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COMMISSION**

**WESTERN FLEMING COUNTY
WATER DISTRICT**

REPORT OF AUDIT

DECEMBER 31, 2011

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DONNA J. HENDRIX

CERTIFIED PUBLIC ACCOUNTANT

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INDEPENDENT AUDITOR'S REPORT

To The Board of Commissioners of the
Western Fleming County Water District
Ewing, Kentucky

We have audited the accompanying financial statements of the business-type activities of Western Fleming County Water District as of and for the year ended December 31, 2011 and 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business activities, of the Western Fleming County Water District as of December 31, 2011 and 2010, and respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 28, 2012, on our consideration of Western Fleming 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 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 important for assessing the results of our audit.

The District has not presented the management's discussion and analysis that Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinions on the financial statements that collectively comprise the Western Fleming County Water District's financial statements as a whole. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial

statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Donna J. Hendrix, CPA

DONNA J. HENDRIX, CPA
Morehead, Kentucky
March 28, 2012

WESTERN FLEMING COUNTY WATER DISTRICT
STATEMENT OF NET ASSETS
PROPRIETARY FUND
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

ASSETS	<u>2011</u>	<u>2010</u>
<u>CURRENT ASSETS</u>		
Cash (Note 2)	\$ 769,272	\$ 759,953
Accounts Receivable (net of allowance for doubtful accounts of \$10,083 and \$5,043 at December 31, 2011 and 2009.)	101,731	110,845
Prepaid Insurance	10,404	9,006
<u>Total Current Assets</u>	<u>881,406</u>	<u>879,805</u>
<u>RESTRICTED ASSETS</u>		
Cash (Note 3)	<u>280,632</u>	<u>423,831</u>
<u>Total Restricted Assets</u>	<u>280,632</u>	<u>423,831</u>
<u>PROPERTY AND EQUIPMENT</u>		
Land	165,710	105,690
Transmission and Distribution Plant	10,116,334	7,765,122
Building, Office Furniture and Equipment	86,709	86,709
Construction in Progress	-	2,010,838
<u>Total Property, Plant and Equipment</u>	<u>10,368,752</u>	<u>9,968,358</u>
Less: Accumulated depreciation	<u>(3,645,469)</u>	<u>(3,405,726)</u>
<u>Net Property, Plant and Equipment</u>	<u>6,723,283</u>	<u>6,562,632</u>
<u>OTHER ASSETS</u>		
Bond Issuance Costs	14,000	14,000
Less: Amortization	<u>(7,464)</u>	<u>(6,531)</u>
	<u>6,536</u>	<u>7,469</u>
TOTAL ASSETS	<u><u>\$ 7,891,857</u></u>	<u><u>\$ 7,873,738</u></u>

See accompanying notes to the financial statements.

WESTERN FLEMING COUNTY WATER DISTRICT
STATEMENT OF NET ASSETS
PROPRIETARY FUND
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

LIABILITIES AND NET ASSETS

	<u>2011</u>	<u>2010</u>
<u>CURRENT LIABILITIES</u>		
Accounts Payable	\$ 26,537	\$ 25,511
Accrued Retirement	3,302	-
Accrued Taxes	1,906	4,684
Accrued Interest Payable	-	-
Current Portion of Long-term Debt	<u>127,671</u>	<u>68,000</u>
<u>Total Current Liabilities</u>	<u>159,416</u>	<u>98,195</u>
<u>LONG-TERM DEBT</u>		
Bonds Payable (Note 5)	<u>3,620,166</u>	<u>3,584,458</u>
<u>Total Liabilities</u>	<u>3,779,581</u>	<u>3,682,654</u>
<u>NET ASSETS</u>		
Investment in Capital Assets, Net of Related Debt	2,975,447	2,910,174
Restricted Net Assets	280,632	423,831
Unrestricted Net Assets	<u>856,198</u>	<u>857,078</u>
<u>Total Net Assets</u>	<u>4,112,276</u>	<u>4,191,083</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 7,891,857</u></u>	<u><u>\$ 7,873,738</u></u>

See accompanying notes to the financial statements.

WESTERN FLEMING COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN
NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
OPERATING INCOME		
Water Operating Revenues	\$ 863,742	\$ 963,139
Total Operating income	863,742	963,139
OPERATING EXPENSES		
Chemicals	100,436	84,813
Contract Service - Accounting	6,350	5,000
Contract Service - Legal	2,375	2,100
Contract Service - Other	36,505	46,126
Insurance	16,833	13,932
Health Insurance	39,364	30,469
Materials and Supplies	42,751	37,035
Office Supplies	13,676	13,441
Telephone & Utilities	6,698	6,229
Miscellaneous	2,759	4,039
Payroll Taxes	11,888	11,524
Purchased Power	105,503	102,755
Purchased Water	72,706	65,007
Retirement	29,334	23,429
Bad Debt Expense	-	3,226
Amortization	933	933
Salaries - Commissioners	11,400	11,000
Salaries - Employees	163,355	158,355
TOTAL OPERATING EXPENSE	662,867	619,414
OPERATING INCOME (LOSS) BEFORE DEPRECIATION	200,875	343,726
Depreciation expense	(239,743)	(191,696)
OPERATING INCOME (LOSS)	(38,868)	152,030
NON-OPERATING INCOME (EXPENSES)		
Customer Tap Fees	5,025	13,475
Interest Income	7,808	10,984
Interest Expense	(52,772)	(80,311)
Total Non-Operating Income (Expense)	(39,939)	(55,852)
STATE CONTRIBUTIONS IN AID OF CONSTRUCTION	-	-
NET INCOME (LOSS) AFTER CONTRIBUTIONS	(78,807)	96,178
NET ASSETS - BEGINNING OF YEAR	4,191,083	4,094,905
NET ASSETS - END OF YEAR	\$ 4,112,276	\$ 4,191,083

See accompanying notes to the financial statements.

WESTERN FLEMING COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

CASH FLOW FROM OPERATING ACTIVITIES	<u>2011</u>	<u>2010</u>
Net Income/(Loss)	\$ (38,868)	\$ 152,030
Adjustments to reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	239,743	191,696
Decrease (Increase) in Current Assets		
Accounts Receivable	9,114	(44,788)
Other Receivables & Prepaid Insurance	(1,398)	-
Increase (Decrease) in Current Liabilities		
Accounts Payable	(7,408)	14,010
Accrued Expenses	9,891	5,054
CASH PROVIDED BY OPERATIONS	<u>211,074</u>	<u>318,002</u>
CASH FLOW FROM INVESTING ACTIVITIES		
Interest Income	7,808	10,984
CASH PROVIDED BY INVESTING	<u>7,808</u>	<u>10,984</u>
CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash (Used) or provided by:		
Investment in Utility Plant	(400,394)	(1,775,537)
(Debt Reduction)/Proceeds	95,379	1,891,458
Investment in Office Equipment		
Interest Expense on Debt	(52,772)	(80,311)
Decrease/(Increase) in Restricted Cash	143,199	(204,042)
Increase in Contributed Capital	-	-
Customer Contributions	5,025	13,475
Bond Issuance Costs	-	-
Investment in Land	-	-
CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(209,563)</u>	<u>(154,957)</u>
PRIOR PERIOD ADJUSTMENT TO RETAINED EARNINGS		
NET INCREASE (DECREASE) IN CASH	<u>9,319</u>	<u>174,028</u>
CASH AT BEGINNING OF PERIOD	759,953	585,925
CASH AT END OF PERIOD	<u>\$ 769,272</u>	<u>\$ 759,953</u>

Supplemental Disclosures:

Interest paid was \$ 52,772 and \$ 80,311 in 2011 and 2010 respectively.

See accompanying notes to the financial statements.

WESTERN FLEMING COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 1: ORGANIZATION AND ACCOUNTING POLICIES

The Western Fleming Water District was created and organized as a public body corporate in Fleming County, Kentucky, pursuant to Chapter 74 of the Kentucky Revised Statutes, by the Fleming County Fiscal Court to operate a water distribution system. The District is regulated by the Kentucky Public Service Commission.

The Reporting Entity

The District, for financial purposes, includes all of the funds relevant to the operation of the District. The financial statements presented herein do not include agencies which have been formed under applicable state laws or separate and distinct units of government apart from the Western Fleming Water District.

The financial statements of the District would include those of separately administered organizations that are controlled by or dependent on the District. Control or dependence is determined on the basis of financial interdependency, selection of government authority, designation of management, ability to significantly influence operations, accountability of fiscal matters, scope of public service and financing relations. The entities included in the financial statements are the general operations of the District.

Based on the foregoing criteria there are no other organizations included in these financial statements.

The District, presented as an enterprise fund, does not apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or after November 30, 1989.

Enterprise Funds

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprise where the intent of the governing body is that the costs (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.

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 management focus. With the measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets (i.e., total assets net of total liabilities) are segmented into invested in capital assets, net of related debt, restricted and unrestricted components. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, and then unrestricted resources as they are needed.

WESTERN FLEMING COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

Note 1: ORGANIZATION AND ACCOUNTING POLICIES

Basis of Accounting

The District maintains its accounting records on the accrual basis during the year. The District's financial statements include the operations of all entities for which the District exercises oversight responsibility. Oversight responsibility includes, but is not limited to financial interdependency, selection of the governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters.

Inventory

Inventory is maintained at lower of cost or market.

Utility Plant

Utility Plant is stated at original cost. The cost of repairs and maintenance is charged to the proper expense account as incurred. Property replacements are capitalized and retirements are charged to the proper plant account and depreciation provision.

Depreciation

Depreciation is applied on the straight-line method over the estimated useful life of the asset, using rates on a straight-line basis determined by reference to Utility Standards Rates (NARUC). The provisions for depreciation in 2010 reflect those standard rates by asset class.

Unbilled Revenue

The District records revenue as billed to its customers on monthly meter reading cycle. At the end of each year, water service that has been rendered from the latest date of each meter reading to the year-end is unbilled.

Power Costs

The cost of power purchases for pumping water is charged to expense as used.

Income Tax Status

The District is a political subdivision created under Kentucky Revised Statutes 74.012, and as such, is exempt from federal and state income taxes. Accordingly, the financial statement include no provision for income taxes.

Cash Flows

For purposes of the statement of cash flows, the District uses the direct method of reporting net cash flow from operating activities, and considers certificates of deposit with a maturity of six months or less to be cash equivalents.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

WESTERN FLEMING COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 For the Years Ended December 31, 2011 and 2010

Net Assets

Net assets represent the difference between assets and liabilities in the statement of net assets. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are legal limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors, laws or regulations of other governments. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

NOTE 2: CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District's cash and cash equivalents consist of checking and savings accounts with local banks. The District does have a deposit policy for custodial credit risk. As of December 31, 2011, \$0 of the bank balance was exposed to custodial credit risk. The current market value of pledged securities by Community Trust Bank at December 31, 2011 was \$1,448,000.

NOTE 3: LONG-TERM DEBT

The following is a summary of revenue bonds of the district at December 31, 2011. Substantially all assets and revenues are pledged as collateral for the following debt:

	<u>Rate</u>	<u>Original Issue</u>	<u>2011</u>	<u>2010</u>
1969 Serial	5-5 1/2%	\$ 445,000	\$ 0	\$ 0
1980 FHA	5 %	560,000	240,000	240,000
1988 FHA	5 %	341,000	228,000	228,000
1997 FHA	4 1/2%	675,000	566,000	566,000
2003 FHA	4 1/2%	500,000	458,500	485,500
2004 KY Rural Water	4.021%	314,000	183,000	202,000
KIA 2010			<u>2,072,336</u>	<u>1,957,958</u>
			<u>\$ 3,747,837</u>	<u>\$ 3,652,458</u>
Less Current Maturities			<u>(127,671)</u>	<u>(68,000)</u>
			<u>\$ 3,620,165</u>	<u>\$ 3,584,458</u>

WESTERN FLEMING COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 For the Years Ended December 31, 2011 and 2010

Bond principal is due on January 1. Interest is due on January 1 and July 1.

Long-term debt will mature as follows:

	<u>Principal</u>
2012	127,671
2013	132,279
2014	135,383
2015	140,000
2016	145,110
2017-2021	671,614
2022-2026	566,580
2027-2031	579,097
2032-2036	606,266
2037-2041	521,336
2042-2046	122,500
Total	<u>\$ 3,747,837</u>

Depreciation fund and bond reserve funds that are required by the 1969, 1988, 03 and 04 bond indentures are held as time deposits and certificates of deposit by Community Trust Bank-Ewing Branch at Ewing, Kentucky. The Depreciation Funds are sufficiently funded. The current depreciation funds currently total \$151,365, the required level is \$116,760. The amount they are over funded by is \$34,605. The depreciation fund required by the 1988 bond indenture requires that a deposit of \$170 be deposited monthly. As of December 31, 2011, the 1988 depreciation reserve fund had a balance of \$69,920. The 2004 bond indenture requires a bond reserve fund be set-up with the Regions bank. This account is set-up and had a balance of \$25,644 as of December 31, 2011.

NOTE 4: CUSTOMERS

The amount of non-residential customers as of December 31, 2011 was 15. The number of residential customers as of December 31, 2011 was 1,434. The total was 1,449.

NOTE 5: 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. In addition to its general liability insurance, the district also carries commercial insurance for all other risks of loss such as worker's compensation and employee health and accident coverage. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

WESTERN FLEMING COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE 6: CONTINGENCIES

The District had elected to be recognized as a reimbursing employer for state unemployment compensation purposes. Accordingly, the District will become liable for direct payment of unemployment benefits as they become due.

DONNA J. HENDRIX

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

Board of Commissioners of the
Western Fleming County Water District
Ewing, Kentucky

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Western Fleming County Water District, as of and for the year ended December 31, 2011, which collectively comprise the Western Fleming County Water District's basic financial statements and have issued our report thereon dated March 28, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Western Fleming 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 Western Fleming County Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Western Fleming County Water District's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow managements 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 combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entities 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, as defined above.

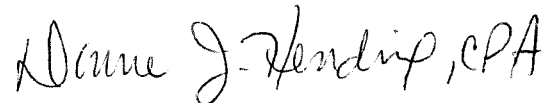
Compliance and Other Matters

As part of obtaining reasonable assurance about whether Western Fleming 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 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*.

We noted certain matters that we reported to management of Western Fleming County Water District, in a separate letter dated March 28, 2012.

This report is intended solely for the information and use of the Board of Commissioners and management of Western Fleming County Water District and the Governor's Office of Local Development and is not intended to be and should not be used by anyone other than these specified parties.



Donna J. Hendrix, CPA
Morehead, KY

March 28, 2012

DONNA J. HENDRIX

CERTIFIED PUBLIC ACCOUNTANT

MEMBER: K.S.C.P.A.
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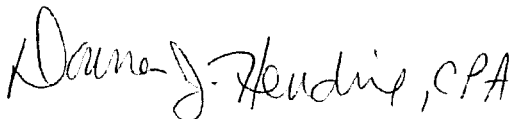
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Board of Commissioners
Western Fleming County Water District
Ewing, Kentucky

In planning and performing my audit of the basic financial statements of Western Fleming County Water District for the year ended December 31, 2011, I considered the District's internal control structure to determine my auditing procedures for the purpose of expressing an opinion on the general purpose financial statements and not to provide assurance on the internal control structure.

However, during my audit, I became aware of one matter that is an opportunity for increasing operating efficiency. The memorandum that accompanies this letter summarizes my comments and suggestions regarding those matters. This letter does not affect my report dated March 28, 2012, on the financial statements of the Western Fleming County Water District.

I will review the status of these comments and suggestions with various District personnel, and I 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.



DONNA J. HENDRIX, CPA

Morehead, Kentucky

March 28, 2012

WESTERN FLEMING COUNTY WATER DISTRICT
MANAGEMENT POINTS, RECOMMENDATIONS, AND RESPONSES
Year Ended December 31, 2011

Status of Prior Year Management Points

2010-1 Lack of Segregation of Duties

Due to the small size of the District, this is challenging. The District is still struggling in this area.

2010-2 Proper Check Voiding Procedures

All voided checks have the signature corner removed. This has been properly implemented.

Current Year Management Points

2011-1 Lack of Segregation of Duties (Repeat of 2010-1 from prior year)

Condition: Due to the small size of the District there is a lack of segregation of duties. The office manager performs and manages all of the accounting transactions. While the work performed by the office manager is sufficient, there remains the overall problem of lack of segregation of duties.

Recommendation: The Board of Commissioners should provide more oversight.

Response: The Board will take steps to insure that separation of duties, where possible, is maximized.

2011-2 Approval of monthly bank statement

Condition: Currently, a board member is receiving the monthly bank statements at his home, but there is no signature present on the monthly bank statement verifying the monthly review of the bank statement.

Recommendation: A board member should be reviewing and signing the monthly bank statement prior to the Office Manager receiving the monthly bank statement.

Response: The board will implement this procedure immediately.