agencies and instrumentalities including repurchase agreements, through sources including national and state banks chartered in Kentucky, obligations and contracts for future delivery backed by the full faith of the United States or its Agency, certificates of deposit and interest bearing accounts in institutions insured by the Federal Depository Insurance Corporation and other investments described therein provided that approved securities are pledged to secure those funds on deposit in an amount equal to the amount of those funds. The District may also invest in mutual funds meeting the requirements of the statute.

Gallatin County Water District's policies regarding deposits of cash are discussed above. The table presented below is designed to disclose the level of custody credit risk assumed by the District based upon how its deposits were insured or secured with collateral at December 31, 2012 and 2011. The categories of credit risk are defined as follows:

Category 1 – Insured by FDIC Insurance or collateralized with a depository surety bond or securities held by the District (public trust) or by its agent in its name.

Category 2 – Uninsured but collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.

Category 3 – Uninsured and uncollateralized; or collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the District's name; or collateralized with no written or approved collateral agreement.

GALLATIN COUNTY WATER DISTRICT  
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
 December 31, 2012 and 2011

**NOTE 3 – CASH AND INVESTMENTS (Continued)**

**December 31, 2012**

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Demand Deposits	\$ 116,984	\$ 116,984	\$ -	\$ -	\$ 115,434
Time and Savings Deposits	1,064,871	990,104	74,767	-	1,064,870
<b>Total Deposits</b>	<b>\$ 1,181,855</b>	<b>\$ 1,107,088</b>	<b>\$ 74,767</b>	<b>\$ -</b>	<b>\$ 1,180,304</b>

**December 31, 2011**

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Demand Deposits	\$ 101,972	\$ 101,972	\$ -	\$ -	\$ 93,318
Time and Savings Deposits	1,098,333	917,860	180,473	-	1,098,333
<b>Total Deposits</b>	<b>\$ 1,200,305</b>	<b>\$ 1,019,832</b>	<b>\$ 180,473</b>	<b>\$ -</b>	<b>\$ 1,191,651</b>

**Reconciliation to Statement of Net Position:**

	December 31, 2012	December 31, 2011
Unrestricted Cash	\$ 659,717	\$ 630,802
Restricted Cash, Including Time Deposits	520,657	560,919
Less Cash on Hand	(70)	(70)
	<b>\$ 1,180,304</b>	<b>\$ 1,191,651</b>

**NOTE 4 – RESTRICTED ASSETS**

Restricted cash and investments consist of the following:

	December 31, 2012	December 31, 2011
Bond and Interest Sinking Account	\$ 135,104	\$ 132,860
Depreciation Account	191,525	175,519
Customer Deposits	25,620	23,285
Speedway Maintenance and Replacement Reserve	41,749	38,224
Short Lived Assets Account	126,659	191,031
<b>Total</b>	<b>\$ 520,657</b>	<b>\$ 560,919</b>

Restricted receivables consist of the following:

	December 31, 2012	December 31, 2011
Interest Receivable	\$ 256	\$ 553
<b>Total</b>	<b>\$ 256</b>	<b>\$ 553</b>

**NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE**

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$12,771 and \$15,863 at December 31, 2012 and 2011, respectively. The amount provided for bad debts represents the portion of the total amounts for which collection is unlikely, based on historical collection data.

**GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2012 and 2011**

**NOTE 6 – CAPITAL ASSETS**

Capital asset activity for the years ended December 31, 2012 and 2011, was as follows:

	Balance at January 1, 2012	Additions	Disposals	Balance at December 31, 2012
Land & Land Rights	\$ 226,229	\$ -	\$ -	\$ 226,229
Organizational Fees	31,926	-	-	31,926
Structures & Improvements	344,910	-	-	344,910
Distribution System	8,462,759	222,664	-	8,685,423
Wells	372,187	-	-	372,187
Machinery & Equipment	286,320	5,127	(28,342)	263,105
Construction in Process	16,967	197,700	(214,667)	-
Totals at Historical Cost	<u>\$ 9,741,298</u>	<u>\$ 425,491</u>	<u>\$ (243,009)</u>	<u>\$ 9,923,780</u>
Less: Accumulated Depreciation				
Organizational Fees	\$ 31,926	\$ -	\$ -	\$ 31,926
Structures & Improvements	78,431	8,973	-	87,404
Distribution System	2,857,141	291,477	-	3,148,618
Wells	107,273	13,908	-	121,181
Machinery & Equipment	207,879	21,203	(28,342)	200,740
Total Accumulated Depreciation	<u>\$ 3,282,650</u>	<u>\$ 335,561</u>	<u>\$ (28,342)</u>	<u>\$ 3,589,869</u>
Capital Assets, Net	<u>\$ 6,458,648</u>	<u>\$ 89,930</u>	<u>\$ (214,667)</u>	<u>\$ 6,333,911</u>
	Balance at January 1, 2011	Additions	Disposals	Balance at December 31, 2011
Land & Land Rights	\$ 226,229	\$ -	\$ -	\$ 226,229
Organizational Fees	31,926	-	-	31,926
Structures & Improvements	344,910	-	-	344,910
Distribution System	8,429,375	33,384	-	8,462,759
Wells	366,887	5,300	-	372,187
Machinery & Equipment	262,931	23,389	-	286,320
Construction in Process	-	16,967	-	16,967
Totals at Historical Cost	<u>\$ 9,662,258</u>	<u>\$ 79,040</u>	<u>\$ -</u>	<u>\$ 9,741,298</u>
Less: Accumulated Depreciation				
Organizational Fees	\$ 31,926	\$ -	\$ -	\$ 31,926
Structures & Improvements	69,459	8,972	-	78,431
Distribution System	2,568,387	288,754	-	2,857,141
Wells	93,630	13,643	-	107,273
Machinery & Equipment	185,557	22,322	-	207,879
Total Accumulated Depreciation	<u>\$ 2,948,959</u>	<u>\$ 333,691</u>	<u>\$ -</u>	<u>\$ 3,282,650</u>
Capital Assets, Net	<u>\$ 6,713,299</u>	<u>\$ (254,651)</u>	<u>\$ -</u>	<u>\$ 6,458,648</u>

Land and land rights are capital assets not being depreciated. Included under the District's Plant Assets were \$300,732 and \$327,936 of fully depreciated assets, at December 31, 2012 and 2011, respectively.

Depreciation expense aggregated \$335,561 and \$333,691 in 2012 and 2011, respectively.

GALLATIN COUNTY WATER DISTRICT  
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
 December 31, 2012 and 2011

**NOTE 7 – CUSTOMER DEPOSITS/ESCROW**

Customer deposits are collected upon installation of water service. This amount is to be refunded to the customer upon discontinuation of service (after the customer's bill has been paid in full) or one year pending a satisfactory payment record. Deposits received from customers are held in an interest bearing account (which is included in the financial statements as restricted cash). Records are maintained which detail the accrued interest on each customer's deposit based on the current annual rate. Accrued interest is paid annually and when the deposit is refunded.

Customer construction deposits represent amounts collected for hookups on future line extensions.

**NOTE 8 – LONG-TERM DEBT**

As of December 31, 2012 and 2011, the long-term debt payable consisted of the following:

**Notes Payable:**

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
Kentucky Infrastructure Authority note payable represents a thirty year loan secured by water revenues. Interest is charged at 1.3% per annum. The original principal balance was \$744,796. Payments of principal, interest, and servicing fees are due semiannually.	\$ 492,895	\$ 516,320
Total Notes Payable	\$ 492,895	\$ 516,320
Current Portion	\$ 23,730	\$ 23,425
Noncurrent Portion	469,165	492,895
Total Notes Payable	\$ 492,895	\$ 516,320

**Bonds Payable:**

RECD Revenue Bonds of 1988 Series A, original issue amount of \$290,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2028.	\$ 187,000	\$ 194,000
RECD Revenue Bonds of 1988 Series B, original issue amount of \$108,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2028.	71,000	74,000
RECD Revenue Bonds of 1993, original issue amount of \$420,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2032.	309,000	318,000
RECD Revenue Bonds of 1996, original issue amount of \$371,000, secured by water revenues. Interest is charged at the rate of 4.875% per annum. Final maturity is January 1, 2035.	299,400	306,100

**GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2012 and 2011**

**NOTE 8 – LONG-TERM DEBT (Continued)**

**Bonds Payable: (Continued)**

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
RECD Revenue Bonds of 2000 Series A, original issue amount of \$370,000, secured by water revenues. Interest is charged at the rate of 4.875% per annum. Final maturity is January 1, 2039.	320,100	325,800
RECD Revenue Bonds of 2000 Series B, original issue amount of \$112,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2039.	97,500	99,200
RECD Revenue Bonds of 2002, original issue amount of \$130,000, secured by water revenues. Interest is charged at the rate of 4.625% per annum. Final maturity is January 1, 2042.	117,900	119,700
RECD Revenue Bonds of 2006, Series A, original issue amount of \$1,394,000, secured by water revenues. Interest is charged at the rate of 4.125% per annum. Final maturity is January 1, 2046.	1,330,000	1,347,000
RECD Revenue Bonds of 2006, Series B original issue amount of \$500,000, secured by water revenues. Interest is charged at the rate of 4.125% per annum. Final maturity is January 1, 2046.	477,800	483,700
<b>Total Bonds Payable</b>	<b>\$ 3,209,700</b>	<b>\$ 3,267,500</b>
Current Portion	\$ 60,800	\$ 57,800
Noncurrent Portion	3,148,900	3,209,700
<b>Total Bonds Payable</b>	<b>\$ 3,209,700</b>	<b>\$ 3,267,500</b>

**Accrued Compensated Absences:**

<b>Current Accrued Compensated Absences</b>	\$ 291	\$ -
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**Changes in Long-term Debt**

The following is a summary of changes in long-term debt for the years ended December 31, 2012 and 2011.

**December 31, 2012**

	<u>Balance at January 1, 2012</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2012</u>	<u>Current Portion</u>
Notes Payable	\$ 516,320	\$ -	\$ (23,425)	\$ 492,895	\$ 23,730
Bonds Payable	3,267,500	-	(57,800)	3,209,700	60,800
Accrued Compensated Absences	-	291	-	291	291
<b>Total Enterprise Fund Debt</b>	<b>\$ 3,783,820</b>	<b>\$ 291</b>	<b>\$ (81,225)</b>	<b>\$ 3,702,886</b>	<b>\$ 84,821</b>

**GALLATIN COUNTY WATER DISTRICT  
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
 December 31, 2012 and 2011**

**NOTE 8 – LONG-TERM DEBT (Continued)**

**December 31, 2011**

	Balance at January 1, 2011	Additions	Repayments	Balance at December 31, 2011	Current Portion
Notes Payable	\$ 539,443	\$ -	\$ (23,123)	\$ 516,320	\$ 23,425
Bonds Payable	3,323,200	-	(55,700)	3,267,500	57,800
Accrued Compensated Absences	9,936	-	(9,936)	-	-
Total Enterprise Fund Debt	<u>\$ 3,872,579</u>	<u>\$ -</u>	<u>\$ (88,759)</u>	<u>\$ 3,783,820</u>	<u>\$ 81,225</u>

The annual requirements for all long-term debt outstanding at December 31, 2012, are as follows:

Due	Bonds	Bond Interest	KIA Note	Note Interest	Note Servicing Fee	Total Payments Due
2013	\$ 60,800	\$ 140,645	\$ 23,730	\$ 6,331	\$ 974	\$ 232,480
2014	63,900	137,698	24,040	6,021	926	232,585
2015	66,100	134,644	24,353	5,708	878	231,683
2016	69,400	131,438	24,671	5,390	829	231,728
2017	73,500	128,039	24,993	5,068	780	232,380
2018-2022	423,500	583,247	129,940	20,366	3,133	1,160,186
2023-2027	533,800	470,554	138,637	11,669	1,795	1,156,455
2028-2032	570,600	340,233	102,531	2,684	414	1,016,462
2033-2037	508,400	219,709	-	-	-	728,109
2038-2042	469,200	113,912	-	-	-	583,112
2043-2046	370,500	23,715	-	-	-	394,215
	<u>\$ 3,209,700</u>	<u>\$ 2,423,834</u>	<u>\$ 492,895</u>	<u>\$ 63,237</u>	<u>\$ 9,729</u>	<u>\$ 6,199,395</u>

The annual requirements for all long-term debt outstanding at December 31, 2011, are as follows:

Due	Bonds	Bond Interest	KIA Note	Note Interest	Note Servicing Fee	Total Payments Due
2012	\$ 57,800	\$ 143,450	\$ 23,425	\$ 6,636	\$ 1,021	\$ 232,332
2013	60,800	140,645	23,730	6,331	974	232,480
2014	63,900	137,698	24,040	6,021	926	232,585
2015	66,100	134,644	24,353	5,708	878	231,683
2016	69,400	131,438	24,671	5,390	829	231,728
2017-2021	403,900	602,840	128,267	22,039	3,391	1,160,437
2022-2026	509,400	495,280	136,852	13,454	2,070	1,157,056
2027-2031	569,600	366,314	130,982	4,294	661	1,071,851
2032-2036	529,000	242,139	-	-	-	771,139
2037-2041	476,600	133,838	-	-	-	610,438
2042-2046	461,000	38,998	-	-	-	499,998
	<u>\$ 3,267,500</u>	<u>\$ 2,567,284</u>	<u>\$ 516,320</u>	<u>\$ 69,873</u>	<u>\$ 10,750</u>	<u>\$ 6,431,727</u>

GALLATIN COUNTY WATER DISTRICT  
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
 December 31, 2012 and 2011

**NOTE 9 – COMPENSATED ABSENCES**

Vacation days accumulate as follows:

At the end of 1 <sup>st</sup> year	1 week of vacation
At the end of 2 <sup>nd</sup> year	2 weeks of vacation
At the end of 5 <sup>th</sup> year	3 weeks of vacation

Vacation, if not taken in the calendar year due, is lost, unless specifically approved by the Commissioners. In 2001, the District approved a policy under which employees accrue 5 days of personal leave per year. In 2009, the District approved a policy under which an employee may accumulate up to 60 days (previously it was 30 days) personal leave. The District accrues a liability for compensated absences, which meet the following criteria:

1. The District's obligation relating to employees' rights to receive compensation for future absences is attributable to employees' services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria, the District accrues a liability for compensated absences. \$291 of accrued compensated absences were payable at December 31, 2012. No compensated absences were accrued at December 31, 2011.

**NOTE 10 – INTEREST EXPENSE**

Interest expense incurred and charged to expense for the years ended December 31, 2012 and 2011 was \$151,185 and \$154,248, respectively. No interest was capitalized in 2012 or 2011.

**NOTE 11 – FUND EQUITY – RESTRICTED NET POSITION**

	2012	2011
Restricted for Debt Service:		
RECD Revenue Bonds of 1988, 1993, 1996, 2000, 2002 and 2006		
Kentucky Infrastructure Authority Note		
Cash	\$ 368,378	\$ 346,603
Add: Accrued Interest Receivable	256	553
Less: Accrued Interest Payable	(72,341)	(73,705)
Total Restricted for Debt Service	\$ 296,293	\$ 273,451

**NOTE 12 – BAD DEBT EXPENSE**

Water revenue charges have been netted with estimated bad debt expense of \$9,405 and \$10,821 at December 31, 2012 and 2011, respectively.

**NOTE 13 – INSURANCE AND RELATED ACTIVITIES**

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risks is covered through the contributions, premiums and assessments to the Kentucky Association of All Lines Fund (KALF). The District is also subject to the risks associated with employee injury. These risks are covered through premiums paid to the Kentucky Association of Counties, Workers' Compensation Self-insurance Fund. Such coverage is retrospectively rated and premiums may be adjusted based on experience.

GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2012 and 2011

**NOTE 14 – THE COUNTY EMPLOYEES’ RETIREMENT SYSTEM**

Entry into the Commonwealth of Kentucky’s County Employees’ Retirement System (CERS) was authorized by the Commissioners in November 1999. Beginning December 1, 1999, electing employees and all new employees of the District may participate in the System. The most recent financial report on CERS is included in the Kentucky Retirement System’s annual report, June 30, 2012 and 2011. Copies of this report will be distributed to each participating employer in the Kentucky Employees Retirement System, County Employees Retirement System, and State Police Retirement System. Copies will also be available to Legislative personnel and state libraries.

**Plan Description** – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. 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. Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce cost-of-living adjustments if, in its judgment, the welfare of the Commonwealth so demands. On July 1, 2012, the COLA was not granted.

**Contributions** – For the fiscal years ended June 30, 2012, and 2011, plan members who began participating prior to September 1, 2008, were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new 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 fiscal years ended June 30, 2012 and 2011, participating employers contributed 18.96% and 16.93%, respectively, of each employee’s creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2012 and 2011, were 18.96% and 16.93%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member’s account while the 1% was deposited to an account created for the payment of health insurance benefits under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members’ accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 5% of their annual creditable compensation.

The District’s total payroll for the year ended December 31, 2012, was \$235,410. Contributions were based on \$227,760 (eligible gross wages). The total pension expense for the fiscal year ended December 31, 2012, was \$43,846 and \$11,974 for the employer and employees, respectively. All contributions were made as required during the year ending December 31, 2012.

The District’s total payroll for the year ended December 31, 2011, was \$235,633. Contributions were based on \$224,750 (eligible gross wages). The total pension expense for the fiscal year ended December 31, 2011, was \$40,438 and \$11,422 for the employer and employees, respectively. All contributions were made as required during the year ending December 31, 2011.

The District’s contribution for the years ended June 30, 2012 and 2011, was .0117% and .0120%, respectively, of the System’s total contribution requirements for all employers.

**GALLATIN COUNTY WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2012 and 2011**

**NOTE 14 – THE COUNTY EMPLOYEES’ RETIREMENT SYSTEM (Continued)**

For non-hazardous duty, the required contributions to the plan were as follows:

	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Retiree Drug Subsidy Contributions</u>	<u>Percentage Contributions</u>
June 30, 2012	476,185,027	447,661,027	-	94.0%
June 30, 2011	432,414,052	435,404,150	-	100.7%
June 30, 2010	453,055,709	373,682,939	9,156,991	84.5%

The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from CERS. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance for current beneficiaries.

**NOTE 15 – RESALE AGREEMENT**

The District has entered into a water resale agreement with the Kentucky American Water District under which agreement, Gallatin County Water District will sell its water to Kentucky American Water at a price of \$1.46 per thousand gallons. A minimum of 559,567 gallons is required to be purchased monthly. The agreement is for a term of 20 years with automatic one year extensions unless terminated by either party upon written notice as specified. Rates may be modified by providing 180 days notice, or by regulatory authority action.

**NOTE 16 - PURCHASED WATER CONTRACT**

Gallatin County Water District has a long-term contract with the City of Warsaw for the purchase of treated water. The original contract for water became effective July 28, 1986, and extended for a period of forty-five (45) years. On June 13, 2007 the contract was amended. Under the agreement, Gallatin County Water District will be charged \$1.25 per 1,000 gallons purchased, with a minimum of 500,000 gallons to be purchased monthly. Additionally, the District agreed to transfer ownership of its 8” Smith Avenue line to the City.

**NOTE 17 – WATER SUPPLY AGREEMENT – ECONOMIC DEPENDENCY**

The District has entered into a water-supply agreement with Kentucky Speedway, LLC. Under the terms of the agreement, Kentucky Speedway, LLC is assessed an annual minimum charge of \$35,000 for annual usage equal to that charge under the District’s approved rates. The Speedway is billed monthly the minimum installment plus sales tax and school tax. When accumulated usage exceeds the annual maximum, the Speedway is charged the current rates in effect for that usage. 10.0% and 10.0% of total water revenue was received from Kentucky Speedway, LLC for the years ended December 31, 2012 and 2011, respectively.

**NOTE 18 – COMMITMENTS AND CONTINGENCIES**

The District has motions before the Public Service Commission and Franklin and Gallatin Courts regarding its service area and the provision of services within that area.

During 2012 the Kentucky Department of Transportation was involved in a project for infrastructure improvements near the Kentucky Speedway. As part of that project, transmission lines belonging to the Gallatin County Water District were to be relocated. The District decided to upgrade the size of the lines during the relocation process to better meet future service demands. At December 31, 2012, the District owed the Kentucky Department of Transportation \$43,590 for cost attributable to the increase line size of these transmission lines.

The District has entered into contracts for relocation and/or improvements to its distribution system at Kentucky Speedway. The District is adding an extension to Highway 1039. The costs of these improvements will be paid with District funds. The line extension is estimated to cost \$110,717.

To the Commissioners of the  
Gallatin County Water District  
Sparta, KY 41086

**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**

**INDEPENDENT AUDITOR'S REPORT**

We have audited, 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, the financial statements of Gallatin County Water District as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Gallatin County Water District's basis financial statements, and have issued our report thereon dated March 8, 2013.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit of the financial statements, we considered Gallatin County Water District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Gallatin County Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of Gallatin County Water District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses.

*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. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses (Items 12-1 and 12-2).

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether Gallatin County Water District's financial statements are free from 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*.

GALLATIN COUNTY WATER DISTRICT'S RESPONSE TO FINDINGS

Gallatin County Water District's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. Gallatin County Water District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP, & WOODS P.S.C  
Certified Public Accountants  
Carrollton, Kentucky

March 8, 2013

**GALLATIN COUNTY WATER DISTRICT  
SCHEDULE OF FINDINGS AND RESPONSES  
For the Year Ended December 31, 2012**

**A. SUMMARY OF AUDIT RESULTS**

1. The auditors' report expresses an unqualified opinion on the financial statements of the Gallatin County Water District.
2. Two deficiencies in internal control related to the audit of the financial statements are reported in the 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. Items 12-1 and 12-2 were reported as material weaknesses.
3. No instances of noncompliance material to the financial statements of Gallatin County Water District, which would be required to be reported in accordance with Government Auditing Standards, were disclosed during the audit.

**B. FINDINGS – FINANCIAL STATEMENTS AUDIT**

**GOVERNMENT AUDITING STANDARDS**

**DEFICIENCIES IN INTERNAL CONTROL**

**12-1 SIZE OF ENTITY, CROSS-TRAINING AND CHECKING PROCEDURES**

**CONDITION:**

Due to the size of the entity, cross-training and checking procedures are not in place for certain administrative positions. This limits internal control. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2011 as 11-1.

**CRITERIA:**

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, and allow timely preparation of financial data consistent with management assertions.

**CAUSE:**

Responsibilities associated with individual positions limit the availability of individuals to rotate duties and implement checking procedures.

**EFFECT:**

This limitation may affect the ability to timely record, process, summarize and report financial data.

**RECOMMENDATION:**

Management should strive to provide cross-training for administrative staff and implement checking processes.

**RESPONSE:**

We concur with the recommendation. Management believes adequate resources have been expended and control procedures implemented, that are commensurate with the staff size and responsibility of financial personnel. Efforts have been made to cross-train employees to improve the staff's ability to rotate duties and increase checking procedures.

GALLATIN COUNTY WATER DISTRICT  
SCHEDULE OF FINDINGS AND RESPONSES (Continued)  
For the Year Ended December 31, 2012

**B. FINDINGS – FINANCIAL STATEMENTS AUDIT (Continued)**

**GOVERNMENT AUDITING STANDARDS (Continued)**

**DEFICIENCIES IN INTERNAL CONTROL (Continued)**

**12-2 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED NOTE DISCLOSURES**

**CONDITION:**

*District financial statements, including the required disclosures, are prepared as part of the annual audit. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2011 as 11-2.*

**CRITERIA:**

*Internal controls should be in place to provide management with reasonable, but not absolute, assurance that financial statements and required notes are prepared in accordance with generally accepted accounting principles.*

**CAUSE:**

*The draft financial statements and disclosures are prepared during the audit process.*

**EFFECT:**

*Management engaged the auditor to prepare the draft of the financial statements, including the related notes to the financial statements.*

**RECOMMENDATION:**

*District management should continue to enhance its knowledge of reporting requirements in providing oversight of this service.*

**RESPONSE:**

*The outsourcing of this service is a result of management's cost benefit decision to avoid incurring internal resource costs. We concur with the recommendation and will continue to improve our overall accounting knowledge in performing our oversight responsibilities. We are aware of our responsibilities for the financial statements. We have reviewed and accepted the financial statements as presented.*

**COMPLIANCE AND OTHER MATTERS**

**NONE**

To the Commissioners of the  
Gallatin County Water District  
Sparta, KY 41086

**RURAL DEVELOPMENT COMPLIANCE LETTER**

We have audited the financial statements of Gallatin County Water District as of December 31, 2012, and have issued our report thereon dated March 8, 2013. 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.

In planning and performing our audit of the financial statements of Gallatin County Water District for the year ended December 31, 2012, we considered its 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 the Gallatin County Water District's internal control over financial reporting. After obtaining an understanding of the control environment and the flow of transactions through the accounting system, we did not rely on the system of internal accounting controls because of the size of the entity. Our review identified material weaknesses in the internal accounting control system as disclosed in the Schedule of Findings and Responses.

The following information is presented as supplemental information in accordance with USDA Rural Development's requirements.

1. The accounting records of Gallatin County Water District appear adequate.
2. Control over fixed assets is adequate. A supply inventory has been taken.
3. USDA Rural Development loan agreements for the 1988, 1993, 1996, 2000, 2002 and 2006 issues require transfers to be made monthly to the Bond and Interest Sinking Account and Depreciation Account. All accounts are properly funded as of December 31, 2012. Transfers required under the 2006 issues to the Depreciation Account and those required in the establishment of a short lived asset account began in January, 2008 Withdrawals were made from the short lived asset account for line improvements.
4. The general accounting records were kept on forms and in the manner suggested by Rural Development.
5. All bank accounts were confirmed directly by the depositories and reconciled to the cash balances as shown in these financial statements. The accounts are insured up to \$250,000 by the Federal Deposit Insurance Corporation. Additionally the Bond and Interest Sinking Fund of the District is secured by FDIC Insurance (\$135,104). Deposits in excess of FDIC coverage at First Farmers Bank are secured by five Federal Home Loan Bank letters of credit totaling \$605,000 and pledged securities with a market value of \$336,235.

6. Insurance coverage may be summarized as follows:

<u>General Liability</u>	\$ 3,000,000	\$1,000,000 Each Occurrence Limit
<u>Public Officials Liability Coverage</u>		
<u>Employment Practices Liability Coverage</u>	\$ 1,000,000	Annual Aggregate \$3,000,000
<u>Vehicles &amp; Equipment</u>	\$ 1,000,000	Liability/Each Accident
<u>Underinsured Motorists Coverage</u>	\$ 250,000	
<u>Property, Buildings, Tanks &amp; Equipment</u>	\$ 3,954,554	(Not more than 125% of applicable building limit or personal property limit as indicated in the Statement of Values)
<u>Commercial Excess Liability Policy</u>	\$ 3,000,000	
<u>Employee Dishonesty</u>	\$ 100,000	
<u>Fidelity Bond (Position)</u>		
Commissioner (2 Positions)	\$ 211,000	
Secretary/Bookkeeper	211,000	
Office Manager	211,000	
<u>Position Bond</u>		
Commissioner(s) & Office Manager	\$ 100,000	each
<u>Workmen's Compensation</u>		
All employees		Statutory

7. Gallatin County Water District is a governmental unit and thus exempt from income taxes.

8. Accounts receivable as of December 31, 2012, may be aged as follows.

<u>Total Accounts Receivable</u>	<u>1-30 Days</u>	<u>31-60 Days</u>	<u>Over 60</u>
\$ 115,913	\$ 98,647	\$ 3,862	\$ 13,404
<u>Total Accounts Receivable</u>	<u>Allowance for Uncollectibles</u>	<u>Net Accounts Receivable</u>	
\$ 115,913	\$ 12,771	\$ 103,142	

Respectfully submitted,

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP & WOODS, PSC  
Certified Public Accountants  
Carrollton, Kentucky

March 8, 2013

March 8, 2013

To the Commissioners of the  
Gallatin County Water District  
Sparta, Kentucky 40011

We have audited the financial statements of Gallatin County Water District for the years ended December 31, 2012 and 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated December 3, 2012. Professional standards also require that we communicate to you the following information related to our audit.

**Significant Audit Findings**

*Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Gallatin County Water District are described in Note 1 to the financial statements. The District adopted Statement of Governmental Standards (GASB Statement) No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflow of Resources, and Net Position; which requires the District to report net position and changes the title of the Statement of Net Assets to the Statement of Net Position (effective for periods beginning after December 15, 2011). We noted no transactions entered into by the District during these years for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the fixed asset depreciable lives is based on each asset's projected useful life expectancy. We evaluated the key factors and assumptions used to develop the fixed asset depreciable lives and evaluated depreciation expense in determining its reasonableness in relation to the financial statements taken as a whole.
- Management's estimate of the allowance for doubtful accounts is based on historical water revenues, historical loss levels, and an analysis of the aging and collectability of individual accounts. We evaluated the key factors and assumptions used to develop the allowance in determining that it is reasonable in relation to the financial statements taken as a whole.

*Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing and completing our audit.

*Corrected and Uncorrected Misstatements*

To the Commissioners of the  
Gallatin County Water District  
Sparta, Kentucky  
Page Two

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management.

The following material misstatements, either individually or in the aggregate, detected as a result of audit procedures were adjusted to the District's trial balance by management:

- Adjust prepaid expenditures for insurance, dues and service agreements.
- Record accounts payable and various accruals.
- Adjust accrued interest and interest expense associated with long term debt.
- Capitalize line improvements, construction and other assets acquired during the year and remove assets sold/abandoned.
- Adjust allowance for doubtful accounts and bad debt expense.
- Adjust depreciation expense.
- Adjust inventory to physical count at year-end.
- Adjust CD balance and interest receivable to year-end actual.
- Record unbilled receivables at year-end.
- Reclassify revenue and expense mispostings.

#### *Disagreements with Management*

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### *Management Representations*

We have requested certain representations from management that are included in the management representation letter dated March 8, 2013.

#### *Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

#### *Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

To the Commissioners of the  
Gallatin County Water District  
Sparta, Kentucky  
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This information is intended solely for the use of the Commissioners and management of Gallatin County Water District and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP & WOODS, PSC  
Certified Public Accountants  
Carrollton, Kentucky

Commissioners of Gallatin County Water District  
4500 Highway 455  
Sparta, Kentucky 41086

In planning and performing our audit of the financial statements of Gallatin County Water District as of and for the year ended December 31, 2012, we considered the District's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

We previously reported on the District's internal control in our report dated March 8, 2013. A separate report contains our report on deficiencies in the District's internal control. This letter does not affect our report dated March 8, 2013, on the financial statements of Gallatin County Water District.

We found the District's accounting system to be capable of providing essential information for effective operating and financial control of the District's operations. At the same time, we observed certain areas where procedural modifications or revisions might provide better internal control. This letter summarizes our comments and suggestions regarding those matters.

We were pleased to note that the District adopted an employee handbook during the year. However, we did suggest that the vacation policy be clarified as to when the accrual of time begins and the possible payments due to a new employee who separates from service. This has already been addressed at the District's February, 2013 meeting.

In our review of disbursements instances where sales tax was paid were noted. This has occurred in the past. Invoices should always be reviewed for sales tax charges as the District is not subject to this tax. Instances were noted where invoices had not been initialed as approved. It was noted that invoices in fact were being reviewed, but that sometimes, due to oversight, the approval had been made on the portion to be returned to the vendor. Efforts will be made to initial those bill portions to be retained.

Although we have indicated some items for review as observed during the audit process, we would like to take this opportunity to compliment the District on the conscientious attitude of its employees. We would like to compliment the District's office manager on the efforts made to address each suggestion and concern made by our office and the timeliness of addressing such concerns to the Commissioners. Such prompt attention and response is indicative of the desire to maintain controls as best as can be achieved with the available District resources. The staff, as always, was most cordial and cooperative with us throughout the audit process.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with District personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

To the Commissioners of the  
Gallatin County Water District  
Sparta, Kentucky  
Page Two

This report is intended solely for the information and use of management, the Rural Economic Community Development Service, Kentucky Infrastructure Authority, other lending agencies, and the Public Service Commission and is not intended to be and should not be used by anyone other than these specified parties.

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP & WOODS, PSC  
Certified Public Accountants  
Carrollton, Kentucky

March 8, 2013