

**From:** David Moore

**Sent:** Monday, March 04, 2013 11:55 AM

**To:** PSC - Reports

**Subject:** Henderson County Water District Audit Report

2012 Audit of Henderson County Water District attachment.

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# **Henderson County Water District**

Report on Audited Financial Statements  
For the fiscal years ended August 31, 2012 and 2011

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**Henderson County Water District  
Management's Discussion and Analysis  
For the fiscal year ended August 31, 2012**

The Henderson County Water District provides water services for the residents of Henderson County, Kentucky who live outside the incorporated limits of the City of Henderson, Kentucky. The following narrative provides an overview of the financial performance of the Henderson County Water District for the fiscal year ended August 31, 2012.

**Overview of the Financial Statements:**

This financial report consists of three parts: 1) Management's Discussion and Analysis, 2) Financial Statements, and 3) Supplemental information. Included in the financial statements are notes which provide additional detail supporting amounts reported therein. The financial statements of the Henderson County Water District report information using accounting principles similar to those of private sector companies.

The statement of net assets, the successor to the balance sheet, includes all of the Henderson County Water District's assets and liabilities and provides information about the nature of assets and liabilities. It also provides a foundation for evaluating the financial strength of the District.

All of the revenues and expenses are accounted for on the statement of revenues, expenses, and changes in net assets. This statement measures the results of the District's operations over the past year and is used by management and others to evaluate whether it was successful in recovering all of its costs through charges for sale of water and generated a profit.

The last statement is the statement of cash flows. This statement provides information regarding the District's cash receipts, payments, investing (capital expenditures), and financing activities. The sources and uses of cash are summarized in this report which also reconciles the changes in cash balances from the beginning of the fiscal year to the end.

**Financial Highlights:**

The Henderson County Water Districts total assets decreased by \$267,578 from \$14,454,335 in 2011 to \$14,186,757, primarily due to the effect of depreciation expense.

Operating revenues increased by \$193,627 or 7% from \$2,656,018 to \$2,849,645, primarily due to increased consumption due to unusually dry conditions experienced during the fiscal year and due to a slight rate increase.

Operating expenses increased by \$232,872 or 9 % from \$2,509,851 in 2011 to \$2,742,723 in 2012. The increase was primarily due to the increased cost of water purchased from the Henderson Water Utility due to the drought experienced during the summer months of 2012.

Operating income decreased by \$ 39,245 or 27% from \$146,167 to \$106,922 due to an increase in the cost of purchased water and an increase in the bad debt provision by approximately \$23,000 during the year. Income or change in net assets decreased from \$137,500 in 2011 to \$(87,796) due to a significant decrease in capital contributions.

**Henderson County Water District  
Management's Discussion and Analysis  
For the fiscal year ended August 31, 2012**

**Condensed Financial Information:**

A summary of condensed financial information is as follows:

|                                  | August 31, 2012      | August 31, 2011      | Change              | Percentage |
|----------------------------------|----------------------|----------------------|---------------------|------------|
| Current assets                   | \$ 2,168,781         | \$ 1,908,063         | \$ 260,718          | 14%        |
| Restricted assets                | 714,284              | 901,160              | (186,876)           | -21%       |
| Capital assets                   | 11,303,692           | 11,645,112           | (341,420)           | -3%        |
| Total assets                     | <u>\$ 14,186,757</u> | <u>\$ 14,454,335</u> | <u>\$ (267,578)</u> | <u>-2%</u> |
| Current liabilities              | \$ 518,084           | \$ 482,439           | \$ 35,645           | 7%         |
| Long-term liabilities            | 3,829,477            | 4,044,904            | (215,427)           | -5%        |
| Total liabilities                | <u>4,347,561</u>     | <u>4,527,343</u>     | <u>(179,782)</u>    | <u>-4%</u> |
| Net assets:                      |                      |                      |                     |            |
| Invested in capital assets       | 7,231,199            | 7,357,192            | (125,993)           | -2%        |
| Restricted - debt service        | 624,424              | 750,128              | (125,704)           | -17%       |
| Unrestricted                     | 1,983,573            | 1,819,672            | 163,901             | 9%         |
| Total net assets                 | <u>9,839,196</u>     | <u>9,926,992</u>     | <u>(87,796)</u>     | <u>-1%</u> |
| Total liabilities and net assets | <u>\$ 14,186,757</u> | <u>\$ 14,454,335</u> | <u>\$ (267,578)</u> | <u>-2%</u> |

Total net assets decreased by \$87,796. As noted earlier in this report, this is due primarily to the decrease in capital contributions for the fiscal year ended August 31, 2012.

|                             | August 31, 2012    | August 31, 2011   | Change              | Percentage   |
|-----------------------------|--------------------|-------------------|---------------------|--------------|
| Operating revenues          | \$ 2,849,645       | \$ 2,656,018      | \$ 193,627          | 7%           |
| Operating expenses          | 2,742,723          | 2,509,851         | 232,872             | 9%           |
| Operating income            | 106,922            | 146,167           | (39,245)            | -27%         |
| Non-operating revenues, net | (215,673)          | (217,478)         | 1,805               | -1%          |
| Capital contributions       | 20,955             | 208,811           | (187,856)           | -90%         |
| Change in net assets        | <u>\$ (87,796)</u> | <u>\$ 137,500</u> | <u>\$ (225,296)</u> | <u>-164%</u> |

Operating revenues increased by \$193,627 primarily due to an increase in overall water consumption and the regular rate increase. Correspondingly, operating expenses increased by \$232,872, due to the increase in purchased water to meet customer demand and an additional provision for bad debt in the amount of \$25,000 required to cover potential losses due to a major commercial customer who filed chapter 11 bankruptcy during the fiscal year ended.

**Henderson County Water District  
Management's Discussion and Analysis  
For the fiscal year ended August 31, 2012**

**Statement of Cash Flows:**

The following is a summary of cash flow activity for the fiscal years ended August 31, 2012 and 2011.

|                                | <u>August 31, 2012</u> | <u>August 31, 2011</u> | <u>Change</u>       | <u>Percentage</u> |
|--------------------------------|------------------------|------------------------|---------------------|-------------------|
| Net cash provided by:          |                        |                        |                     |                   |
| Operating activities           | \$ 592,603             | \$ 619,970             | \$ (27,367)         | -4%               |
| Non-capital financing          | 2,787                  | 1,875                  | 912                 | 49%               |
| Capital and related financing  | (597,467)              | (562,379)              | (35,088)            | 6%                |
| Investing activities           | <u>(122,973)</u>       | <u>17,387</u>          | <u>(140,360)</u>    | <u>-807%</u>      |
| Net change in cash equivalents | <u>\$ (125,050)</u>    | <u>\$ 76,853</u>       | <u>\$ (201,903)</u> | <u>-263%</u>      |

Cash flows from operating activities were down by \$27,367 due primarily to the decrease in operating income which resulted from increased operating costs. Cash flows from capital and related financing activities were consistent with that of prior years.

**Capital Assets:**

The vast majority of the assets of the Henderson County Water District are invested in the system infrastructure, similar to most utility concerns. To protect this investment, the District is diligent in continually monitoring the condition of the system and performing maintenance to ensure it remains in a state of good repair. Management monitors its financial performance regularly to ensure a reasonable return on investment is received so funds are available to provide for capital expenditures necessary to meet these objectives. The District expended \$192,341 on capital assets during 2012, and \$303, 888, during 2011.

**Long-term Debt:**

As of August 31, 2012, the Henderson County Water District had \$4,013,016 in long-term debt outstanding, consisting of Revenue Bond Series B of \$280,000, and Revenue Bond Series 2006 A, in the amount of \$3,972,000. Revenues of the district are pledged to secure these obligations. Subsequent to the fiscal year ended August 31, 2012, the District issued an additional \$1,695,000 in revenue bonds.

**Economic Factors:**

Water sales for the fiscal year ending August 31, 2013 are estimated by management to remain relatively at similar levels of previous years, increasing only to pass through the annual increases required due to increased costs of water. Revenues for the fiscal year ended August 31, 2013 are estimated to be \$2,788,000 and operating expenses are estimated at \$2,745,156, resulting in a net operating income of \$42,844.

**Contact Information:**

The financial statements are designed to provide our citizens, customers, and creditors with a general overview of the Henderson County Water District's results of operations. Additional information can be obtained by contacting Mr. David Moore, Superintendent of the Henderson County Water District at 655 South Main Street, Henderson, Kentucky 42420, or telephonically at 270.826.9802.



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners  
Henderson County Water District

We have audited the accompanying statement of net assets of the Henderson County Water District as of and for the fiscal year ended August 31, 2012, and the related statements of revenues, expenses and changes in net assets, and cash flows for the fiscal year then ended. These financial statements are the responsibility of the Henderson County Water District's, management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Henderson County Water District for the fiscal year ended August 31, 2011. Those financial statements were audited by other auditors , who expressed an unqualified opinion on the financial statements in their report dated December 28, 2011 and whose report thereon has been furnished to us.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the Henderson County Water District as of August 31, 2012, and the 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 a report dated November 17, 2012 on our consideration of the Henderson County Water District's internal control over financial reporting and our test of its compliance with law, regulation, contracts, and grants. 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 1 through 3 and 16 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 and the other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally 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.

A handwritten signature in black ink that reads 'Myriad CPA Group, LLC'. The signature is written in a cursive, flowing style.

Henderson, Kentucky  
December 3, 2012

**Henderson County Water District  
Statements of Net Assets  
As of August 31, 2012 and 2011**

|  | <b>2012</b>          | <b>2011</b>          |
|--|----------------------|----------------------|
| <b><u>Assets</u></b>   |                      |                      |
| <b><u>Current assets:</u></b>  |                      |                      |
| Cash and cash equivalents  | \$ 879,584           | \$ 827,512           |
| Investments, at cost   | 743,464              | 603,691              |
| Receivables, net of allowance for uncollectible amounts                    | 434,433              | 324,936              |
| Interest receivable  | 4,544                | 2,681                |
| Inventories  | 71,137               | 117,500              |
| Prepaid expenses   | 35,619               | 31,743               |
| <b>Total current assets</b>  | <b>2,168,781</b>     | <b>1,908,063</b>     |
| <b><u>Property, Plant and Equipment:</u></b>                               |                      |                      |
| Land   | 262,181              | 262,181              |
| Distribution systems   | 17,050,058           | 16,876,580           |
| Buildings  | 781,319              | 777,819              |
| Equipment  | 632,508              | 622,420              |
| Construction in progress   | 18,155               | 12,880               |
| Less: accumulated depreciation   | (7,440,529)          | (6,906,768)          |
| <b>Total property, plant and equipment</b>                                 | <b>11,303,692</b>    | <b>11,645,112</b>    |
| <b><u>Other noncurrent assets:</u></b>                                     |                      |                      |
| Restricted cash and cash equivalents                                       | 242,218              | 419,340              |
| Restricted investments, at cost  | 382,206              | 381,915              |
| Unamortized bond costs, net  | 89,860               | 99,905               |
| <b>Total other noncurrent assets</b>                                       | <b>714,284</b>       | <b>901,160</b>       |
| <b>Total assets</b>  | <b>\$ 14,186,757</b> | <b>\$ 14,454,335</b> |
| <b>Liabilities and Net Assets</b>  |                      |                      |
| <b><u>Liabilities:</u></b>   |                      |                      |
| <b><u>Current liabilities:</u></b>   |                      |                      |
| Accounts payable   | \$ 121,667           | \$ 120,510           |
| Interest payable   | 29,480               | 15,552               |
| Other liabilities  | 50,975               | 33,202               |
| Customer security deposits   | 72,946               | 70,159               |
| Bonds and notes payable-current portion                                    | 243,016              | 243,016              |
| <b>Total current liabilities</b>   | <b>518,084</b>       | <b>482,439</b>       |
| <b><u>Noncurrent liabilities:</u></b>                                      |                      |                      |
| Bonds and notes payable-net of current portion and deferred refunding loss | 3,829,477            | 4,044,904            |
| <b>Total noncurrent liabilities</b>  | <b>3,829,477</b>     | <b>4,044,904</b>     |
| <b>Total liabilities</b>   | <b>4,347,561</b>     | <b>4,527,343</b>     |
| <b><u>Net assets:</u></b>  |                      |                      |
| Invested in capital assets, net of related debt                            | 7,231,199            | 7,357,192            |
| Restricted for debt service  | 750,128              | 750,128              |
| Unrestricted   | 1,857,869            | 1,819,672            |
| <b>Total net assets</b>  | <b>9,839,196</b>     | <b>9,926,992</b>     |
| <b>Total liabilities and net assets</b>                                    | <b>\$ 14,186,757</b> | <b>\$ 14,454,335</b> |

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

**Henderson County Water District**  
**Statements of Revenues, Expenses, and Changes in Fund Net Assets**  
**For the fiscal years ended August 31, 2012 and 2011**

|   | <b>2012</b>         | <b>2011</b>         |
|---|---------------------|---------------------|
| <b><u>Operating revenues:</u></b>               |                     |                     |
| Water   | \$ 2,764,639        | \$ 2,548,892        |
| Penalties and sundry                            | 85,006              | 107,126             |
| <b>Total operating revenues</b>                 | <b>2,849,645</b>    | <b>2,656,018</b>    |
| <b><u>Operating expenses:</u></b>               |                     |                     |
| Purchased water                                 | 1,163,826           | 1,021,815           |
| Pumping utilities                               | 42,133              | 41,047              |
| Maintenance of system                           | 230,796             | 213,764             |
| Vehicle and equipment                           | 55,687              | 60,508              |
| Customer accounts                               | 186,573             | 156,875             |
| Administration                                  | 529,947             | 479,833             |
| Depreciation                                    | 533,761             | 536,009             |
| <b>Total operating expenses</b>                 | <b>2,742,723</b>    | <b>2,509,851</b>    |
| <b>Operating income</b>                         | <b>106,922</b>      | <b>146,167</b>      |
| <b><u>Nonoperating revenues (expenses):</u></b> |                     |                     |
| Investment income                               | 18,901              | 20,405              |
| Interest expense - notes and other              | (139)               | (6,908)             |
| Interest expense - bonds                        | (223,266)           | (219,537)           |
| Amortization of debt issue costs                | (11,169)            | (11,438)            |
| <b>Total nonoperating revenues (expenses)</b>   | <b>(215,673)</b>    | <b>(217,478)</b>    |
| <b>Income (loss) before contributions</b>       | <b>(108,751)</b>    | <b>(71,311)</b>     |
| Capital contributions                           | 20,955              | 208,811             |
| <b>Change in net assets</b>                     | <b>(87,796)</b>     | <b>137,500</b>      |
| Net assets, beginning of year                   | 9,926,992           | 9,789,492           |
| <b>Net assets, end of year</b>                  | <b>\$ 9,839,196</b> | <b>\$ 9,926,992</b> |

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

**Henderson County Water District**  
**Statements of Cash Flows**  
For the fiscal years ended August 31, 2012 and 2011

|   | <b>2012</b>         | <b>2011</b>         |
|---|---------------------|---------------------|
| <b><u>Cash flows from operating activities:</u></b>   |                     |                     |
| Cash received from customers  | \$ 2,655,142        | \$ 2,567,092        |
| Cash payments to suppliers for goods and services   | (1,503,692)         | (1,431,756)         |
| Cash payments to employees for services   | (643,853)           | (622,492)           |
| Other operating revenues  | 85,006              | 107,126             |
| <b>Net cash provided by operating activities</b>  | <b>592,603</b>      | <b>619,970</b>      |
| <b><u>Cash flows from noncapital financing activities:</u></b>  |                     |                     |
| Increase (decrease) in customer deposits  | 2,787               | 1,875               |
| <b>Net cash provided by noncapital financing activities</b>   | <b>2,787</b>        | <b>1,875</b>        |
| <b><u>Cash flows from capital and related financing activities:</u></b>                               |                     |                     |
| Acquisition and construction of capital assets  | (192,341)           | (303,888)           |
| Capital contributions   | 20,955              | 208,811             |
| Principal paid on revenue bond maturities and other capital notes                                     | (243,016)           | (273,849)           |
| Interest paid on revenue bonds and other capital notes  | (183,065)           | (193,453)           |
| <b>Net cash (used) by capital and related financing activities</b>                                    | <b>(597,467)</b>    | <b>(562,379)</b>    |
| <b><u>Cash flows from investing activities:</u></b>   |                     |                     |
| (Increase) decrease in investment securities  | (140,064)           | (3,408)             |
| Interest income   | 17,091              | 20,795              |
| <b>Net cash provided by investing activities</b>  | <b>(122,973)</b>    | <b>17,387</b>       |
| Net increase (decrease) in cash and cash equivalents  | (125,050)           | 76,853              |
| Cash and cash equivalents, beginning of year  | 1,246,852           | 1,169,999           |
| <b>Cash and cash equivalents, end of year</b>   | <b>\$ 1,121,802</b> | <b>\$ 1,246,852</b> |
| <b><u>Reconciliation of operating income to net cash provided (used) by operating activities:</u></b> |                     |                     |
| Operating income  | \$ 106,922          | \$ 146,167          |
| Adjustments to reconcile operating income to net cash provided by operating activities:               |                     |                     |
| Depreciation  | 533,761             | 536,009             |
| (Increase) decrease in accounts receivable  | (109,497)           | 18,200              |
| (Increase) decrease in inventories  | 46,363              | (71,739)            |
| (Increase) decrease in prepaid expenses   | (3,876)             | (3,335)             |
| (Increase) decrease in deferred charges   | -                   | 192                 |
| Increase (decrease) in accounts payable   | 1,157               | (8,395)             |
| Increase (decrease) in accrued liabilities  | 17,773              | 2,871               |
| <b>Net cash provided by operating activities</b>  | <b>\$ 592,603</b>   | <b>\$ 619,970</b>   |
| <b><u>Summary of Cash and Cash Equivalents:</u></b>   |                     |                     |
| Unrestricted cash equivalents   | \$ 879,584          | \$ 827,512          |
| Restricted cash equivalents   | 242,218             | 419,340             |
| <b>Total cash equivalents</b>   | <b>\$ 1,121,802</b> | <b>\$ 1,246,852</b> |

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

**Henderson County Water District**  
**Notes to the Financial Statements**  
**For the fiscal years ended August 31, 2012 and 2011**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Henderson County Water District, “Water District”, was created by the fiscal court of Henderson County under the provisions by Chapter 74 of the Kentucky Revised Statutes.

The accounting and reporting framework and the more significant accounting principles are discussed in subsequent subsections of this Note. The rest of these Notes are organized to provide explanations, including required disclosures, of the Henderson County Water District financial activities for the fiscal year ended August 31, 2012.

**Financial Reporting Entity:**

The financial statements of the Henderson County Water District comprise a single business-type activity generally financed in whole or in part with fees charged to external customers. In evaluating how to define the Water District for financial reporting purposes, management has considered any potential component units, based upon the Water District’s ability to exercise significant oversight responsibility. Oversight responsibility was determined on the basis of the Water District’s ability to significantly influence operations, select the governing body, participate in fiscal management, and the scope of public service. Based upon the application of these criteria, no potential component units were noted.

**Fund Types:**

A fund is an accounting entity with a self-balancing set of accounts established to record the financial position and results of operations of a specific governmental activity. The Water District maintains the following business-type enterprise fund:

Proprietary Fund Type:

Proprietary Funds are accounted for on a flow of economic resources measurement focus. The accounting objectives are a determination of net income, financial position and changes in cash flow. All assets and liabilities associated with a proprietary fund’s activities are included on its balance sheet. Proprietary fund equity is segregated into contributed capital and retained earnings.

**Measurement Focus/Basis of Accounting:**

The financial statements of the Water District are prepared in accordance with generally accepted accounting principles (GAAP). The Water District’s reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The Water District’s reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

Proprietary fund types are accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recorded when they are earned, including unbilled water services which are accrued. Expenses are recorded at the time liabilities are incurred.

Operating income reported in proprietary fund financial statements includes revenues and expenses related to the primary, continuing operations of the fund. Principal operating revenues for proprietary funds are charges to customers for services. Principal operating expenses are the costs of providing goods or services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

**Inventories:**

Inventories are carried at the lower of cost (primarily first-in, first-out) or market.

**Cash and Investments:**

The Water District reporting entity considers highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Investments are reported at fair value which is determined using selected bases. Short-term investments are reported at cost, which approximates fair value. Cash deposits are reported at carrying amount which reasonably estimates fair value.

**Henderson County Water District  
Notes to the Financial Statements  
For the fiscal years ended August 31, 2012 and 2011**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued**

**Receivables:**

All receivables are reported net of estimated uncollectable amounts.

**Donated Lines:**

From time to time prospective users have constructed and paid for line extensions and donated these additions to the Water District. These additions are recorded at cost invoiced to the user and are depreciated at rates based on their estimated useful life. Such additions are recorded as capital contributions.

**Capital Assets, Depreciation, and Amortization:**

The Water District's plant and equipment with useful lives of more than one year are stated at historical cost and comprehensively reported in the basic financial statements. Donated assets are stated at fair value on the date donated. The costs of normal maintenance and repairs that do not add to the asset value or materially extend the useful life are not capitalized. Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in operations.

Estimated useful lives for depreciable assets are as follows:

|                                |             |
|--------------------------------|-------------|
| Buildings                      | 10-50 years |
| Distribution systems           | 15-50 years |
| Machinery and equipment        | 5-10 years  |
| Office equipment and furniture | 5-10 years  |

**Tap Fees:**

Tap fees collected from new customers are recorded as capital contributions. The cost of installing the service lines and setting the water meters are capitalized and depreciated over their estimated useful lives.

**Long-term Debt and Deferred Bond Costs:**

In the basic financial statements, outstanding debt is reported as liabilities. Bond issuance costs are capitalized and amortized over the terms of the respective bonds using a method that approximates the effective interest method.

**Compensated Absences:**

Accumulated unpaid vacation amounts are reported as "Other liabilities" in the basic financial statements. The accrued compensated balance at August 31, 2012 and 2011 was \$28,338 and \$14,101, respectively.

**Proprietary Fund Net Assets:**

Proprietary fund net assets are divided into three components:

Invested in capital assets, net of related debt – consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.

Restricted net assets – consist of net assets that are restricted by the Water District's creditor (for example through debt covenants), by the state enabling legislation, by grantors (both federal and state), and by other contributors.

Unrestricted – all other net assets are reported in this category.

**Use of Restricted Resources:**

When an expense is incurred that can be paid using either restricted or unrestricted resources (net assets), the Water District's policy is to apply the expense toward restricted resources and then toward unrestricted resources.

**NOTE 2 – ALLOWANCE FOR UNCOLLECTABLE ACCOUNTS**

The allowance for uncollectable accounts receivable at August 31, 2012 and 2011 was \$52,296 and \$22,390, respectively.

**Henderson County Water District  
Notes to the Financial Statements  
For the fiscal years ended August 31, 2012 and 2011**

**NOTE 3 – DEPOSITS WITH FINANCIAL INSTITUTIONS**

Custodial credit risk for deposits is the risk that in the event of a bank failure, the Water District’s deposits may not be returned or the Water District will not be able to recover collateral securities in the possession of an outside party. At August 31, 2012, the carrying amount of the Water District’s deposits, including certificates of deposit, was \$2,247,472. Of the total bank balances (including certificates of deposit), \$500,000 was covered by Federal Depository Insurance, with the remaining balance covered by pledged collateral held by the custodial banks in the Water District’s name. As of the date of the auditor’s report, the Water District’s demand and time deposits with the local custodial banks were fully covered by Federal Depository Insurance or by pledged collateral.

Kentucky Revised Statutes authorize governmental units to invest in obligations of the United States and its agencies, obligations of the Commonwealth of Kentucky and its agencies, shares in savings and loan associates insured by federal agencies and deposits in national or state chartered banks insured by federal agencies and larger amounts in such institutions providing such banks pledge as security obligations of the United States government or its agencies.

**NOTE 4 – INVESTMENTS**

Investments stated at cost consisted of the following at August 31, 2012 and 2011:

|  | <b>2012</b>         | <b>2011</b>       |
|--|---------------------|-------------------|
| <b><u>Current:</u></b>                 |                     |                   |
| Certificates of deposit                | \$ 743,464          | \$ 603,691        |
| <b><u>Noncurrent (restricted):</u></b> |                     |                   |
| Certificates of deposit                | 382,206             | 381,915           |
| <b>Total investments, at cost</b>      | <b>\$ 1,125,670</b> | <b>\$ 985,606</b> |

**NOTE 5 – RISK MANAGEMENT**

The Water District is exposed to various risks related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Water District purchases commercial insurance for all risks of loss. There have been no significant reductions in insurance coverage and settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

**Henderson County Water District  
Notes to the Financial Statements  
For the fiscal years ended August 31, 2012 and 2011**

**NOTE 6 – CAPITAL ASSETS**

The following is a summary of changes in capital assets for the year ended August 31, 2012:

|  | <b>Balance<br/>8/31/2011</b> | <b>Increases</b>    | <b>Decreases</b> | <b>Balance<br/>8/31/2012</b> |
|--|------------------------------|---------------------|------------------|------------------------------|
| <b><u>Capital assets, not being depreciated:</u></b> |                              |                     |                  |                              |
| Land   | \$ 262,181                   | \$ -                | \$ -             | \$ 262,181                   |
| Construction in progress                             | 12,880                       | 5,275               | -                | 18,155                       |
| <b>Capital assets, being depreciated:</b>            |                              |                     |                  |                              |
| Distribution systems                                 | 16,876,580                   | 173,478             | -                | 17,050,058                   |
| Buildings  | 777,819                      | 3,500               | -                | 781,319                      |
| Equipment  | 622,420                      | 10,088              | -                | 632,508                      |
| <b>Total capital assets</b>                          | <b>18,551,880</b>            | <b>192,341</b>      | <b>-</b>         | <b>18,744,221</b>            |
| <b><u>Less: accumulated depreciation</u></b>         |                              |                     |                  |                              |
| Distribution systems                                 | (6,265,121)                  | (485,723)           | -                | (6,750,844)                  |
| Buildings  | (269,821)                    | (21,350)            | -                | (291,171)                    |
| Equipment  | (371,826)                    | (26,688)            | -                | (398,514)                    |
| <b>Total accumulated depreciation</b>                | <b>(6,906,768)</b>           | <b>(533,761)</b>    | <b>-</b>         | <b>(7,440,529)</b>           |
| <b>Capital assets, net</b>                           | <b>\$11,645,112</b>          | <b>\$ (341,420)</b> | <b>\$ -</b>      | <b>\$11,303,692</b>          |

**NOTE 7 – CHANGES IN LONG-TERM DEBT**

|   | <b>Beginning<br/>Balance</b> | <b>Additions</b> | <b>Payments</b>     | <b>Amortization</b> | <b>Ending<br/>Balance</b> | <b>Current<br/>Portion</b> | <b>Long-term<br/>Portion</b> |
|---|------------------------------|------------------|---------------------|---------------------|---------------------------|----------------------------|------------------------------|
| Revenue bonds series 2003 B                 | \$ 365,000                   | \$ -             | \$ (85,000)         | \$ -                | \$ 280,000                | \$ 156,000                 | \$ 3,816,000                 |
| Revenue bonds series 2006 A                 | 4,128,000                    | -                | (156,000)           | -                   | 3,972,000                 | 85,000                     | 195,000                      |
| Henderson County Fiscal Court note          | 6,048                        | -                | (2,016)             | -                   | 4,032                     | 2,016                      | 2,016                        |
| <b>Bonds/notes payable, August 31, 2012</b> | <b>4,499,048</b>             | <b>-</b>         | <b>(243,016)</b>    | <b>-</b>            | <b>4,256,032</b>          | <b>243,016</b>             | <b>4,013,016</b>             |
| <b><u>Components of long-term debt:</u></b> |                              |                  |                     |                     |                           |                            |                              |
| Deferred defeasance 2003 B refunding        | (195,144)                    | -                | -                   | 22,422              | (172,722)                 | -                          | (172,722)                    |
| Deferred defeasance 2006 A refunding        | (15,984)                     | -                | -                   | 5,167               | (10,817)                  | -                          | (10,817)                     |
|   | <b>\$4,287,920</b>           | <b>\$ -</b>      | <b>\$ (243,016)</b> | <b>\$ 27,589</b>    | <b>\$4,072,493</b>        | <b>\$ 243,016</b>          | <b>\$ 3,829,477</b>          |

On April 11, 2006, the Henderson County Water District issued \$4,692,000 Kentucky Rural Water Finance Corporation Public Projects refunding Revenue Bonds Series 2006 A, interest ranging from 4.0% to 4.25%, to advance refund outstanding 1997 Water Revenue Bonds and 2000 Water Revenue Bonds with outstanding balances of \$1,745,000 and \$2,600,000, respectively. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the 1997 and 2000 series bonds of \$326,367. This difference, reported in the accompanying financial statements as a deduction from bonds payable, will be charged to operations (included in "interest expense") through the year 2025 using the effective-interest method.

**Henderson County Water District  
Notes to the Financial Statements  
For the fiscal years ended August 31, 2012 and 2011**

**NOTE 7 – CHANGES IN LONG-TERM DEBT, continued**

On August 28, 2003, the Henderson County Water District issued \$955,000 Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds Series 2003 B, interest ranging from 2.0% to 4.5%, to advance refund outstanding 1993 Water Refunding Revenue Bonds and 1994 Water Refunding Revenue Bonds with outstanding balances of \$450,000 and \$815,000, respectively. \$401,333 of current debt service reserve and bond sinking funds were used toward the payoff of the 1993 and 1994 refunding revenue bonds. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the 1993 and 1994 series bonds of \$110,815. This difference reported in the accompanying financial statements as a deduction from bonds payable, will be charged to operations (included in “interest expense”) through the year 2014 using the effective-interest method.

|   | <b>2012</b>         | <b>2011</b>         |
|---|---------------------|---------------------|
| <b>Revenue bonds:</b>   |                     |                     |
| \$955,000 Public Projects Water Refunding Revenue Bonds dated August 15, 2003 due in annual installments of \$65,000 to \$100,000 through February 1, 2015, interest payable semiannually on February 1 and August 1, escalating from 2.0% to 4.5%. | \$ 280,000          | \$ 365,000          |
| \$4,629,000 Public Projects Water Refunding Revenue Bonds dated April 11, 2006 due in annual installments of \$136,000 to \$371,000 through January 1, 2026, interest payable semiannually on January 1 and July 1, escalating from 4.0% to 4.25%.  | 3,972,000           | 4,128,000           |
| Deferred defeasance amount on debt refunding  | (183,539)           | (211,128)           |
| <b>Total bonds payable</b>  | <b>4,068,461</b>    | <b>4,281,872</b>    |
| <b>Total bonds and notes payable</b>  | <b>4,072,493</b>    | <b>4,287,920</b>    |
| Less: current portion   | 243,016             | 243,016             |
| <b>Long-term portion</b>  | <b>\$ 3,829,477</b> | <b>\$ 4,044,904</b> |

The annual requirements to amortize all bonds/notes outstanding as of August 31, 2012, including interest payments of \$1,311,380 are as follows:

| <b>Year ending August 31</b> | <b>Notes Payable</b> | <b>Revenue Bonds</b> | <b>Total</b>        |
|------------------------------|----------------------|----------------------|---------------------|
| 2013                         | \$ 2,016             | \$ 412,952           | \$ 414,968          |
| 2014                         | 2,016                | 426,548              | 428,564             |
| 2015                         | -                    | 419,440              | 419,440             |
| 2016                         | -                    | 411,369              | 411,369             |
| 2017                         | -                    | 407,350              | 407,350             |
| Thereafter                   | -                    | 3,485,721            | 3,485,721           |
|                              | <b>\$ 4,032</b>      | <b>\$ 5,563,380</b>  | <b>\$ 5,567,412</b> |

There are a number of limitations and restrictions contained in the various bond indentures. The Water District is in compliance with all significant limitations and restrictions.

**Henderson County Water District  
Notes to the Financial Statements  
For the fiscal years ended August 31, 2012 and 2011**

**NOTE 8 – PENSION PLAN**

**Plan Description:**

The Water District contributes to the County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System (KRS). CERS provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are 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 five percent 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 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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.

**Funding Policy:**

Plan members are required to contribute 5.0% of their annual creditable compensation and the Water District is 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 preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a 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. The current rate is 19.55% of annual creditable compensation. The Water District's contributions to CERS for the years ending August 31, 2012, 2011, and 2010 were \$76,148, \$66,079, and \$62,219, respectively, equal to the required contributions each year.

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, are required to contribute a total of 6.0% of their annual creditable compensation. For plan members who began participating prior to September 1, 2008, their contributions remain at 5.0% of their annual creditable compensation.

**NOTE 9 – OTHER EMPLOYEE BENEFITS**

**Compensated Absences:**

All employees of the Water District earn and accrue vacation and sick time. Employees accumulate two weeks paid vacation after the first year of service, three weeks after five years of service, and four weeks after twenty years of service. Employees accrue one sick day per month and may be carried over each year. Upon termination, accumulated sick days are converted to vacation days at the rate of four sick days equaling one vacation day. An employee leaving for any reason, including retirement will be paid their accumulated vacation and sick days converted to vacation as noted above. This liability is recorded in the financial statements.

**Post Employment Benefits:**

In addition to the pension benefits described in Note 8, The Water District participates in the Kentucky Retirement Systems Insurance Fund "Fund". The Fund was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.701 to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System "Systems". The Fund pays a prescribed contribution for the whole or partial payments of required premiums to purchase hospital and medical insurance.

**Henderson County Water District  
Notes to the Financial Statements  
For the fiscal years ended August 31, 2012 and 2011**

**NOTE 9 – OTHER EMPLOYEE BENEFITS, continued**

For the most recent year available (June 30, 2011), insurance premiums withheld from benefit payments for members of the Systems approximated \$29,350,195 and \$1,225,236 for KERS and KERS hazardous, respectively, \$29,219,273 and \$2,017,208 for CERS and CERS hazardous, respectively, \$250,282 for SPRS. The Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous members killed in the line of duty. As of June 30, 2011, the Fund had 92,989 retirees and beneficiaries for whom benefits were available.

The amount of contribution paid by the Fund is based on years of service. For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

| <b>Years of Service</b> | <b>Paid by<br/>Insurance<br/>Fund</b> |
|-------------------------|---------------------------------------|
| 20 or more              | 100%                                  |
| 15-19                   | 75%                                   |
| 10-14                   | 50%                                   |
| 4-9                     | 25%                                   |
| Less than 4             | 0%                                    |

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participating on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on or after July 1, 2003 earn fifteen (\$15) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon death of a hazardous employee, such employee's spouse receives ten (\$10) per month for insurance benefits for each year of the deceased employee's earned hazardous service. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is not protected under the inviolable contract provisions of Kentucky Revised Statutes. The General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

In prior years, the employer's required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

Kentucky retirement Systems (KRS) commenced self-funding of healthcare benefits for its Medicare eligible retirees on January 1, 2006. A self-funded plan is one in which KRS assumes the financial risk for providing healthcare benefits to its retirees. The self-funded plan pays for claims out-of-pocket as they are presented instead of paying a predetermined premium to an insurance carrier for a fully-insured plan. KRS funds the risk of its self-insured program directly from its insurance assets. KRS selected Catalyst Rx and UMR to administer the pharmaceutical and medical benefits, respectively, for its retirees.

Stop-loss insurance can be arranged to limit the Kentucky Retirement Systems' loss to a specified amount to ensure that catastrophic claims do not upset the financial integrity of the self-funded plan. The amount of stop-loss insurance is a function of Kentucky Retirement Systems' size, nature of its business, financials, and tolerance for risk. Kentucky Retirement Systems continues to evaluate the use of stop-loss insurance.

**Henderson County Water District**  
**Notes to the Financial Statements**  
**For the fiscal years ended August 31, 2012 and 2011**

**NOTE 10 – SUBSEQUENT EVENTS**

In accordance with ASC 855, subsequent events were evaluated through December 3, 2012, the date these financial statements were issued.

On November 14, 2012, the Board of Commissioners of the District voted to issue revenue bonds in the amount of \$1,695,000 for the purpose of providing financing for a water line replacement project.

**Henderson County Water District**  
**Schedule of Revenues, Expenses, and Changes in Fund Net Assets – Budget and Actual**  
**For the fiscal years ended August 31, 2012 and 2011**

|   | <u>Actual<br/>Amounts</u>  | <u>Budgeted<br/>Amounts</u> | <u>Over/Under<br/>Budget</u> |
|---|----------------------------|-----------------------------|------------------------------|
| <b><u>Operating revenues:</u></b>               |                            |                             |                              |
| Water   | \$ 2,764,639               | \$ 2,600,000                | \$ 164,639                   |
| Penalties and sundry                            | 85,006                     | 112,000                     | (26,994)                     |
| <b>Total operating revenues</b>                 | <b><u>2,849,645</u></b>    | <b><u>2,712,000</u></b>     | <b><u>\$ 137,645</u></b>     |
| <b><u>Operating expenses:</u></b>               |                            |                             |                              |
| Purchased water                                 | 1,163,826                  | 1,040,000                   | 123,826                      |
| Pumping utilities                               | 42,133                     | 42,000                      | 133                          |
| Maintenance of system                           | 230,796                    | 214,000                     | 16,796                       |
| Vehicle and equipment                           | 55,687                     | 56,000                      | (313)                        |
| Customer accounts                               | 186,573                    | 160,000                     | 26,573                       |
| Administration                                  | 529,947                    | 499,550                     | 30,397                       |
| Depreciation                                    | 533,761                    | 540,000                     | (6,239)                      |
| <b>Total operating expenses</b>                 | <b><u>2,742,723</u></b>    | <b><u>2,551,550</u></b>     | <b><u>191,173</u></b>        |
| <b>Operating income</b>                         | <b><u>106,922</u></b>      | <b><u>160,450</u></b>       | <b><u>(53,528)</u></b>       |
| <b><u>Nonoperating revenues (expenses):</u></b> |                            |                             |                              |
| Investment income                               | 18,901                     | 18,000                      | 901                          |
| Interest expense - refundable credits           | -                          | (2,400)                     | 2,400                        |
| Interest expense - notes                        | (139)                      | (1,997)                     | 1,858                        |
| Interest expense - bonds                        | (223,266)                  | (190,350)                   | (32,916)                     |
| Loan service fees                               | -                          | (892)                       | 892                          |
| Amortization of debt issue costs                | (11,169)                   | (45,589)                    | 34,420                       |
| <b>Total nonoperating revenues (expenses)</b>   | <b><u>(215,673)</u></b>    | <b><u>(223,228)</u></b>     | <b><u>7,555</u></b>          |
| <b>Income (loss) before contributions</b>       | <b><u>(108,751)</u></b>    | <b><u>(62,778)</u></b>      | <b><u>(45,973)</u></b>       |
| Capital contributions                           | 20,955                     | -                           | 20,955                       |
| <b>Change in net assets</b>                     | <b><u>(87,796)</u></b>     | <b><u>(62,778)</u></b>      | <b><u>(25,018)</u></b>       |
| Net assets, beginning of year                   | 9,926,992                  | 9,926,992                   | -                            |
| <b>Net assets, end of year</b>                  | <b><u>\$ 9,839,196</u></b> | <b><u>\$ 9,864,214</u></b>  | <b><u>\$ (25,018)</u></b>    |

**Henderson County Water District**  
**Schedule of System Maintenance, Customer Accounts, and Administrative Expenses**  
**For the fiscal years ended August 31, 2012 and 2011**

|   | <b>2012</b>       | <b>2011</b>       |
|---|-------------------|-------------------|
| <b><u>Maintenance of system</u></b>           |                   |                   |
| Maintenance of mains                          | \$ 172,539        | \$ 160,772        |
| Materials and supplies - transmission         | 51,839            | 48,376            |
| Materials and supplies - pumping              | 5,740             | 4,616             |
| Maintenance of tanks                          | 321               | -                 |
| Rental - equipment                            | 357               | -                 |
| <b>Total maintenance of system</b>            | <b>\$ 230,796</b> | <b>\$ 213,764</b> |
| <b><u>Customer accounts:</u></b>              |                   |                   |
| Salaries - meter reading                      | \$ 45,061         | \$ 46,783         |
| Billing and collections - labor and materials | 103,253           | 99,967            |
| Bad debts                                     | 37,970            | 10,160            |
| Collection fees                               | 289               | (35)              |
| <b>Total customer accounts</b>                | <b>\$ 186,573</b> | <b>\$ 156,875</b> |
| <b><u>Administration:</u></b>                 |                   |                   |
| Salaries                                      | \$ 81,062         | \$ 78,275         |
| Vacation and unassigned salaries              | 80,451            | 62,208            |
| Commissioner's fees                           | 7,650             | 9,100             |
| Payroll taxes                                 | 31,373            | 31,459            |
| Employee benefits                             | 198,134           | 179,453           |
| Office and computer expense                   | 10,003            | 9,442             |
| Telephone and utilities                       | 10,835            | 11,079            |
| Advertising                                   | 271               | 691               |
| Professional fees                             | 41,022            | 34,803            |
| Insurance                                     | 38,288            | 36,208            |
| Regulatory commission                         | 4,528             | 4,543             |
| Maintenance - office                          | 14,784            | 13,432            |
| Miscellaneous and general                     | 11,546            | 9,140             |
| <b>Total administration</b>                   | <b>\$ 529,947</b> | <b>\$ 479,833</b> |

**Henderson County Water District  
Schedule of Insurance Coverage  
For the fiscal years ended August 31, 2012 and 2011**

| <u>Insurance Type</u>                                      | <u>Coverage</u>                |
|--|--------------------------------|
| <b><u>Fire and extended coverage:</u></b>                  |                                |
| Water tank and pump house,<br>Office building and contents | \$4,086,672 - 90% Co-insurance |
| <b><u>Comprehensive general liability:</u></b>             |                                |
| Bodily injury  | \$3,000,000 each occurrence    |
| Property damage  | \$3,000,000 each occurrence    |
| <b><u>Automobile liability:</u></b>                        |                                |
| Bodily injury  | \$3,000,000 each occurrence    |
| Property damage  | \$3,000,000 each occurrence    |
| Uninsured motorist   | \$300,000 each occurrence      |
| Flood  | \$1,000,000                    |
| Business income  | \$500,000                      |
| Workman's compensation                                     | Statutory                      |
| <b><u>Money and securities:</u></b>                        |                                |
| Employee dishonesty  | \$150,000                      |
| Crime (other than employee dishonesty)                     | \$150,000                      |
| Legal defense  | \$100,000                      |
| Director and officer umbrella liability                    | \$3,000,000                    |
| Commissioners and employees are bonded.                    |                                |



**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 Commissioners  
Henderson County Water District

We have audited the financial statements of the Henderson County Water District, as of and for the year ended August 31, 2012, which collectively comprise the Henderson County Water District's basic financial statements and have issued our report thereon dated December 3, 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**

Management of Henderson County Water District, is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Henderson 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 Henderson County Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Henderson 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 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 noted the following deficiency in internal control over financial reporting that we consider to be material weaknesses, as defined above:

**Control Risk Due to Lack of Segregation of Duties:**

Due to the limited number of staff employed by the District, incompatible work functions are often performed by the same individual requiring a high degree of trust. Ideally, each key step of an accounting system should be segregated among employees; however, this is not always feasible due to the cost versus benefit relationship inherent in providing internal control. In the process of segregating functions among employees, management must make decisions relating to the applicable costs in relation to the expected benefits to be achieved.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Henderson 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 Henderson County Water District, in a separate letter dated December 3, 2012.

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

*Myriad Co Group, LLC*

Henderson, Kentucky  
December 3, 2012