

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

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Levee Road Water Association, Inc.

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Financial Statements and
Independent Auditor's Report
December 31, 2011 and 2010

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Independent Auditor's Report

To the Board of Directors
Levee Road Water Association, Inc.

We have audited the accompanying statements of financial position of Levee Road Water Association, Inc. as of December 31, 2011 and 2010, and the related statements of activities, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of Levee Road Water Association, Inc.'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 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 audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Levee Road Water Association, Inc. as of December 31, 2011 and 2010, and the changes in its net assets 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 our report dated June 29, 2012 on our consideration of Levee Road Water Association, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Faulkner, King & Wenz, PSC

June 29, 2012

LIABILITIES AND NET ASSETS

	<u>2011</u>	<u>2010</u>
CURRENT LIABILITIES		
Accounts payable	\$ 16,659	\$ 10,600
Taxes payable	2,616	1,506
Water deposits payable	7,720	5,840
Accrued interest payable	3,212	3,506
Notes payable - current portion	<u>12,056</u>	<u>11,571</u>
TOTAL CURRENT LIABILITIES	42,263	33,023
Noncurrent notes payable	<u>105,907</u>	<u>118,113</u>
TOTAL LIABILITIES	<u>148,170</u>	<u>151,136</u>
NET ASSETS		
Unrestricted net assets - general	(528,958)	(464,461)
Unrestricted net assets - tap on fees	454,361	449,041
Unrestricted net assets - grants	1,480,879	1,448,879
Temporarily restricted net assets	<u>165,237</u>	<u>169,406</u>
TOTAL NET ASSETS	<u>1,571,519</u>	<u>1,602,865</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,719,689</u>	<u>\$ 1,754,001</u>

LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED DECEMBER 31, 2011 and 2010

	2011	2010
OPERATING INCREASES IN UNRESTRICTED NET ASSETS		
Water sales	\$ 237,799	\$ 230,059
Other water revenues	120	1,917
TOTAL OPERATING INCREASES IN UNRESTRICTED NET ASSETS	237,919	231,976
OPERATING DECREASES IN UNRESTRICTED NET ASSETS		
Water purchased	112,359	103,578
Salaries and payroll taxes	49,173	47,851
Directors fees	12,000	12,000
Office supplies	3,704	4,995
Office rental	4,800	4,800
Testing and lab fees	6,575	8,852
Insurance	4,092	3,816
Telephone and utilities	4,164	3,833
Professional services	8,720	7,875
Travel	2,009	1,754
Advertising	-	938
Repairs and maintenance	14,590	7,464
Rent	600	600
Provision for doubtful accounts	6,016	4,246
Miscellaneous	3,373	2,863
Contract labor	1,683	2,943
TOTAL OPERATING DECREASES IN UNRESTRICTED NET ASSETS	233,858	218,408
OPERATING INCREASE IN UNRESTRICTED NET ASSETS BEFORE DEPRECIATION	4,061	13,568
Depreciation	66,189	61,119
OPERATING DECREASE IN UNRESTRICTED NET ASSETS	(62,128)	(47,551)
NONOPERATING INCREASES (DECREASES) IN UNRESTRICTED NET ASSETS		
Interest income	1,021	1,989
Interest expense	(7,559)	(8,203)
	(6,538)	(6,214)
NET DECREASE IN UNRESTRICTED NET ASSETS	\$ (68,666)	\$ (53,765)

**LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2011 and 2010**

	<u>Unrestricted Net assets</u>	<u>Temporarily Restricted Net assets</u>	<u>Contributed Capital Members</u>	<u>Contributed Capital Grants</u>	<u>Total</u>
Balances, January 1, 2010	\$ (421,158)	\$ 179,868	\$ 443,376	\$ 1,358,249	\$ 1,560,335
2010 net change in unrestricted net assets	(53,765)				(53,765)
Transfers	10,462	(10,462)			-
Membership dues			2,480		2,480
Grants				90,630	90,630
Tap-on fees			3,185		3,185
Balances, December 31, 2010	(464,461)	169,406	449,041	1,448,879	1,602,865
2011 net change in unrestricted net assets	(68,666)				(68,666)
Transfers	4,169	(4,169)			-
Membership dues			2,590		2,590
Grants				32,000	32,000
Tap-on fees			2,730		2,730
Balances, December 31, 2011	<u>\$ (528,958)</u>	<u>\$ 165,237</u>	<u>\$ 454,361</u>	<u>\$ 1,480,879</u>	<u>\$ 1,571,519</u>

LEVEE ROAD WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating decrease in unrestricted net assets	\$ (62,128)	\$ (47,551)
Adjustments to reconcile operating decrease in unrestricted net assets to net cash provided by operating activities:		
Depreciation	66,189	61,119
Provision for doubtful accounts	6,016	4,246
Changes in operating assets and liabilities		
Increase in accounts receivable	(10,895)	(9,714)
Decrease in prepaid expenses	65	657
Increase (decrease) in accounts payable	6,059	(3,467)
Increase in taxes payable	1,110	340
Increase in water deposits payable	1,880	1,640
	<u>8,296</u>	<u>7,270</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES		
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(32,000)	(97,886)
Interest paid on RD loans	(7,853)	(8,786)
Principal payments on borrowings	(11,721)	(10,787)
Proceeds from grants	32,000	90,630
Proceeds from membership dues	2,590	2,480
Proceeds from tap-on fees	2,730	3,185
	<u>(14,254)</u>	<u>(21,164)</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES		
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income received	1,020	2,023
DECREASE IN CASH	(4,938)	(11,871)
CASH AT BEGINNING OF YEAR	<u>182,196</u>	<u>194,067</u>
CASH AT END OF YEAR	<u>\$ 177,258</u>	<u>\$ 182,196</u>
CASH CONSISTS OF:		
Cash - unrestricted	\$ 12,135	\$ 12,903
Cash - restricted	165,123	169,293
	<u>\$ 177,258</u>	<u>\$ 182,196</u>

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Introduction:

Levee Road Water Association, Inc. (the Association) is a water utility which operates in Montgomery County, Kentucky, and its sales are primarily to residential customers. The Association was incorporated July 20, 1970 as a nonstock, nonprofit corporation formed under the provisions of Chapter 273 of the Kentucky Revised Statutes (KRS).

Basis of Accounting:

The accrual basis of accounting is used for financial statement reporting purposes.

Basis of presentation:

Financial statement presentation follows the recommendations of the ASC 958-205-05 (formerly Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations.") Under ASC 958-205-05, the Association is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. Accordingly, all net assets of the Association have been recorded as unrestricted or temporarily restricted.

Cash and Cash Equivalents:

For the statement of cash flows, the Association considers all highly liquid debt instruments purchased with a maturity of one year or less to be cash equivalents.

The Association's deposits at December 31, 2011 were entirely covered by federal depository insurance.

Customer Accounts Receivable:

Accounts receivable are recorded at the amount the Association expects to collect on water customer balances outstanding at year-end and are reflected net of an allowance for doubtful accounts of \$27,066 and \$21,050 for years ended December 31, 2011 and 2010, respectively. The Association generally charges off past due accounts at the point which the accounts are more than 120 days past due and the responsible party is no longer a water customer of the Association.

The allowance for doubtful accounts is estimated based on an analysis of customer accounts which are past due over 30 days. Percentages of the balance of each age group of accounts are included in the allowance calculation, including an allocation of 100% of accounts outstanding for more than 90 days.

Property, plant and equipment:

Property, plant and equipment are 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. The thresholds for capitalization are:

Buildings and grounds	\$5,000
Building improvements	\$2,000
Water systems	\$3,000
Land	\$5,000
Vehicles and equipment	\$1,000

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Depreciation:

Property, plant and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method and are recognized in accordance with Statement of Financial Accounting Standards No. 93, "Recognition of Depreciation by Not-for-Profit Organizations.". The range of useful lives used in computing depreciation is:

<u>Classification</u>	<u>Range of lives</u>
Buildings	20-40 years
Water plant	25-40 years
Water systems	10-30 years
Office equipment	7-10 years
Other equipment	7 years
Vehicles	5 years

Total depreciation expense was \$66,189 and \$61,119 for the years ended December 31, 2011 and 2010, respectively.

Purchased Water Costs:

Water purchases are charged to expense as delivered to the distribution system. The Association is economically dependent on Mt. Sterling Water and Sewer System as the sole supplier of water.

Contributed Capital:

Water tap-on fees, donated water lines and grant proceeds are accounted for as contributed capital and are restricted for use in financing capital improvements to the water system.

Estimates:

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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Regulation Requirements:

The Association is subject to the regulatory authority of the Kentucky Public Service Commission (PSC) pursuant to KRS 278.040.

Capitalized interest:

The Association follows the policy of capitalizing interest as a component of construction cost.

Income Tax Status:

The Association is a nonprofit tax-exempt organization as prescribed by Internal Revenue Code, Section 501 c (12). Accordingly, the financial statements include no provision for income taxes.

The Accounting Standards Codification (ASC) 740-10-50, (formerly the Financial Accounting Standards Board Interpretation (FIN 48), *Accounting for Uncertainty in Income Taxes*,) requires entities to disclose known or anticipated positions of income tax uncertainty. The Association is not aware of any uncertain income tax positions as of June 29, 2012. The Association has never been audited by the Internal Revenue Service (IRS). However, the tax years of 2008 forward could be subject to examination by the IRS or other applicable tax jurisdictions.

LEVEE ROAD WATER ASSOCIATION, INC.
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2011 AND 2010

NOTE 2 - UTILITY PLANT IN SERVICE

The cost of Water System assets is summarized below by major categories:

	<u>2011</u>	<u>2010</u>
Water towers	\$ 586,576	\$ 586,576
Transmission and distribution mains	1,265,634	1,265,634
Meters and meter installations	<u>513,254</u>	<u>481,254</u>
Total cost	<u>\$ 2,365,464</u>	<u>\$ 2,333,464</u>

NOTE 3 - LONG-TERM DEBT

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

	<u>Current</u>	<u>2011 Noncurrent</u>	<u>2010 Current</u>	<u>Noncurrent</u>
Rural Development, dated February 21, 1973, annual payment due each January, with interest rate of 5%, interest and principal payment of \$9,070, final payment due in 2013	\$ 8,465	\$ 3,687	\$8,042	\$ 12,178
Rural Development, dated November 6, 1985, annual payment due each November, with interest rate of 7%, interest and principal payment of \$7,808, final payment due November 6, 2025	2,919	66,924	2,885	69,829
Rural Development, dated January 30, 1995, annual payment due each January, with interest rate of 5.25%, interest and principal payment of \$2,696, final payment due January, 2035	<u>672</u>	<u>35,296</u>	<u>644</u>	<u>36,106</u>
Total	<u>\$12,056</u>	<u>\$ 105,907</u>	<u>\$ 11,571</u>	<u>\$ 118,113</u>

The above loans are secured by statutory mortgage liens on the water supply distribution system as well as all present and future contract rights, accounts receivable, and general intangibles of the Association and are subject to early redemption by the Association prior to maturity. The loan agreements also outline various compliance requirements.

LEVEE ROAD WATER ASSOCIATION, INC.
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2011 AND 2010

NOTE 3 - LONG-TERM DEBT (Continued)

Installments due for principal and interest for each of the next five years and in total are as follows:

<u>Years ended</u> <u>December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012 (included in current liabilities)	\$ 12,056	\$ 7,517	\$ 19,573
2013	7,653	6,722	14,375
2014	4,229	6,275	10,504
2015	4,510	5,994	10,504
2016	4,809	5,695	10,504
Later years	<u>84,706</u>	<u>40,353</u>	<u>125,059</u>
Total	<u>\$ 117,963</u>	<u>\$ 72,556</u>	<u>\$ 190,519</u>

NOTE 4 - SPECIAL FUNDS AND RESTRICTIONS

The debt agreements with Rural Development require the following accounts be maintained by the utility as long as any outstanding debt remains:

General account - All operating funds received shall be deposited in this account. Funds will be used for operating and maintenance expenses and will be transferred to other accounts as needed.

Funded depreciation reserve account - The Association must deposit \$150 monthly into this account. These funds may be used for debt service or for unusual repairs or improvements if proper approvals are obtained and no funds are available in the general account. The balance as of December 31, 2011 and 2010 was \$55,921 and \$53,848, respectively.

Debt service reserve account - Required deposits of \$1,500 are to be made monthly into this account. Funds are to be used to make payments on Rural Development loans. The account was established per Rural Development loan requirements. The balance as of December 31, 2011 and 2010 was \$109,202 and \$115,445, respectively.

NOTE 5 - RELATED PARTY TRANSACTIONS

In addition to salaries and directors fees paid, the Association paid board members and certain members of their immediate families a total of \$7,904 and \$8,350 in 2011 and 2010, respectively, for expenses relating to testing, travel, contract labor and repairs and maintenance.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

The Association has received grants from Rural Development, Appalachian Regional Commission, Housing and Urban Development, and Kentucky Infrastructure Authority in connection with the construction of water lines and towers. These grants require the fulfillment of certain conditions as set forth in the terms of the grant. Failure to fulfill the conditions could result in the return of the funds to grantors. Management is not aware of any violations of these conditions.

LEVEE ROAD WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

NOTE 7 - CONCENTRATION OF CREDIT RISK

The Association sells water to residential, agricultural, and commercial customers in rural Montgomery County, Kentucky, and is subject to the credit risks associated with serving an agricultural based area.

NOTE 8 - 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 other risks of losses such as workers' compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 9 - Subsequent Events

Subsequent events for Levee Road Water Association, Inc. have been evaluated through June 29, 2012, which is the date the financial statements were available to be issued.

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

To the Board of Directors
Levee Road Water Association, Inc.

We have audited the financial statements of Levee Road Water Association, Inc. as of and for the year ended December 31, 2011, and have issued our report thereon dated June 29, 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 Levee Road Water Association, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

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

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

Findings:

- 2011-01 Condition: Lack of adequate controls in financial accounting and reporting to properly prepare financial statements and disclosures according to generally accepted accounting principles.
- 2011-02 Condition: Lack of segregation of duties.

Management Response and Corrective Action Plan: It does not appear that it would be economically feasible for our organization to enlarge its staff or contract an individual with appropriate skill and knowledge in applying new authoritative guidance. Thus, it is important that our Board provide oversight and independent review functions.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Levee Road Water Association, Inc.'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*.

Levee Road Water Association, Inc.'s response to the findings identified in our audit is described in the paragraph above. We did not audit Levee Road Water Association, Inc.'s response and, accordingly, we express no opinion on it

This report is intended solely for the information and use of management, the Board of Directors, others within the organization, Rural Development, the Public Service Commission and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Faulkner, King & Wenz, PSC

June 29, 2012

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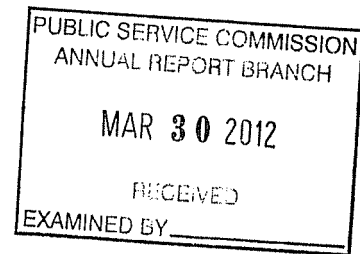
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March 29, 2012

Mr. Jeff Cline
Filings Division
Kentucky Public Service Commission
P. O. Box 615
Frankfort, KY 40602



Dear Mr. Cline:

Brenda Murphy of Levee Road Water Association, Inc. in Montgomery County, Kentucky has authorized me to write to you to request an extension of time to file the Association's 2011 Annual Report to the Public Service Commission.

Our firm is currently in the middle of preparing and processing tax returns and have not yet started the Association's 2011 audit of it's financial statements. We plan to start the 2011 audit and the PSC Report after tax season. On behalf of Levee Road Water Association, I am requesting an extension until May 31.

Thank you for your patience and for your consideration in this matter. If you need further information, feel free to contact me.

Sincerely,

Faulkner, King & Wenz, PSC

Lesley Butcher