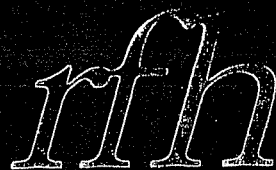


HARRISON COUNTY WATER  
ASSOCIATION, INC.  
Cynthiana, Kentucky

---

FINANCIAL STATEMENTS  
December 31, 2011 and 2010



Ray, Foley, Hensley & Company, PLLC

Certified Public Accountants and Consultants

PUBLIC SERVICE COMMISSION  
ANNUAL REPORT BRANCH  
APR 2 2012  
RECEIVED  
EXAMINED BY \_\_\_\_\_

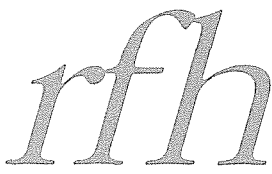
**HARRISON COUNTY WATER  
ASSOCIATION, INC.  
Cynthiana, Kentucky**

---

**FINANCIAL STATEMENTS  
December 31, 2011 and 2010**

## CONTENTS

Independent Auditors' Report.....	1
<i>Financial Statements</i>	
Balance Sheets.....	2
Statements of Revenues, Expenses and Changes in Retained Earnings.....	3
Statements of Cash Flows.....	4
Notes to Financial Statements.....	5-9
Report in Accordance With <b>Government Auditing Standards</b> .....	10



# Ray, Foley, Hensley & Company, PLLC

Certified Public Accountants and Consultants

Stephen R. Allen, CPA/PFS  
Dennis H. England, CPA  
Michael D. Foley, CPA  
Lyman Hager, Jr., CPA/PFS  
Jerry W. Hensley, CPA

## INDEPENDENT AUDITORS' REPORT

J. Carroll Luby, CPA

Board of Directors  
Harrison County Water Association, Inc.  
Cynthiana, Kentucky

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Harrison County Water Association, Inc. as of December 31, 2011 and 2010 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with **Government Auditing Standards**, we have also issued a report dated March 26, 2012 on our consideration of Harrison County Water Association, Inc.'s internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with **Government Auditing Standards** and should be read in conjunction with this report in considering the results of our audit.

*Ray, Foley, Hensley & Company*

Ray, Foley, Hensley & Company, PLLC  
March 26, 2012

230 Lexington Green Circle, Suite 600 • Lexington, Kentucky 40503-3326  
Phone: 859-231-1800 • Fax: 859-422-1800 • Toll-Free: 1-800-342-7299  
www.rfhco.com

Members American Institute of Certified Public Accountants and Kentucky Society of Certified Public Accountants

**HARRISON COUNTY WATER ASSOCIATION, INC.**  
**BALANCE SHEETS**  
**December 31,**

---

<b>ASSETS</b>	<b>2011</b>	<b>2010</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 308,503	\$ 562,005
Cash and cash equivalents - construction	79,871	434,711
Accounts receivable customers	155,593	187,442
Accrued interest receivable	11,948	12,793
Other receivable	130,568	18,119
Prepaid expenses	13,224	12,280
Inventory	<u>15,255</u>	<u>16,028</u>
Total current assets	<u>714,962</u>	<u>1,243,378</u>
<b>Restricted Assets</b>		
Cash and cash equivalents	23,599	2,500
Certificates of deposit	<u>1,968,359</u>	<u>1,965,969</u>
Total restricted assets	<u>1,991,958</u>	<u>1,968,469</u>
<b>Fixed Assets</b>		
Property, plant and equipment	17,878,763	17,617,486
Less accumulated depreciation	(9,502,985)	(9,084,565)
Construction-in-progress	<u>2,182,326</u>	<u>1,604,577</u>
Total capital assets	<u>10,558,104</u>	<u>10,137,498</u>
Total assets	<u>\$ 13,265,024</u>	<u>\$ 13,349,345</u>
<b>LIABILITIES AND EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 95,011	\$ 99,960
Taxes payable	8,882	9,446
Customer deposits payable	111,087	106,046
Construction payable	139,682	108,267
Accrued interest payable	28,711	37,098
Accrued sick pay	14,247	15,473
Current portion of bonds payable	<u>44,548</u>	<u>22,299</u>
Total current liabilities	<u>442,168</u>	<u>398,589</u>
<b>Long-term Debt</b>		
Bonds payable, net	<u>2,092,049</u>	<u>2,330,525</u>
<b>Equity</b>		
Contributed capital		
Customer contributions	2,401,635	2,361,235
Grants in aid of construction	8,731,864	8,513,105
Retained earnings-appropriated	238,205	218,859
Retained earnings-unappropriated (deficit)	<u>(640,897)</u>	<u>(472,968)</u>
Total equity	<u>10,730,807</u>	<u>10,620,231</u>
Total liabilities and equity	<u>\$ 13,265,024</u>	<u>\$ 13,349,345</u>

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

**HARRISON COUNTY WATER ASSOCIATION, INC.**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES**  
**IN RETAINED EARNINGS**  
**for the years ended December 31,**

	<b>2011</b>	<b>2010</b>
<b>OPERATING INCOME</b>		
Water sales	\$ 2,147,359	\$ 2,278,697
Late charges	38,988	39,486
Other service	8,643	8,630
Other revenue	<u>13,029</u>	<u>7,485</u>
Total operating income	<u>2,208,019</u>	<u>2,334,298</u>
<b>OPERATING EXPENSES</b>		
Purchased water	1,027,850	1,015,995
Salaries	353,290	348,871
Payroll taxes	29,300	27,910
Employee benefits	136,838	162,526
Utilities	72,193	66,596
Material & supplies	42,566	37,370
Office supplies	51,932	37,878
Transportation	50,791	42,140
Repairs	18,428	18,920
Insurance	25,502	25,780
Billing	29,256	29,034
Accounting	17,850	15,450
Legal	3,748	314
Other contractual services	7,894	8,466
Bad debt expense	13,276	12,291
Telephone	6,598	5,998
Miscellaneous	47	36
Regulatory assessment fee	<u>3,569</u>	<u>3,173</u>
Total operating expense	<u>1,890,928</u>	<u>1,858,748</u>
Operating income before depreciation	317,091	475,550
Depreciation expense	<u>(418,420)</u>	<u>(416,739)</u>
<b>OPERATING INCOME</b>	(101,329)	58,811
Non-operating income (expenses)		
Interest income	51,502	41,265
Interest expense	<u>(98,756)</u>	<u>(79,589)</u>
<b>NET INCOME (LOSS)</b>	(148,583)	20,487
Retained earnings - beginning	(472,968)	(616,582)
Transfer from (to) reserves	<u>(19,346)</u>	<u>123,127</u>
<b>RETAINED EARNINGS - ENDING</b>	<u>\$ (640,897)</u>	<u>\$ (472,968)</u>

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

**HARRISON COUNTY WATER ASSOCIATION, INC.**  
**STATEMENTS OF CASH FLOWS**  
for the years ended December 31,

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 2,127,419	\$ 2,307,539
Payments to suppliers	(1,339,220)	(1,197,811)
Payments for employee services and benefits	<u>(521,218)</u>	<u>(527,939)</u>
Net cash provided by operating activities	<u>266,981</u>	<u>581,789</u>
<b>CASH FINANCING ACTIVITIES</b>		
Retirement of note principal	(216,227)	(423,759)
Debt proceeds	-	885,000
Interest paid	(107,143)	(79,551)
Customer contributions	40,400	68,800
Proceeds from grants	<u>218,759</u>	<u>811,499</u>
Net cash provided by (used in) financing activities	<u>(64,211)</u>	<u>1,261,989</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from certificates of deposit	7,246	(112,034)
Loss on sale of asset	-	4,874
Construction in progress	(577,749)	(1,368,690)
Purchase of fixed assets	(261,276)	(223,697)
Interest income	<u>41,766</u>	<u>47,342</u>
Net cash (used in) investing activities	<u>(790,013)</u>	<u>(1,652,205)</u>
<b>NET INCREASE (DECREASE) IN CASH</b>	(587,243)	191,573
Cash and cash equivalents at beginning of year	<u>999,216</u>	<u>807,643</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 411,973</u>	<u>\$ 999,216</u>
<b>Reconciliation of operating income (loss) to net cash provided (used) by operating activities:</b>		
Operating income	\$ (101,329)	\$ 58,811
Noncash items included in operating income		
Depreciation	418,420	416,739
Changes in assets and liabilities		
(Increase) decrease in accounts receivables	31,849	(8,640)
(Increase) decrease in other receivables	(112,449)	(18,119)
(Increase) decrease in inventory	773	555
Increase (decrease) in accounts payable	26,466	118,006
Increase (decrease) in other payables	(1,790)	11,368
Increase (decrease) in customer deposits	<u>5,041</u>	<u>3,069</u>
Net cash provided by operating activities	<u>\$ 266,981</u>	<u>\$ 581,789</u>

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

**HARRISON COUNTY WATER ASSOCIATION, INC.  
NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2011 and 2010**

**1. ORGANIZATION AND ACCOUNTING POLICIES**

The Harrison County Water Association, Inc. distributes and sells water to approximately 5,500 members. The Association serves primarily Harrison County outside the City of Cynthiana and parts of the adjacent counties. Its suppliers of water are the City of Cynthiana, Kentucky American Water, the City of Paris, and the Nicholas County Water District.

The Harrison County Water Association, Inc. was created and organized as a non-profit association under Section 501(c)12 of the Internal Revenue Code. No income tax is applicable due to the Association's tax exempt status.

The District applies all applicable FASB and AICPA pronouncements issued on or before November 30, 1989 that are not in conflict with applicable GASB pronouncements.

The Association maintains its accounting records on the cash basis during the year. Adjustments are made to the accrual basis from memorandum records at year end.

The Association considers all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents. Cash and cash equivalents for purposes of the statement of cash flows include restricted and unrestricted accounts.

The Association charges all uncollected accounts directly against current earnings.

Inventory is maintained at lower of cost (first-in, first-out method) or market.

Fixed assets are recorded at cost. Depreciation has been provided using the straight-line method over the estimated useful life of the asset. Land is not subject to depreciation. Interest costs during construction of fixed assets are capitalized as a part of the cost.

The preparation of financial statements in conformity with generally accepted accounting principles 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 period. Actual results could differ from those estimates.

**2. CASH AND INVESTMENTS**

The Harrison County Water Association, Inc.'s deposits and investments at December 31, 2011 and 2010 were substantially covered by Federal Depository Insurance or by collateral held by the custodial banks in the Association's name. At December 31, 2011 and 2010, the bank balances of the Association's deposits were \$2,434,035 and \$3,004,716 respectively

For purposes of the statement of cash flows, the Association includes cash and cash equivalents with the following restrictions:

	2011	2010
Cash and cash equivalents	\$ 308,503	\$ 562,005
Cash and cash equivalents-construction	79,871	434,711
Cash and cash equivalents-restricted	<u>23,599</u>	<u>2,500</u>
	<u>\$ 411,973</u>	<u>\$ 999,216</u>



**HARRISON COUNTY WATER ASSOCIATION, INC.  
NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2011 and 2010**

**3. PROPERTY PLANT & EQUIPMENT**

	Balance 12/31/10	Additions	Deductions	Balance 12/31/11
Capital Assets not depreciated:				
Land	\$ 28,035	\$ -	\$ -	\$ 28,035
Construction in Progress	<u>1,604,577</u>	<u>577,749</u>	<u>-</u>	<u>2,182,326</u>
Totals	<u>1,632,612</u>	<u>577,749</u>	<u>-</u>	<u>2,210,361</u>
Capital assets that are depreciated:				
Property & Equipment	17,589,451	261,277		17,850,728
Less accumulated depreciation	<u>9,084,565</u>	<u>418,420</u>	<u>-</u>	<u>9,502,985</u>
Totals	<u>8,504,886</u>	<u>(157,143)</u>	<u>-</u>	<u>8,347,743</u>
Capital Assets, net	<u>\$ 10,137,498</u>	<u>\$ 420,606</u>	<u>\$ -</u>	<u>\$ 10,558,104</u>

**4. CONSTRUCTION IN PROGRESS**

A balance of \$80,857 relates to the Construction in Progress for the West Bypass construction. This project was placed on hold by the state. Construction resumed on August 1, 2011.

A balance of \$2,101,469 relates to the Construction in Progress for the Phase 10 project. In October 2009, the Association was awarded a Kentucky Infrastructure Authority grant of \$820,000, a Rural Development grant of \$295,000, and a loan from Rural Development of \$885,000 to complete the project. As of December 31, 2011, the Association had drawn down \$862,188 of the Kentucky Infrastructure Authority grant, spent \$885,000 of the Rural Development loan, and drawn down \$177,592 of the RD Grant.

**HARRISON COUNTY WATER ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**5. LONG-TERM DEBT**

The following is a summary of the notes outstanding for the association for the years ended December 31,

<b>Notes- U.S. Department of Agriculture</b>	<b>2011</b>	<b>2010</b>
Loan-\$656,000 Date 9/21/95 in annual installments of \$37,609 through 2041 Interest at 4.75%	\$ 594,467	\$ 603,414
Loan-\$650,000 Date 8/8/01 in annual installments of \$37,902 through 2041 Interest at 4.875%	391,342	593,004
Loan-\$300,000 Date 11/25/03 in annual installments of \$16,912 through 2043 Interest at 4.625%	266,806	271,406
Loan-\$885,000 Date 12/02/2010 in annual installments of \$39,348 starting in 2013 through 2050 Interest at 3%	<u>883,982</u>	<u>885,000</u>
	<u>2,136,597</u>	<u>2,352,824</u>
Less: current portion	<u>(44,548)</u>	<u>(22,299)</u>
Long-term portion of bonds payable	<u>\$ 2,092,049</u>	<u>\$2,330,525</u>

**HARRISON COUNTY WATER ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**5. LONG-TERM DEBT, continued**

The annual requirements to amortize all notes and leases outstanding as of December 31, 2011 are as follows:

Year Ending December 31,	Principle	Interest	Total
2012	\$ 44,549	\$ 87,223	\$ 131,772
2013	47,522	84,247	131,769
2014	49,570	82,201	131,771
2015	51,706	80,065	131,771
2016	53,938	77,833	131,771
2017-2021	306,824	352,031	658,855
2022-2026	368,631	279,170	647,801
2027-2031	258,624	210,721	469,345
2032-2036	315,009	154,336	469,345
2037-2041	364,096	85,089	449,185
2042-2046	164,924	31,816	196,740
2047-2049	<u>111,204</u>	<u>6,735</u>	<u>117,939</u>
	<u>\$ 2,136,597</u>	<u>\$ 1,531,467</u>	<u>\$ 3,668,064</u>

**6. PENSION PLAN**

The Association has contributed to the employees' IRA account annually for all full-time employees. The plan is funded by contributions from employees of up to \$2,500 per employee and the Association matches these contributions. In 2011 and 2010, employee contributions totaled \$22,500 and \$21,500 and employer contributions totaled \$22,500 and \$21,500.

**7. RISK MANAGEMENT**

The Association 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 Association 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.

**8. COMPLIANCE WITH LOAN AGREEMENT**

The loan agreement between Rural Economic Community Development (U.S. Department of Agriculture) concerning the various loans requires certain reserves be created and maintained as follows:

**Bond and interest reserve** – This reserve is required to accumulate a balance sufficient to retire the next installment on the loans and this required balance at December 31, 2011 is \$42,738. The balance of appropriated investments as of December 31, 2011 and 2010 is \$124,250 and \$97,500.

**Depreciation reserve** – This reserve is required to maintain a reserve for unusual repairs. The required balance at December 31, 2011 is \$84,380. The balance of appropriated investments as of December 31, 2011 and 2010 is \$195,000 and \$309,443.

**HARRISON COUNTY WATER ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

---

**9. DEFICIT RETAINED EARNINGS**

The Association has a deficit in retained earnings at December 31, 2011 of \$640,897 and 2010 of \$472,968. The deficit is primarily a result of user charges insufficient to provide for depreciation on contributed assets. Accumulated depreciation on contributed assets was approximately \$5,427,684 and \$5,208,440 at December 31, 2011 and 2010, respectively.

**10. RECLASSIFICATIONS**

Total amounts for 2010 are presented herein for comparative purposes only and in some instances have been reclassified from the amount presented in the prior year's audited financial statements.

**11. SUBSEQUENT EVENTS**

The Association has evaluated and considered the need to recognize or disclose subsequent events through March 26, 2012, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the year ended December 31, 2011, have not been evaluated by the Association.

**HARRISON COUNTY WATER ASSOCIATION, INC.  
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH  
LAWS AND REGULATIONS BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

---

To the Board of Directors  
Harrison County Water Association, Inc.  
Cynthiana, Kentucky

We have audited the financial statements of the Harrison County Water Association, Inc. as of and for the year ended December 31, 2011, and have issued our report thereon dated March 26, 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 the Association's internal control over financial reporting in order to determine 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 Harrison County Water Association, Inc.'s internal control over financial reporting. Accordingly, we do not express such an opinion on the effectiveness of Harrison County Water Association, Inc.'s internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Association'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 that are required to be reported under *Government Auditing Standards*.

This communication is intended solely for the information and use of management, the Board of Directors, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

*Ray, Foley, Hensley, & Company*  
Ray, Foley, Hensley & Company, PLLC  
March 26, 2012