

*Gallatin County Water District
4500 Hwy 455
Sparta, Ky. 41086
859-643-5200*

RECEIVED

FEB 09 2010

**PUBLIC SERVICE
COMMISSION**

February 8, 2010

Linda Faulkner
Division Director Filings
Public Service Commission
211 Sower Blvd.
Frankfort, Ky. 40602-0615

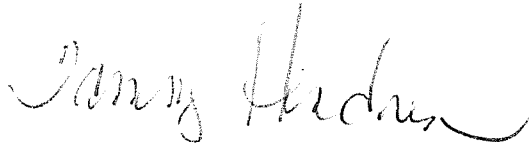
RE: Case No. 2006-00399

Dear Ms. Faulkner,

Per our conversation on Thursday February 4, 2010 please find enclosed a copy of our 2008 annual audit as well as a completion letter and a copy of the as-built drawings for the above referenced project.

I will forward a copy of the 2009 audit as soon as it is completed. If you need additional information please feel free to give me a call at the above telephone number.

Sincerely,



Tammy Hendren
Office Manager

GASTINEAU AND ASSOCIATES, Inc.

3465 Rabbits Foot Trail
Lexington, KY 40503-3744
Telephone(859) 421-4641
Fax (859) 219-8048

April 9, 2009

Mr. Vic Satchwell, Chairman
Gallatin County Water District
4500 Highway 455
Sparta, KY 41086

Re: Extension 5

Dear Mr. Satchwell;

This letter is to certify that all work has been completed on the Rural Development project designated as Extension 5. All contractors have been paid. All five of the original contracts have been in service in excess of one year. Thus their warranty period has expired. The tank painting and office building contracts have until December 2009 remaining on their warranties.

We delivered AS BUILT plans to your office on April 9, 2009 and we have been paid in full. Therefore, we certify that the project has been completed in accordance with the plans, specifications, and requirements of USDA Rural Development.

Sincerely,



Ronald E. Gastineau, P.E.

Cc: Ernest Scruggs, RDA

*Gallatin County Water District
4500 Hwy 455
Sparta, Ky. 41086
859-643-5200*

August 13, 2009

Ernest Scruggs
Rural Development Specialist
486 Helton Street
Williamstown, Ky. 41097

Dear Mr. Scuggs,

We have been notified by our engineers, Gastineau & Associates that the project has been completed. They have provided us with the plans and specs. We concur and accept the project as complete.

Sincerely,



Vic Satchwell
Chairman of the Board

GALLATIN COUNTY WATER DISTRICT
BASIC FINANCIAL STATEMENTS,
SUPPLEMENTARY INFORMATION,
AND INDEPENDENT AUDITORS' REPORTS

At December 31, 2008 and 2007

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

Years Ended December 31, 2008 and 2007

TABLE OF CONTENTS

Independent Auditors' Report	1
Management's Discussion and Analysis	2-5
Basic Financial Statements:	
Statement of Net Assets	6
Statement of Revenues, Expenses, and Changes in Fund Net Assets	7
Statement of Cash Flows	8-9
Notes to Basic Financial Statements	10-20
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <u>Government Auditing Standards</u>	21-22
Schedule of Findings and Responses	23-24
Rural Development Compliance Letter	25-26

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

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of Gallatin County Water District as of and for the years ended December 31, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of Gallatin County Water District'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 the 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 the Gallatin County Water District as of December 31, 2008 and 2007, and the changes in financial position, and cash flows thereof 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 March 24, 2009, on our consideration of the Gallatin County Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

The management's discussion and analysis on pages 2-5, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Raisor, Zapp & Woods, PSC

RAISOR, ZAPP & WOODS, PSC
Certified Public Accountants

March 24, 2009

**GALLATIN COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008**

Our discussion and analysis of the Gallatin County Water District's financial performance provides an overview of the District's financial activities for the year ended December 31, 2008. Please read it in conjunction with the District's financial statements, which begin on page 6.

REQUIRED FINANCIAL STATEMENTS

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

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

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

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

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

FINANCIAL HIGHLIGHTS

The following are key financial highlights:

- Total assets at year-end were \$8,416,361 and exceeded liabilities in the amount of \$4,261,283 (i.e. net assets). Of the total net assets, \$673,693 was unrestricted and was available to support short-term operations. Total net assets increased from year end 2007 to 2008 in the amount of \$22,691 due to grant funds received for the District's system improvement project.
- Water charges decreased approximately \$17,000 during the year, due to the drought in the previous year.
- Operating expenses increased by approximately \$206,000, largely attributable to depreciation, and the painting of the District's Eagle Tunnel Tank.
- Rural Economic and Community Grant proceeds were \$214,932 during 2008. These proceeds were used for system improvements and an addition to the District's Administrative Offices.
- The District was in compliance with all debt covenants required by borrowing agreements.

Balance Sheet, Statement of Net Assets

Utility Plant decreased by \$147,840, net of depreciation, in 2008. (See diagram below.)

**GALLATIN COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008**

Condensed Assets

	<u>2008</u>	<u>2007</u>	<u>Difference</u>
Utility Plant	\$ 7,265,127	\$ 7,412,967	\$ (147,840)
Current Assets	717,879	701,022	16,857
Other Non-current Assets	433,355	377,475	55,880
Total Net Assets	<u>\$ 8,416,361</u>	<u>\$ 8,491,464</u>	<u>\$ (75,103)</u>

At the end of December 31, 2008, the District had \$7,265,127 invested in capital assets (net of depreciation) including buildings, equipment, and water lines. (See table below.)

	<u>2008</u>	<u>2007</u>
Land & Land Rights	\$ 226,229	\$ 226,229
Structures & Improvements	213,950	220,577
Distribution System	6,374,328	6,553,311
Wells	300,015	313,393
Machinery & Equipment	94,080	85,326
Construction-in-progress	<u>56,525</u>	<u>14,131</u>
Totals	<u>\$ 7,265,127</u>	<u>\$ 7,412,967</u>

This year's major additions included:

- Machinery and equipment acquisitions included the purchase of an excavator.
- Distribution system additions included a line extension on U.S. 42.
- At year end, construction in process included work on an addition to the District's office building.

Long-term debt decreased by normal principal payments made during the year. The decrease in current and accrued liabilities is attributed to the decrease in obligations due on capital projects at December 31, 2008.

Condensed Liabilities

	<u>2008</u>	<u>2007</u>	<u>Difference</u>
Long Term Debt	\$ 3,956,080	\$ 4,029,961	\$ (73,881)
Current & Accrued Liabilities	198,998	222,911	(23,913)
Total Liabilities	<u>\$ 4,155,078</u>	<u>\$ 4,252,872</u>	<u>\$ (97,794)</u>

**GALLATIN COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008**

Net Assets

At December 31, 2008, net assets increased \$22,691, as a result of grant proceeds and contributions in aid of construction of \$248,202 offset by the District's loss from operations (before contributions) of \$225,511.

	<u>2008</u>	<u>2007</u>	<u>Difference</u>
Invested in Capital Assets, Net of Related Debt	\$ 3,299,620	\$ 3,301,241	\$ (1,621)
Restricted for Capital Projects	81,723	108,431	(26,708)
Restricted for Debt Service	206,247	160,378	45,869
Unrestricted	673,693	668,542	5,151
Total	<u>\$ 4,261,283</u>	<u>\$ 4,238,592</u>	<u>\$ 22,691</u>

Income Statement

Operating Revenues for 2008 decreased approximately \$24,000 (3%). Operating expenses increased in 2008 due mainly to painting of an 100,000 gallon elevated tank, labor and related expenses, and increased maintenance costs. Depreciation increased due to the depreciation associated with the first full year of service for the 2006 improvement assets.

Condensed Statement of Revenues and Expenses

	<u>2008</u>	<u>2007</u>	<u>Difference</u>
Operating Revenue	\$ 893,991	\$ 917,832	\$ (23,841)
Operating Expenses	977,434	771,173	(206,261)
Net Operating Revenue	\$ (83,443)	\$ 146,659	\$ (230,102)
Non-Operating Income (Expenses)	(142,068)	(124,808)	(17,260)
Net Income Before Contributions	<u>\$ (225,511)</u>	<u>\$ 21,851</u>	<u>\$ (247,362)</u>

Statement of Cash Flows

Cash from Operating Activities was down \$136,908 in 2008 due to costs associated with tank painting. Cash from capital and related financing activities in 2008 reflect grant monies received and used to finance capital improvements equipment. Cash used in investing activities reflects the redemption of certificates of deposit. Cash is consistent with expectations for the year.

Condensed Statement of Cash Flows

	<u>2008</u>	<u>2007</u>	<u>Difference</u>
Cash from Operating Activities	\$ 261,880	\$ 398,788	\$ (136,908)
Cash from Capital & Related Financing Activities	(113,101)	(210,691)	97,590
Cash from Investing Activities	77,174	(188,574)	265,748
Change in Cash	\$ 225,953	\$ (477)	\$ 226,430
Cash Balance, Beginning of Year	408,125	408,602	(477)
Cash Balance, End of Year	<u>\$ 634,078</u>	<u>\$ 408,125</u>	<u>\$ 225,953</u>

**GALLATIN COUNTY WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008**

Debt

At year-end, the District had \$4,011,401 in notes payable and bonds payable compared to \$4,061,643 last year as shown below. The decrease is attributable to the payment of scheduled principal and interest payments.

	<u>2008</u>	<u>2007</u>
Notes Payable	\$ 584,801	\$ 607,043
Bonds Payable	<u>3,426,600</u>	<u>3,454,600</u>
Totals	<u>\$ 4,011,401</u>	<u>\$ 4,061,643</u>

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The District anticipates the completion of the addition to its office building during 2009.

The District anticipates operating income in 2009 to be comparable to its 2008 results.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office at 4500 Highway 455, Sparta, KY 41086.

Tammy Hendren
Office Manager

GALLATIN COUNTY WATER DISTRICT
STATEMENT OF NET ASSETS
December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Current Assets:		
Cash, Including Time Deposits	\$ 582,166	\$ 568,641
Accounts Receivable Trade (Net)	95,517	96,197
Accounts Receivable-Other	1,276	-
Inventory	25,983	24,864
Prepaid Expense	12,937	11,320
Total Current Assets	<u>\$ 717,879</u>	<u>\$ 701,022</u>
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 386,154	\$ 227,630
Interest Receivable	1,307	3,355
Grant Funds Receivable	-	99,168
Bond Issuance Costs, Net	45,894	47,322
Capital Assets (Net)	7,265,127	7,412,967
Total Noncurrent Assets	<u>\$ 7,698,482</u>	<u>\$ 7,790,442</u>
Total Assets	<u>\$ 8,416,361</u>	<u>\$ 8,491,464</u>
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 13,559	\$ 11,538
Accounts Payable - Construction	6,814	-
Accounts Payable - Retainage	4,822	-
Accrued Wages	5,803	4,401
Accrued Compensated Absences	6,967	6,694
Accrued Payroll Taxes/Employee Withholding	9,020	9,115
Utility Tax Payable	1,959	1,991
Sales Tax Payable	346	410
Deposits Payable	-	2,000
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable	77,476	39,115
Revenue Bonds Payable	49,700	28,000
Note Payable - Kentucky Infrastructure Authority	22,532	22,242
Accounts Payable - Construction	-	89,147
Retainage Payable - Construction	-	8,258
Total Current Liabilities	<u>\$ 198,998</u>	<u>\$ 222,911</u>
Noncurrent Liabilities:		
Revenue Bonds Payable	\$ 3,376,900	\$ 3,426,600
Note Payable - Kentucky Infrastructure Authority	562,269	584,801
Escrow - Customer Construction Deposits	350	350
Noncurrent Liabilities Payable from Restricted Assets:		
Customer Deposits Payable	16,561	18,210
Total Noncurrent Liabilities	<u>\$ 3,956,080</u>	<u>\$ 4,029,961</u>
Total Liabilities	<u>\$ 4,155,078</u>	<u>\$ 4,252,872</u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	\$ 3,299,620	\$ 3,301,241
Restricted for Capital Projects	81,723	108,431
Restricted for Debt Service	206,247	160,378
Unrestricted	673,693	668,542
Total Net Assets	<u>\$ 4,261,283</u>	<u>\$ 4,238,592</u>

GALLATIN COUNTY WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For the Years Ended December 31, 2008 and 2007

Operating Revenues:	2008	2007
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 839,297	\$ 856,078
Total Charges for Services	\$ 839,297	\$ 856,078
Other Charges and Miscellaneous:		
Billing Service Charges	\$ 32,167	\$ 33,813
Reconnect and Disconnect Charges	21,140	20,922
Miscellaneous	1,387	7,019
Total Other Charges and Miscellaneous	\$ 54,694	\$ 61,754
Total Operating Revenues	\$ 893,991	\$ 917,832
 Operating Expenses:		
Bank Charges	\$ 5,532	\$ 4,652
Commissioner Fees	6,700	6,500
Contractual Service - Sampling	14,385	8,790
Dues	1,015	788
Health Insurance	68,732	56,748
Insurance	24,336	22,960
Labor	191,831	183,231
Maintenance of Mains	38,921	23,652
Miscellaneous	-	578
Office Supplies and Expense	20,235	21,189
Other Interest Expense	154	188
Payroll Taxes	14,340	13,837
Professional Services	14,025	30,540
Purchased Water	5,434	28,965
Regulatory Fees	1,493	1,270
Retirement Expense	28,374	26,887
Travel/Transportation Expense	27,118	21,399
Uniforms	2,770	2,588
Utilities - Office	8,714	9,044
Utilities - Pumping	50,010	45,938
Water Reservoir Painting	104,165	-
Depreciation Expense	349,150	261,429
Total Operating Expenses	\$ 977,434	\$ 771,173
Net Operating Income (Loss)	\$ (83,443)	\$ 146,659
 Nonoperating Revenue (Expense):		
Investment Income	\$ 21,223	\$ 22,194
Interest Expense	(161,863)	(133,721)
Amortization of Bond Issuance Costs	(1,428)	(1,429)
Gain (Loss) on Equipment Sold/Abandoned	-	(11,852)
Total Nonoperating Revenues (Expense)	\$ (142,068)	\$ (124,808)
Net Income (Loss) Before Contributions	\$ (225,511)	\$ 21,851
Capital Contributions	248,202	637,588
Net Income	\$ 22,691	\$ 659,439
Net Assets--Beginning of Year	4,238,592	3,579,153
Net Assets--End of Year	\$4,261,283	\$4,238,592

**GALLATIN COUNTY WATER DISTRICT
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2008 and 2007**

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 869,123	\$ 892,619
Payments to Suppliers	(432,914)	(332,850)
Payments to Employees	(196,856)	(188,922)
Other Receipts (Payments)	22,527	27,941
Net Cash Provided (Used) by Operating Activities	\$ 261,880	\$ 398,788
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Contributions	\$ 19,270	\$ 18,020
Rural Development Grant Proceeds	314,100	520,400
Fiscal Court Capital Contribution	14,000	-
Purchases of Capital Assets	(286,727)	(1,816,985)
Bond Issuance Costs Paid	-	(21,352)
Proceeds from Interim Financing	-	1,243,453
Principal Paid on Interim Financing	-	(1,835,383)
Proceeds from Revenue Bonds Issued	-	1,894,000
Principal Paid on Capital Debt	(50,242)	(49,355)
Interest Paid on Capital Debt (including capitalized interest)	(123,502)	(163,489)
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ (113,101)	\$ (210,691)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Investments	\$ (334,243)	\$ (331,072)
Proceeds from Cashed Investments	388,146	122,368
Interest on Investments	23,271	20,130
Net Cash Provided (Used) by Investing Activities	\$ 77,174	\$ (188,574)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 225,953	\$ (477)
Balances-Beginning of the Year	408,125	408,602
Balances-End of the Year	\$ 634,078	\$ 408,125

	Balances Per December 31, 2008 Statement of Net Assets	Balances Per December 31, 2008 Statement of Cash Flows
Cash	\$ 315,660	\$ 315,660
Time Deposits	266,506	-
Restricted Cash	318,418	318,418
Restricted Time Deposits	67,736	-
Total Cash and Cash Equivalents, End of Year	\$ 968,320	\$ 634,078

	Balances Per December 31, 2007 Statement of Net Assets	Balances Per December 31, 2007 Statement of Cash Flows
Cash	\$ 246,274	\$ 246,274
Time Deposits	322,367	-
Restricted Cash	161,851	161,851
Restricted Time Deposits	65,779	-
Total Cash and Cash Equivalents, End of Year	\$ 796,271	\$ 408,125

(Continued)

**GALLATIN COUNTY WATER DISTRICT
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2008 and 2007**

	2008	2007
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ (83,443)	\$ 146,659
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	349,150	261,429
Change in Assets and Liabilities:		
Receivables, Net	680	(3,160)
Accounts Receivable - Other	(1,276)	6,643
Inventories	(1,119)	(5,760)
Prepaid Expenses	(1,617)	(1,343)
Accounts and Other Payables	1,670	(5,171)
Accrued Expenses	(516)	336
Customer Meter Deposits Payable	(1,649)	(845)
	\$ 261,880	\$ 398,788
Net Cash Provided by Operating Activities	\$ 261,880	\$ 398,788

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

At December 31, 2008 and 2007, Gallatin County Water District had incurred \$11,987 and \$97,405 of capitalized expenditures for the acquisition/construction of plant assets, included in accounts/retainage payable-construction on the Statement of Net Assets.

GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2008 and 2007

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES

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

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

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

Basis of presentation and accounting: As stated in Kentucky Revised Statutes (KRS) 278.012, "any water association formed for the purpose of furnishing water services to the general public pursuant to KRS Chapter 273 is deemed to be and shall be a public utility and shall be subject to the jurisdiction of the Public Service Commission." In KRS 278.220, it is outlined that the Public Service Commission may establish a system of accounts to be kept by the utilities subject to its jurisdiction, and may prescribe the manner in which such accounts shall be kept. The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements 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.

All activities of the District are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted; and unrestricted components.

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

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

GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007

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

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

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

Inventory: Inventories are stated at latest cost.

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

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

Contributed capital: Under the Governmental Accounting Standards Board's (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the District recognizes capital contributions as revenues, instead of contributed capital. Grants totaling \$214,932 were received by the District for the year ended December 31, 2008, and \$619,568 for the year ended December 31, 2007. Also, tap-on fees of \$19,270 and \$18,020 were received by the District for the years ended December 31, 2008 and 2007. In 2008 the Gallatin County Fiscal Court contributed \$14,000 for hydrant installations.

Net assets: Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net assets are classified in the following three components: invested in capital assets, net of related debt; restricted; and unrestricted net assets. Invested in capital assets, net of related debt, consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted net assets consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net assets consist of all other net assets not included in the above categories.

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

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

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS

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

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

GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS (Continued)

Transfers sufficient to meet the total obligation outstanding on all issues were made timely during the years ended December 31, 2008 and 2007.

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

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

Transfers were made as required in 2008 and 2007.

A funded short lived asset account is required under the letter of conditions establishing funding for the 2006 system improvement project. Under this agreement, the District must deposit \$5,535 monthly into the account. This account may be used as needed to replace or add short lived assets in the District's water system. Transfers began in January, 2008.

NOTE 3 – CASH AND INVESTMENTS

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

Gallatin County Water District's policies regarding deposits of cash are discussed above. The table presented below is designed to disclose the level of custody credit risk assumed by the District based upon how its deposits were insured or secured with collateral at December 31, 2008 and 2007. The categories of credit risk are defined as follows:

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

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

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

GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007

NOTE 3 – CASH AND INVESTMENTS (Continued)

December 31, 2008

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Custody Credit Risk Category</u>			<u>Total Carrying Value</u>
		<u>1</u>	<u>2</u>	<u>3</u>	
Demand Deposits	\$ 616,577	\$ 477,844	\$ 138,733	\$ -	\$ 634,007
Time Deposits	334,243	334,243	-	-	334,243
Total Deposits	\$ 950,820	\$ 812,087	\$ 138,733	\$ -	\$ 968,250

December 31, 2007

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Custody Credit Risk Category</u>			<u>Total Carrying Value</u>
		<u>1</u>	<u>2</u>	<u>3</u>	
Demand Deposits	\$ 406,148	\$ 195,961	\$ 210,187	\$ -	\$ 408,055
Time Deposits	388,146	322,368	65,778	-	388,146
Total Deposits	\$ 794,294	\$ 518,329	\$ 275,965	\$ -	\$ 796,201

Reconciliation to Statement of Net Assets:

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Unrestricted Cash	\$ 582,166	\$ 568,641
Restricted Cash, Including Time Deposits	386,154	227,630
Less Cash on Hand	(70)	(70)
	\$ 968,250	\$ 796,201

NOTE 4 – RESTRICTED ASSETS

Restricted cash and investments consist of the following:

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Bond and Interest Sinking Account	\$ 126,829	\$ 61,443
Depreciation Account	126,495	109,496
Customer Deposits	22,015	22,229
Construction Account	14,889	9,263
Speedway Maintenance and Replacement Reserve	29,092	25,199
Short Lived Assets Account	66,834	-
Total	\$ 386,154	\$ 227,630

Excess Revenue Account balances were reclassified from restricted cash in 2007 to unrestricted in 2008.

Restricted receivables consist of the following:

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Grant Funds Receivable	\$ -	\$ 99,168
Interest Receivable	1,307	3,355
Total	\$ 1,307	\$ 102,523

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$12,206 and \$14,699 at December 31, 2008 and 2007, respectively. The amount provided for bad debts represents the portion of the total amounts for which collection is unlikely, based on historical collection data.

**GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007**

NOTE 6 – CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2008 and 2007, was as follows:

	Balance at January 1, 2008	Additions	Disposals	Balance at December 31, 2008
Land & Land Rights	\$ 226,229	\$ -	\$ -	\$ 226,229
Organizational Fees	31,926	-	-	31,926
Structures & Improvements	265,112	351	-	265,463
Distribution System	8,224,722	122,674	-	8,347,396
Wells	366,887	-	-	366,887
Machinery & Equipment	237,019	35,891	-	272,910
Construction in Process	14,131	237,100	(194,706)	56,525
Totals at Historical Cost	\$ 9,366,026	\$ 396,016	\$ (194,706)	\$ 9,567,336
Less: Accumulated Depreciation				
Organizational Fees	\$ (31,926)	\$ -	\$ -	\$ (31,926)
Structures & Improvements	(44,535)	(6,978)	-	(51,513)
Distribution System	(1,671,411)	(301,657)	-	(1,973,068)
Wells	(53,494)	(13,378)	-	(66,872)
Machinery & Equipment	(151,693)	(27,137)	-	(178,830)
Total Accumulated Depreciation	\$ (1,953,059)	\$ (349,150)	\$ -	\$ (2,302,209)
Capital Assets, Net	\$ 7,412,967	\$ 46,866	\$ (194,706)	\$ 7,265,127
	Balance at January 1, 2007	Additions	Disposals	Balance at December 31, 2007
Land & Land Rights	\$ 226,229	\$ -	\$ -	\$ 226,229
Organizational Fees	31,926	-	-	31,926
Structures & Improvements	265,112	-	-	265,112
Distribution System	5,874,047	2,358,675	(8,000)	8,224,722
Wells	231,227	135,660	-	366,887
Machinery & Equipment	215,163	21,856	-	237,019
Construction in Process	1,067,293	1,444,504	(2,497,666)	14,131
Totals at Historical Cost	\$ 7,910,997	\$ 3,960,695	\$ (2,505,666)	\$ 9,366,026
Less: Accumulated Depreciation				
Organizational Fees	\$ (31,926)	\$ -	\$ -	\$ (31,926)
Structures & Improvements	(37,557)	(6,978)	-	(44,535)
Distribution System	(1,454,370)	(219,921)	2,880	(1,671,411)
Wells	(44,041)	(9,453)	-	(53,494)
Machinery & Equipment	(126,616)	(25,077)	-	(151,693)
Total Accumulated Depreciation	\$ (1,694,510)	\$ (261,429)	\$ 2,880	\$ (1,953,059)
Capital Assets, Net	\$ 6,216,487	\$ 3,699,266	\$ (2,502,786)	\$ 7,412,967

Included under the District's Plant Assets were \$68,858 and \$62,870 of fully depreciated assets, at December 31, 2008 and 2007, respectively.

Depreciation expense aggregated \$349,150 and \$261,429 in 2008 and 2007, respectively.

**GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007**

NOTE 7 – CUSTOMER DEPOSITS/ESCROW

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

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

NOTE 8 – LONG-TERM DEBT

As of December 31, 2008 and 2007, the long-term debt payable consisted of the following:

Notes Payable:

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Kentucky Infrastructure Authority note payable represents a thirty year loan secured by water revenues. Interest is charged at 1.3% per annum. The original principal balance was \$744,796. Payments of principal, interest, and servicing fees are due semiannually.	\$ 584,801	\$ 607,043
Total Notes Payable	\$ 584,801	\$ 607,043
Current Portion	\$ 22,532	\$ 22,242
Noncurrent Portion	562,269	584,801
Total Notes Payable	\$ 584,801	\$ 607,043

Bonds Payable:

RECD Revenue Bonds of 1988 Series A, original issue amount of \$290,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2028.	\$ 214,000	\$ 220,000
RECD Revenue Bonds of 1988 Series B, original issue amount of \$108,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2028.	82,000	84,000
RECD Revenue Bonds of 1993, original issue amount of \$420,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2032.	343,000	350,000
RECD Revenue Bonds of 1996, original issue amount of \$371,000, secured by water revenues. Interest is charged at the rate of 4.875% per annum. Final maturity is January 1, 2035.	324,100	329,500

**GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007**

NOTE 8 – LONG-TERM DEBT (Continued)

Bonds Payable: (Continued)

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
RECD Revenue Bonds of 2000 Series A, original issue amount of \$370,000, secured by water revenues. Interest is charged at the rate of 4.875% per annum. Final maturity is January 1, 2039.	341,300	346,000
RECD Revenue Bonds of 2000 Series B, original issue amount of \$112,000, secured by water revenues. Interest is charged at the rate of 5.0% per annum. Final maturity is January 1, 2039.	103,700	105,100
RECD Revenue Bonds of 2002, original issue amount of \$130,000, secured by water revenues. Interest is charged at the rate of 4.625% per annum. Final maturity is January 1, 2042.	124,500	126,000
RECD Revenue Bonds of 2006, Series A, original issue amount of \$1,394,000, secured by water revenues. Interest is charged at the rate of 4.125% per annum. Final maturity is January 1, 2046.	1,394,000	1,394,000
RECD Revenue Bonds of 2006, Series B original issue amount of \$500,000, secured by water revenues. Interest is charged at the rate of 4.125% per annum. Final maturity is January 1, 2046.	500,000	500,000
Total Bonds Payable	\$ 3,426,600	\$ 3,454,600
Current Portion	\$ 49,700	\$ 28,000
Noncurrent Portion	3,376,900	3,426,600
Total Bonds Payable	\$ 3,426,600	\$ 3,454,600

Accrued Compensated Absences:

Current Accrued Compensated Absences	\$ 6,967	\$ 6,694
---	-----------------	-----------------

Changes in Long-term Debt

The following is a summary of changes in long-term debt for the years ended December 31, 2008 and 2007.

December 31, 2008

	Balance at January 1, 2008	Additions	Repayments	Balance at December 31, 2008	Current Portion
Notes Payable	\$ 607,043	\$ -	\$ (22,242)	\$ 584,801	\$ 22,532
Bonds Payable	3,454,600	-	(28,000)	3,426,600	49,700
Accrued Compensated Absences	6,694	273	-	6,967	6,967
Total Enterprise Fund Debt	\$ 4,068,337	\$ 273	\$ (50,242)	\$ 4,018,368	\$ 79,199

GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007

NOTE 8 – LONG-TERM DEBT (Continued)

December 31, 2007

	Balance at January 1, 2007	Additions	Repayments	Balance at December 31, 2007	Current Portion
Notes Payable	\$ 628,998	\$ -	\$ (21,955)	\$ 607,043	\$ 22,242
Notes Payable-Interim Financing	591,930	1,243,453	(1,835,383)	-	-
Bonds Payable	1,588,000	1,894,000	(27,400)	3,454,600	28,000
Accrued Compensated Absences	7,056	-	(362)	6,694	6,694
Total Enterprise Fund Debt	\$ 2,815,984	\$ 3,137,453	\$ (1,885,100)	\$ 4,068,337	\$ 56,936

The annual requirements for all long-term debt outstanding at December 31, 2008, are as follows:

Due	Bonds	Bond Interest	KIA Note	Note Interest	Note Servicing Fee	Total Payments Due
2009	\$ 49,700	\$ 151,170	\$ 22,532	\$ 7,529	\$ 1,158	\$ 232,089
2010	53,700	148,692	22,826	7,236	1,113	233,567
2011	55,700	146,118	23,123	6,938	1,067	232,946
2012	57,800	143,450	23,425	6,636	1,021	232,332
2013	60,800	140,645	23,730	6,331	974	232,480
2014-2018	349,900	656,297	123,376	26,930	4,143	1,160,646
2019-2023	443,200	562,738	131,634	18,672	2,873	1,159,117
2024-2028	559,800	444,621	140,446	9,861	1,517	1,156,245
2029-2033	549,400	315,322	73,709	1,443	222	940,096
2034-2038	509,100	197,348	-	-	-	706,448
2039-2043	454,200	94,833	-	-	-	549,033
2044 and thereafter	283,300	12,029	-	-	-	295,329
	\$ 3,426,600	\$ 3,013,263	\$ 584,801	\$ 91,576	\$ 14,088	\$ 7,130,328

The annual requirements for all long-term debt outstanding at December 31, 2007, are as follows:

Due	Bonds	Bond Interest	KIA Note	Note Interest	Note Servicing Fee	Total Payments Due
2008	\$ 28,000	\$ 153,459	\$ 22,242	\$ 7,819	\$ 1,203	\$ 212,723
2009	49,700	151,170	22,532	7,529	1,158	232,089
2010	53,700	148,692	22,826	7,236	1,113	233,567
2011	55,700	146,118	23,123	6,938	1,067	232,946
2012	57,800	143,450	23,425	6,636	1,021	232,332
2013-2017	333,700	672,464	121,788	28,518	4,388	1,160,858
2018-2022	423,500	583,247	129,939	20,366	3,133	1,160,185
2023-2027	533,800	470,554	138,637	11,669	1,795	1,156,455
2028-2032	570,600	340,233	102,531	2,684	414	1,016,462
2033-2037	508,400	219,709	-	-	-	728,109
2038-2042	469,200	113,912	-	-	-	583,112
2043 and thereafter	370,500	23,715	-	-	-	394,215
	\$ 3,454,600	\$ 3,166,723	\$ 607,043	\$ 99,395	\$ 15,292	\$ 7,343,053

**GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007**

NOTE 9 – COMPENSATED ABSENCES

Vacation days accumulate as follows:

At the end of 1 st year	1 week of vacation
At the end of 2 nd year	2 weeks of vacation
At the end of 5 th year	3 weeks of vacation

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

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

In accordance with the above criteria, the District has accrued a liability for compensated absences in the amount of \$6,967 and \$6,694 at December 31, 2008 and 2007, respectively.

NOTE 10 – INTEREST EXPENSE

Interest expense incurred and charged to expense for the years ended December 31, 2008 and 2007 was \$162,017 and \$133,909, respectively. No interest was capitalized in 2008. Interest of \$23,200 (net of interest earned) was capitalized in 2007.

NOTE 11 – FUND EQUITY – RESTRICTED NET ASSETS

	December 31, 2008	December 31, 2007
Restricted Capital Projects:		
Monies Restricted for Future Projects	\$ 81,723	\$ 9,263
Grant Funds Receivable Restricted for Construction Costs	-	99,168
	\$ 81,723	\$ 108,431
Restricted for Debt Service:		
RECD Revenue Bonds of 1988, 1993, 1996, 2000, 2002 and 2006		
Kentucky Infrastructure Authority Note		
Cash	\$ 282,416	\$ 196,138
Add: Accrued Interest Receivable	1,307	3,355
Less: Accrued Interest Payable	(77,476)	(39,115)
Total Restricted for Debt Service	\$ 206,247	\$ 160,378

NOTE 12 – BAD DEBT EXPENSE

Water revenue charges have been netted with estimated bad debt expense of \$7,024 and \$13,835 at December 31, 2008 and 2007, respectively.

NOTE 13 – INSURANCE AND RELATED ACTIVITIES

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

**GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007**

NOTE 14 – THE COUNTY EMPLOYEES’ RETIREMENT SYSTEM

Entry into the Commonwealth of Kentucky’s County Employees’ Retirement System (CERS) was authorized by the Commissioners in November 1999. Beginning December 1, 1999, electing employees and all new employees of the District may participate in the System. The most recent financial report on CERS is included in the Kentucky Retirement System’s annual report, June 30, 2008 and 2007. Copies of this report will be distributed to each participating employer in the Kentucky Employees Retirement System, County Employees Retirement System, and State Police Retirement System. Copies will also be available to Legislative personnel and state libraries.

Plan Description – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the plan documents. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Contributions – For the years ended June 30, 2008, and 2007, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565 (3), normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems (Board) on the basis of an annual valuation last 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. For the years ended June 30, 2008 and 2007, participating employers contributed 13.19% of each employee’s creditable compensation through June 30, 2007 and 16.17% of each employee’s creditable compensation through June 30, 2008. The rate was decreased to 13.50% July 1, 2008. These were the actuarially determined rates determined by the Board to be paid on creditable compensation. Administrative costs of the Kentucky Retirement System are financed through employer contributions and investment earnings.

The District’s total payroll for the year ended December 31, 2008, was \$201,577. Contributions were based on \$194,877 (eligible gross wages). The total pension expense for the fiscal year ended December 31, 2008, was \$28,876 and \$9,744 for the employer and employees, respectively. All contributions were made as required during the year ending December 31, 2008.

The District’s total payroll for the year ended December 31, 2007, was \$192,266. Contributions were based on \$185,766 (eligible gross wages). The total pension expense for the fiscal year ended December 31, 2007, was \$27,338 and \$9,288 for the employer and employees, respectively. All contributions were made as required during the year ending December 31, 2007.

The District’s contribution for the years ended June 30, 2008 and 2007, was .007% and .009%, respectively, of the System’s total contribution requirements for all employers.

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

	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributions
June 30, 2008	544,853,127	347,035,445	6,003,181	64.8%
June 30, 2007	398,108,795	271,869,651	9,623,431	70.7%
June 30, 2006	356,066,426	219,701,869	-	61.7%

**GALLATIN COUNTY WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2008 and 2007**

NOTE 15 – CONSTRUCTION PROJECTS

During 2006, the District began work on a project providing system improvements (storage tanks, pump stations, and telemetry and waterlines) to improve water service. The project was financed with a RUS loan in the amount of \$1,894,000 (issued during 2007) and a RUS Grant of \$900,000. Contracts were awarded as follows: Coomer Construction, \$253,594, National Water Services \$118,665, Kentucky Glass Lined Tanks \$183,294, Caldwell Tank Builders, Inc. \$816,120 and Lykins Contracting \$688,770. Gastineau and Associates are engineers for the project. At December 31, 2007 the project as originally bid was substantially complete with final draws and retainages outstanding.

At the end of 2007 approximately \$280,000 in grant money remained available for construction and capital acquisitions. These funds have been obligated or expended during 2008 as follows: Purchase of a Caterpillar mini hydraulic excavator, a line extension on U.S. Highway 42, and an expansion of the District's administrative offices. Approximately \$40,000 remains to be paid out on the contracts. The District will receive \$65,500 as the final draw on the Rural Development Grant when all construction is complete and accepted.

NOTE 16 – RESALE AGREEMENT

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

NOTE 17 - PURCHASED WATER CONTRACT

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

NOTE 18 – WATER SUPPLY AGREEMENT – ECONOMIC DEPENDENCY

The District has entered into a water-supply agreement with Kentucky Speedway, LLC. Under the terms of the agreement, Kentucky Speedway, LLC is assessed an annual minimum charge of \$35,000 for annual usage up to 8,500,000 gallons. The Speedway is billed monthly the minimum installment plus sales tax and school tax. When accumulated usage exceeds the annual maximum, the Speedway is charged the current rates in effect for that usage. Five percent (5.0%) of total water revenue was received from Kentucky Speedway, LLC for the years ended December 31, 2008 and 2007.

NOTE 19 – CONTINGENCIES

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

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

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

We have audited the financial statements of Gallatin County Water District, as of and for the year ended December 31, 2008, and have issued our report thereon dated March 24, 2009. 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 Gallatin County Water District'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 Gallatin County Water District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Gallatin County Water District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Gallatin County Water District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Gallatin County Water District's financial statements that is more than inconsequential will not be prevented or detected by Gallatin County Water District's internal control. We consider items 08-1 and 08-2 described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Gallatin County Water District's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We consider the significant deficiencies described above to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether Gallatin 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 others matters that we reported to management of Gallatin County Water District, in a separate letter dated, March 24, 2009.

Gallatin County Water District's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Gallatin County Water District's response and, accordingly, we express no opinion on it.

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

Raisor, Zapp & Woods, P.S.C.

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

March 24, 2009

GALLATIN COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2008

A. SUMMARY OF AUDIT RESULTS

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

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

SIGNIFICANT DEFICIENCIES

08-1 SIZE OF ENTITY

CONDITION:

Due to size of administrative staff, the internal control is limited.

CRITERIA:

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition.

CAUSE:

The size of the District's administrative staff limits the ability to rotate duties and implement checking procedures.

EFFECT:

The staff size of the District limits the ability to rotate duties and implement checking procedures. This limitation may affect the ability to record, process, summarize and report financial data.

RECOMMENDATION:

Management should strive to separate duties as staff and cost benefits allow.

RESPONSE:

The District is continuing its cross-training efforts to implement checking procedures and rotation of duties.

08-2 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED NOTE DISCLOSURES

CONDITION:

District financial statements, including the required disclosures, are prepared as part of annual audit.

CRITERIA:

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

GALLATIN COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2008

B. FINDINGS – FINANCIAL STATEMENTS AUDIT (CONTINUED)

SIGNIFICANT DEFICIENCIES (Continued)

08-2 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED NOTE DISCLOSURES (Continued)

CAUSE:

The draft accrual basis financial statements and disclosures are prepared during the audit process. The entries are entered into the District's general ledger/financial reports.

EFFECT:

Management engaged auditor to prepare the draft of the financial statements, including the related notes to the financial statements. Management reviewed, approved, and accepted responsibility for the financial statements prior to their issuance.

RECOMMENDATION:

The outsourcing of this service is not unusual for a District this size and is a result of management's cost benefit decision to use others' accounting expertise rather than incur internal resource costs. We recommend that District Management continue to enhance its knowledge of reporting requirements in providing oversight of this service.

RESPONSE:

We concur with the recommendation and will continue to improve our overall accounting knowledge.

COMPLIANCE AND OTHER MATTERS

NONE

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

RURAL DEVELOPMENT COMPLIANCE LETTER

We have audited the financial statements of Gallatin County Water District as of December 31, 2008, and have issued our report thereon dated March 24, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Gallatin County Water District for the year ended December 31, 2008, we considered its internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Gallatin County Water District's internal control over financial reporting. After obtaining an understanding of the control environment and the flow of transactions through the accounting system, we did not rely on the system of internal accounting controls because of the size of the entity. Two significant deficiencies in internal control were identified and reported as material weaknesses.

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

1. The accounting records of Gallatin County Water District appear adequate.
2. Control over fixed assets is adequate. A supply inventory has been taken.
3. USDA Rural Development loan agreements for the 1988, 1993, 1996, 2000, 2002 and 2006 issues require transfers to be made monthly to the Bond and Interest Sinking Account and Depreciation Account. All accounts are properly funded as of December 31, 2008. Transfers required under the 2006 issues to the Depreciation Account and those required in the establishment of a short lived asset account began in January, 2008.
4. The general accounting records were kept on forms and in the manner suggested by Rural Development.
5. All bank accounts were confirmed directly by the depositories and reconciled to the cash balances as shown in these financial statements. The accounts are insured up to \$250,000 by the Federal Deposit Insurance Corporation. Deposits held at Integra Bank National Association are also secured by Kentucky Municipal Bonds with a market value of \$509,900. Deposits in excess of FDIC coverage at First Farmers Bank are secured by two Federal Home Loan Bank letters of credit for \$200,000 and \$100,000, respectively.

6. Insurance coverage may be summarized as follows:

<u>General and Public Officials Liability</u>	\$	3,000,000	
<u>Vehicles & Equipment</u>	\$	3,000,000	Liability/Each Accident
<u>Property, Buildings, Tanks & Equipment</u>	\$	4,005,372	
<u>Employee Dishonesty</u>	\$	150,000	
<u>Fidelity Bond (Position)</u>			
Commissioner (2 Positions)	\$	211,000	
Secretary/Bookkeeper		211,000	
Office Manager		211,000	
<u>Position Bond</u>			
Commissioner(s) & Office Manager	\$	100,000	each
<u>Workmen's Compensation</u>			
All employees			Statutory

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

8. Accounts receivable as of December 31, 2008, may be aged as follows.

<u>Total Accounts Receivable</u>	<u>1-30 Days</u>	<u>31-60 Days</u>	<u>Over 60</u>
\$ 107,723	\$ 94,128	\$ 3,590	\$ 10,005

<u>Total Accounts Receivable</u>	<u>Allowance for Uncollectibles</u>	<u>Net Accounts Receivable</u>
\$ 107,723	\$ 12,206	\$ 95,517

Respectfully submitted,

Raisor, Zapp & Woods, PSC

RAISOR, ZAPP & WOODS, PSC
Certified Public Accountants

March 24, 2009