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DAMON R. TALLEY

ATTORNEY AT LAW

August 29, 2012

Mr. Jeff Derouen
Executive Director
Public Service Commission
PO Box 615
Frankfort, KY 40602

RECEIVED

AUG 29 2012

**PUBLIC SERVICE
COMMISSION**

RE: Hardin County Water District No. 2
Bond Refunding

Dear Mr. Derouen:

Enclosed for filing are the original and ten (10) copies of the Application of the Hardin County Water District No. 2 to issue securities pursuant to KRS 278.300 for the purpose of refunding certain high interest Bonds of the Applicant.

No rate increase will be required.

The tentative Closing date is **October 2, 2012.**

Should you need any additional information, please let me know.

Yours truly,

DAMON R. TALLEY, P.S.C.



DAMON R. TALLEY, ATTORNEY FOR
HARDIN COUNTY WATER DISTRICT NO. 2

DRT:ms

Enclosures

cc: Hardin County Water District No. 2

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

THE APPLICATION OF THE HARDIN)
COUNTY WATER DISTRICT NO. 2 TO ISSUE)
SECURITIES IN THE APPROXIMATE)
PRINCIPAL AMOUNT OF \$6,070,000 FOR)
THE PURPOSE OF REFUNDING CERTAIN) CASE NO. 2012- _____
OUTSTANDING REVENUE BONDS OF THE)
DISTRICT PURSUANT TO THE PROVISIONS)
OF KRS 278.300 AND 807 KAR 5 :001)

RECEIVED

AUG 29 2012

**PUBLIC SERVICE
COMMISSION**

** ** ** ** **

APPLICATION

The Applicant, Hardin County Water District No. 2 (the "District"), files this Petition and Application, pursuant to KRS 278.300, 807 KAR 5:001, and all other applicable laws and regulations, and requests that the Public Service Commission of Kentucky (the "Commission") enter an Order authorizing the District to issue certain securities in the approximate principal amount of \$6,070,000 for the purpose of refunding certain outstanding water system revenue bonds of the District. In support of the Petition and Application, and in compliance with the rules and regulations of the commission, the District states as follows:

1. The District was established by the Order of the County Court of Hardin County entered on June 23, 1965, pursuant to the provisions of KRS Chapter 74. The District is now, and has been since its inception, regulated by the Commission, and all records and proceedings of the Commission with reference to the District are incorporated in this Application by reference.

2. The governing body of the District is its Board of Commissioners. The District is a public body corporate, with power to make contracts in furtherance of its lawful and proper purposes as provided in KRS 74.070 and all other applicable laws.

3. The mailing address of the District is as follows:

Hardin County Water District No.2
360 Ring Road, P.O. Box 970
Elizabethtown, KY 42702
Attn: James R. Jeffries, Manager
Telephone: (270) 737-1056

4. A general description of the District's water system property, together with a statement of the original cost, is contained in the District's Annual Report for 2011 which is on file with the Commission. The Annual Report is incorporated herein by reference.

5. The District proposes to issue new securities, to be designated as Water System Refunding Revenue Bonds, Series 2012A (the "2012A Bonds"), in the principal amount of \$6,070,000 for the purpose of currently refunding the following revenue bonds:

- A. Water System Refunding Revenue Bonds, Series 2003, in the outstanding principal amount of \$3,290,000 (the "2003 Bonds"), which bear interest at rates ranging from 3.75% to 4.625% per annum; and
- B. Water System Revenue Bonds, Series 2005A, in the outstanding principal amount of \$2,775,000 (the "2005A Bonds"), which bear interest at a fixed rate of 4.375% per annum.

6. The actual Debt Service Schedule for the proposed 2012A Bonds is shown in **Exhibit 1**, which is attached hereto and incorporated herein by reference. **Exhibit 1** also shows the actual coupon rate for each maturity and the actual average coupon rate. **Exhibit 1** was prepared after competitive bids for the proposed 2012A Bonds were received on August 28, 2012. Consequently, **Exhibit 1** reflects the actual interest rates and the actual Debt Service Schedule for the proposed 2012A Bonds. The 2012A Bonds were sold pursuant to public advertisement soliciting competitive bids according to Kentucky law.

7. As shown in **Exhibit 1**, the proposed 2012A Bonds will bear interest at rates ranging from 1.00% to 3.75%.

8. The issuance of the 2012A Bonds will provide the District with the funds necessary: (a) to allow it to currently refund the 2003 Bonds and the 2005A Bonds; and (b) to pay the fees and expenses incident to the issuance of the 2012A Bonds.

9. The Sources and Uses of the funds to be obtained from the issuance of the 2012A Bonds are detailed in **Exhibit 2**, which is attached hereto and incorporated herein by reference.

10. The proposed refinancing of the 2003 and 2005A Bonds will result in total gross savings of approximately \$1,908,329 and a net present value savings of \$1,028,496. This represents a net present value savings of approximately 16.96%. These savings are shown in the Gross Debt Service Comparison schedule, which is attached hereto and incorporated herein by reference as **Exhibit 3**.

11. The Debt Service Schedule of the 2003 Bonds which are being currently refunded is set forth in **Exhibit 4**, which is attached hereto and incorporated herein by reference.

12. The Debt Service Schedule of the 2005A Bonds which are being currently refunded is set forth in **Exhibit 5**, which is attached hereto and incorporated herein by reference.

13. The District represents that the issuance of the 2012A Bonds will be in the public interest and is intended to accomplish the purpose of strengthening the financial condition of the District by producing substantial debt service savings. This is a lawful object within the corporate purposes of the District's utility operations. The issuance of the 2012A Bonds is necessary, appropriate for, and consistent with the proper performance by the District of its

service to the public and will not impair its ability to perform that service.

14. The District represents that it will, as soon as reasonably possible after the issuance of the 2012A Bonds, file with the Commission a statement setting forth the date of issuance of the 2012A Bonds, the price paid, the fees and expenses incurred in the issuance of the 2012A Bonds, and the terms and interest rates of the 2012A Bonds.

15. The detailed Income Statement and Balance Sheet for the twelve (12) month period ending on December 31, 2011 are attached hereto and incorporated herein by reference as **Exhibits 6 and 7** respectively.

16. The remaining financial schedules and other information necessary for the Financial Exhibit required by 807 KAR 5:001, Section 6 and Section 11 (2)(a) are contained in the 2011 Annual Report which is on file with the Commission. The Annual Report is incorporated herein by reference.

17. Pursuant to KAR 5:001, the District hereby states as follows:

- A. Section 6(4) Mortgages: The District does not have any mortgages in effect as of the date hereof;
- B. Section 6(5) Bonds: The 2012A Bonds will be secured by a pledge of the revenues of the District's System;
- C. Section 11(2)(b): The District does not have any trust deeds in effect as of the date hereof; and
- D. Section 11(2)(c): No property is being acquired as the proceeds of the securities are being used for the purpose of currently refunding the 2003 Bonds and the 2005A Bonds.

18. A copy of the District's audited financial statements for the years ended December 31, 2011 and 2010 is attached hereto and incorporated herein by reference as **Exhibit 8**.

19. The District hereby requests and moves for a deviation, pursuant to 807 KAR 5:001, Section 14, from the requirements of 807 KAR 5:001, Section 11(2)(a), which requires that the financial data filed with the Application be for a twelve (12) month period ending within ninety (90) days of the filing of the Application. The District states that there has been no material change in the financial condition or operation of the District since December 31, 2012. The financial data filed with this Application is for the twelve (12) month period ending December 31, 2011. This is the most recent published financial data available. Because of the volatility of the bond market, the District cannot run the risk of delaying the closing of the 2012A Bonds while more current financial data is compiled. The current, favorable market conditions could disappear overnight.

20. The District believes that the financial information submitted with this Application is sufficient to enable the Commission to adequately, effectively and efficiently review this Application to issue securities.

21. The sale of the proposed 2012A Bonds was held on August 28, 2012 and the closing is tentatively scheduled for **October 2, 2012**.

22. No rate adjustment will be necessary.

WHEREFORE, the District respectfully requests that the Commission take the following actions:

1. Place this Application to issue securities at the head of the docket as provided by KRS 278.300(2);
2. Authorize the issuance of the securities requested in the Application prior to the proposed Closing date of **October 2, 2012**.
3. Grant the District a deviation, to the extent necessary, from 801 KAR 5:001, Section 11(2)(a) to allow the submission of the District's Audit for the twelve (12) month period ending December 31, 2011 in lieu of more recent financial data; and
4. Process this Application without a formal hearing in order to save time and expense. The District will promptly respond to any inquiries or information requests by the Commission's staff.

This August 28, 2012.

Respectfully submitted,
HARDIN COUNTY WATER
DISTRICT NO. 2

BY:


MICHAEL L. BELL, CHAIRMAN


DAMON R. TALLEY, P.S.C.

Counsel for Applicant

PO Box 150

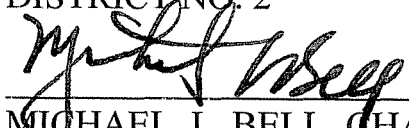
Hodgenville, KY 42748-0150

(270) 358-3187 FAX (270) 358-9560

COMMONWEALTH OF KENTUCKY)
) SS:
COUNTY OF HARDIN)

The undersigned, MICHAEL L. BELL, being first duly sworn, deposes and states that he is the Chairman of the Commission of Hardin County Water District No. 2; that he has read the foregoing Application and has noted the contents thereof; and that the statements of fact set forth therein are true and correct.

IN TESTIMONY WHEREOF, witness the signature of the undersigned on this August 28, 2012.

HARDIN COUNTY WATER
DISTRICT NO. 2
BY: 
MICHAEL L. BELL, CHAIRMAN

Subscribed and sworn to before me by Michael L. Bell, in his capacity as Chairman of the Commission of the Hardin County Water District No. 2, on this August 28, 2012.

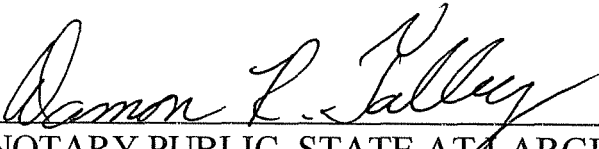

NOTARY PUBLIC, STATE AT LARGE
MY COMMISSION EXPIRES: 6-9-15

EXHIBIT LIST

1. DEBT SERVICE SCHEDULE FOR 2012A BONDS
2. SOURCES AND USES FOR 2012A BONDS
3. GROSS DEBT SERVICE COMPARISON
(2012A AND PRIOR BONDS BEING REFUNDED)
4. DEBT SERVICE SCHEDULE FOR 2003 BONDS BEING
REFUNDED
5. DEBT SERVICE SCHEDULE FOR 2005A BONDS BEING
REFUNDED
6. INCOME STATEMENT
7. BALANCE SHEET
8. 2011 AUDIT

BOND DEBT SERVICE

Hardin County Water District No. 2 Revenue Bonds
Series 2012 (Refunding of 2003 and 2005 RD) - Shorten 05 Scenario

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service
10/02/2012					
01/01/2013	215,000	1.000%	41,181.04	256,181.04	
07/01/2013			82,212.50	82,212.50	
12/31/2013					338,393.54
01/01/2014	180,000	2.000%	82,212.50	262,212.50	
07/01/2014			80,412.50	80,412.50	
12/31/2014					342,625.00
01/01/2015	185,000	2.000%	80,412.50	265,412.50	
07/01/2015			78,562.50	78,562.50	
12/31/2015					343,975.00
01/01/2016	190,000	2.000%	78,562.50	268,562.50	
07/01/2016			76,662.50	76,662.50	
12/31/2016					345,225.00
01/01/2017	195,000	2.000%	76,662.50	271,662.50	
07/01/2017			74,712.50	74,712.50	
12/31/2017					346,375.00
01/01/2018	195,000	2.000%	74,712.50	269,712.50	
07/01/2018			72,762.50	72,762.50	
12/31/2018					342,475.00
01/01/2019	200,000	2.000%	72,762.50	272,762.50	
07/01/2019			70,762.50	70,762.50	
12/31/2019					343,525.00
01/01/2020	205,000	2.125%	70,762.50	275,762.50	
07/01/2020			68,584.38	68,584.38	
12/31/2020					344,346.88
01/01/2021	210,000	2.250%	68,584.38	278,584.38	
07/01/2021			66,221.88	66,221.88	
12/31/2021					344,806.26
01/01/2022	215,000	2.375%	66,221.88	281,221.88	
07/01/2022			63,668.75	63,668.75	
12/31/2022					344,890.63
01/01/2023	220,000	2.375%	63,668.75	283,668.75	
07/01/2023			61,056.25	61,056.25	
12/31/2023					344,725.00
01/01/2024	230,000	2.500%	61,056.25	291,056.25	
07/01/2024			58,181.25	58,181.25	
12/31/2024					349,237.50
01/01/2025	235,000	2.500%	58,181.25	293,181.25	
07/01/2025			55,243.75	55,243.75	
12/31/2025					348,425.00
01/01/2026	245,000	2.750%	55,243.75	300,243.75	
07/01/2026			51,875.00	51,875.00	
12/31/2026					352,118.75
01/01/2027	245,000	2.750%	51,875.00	296,875.00	
07/01/2027			48,506.25	48,506.25	
12/31/2027					345,381.25
01/01/2028	255,000	2.750%	48,506.25	303,506.25	
07/01/2028			45,000.00	45,000.00	
12/31/2028					348,506.25
01/01/2029	265,000	2.750%	45,000.00	310,000.00	
07/01/2029			41,356.25	41,356.25	
12/31/2029					351,356.25
01/01/2030	270,000	3.000%	41,356.25	311,356.25	
07/01/2030			37,306.25	37,306.25	
12/31/2030					348,662.50

BOND DEBT SERVICE

Hardin County Water District No. 2 Revenue Bonds
 Series 2012 (Refunding of 2003 and 2005 RD) - Shorten 05 Scenario

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service
01/01/2031	280,000	3.250%	37,306.25	317,306.25	
07/01/2031			32,756.25	32,756.25	
12/31/2031					350,062.50
01/01/2032	295,000	3.250%	32,756.25	327,756.25	
07/01/2032			27,962.50	27,962.50	
12/31/2032					355,718.75
01/01/2033	300,000	3.500%	27,962.50	327,962.50	
07/01/2033			22,712.50	22,712.50	
12/31/2033					350,675.00
01/01/2034	210,000	3.500%	22,712.50	232,712.50	
07/01/2034			19,037.50	19,037.50	
12/31/2034					251,750.00
01/01/2035	220,000	3.500%	19,037.50	239,037.50	
07/01/2035			15,187.50	15,187.50	
12/31/2035					254,225.00
01/01/2036	230,000	3.750%	15,187.50	245,187.50	
07/01/2036			10,875.00	10,875.00	
12/31/2036					256,062.50
01/01/2037	235,000	3.750%	10,875.00	245,875.00	
07/01/2037			6,468.75	6,468.75	
12/31/2037					252,343.75
01/01/2038	250,000	3.750%	6,468.75	256,468.75	
07/01/2038			1,781.25	1,781.25	
12/31/2038					258,250.00
01/01/2039	85,000	3.750%	1,781.25	86,781.25	
07/01/2039			187.50	187.50	
12/31/2039					86,968.75
01/01/2040	10,000	3.750%	187.50	10,187.50	
12/31/2040					10,187.50
	6,070,000		2,581,293.56	8,651,293.56	8,651,293.56

SOURCES AND USES OF FUNDS

Hardin County Water District No. 2 Revenue Bonds
Series 2012 (Refunding of 2003 and 2005 RD) - Shorten 05 Scenario

Dated Date 10/02/2012
Delivery Date 10/02/2012

Sources:	Refunding of 03	Refunding of 2005 RD - Shorten Scenario	Total
Bond Proceeds:			
Par Amount	3,187,046.00	2,882,954.00	6,070,000.00
Premium	75,487.30	64,467.95	139,955.25
	<u>3,262,533.30</u>	<u>2,947,421.95</u>	<u>6,209,955.25</u>
Other Sources of Funds:			
Transfer from Prior Sinking Fund	56,300.63	41,069.34	97,369.97
Release from Debt Service Reserve	116,053.55		116,053.55
Cash for Additional DSR Deposit		15,333.00	15,333.00
	<u>172,354.18</u>	<u>56,402.34</u>	<u>228,756.52</u>
	<u>3,434,887.48</u>	<u>3,003,824.29</u>	<u>6,438,711.77</u>

Uses:	Refunding of 03	Refunding of 2005 RD - Shorten Scenario	Total
Refunding Escrow Deposits:			
Cash Deposit	0.91	2,806,477.87	2,806,478.78
SLGS Purchases	3,361,846.00		3,361,846.00
	<u>3,361,846.91</u>	<u>2,806,477.87</u>	<u>6,168,324.78</u>
Other Fund Deposits:			
Deposit to Debt Service Reserve Fund		131,386.55	131,386.55
Cost of Issuance:			
Financial Advisor	8,663.30	7,836.70	16,500.00
Bond Counsel	11,381.29	10,295.35	21,676.64
Local Counsel	10,500.98	9,499.02	20,000.00
CPA (Parity Certificate)	787.57	712.43	1,500.00
Rating Agency	7,350.68	6,649.32	14,000.00
	<u>38,683.82</u>	<u>34,992.82</u>	<u>73,676.64</u>
Underwriter's Discount:			
Underwriter's Discount	32,117.43	29,052.95	61,170.38
Other Delivery Date Expenses:			
Trustee Fee	262.52	237.48	500.00
Other Uses of Funds:			
Additional Proceeds	1,976.80	1,676.62	3,653.42
	<u>3,434,887.48</u>	<u>3,003,824.29</u>	<u>6,438,711.77</u>

Exhibit 3

Gross Debt Service Comparison

2012A Bonds

and

Prior Bonds Being Refunded

SAVINGS

Hardin County Water District No. 2 Revenue Bonds
Series 2012 (Refunding of 2003 and 2005 RD) - Shorten 05 Scenario

Date	Prior Debt Service	Refunding Debt Service	Refunding Expenses	Refunding Net Cash Flow	Savings	Present Value to 10/02/2012 @ 2.8289532%
12/31/2013	385,722.81	338,393.54	500.00	338,893.54	46,829.27	45,830.70
12/31/2014	382,374.38	342,625.00	500.00	343,125.00	39,249.38	37,250.88
12/31/2015	384,355.63	343,975.00	500.00	344,475.00	39,880.63	36,821.18
12/31/2016	386,016.88	345,225.00	500.00	345,725.00	40,291.88	36,187.58
12/31/2017	387,284.38	346,375.00	500.00	346,875.00	40,409.38	35,302.10
12/31/2018	383,225.63	342,475.00	500.00	342,975.00	40,250.63	34,200.91
12/31/2019	384,393.44	343,525.00	500.00	344,025.00	40,368.44	33,366.95
12/31/2020	385,244.37	344,346.88	500.00	344,846.88	40,397.49	32,480.31
12/31/2021	385,778.44	344,806.26	500.00	345,306.26	40,472.18	31,653.11
12/31/2022	385,995.63	344,890.63	500.00	345,390.63	40,605.00	30,891.30
12/31/2023	385,685.94	344,725.00	500.00	345,225.00	40,460.94	29,943.01
12/31/2024	390,217.19	349,237.50	500.00	349,737.50	40,479.69	29,142.55
12/31/2025	388,790.63	348,425.00	500.00	348,925.00	39,865.63	27,915.90
12/31/2026	387,518.76	352,118.75	500.00	352,618.75	34,900.01	23,733.03
12/31/2027	386,379.69	345,381.25	500.00	345,881.25	40,498.44	26,841.96
12/31/2028	389,260.94	348,506.25	500.00	349,006.25	40,254.69	25,955.04
12/31/2029	391,946.89	351,356.25	500.00	351,856.25	40,090.64	25,149.50
12/31/2030	389,035.95	348,662.50	500.00	349,162.50	39,873.45	24,334.11
12/31/2031	391,114.07	350,062.50	500.00	350,562.50	40,551.57	24,079.32
12/31/2032	392,554.70	355,718.75	500.00	356,218.75	36,335.95	20,970.70
12/31/2033	393,357.83	350,675.00	500.00	351,175.00	42,182.83	23,712.33
12/31/2034	295,835.95	251,750.00	500.00	252,250.00	43,585.95	23,836.32
12/31/2035	295,593.75	254,225.00	500.00	254,725.00	40,868.75	21,729.99
12/31/2036	295,412.50	256,062.50	500.00	256,562.50	38,850.00	20,083.85
12/31/2037	294,292.20	252,343.75	500.00	252,843.75	41,448.45	20,849.58
12/31/2038	298,117.20	258,250.00	500.00	258,750.00	39,367.20	19,255.36
12/31/2039	160,103.13	86,968.75	500.00	87,468.75	72,634.38	34,644.57
12/31/2040	159,970.32	10,187.50		10,187.50	149,782.82	69,587.40
12/31/2041	159,596.88				159,596.88	72,117.19
12/31/2042	159,471.88				159,471.88	70,083.73
12/31/2043	159,573.44				159,573.44	68,205.31
12/31/2044	158,901.56				158,901.56	66,056.41
	10,573,122.99	8,651,293.56	13,500.00	8,664,793.56	1,908,329.43	1,122,212.18

Savings Summary

PV of savings from cash flow	1,122,212.18
Less: Prior Sinking Funds and DSR Releases	-228,756.52
Plus: Deposits to DSR and Rounding	135,039.97
Net PV Savings	1,028,495.63

SUMMARY OF REFUNDING RESULTS

Hardin County Water District No. 2 Revenue Bonds
Series 2012 (Refunding of 2003 and 2005 RD) - Shorten 05 Scenario

Dated Date	10/02/2012
Delivery Date	10/02/2012
Arbitrage yield	2.828953%
Escrow yield	0.090772%
Bond Par Amount	6,070,000.00
True Interest Cost	2.944346%
Net Interest Cost	3.015048%
Average Coupon	3.109968%
Average Life	13.674
Par amount of refunded bonds	6,065,500.00
PV of prior debt to 10/02/2012 @ 2.828953%	7,357,526.71
Net PV Savings	1,028,495.63
Percentage savings of refunded bonds	16.956486%
Percentage savings of refunding bonds	16.943915%

BOND DEBT SERVICE

Hardin County Water District No. 2 Revenue Bonds
Refunding of 03

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service
10/02/2012					
01/01/2013	117,297	1.000%	21,081.30	138,378.30	
07/01/2013			42,049.86	42,049.86	
12/31/2013					180,428.16
01/01/2014	99,327	2.000%	42,049.86	141,376.86	
07/01/2014			41,056.59	41,056.59	
12/31/2014					182,433.45
01/01/2015	103,259	2.000%	41,056.59	144,315.59	
07/01/2015			40,024.00	40,024.00	
12/31/2015					184,339.59
01/01/2016	107,036	2.000%	40,024.00	147,060.00	
07/01/2016			38,953.64	38,953.64	
12/31/2016					186,013.64
01/01/2017	110,579	2.000%	38,953.64	149,532.64	
07/01/2017			37,847.85	37,847.85	
12/31/2017					187,380.49
01/01/2018	108,903	2.000%	37,847.85	146,750.85	
07/01/2018			36,758.82	36,758.82	
12/31/2018					183,509.67
01/01/2019	112,066	2.000%	36,758.82	148,824.82	
07/01/2019			35,638.16	35,638.16	
12/31/2019					184,462.98
01/01/2020	115,157	2.125%	35,638.16	150,795.16	
07/01/2020			34,414.62	34,414.62	
12/31/2020					185,209.78
01/01/2021	118,249	2.250%	34,414.62	152,663.62	
07/01/2021			33,084.32	33,084.32	
12/31/2021					185,747.94
01/01/2022	121,352	2.375%	33,084.32	154,436.32	
07/01/2022			31,643.26	31,643.26	
12/31/2022					186,079.58
01/01/2023	124,181	2.375%	31,643.26	155,824.26	
07/01/2023			30,168.61	30,168.61	
12/31/2023					185,992.87
01/01/2024	131,677	2.500%	30,168.61	161,845.61	
07/01/2024			28,522.65	28,522.65	
12/31/2024					190,368.26
01/01/2025	134,036	2.500%	28,522.65	162,558.65	
07/01/2025			26,847.20	26,847.20	
12/31/2025					189,405.85
01/01/2026	141,483	2.750%	26,847.20	168,330.20	
07/01/2026			24,901.81	24,901.81	
12/31/2026					193,232.01
01/01/2027	138,912	2.750%	24,901.81	163,813.81	
07/01/2027			22,991.77	22,991.77	
12/31/2027					186,805.58
01/01/2028	146,081	2.750%	22,991.77	169,072.77	
07/01/2028			20,983.15	20,983.15	
12/31/2028					190,055.92
01/01/2029	152,889	2.750%	20,983.15	173,872.15	
07/01/2029			18,880.93	18,880.93	
12/31/2029					192,753.08
01/01/2030	154,562	3.000%	18,880.93	173,442.93	
07/01/2030			16,562.50	16,562.50	
12/31/2030					190,005.43

BOND DEBT SERVICE

Hardin County Water District No. 2 Revenue Bonds
Refunding of 03

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service
01/01/2031	160,000	3.250%	16,562.50	176,562.50	
07/01/2031			13,962.50	13,962.50	
12/31/2031					190,525.00
01/01/2032	170,000	3.250%	13,962.50	183,962.50	
07/01/2032			11,200.00	11,200.00	
12/31/2032					195,162.50
01/01/2033	175,000	3.500%	11,200.00	186,200.00	
07/01/2033			8,137.50	8,137.50	
12/31/2033					194,337.50
01/01/2034	80,000	3.500%	8,137.50	88,137.50	
07/01/2034			6,737.50	6,737.50	
12/31/2034					94,875.00
01/01/2035	85,000	3.500%	6,737.50	91,737.50	
07/01/2035			5,250.00	5,250.00	
12/31/2035					96,987.50
01/01/2036	90,000	3.750%	5,250.00	95,250.00	
07/01/2036			3,562.50	3,562.50	
12/31/2036					98,812.50
01/01/2037	90,000	3.750%	3,562.50	93,562.50	
07/01/2037			1,875.00	1,875.00	
12/31/2037					95,437.50
01/01/2038	100,000	3.750%	1,875.00	101,875.00	
12/31/2038					101,875.00
	3,187,046		1,245,190.78	4,432,236.78	4,432,236.78

BOND DEBT SERVICE

Hardin County Water District No. 2 Revenue Bonds
Refunding of 2005 RD - Shorten Scenario

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service
10/02/2012					
01/01/2013	97,703	1.000%	20,099.74	117,802.74	
07/01/2013			40,162.64	40,162.64	
12/31/2013					157,965.38
01/01/2014	80,673	2.000%	40,162.64	120,835.64	
07/01/2014			39,355.91	39,355.91	
12/31/2014					160,191.55
01/01/2015	81,741	2.000%	39,355.91	121,096.91	
07/01/2015			38,538.50	38,538.50	
12/31/2015					159,635.41
01/01/2016	82,964	2.000%	38,538.50	121,502.50	
07/01/2016			37,708.86	37,708.86	
12/31/2016					159,211.36
01/01/2017	84,421	2.000%	37,708.86	122,129.86	
07/01/2017			36,864.65	36,864.65	
12/31/2017					158,994.51
01/01/2018	86,097	2.000%	36,864.65	122,961.65	
07/01/2018			36,003.68	36,003.68	
12/31/2018					158,965.33
01/01/2019	87,934	2.000%	36,003.68	123,937.68	
07/01/2019			35,124.34	35,124.34	
12/31/2019					159,062.02
01/01/2020	89,843	2.125%	35,124.34	124,967.34	
07/01/2020			34,169.76	34,169.76	
12/31/2020					159,137.10
01/01/2021	91,751	2.250%	34,169.76	125,920.76	
07/01/2021			33,137.56	33,137.56	
12/31/2021					159,058.32
01/01/2022	93,648	2.375%	33,137.56	126,785.56	
07/01/2022			32,025.49	32,025.49	
12/31/2022					158,811.05
01/01/2023	95,819	2.375%	32,025.49	127,844.49	
07/01/2023			30,887.64	30,887.64	
12/31/2023					158,732.13
01/01/2024	98,323	2.500%	30,887.64	129,210.64	
07/01/2024			29,658.60	29,658.60	
12/31/2024					158,869.24
01/01/2025	100,964	2.500%	29,658.60	130,622.60	
07/01/2025			28,396.55	28,396.55	
12/31/2025					159,019.15
01/01/2026	103,517	2.750%	28,396.55	131,913.55	
07/01/2026			26,973.19	26,973.19	
12/31/2026					158,886.74
01/01/2027	106,088	2.750%	26,973.19	133,061.19	
07/01/2027			25,514.48	25,514.48	
12/31/2027					158,575.67
01/01/2028	108,919	2.750%	25,514.48	134,433.48	
07/01/2028			24,016.85	24,016.85	
12/31/2028					158,450.33
01/01/2029	112,111	2.750%	24,016.85	136,127.85	
07/01/2029			22,475.32	22,475.32	
12/31/2029					158,603.17
01/01/2030	115,438	3.000%	22,475.32	137,913.32	
07/01/2030			20,743.75	20,743.75	
12/31/2030					158,657.07

BOND DEBT SERVICE

Hardin County Water District No. 2 Revenue Bonds
Refunding of 2005 RD - Shorten Scenario

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service
01/01/2031	120,000	3.250%	20,743.75	140,743.75	
07/01/2031			18,793.75	18,793.75	
12/31/2031					159,537.50
01/01/2032	125,000	3.250%	18,793.75	143,793.75	
07/01/2032			16,762.50	16,762.50	
12/31/2032					160,556.25
01/01/2033	125,000	3.500%	16,762.50	141,762.50	
07/01/2033			14,575.00	14,575.00	
12/31/2033					156,337.50
01/01/2034	130,000	3.500%	14,575.00	144,575.00	
07/01/2034			12,300.00	12,300.00	
12/31/2034					156,875.00
01/01/2035	135,000	3.500%	12,300.00	147,300.00	
07/01/2035			9,937.50	9,937.50	
12/31/2035					157,237.50
01/01/2036	140,000	3.750%	9,937.50	149,937.50	
07/01/2036			7,312.50	7,312.50	
12/31/2036					157,250.00
01/01/2037	145,000	3.750%	7,312.50	152,312.50	
07/01/2037			4,593.75	4,593.75	
12/31/2037					156,906.25
01/01/2038	150,000	3.750%	4,593.75	154,593.75	
07/01/2038			1,781.25	1,781.25	
12/31/2038					156,375.00
01/01/2039	85,000	3.750%	1,781.25	86,781.25	
07/01/2039			187.50	187.50	
12/31/2039					86,968.75
01/01/2040	10,000	3.750%	187.50	10,187.50	
12/31/2040					10,187.50
	2,882,954		1,336,102.78	4,219,056.78	4,219,056.78

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES:		
Water sales	\$ 8,119,565	\$ 8,139,065
Other operating income	311,805	323,644
	<hr/>	<hr/>
TOTAL OPERATING REVENUES	8,431,370	8,462,709
OPERATING EXPENSES:		
Power purchased	413,071	407,418
Pumping and treatment labor	396,332	380,689
Purification supplies and expense	501,256	488,983
Transmission and distribution labor	1,147,028	1,138,286
Transmission and distribution supplies and expense	216,708	242,454
Transmission and distribution maintenance and repairs	45,507	55,323
Equipment rental	1,493	3,397
Transportation expense	170,367	151,316
Water treatment maintenance and expense	104,094	86,870
General and administrative expenses	1,536,027	1,692,919
Depreciation	1,589,067	1,762,676
	<hr/>	<hr/>
TOTAL OPERATING EXPENSES	6,120,950	6,410,331
OPERATING INCOME	2,310,420	2,052,378
NON-OPERATING REVENUES (EXPENSES):		
Investment income	1,085,665	283,473
Other income	104,028	157,063
Gain (loss) on disposal of assets	12,078	(173,259)
Interest expense on long-term debt	(744,100)	(840,346)
Interest expense on customer deposits	(1,678)	(1,626)
Amortization of bond discount and expense	(85,266)	(227,728)
	<hr/>	<hr/>
TOTAL NON-OPERATING REVENUES (EXPENSES)	370,727	(802,423)
CAPITAL CONTRIBUTIONS	682,822	1,733,116
CHANGE IN NET ASSETS	3,363,969	2,983,071
NET ASSETS, beginning of year	<hr/> 44,356,324	<hr/> 41,373,253
NET ASSETS, end of year	<hr/> \$ 47,720,293	<hr/> \$ 44,356,324

See accompanying notes to financial statements.

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF NET ASSETS

DECEMBER 31, 2011 AND 2010

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,917,613	\$ 5,489,710
Investments	11,468,166	6,853,989
Accounts receivable, net	684,957	598,659
Prepaid insurance	-	42,874
Prepaid postage	37,935	-
State grants receivable	-	42,005
Materials and supplies	320,000	411,245
TOTAL CURRENT ASSETS	16,428,671	13,438,482
NONCURRENT ASSETS:		
Restricted cash and cash equivalents	2,807,847	3,379,355
Restricted investments	963,005	963,005
Bond discount	394,744	436,040
Deferred amount on bond refundings	281,009	324,982
Capital assets, net of accumulated depreciation	46,506,267	46,732,610
TOTAL NONCURRENT ASSETS	50,952,872	51,835,992
TOTAL ASSETS	67,381,543	65,274,474
<u>LIABILITIES</u>		
CURRENT LIABILITIES:		
Accounts payable	132,637	189,923
Construction projects payable	73,025	-
Accrued taxes	23,166	22,348
Accrued liabilities	51,659	44,076
Accrued vacation	82,600	79,229
Customer deposits	28,791	27,482
Customer advances for construction	33,250	119,749
Bonds payable	913,500	1,211,000
TOTAL CURRENT LIABILITIES	1,338,628	1,693,807
NONCURRENT LIABILITIES:		
Customer deposits	259,122	247,343
Bonds payable	18,063,500	18,977,000
TOTAL NONCURRENT LIABILITIES	18,322,622	19,224,343
TOTAL LIABILITIES	19,661,250	20,918,150
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	28,131,995	27,305,632
Restricted for debt service	2,284,941	2,608,194
Unrestricted	17,303,357	14,442,498
TOTAL NET ASSETS	\$ 47,720,293	\$ 44,356,324

See accompanying notes to financial statements.

Exhibit 8

2011 Audit

HARDIN COUNTY WATER DISTRICT NO. 2

INDEPENDENT AUDITOR'S REPORT
ON FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

YEARS ENDED DECEMBER 31, 2011 AND 2010

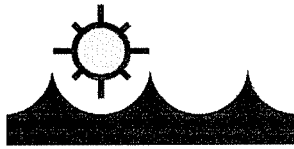
HARDIN COUNTY WATER DISTRICT NO. 2

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LETTER OF TRANSMITTAL



Hardin County Water District No. 2

360 Ring Road • P.O. Box 970 • Elizabethtown, KY 42702
Telephone (270) 737-1056 • Fax (270) 737-2301 • TTY 1-800-648-6956 or 711
www.hardincountywater2.org

Board of Commissioners: Mike Bell, Cordell Tabb, John Effinger, Morris Miller, Tim Davis
General Manager: James Jeffries

February 20, 2012

TO: Hardin County Water District No. 2 Board of Commissioners

We are pleased to submit the Financial Report for Hardin County Water District No. 2 for the year ended December 31, 2011. This report has been prepared in accordance with generally accepted accounting principles (GAAP), as set forth in the pronouncements of the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

Responsibility for both the accuracy of the data presented and the completeness and fairness of presentation, including all disclosures, rests with the District. We believe the data as presented is accurate, that it is presented in a manner designed to fairly set forth the financial position and the results of operations of the District as measured by its and that all disclosures necessary to enable the reader to gain maximum understanding of the District's financial affairs have been included.

District management's narrative on the financial activities of the District is in the Management's Discussion and Analysis (MD&A) section of this report, immediately following the Independent Auditor's Report. The letter of transmittal is written to complement the MD&A and the financial statements, and should be read from that perspective and in conjunction with all other sections of the report.

This report is a joint effort between our staff and Stiles, Carter, and Associates, Certified Public Accountants. I would like to recognize Mr. Scott Clark, Customer Service and Administrative Manager, for his role in leading the District in this effort. I also recognized Ms. Lea Ona Sims and Ms. Amber Summers for their continued role in keeping the finances of the District. Mr. Brian Woosley was the lead auditor for Stiles, Carter, and Associates and our staff spent several hours working closely with Mr. Woosley to complete this report.

Financial Performance and Highlights

Operating revenue for 2011 was flat against the record level set in 2010. Total water revenue finished at \$8,431,370, down just 0.4%. Customer occupancy remains high against historical trends which contribute to a favorable peak in the revenue levels which began in 2010.

Operating expenses continue to be favorably managed by the District staff. Total operating expenses for 2011 finished at \$6,120,950, a reduction of \$289,381 or 4.5% from 2010. Depreciation accounted for \$173,609 of the reduction and the remaining \$115,772 is attributed to a reduction in spending in the operations and overhead areas. While the reduction in depreciation is skewed by one time write offs that occurred in 2010, the balance of the reduction is a result of effective management by the departmental heads. The 2011 performance in cost management, depreciation notwithstanding, follows a 5 year historical trend in which the average annual increase in operating costs is 2.0%.

The District continued for a second year the practice of investing reserve funds in the bond market in lieu of Certificates of Deposits. The District maintains two reserve accounts, one with Vanguard Investments

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Hardin County Water District No. 2 Annual Report 2011

and one with Dupree Investments. The Vanguard and Dupree accounts in 2011 returned a total of \$242,284.28 and \$771,892.74 respectively.

Capital Improvement and Projects

The District entered into agreements with 9 residents of St. Johns Road and Spears Lane for the expansion of our 4" water main. Each resident contributed \$1,998.14 while the District contributed \$4,192.81 and fronted the final \$13,986.96 to finance the extension. The 6,400 foot expansion was completed before the Christmas holiday and had two active customers by the end of the year.

The District's construction crew completed the first section of the Elizabethtown to Radcliff Connector relocation project. The project resulted in the relocation of almost 12,000 feet of water line along Rineyville Road. The cost of the project to the District was \$488K which was reimbursed by the State Highway Department.

The District also agreed to assist with the FLEX factory construction in the Hugh's Industrial Park. District crews relocated 820 feet of 12" ductile iron pipe along Black Branch Road to accommodate the site development for FLEX. The Elizabethtown Industrial Foundation financed the materials of the project which cost a total of \$60,000.

The District continued procurement of the Louisville Water Connection Project by completed a yearlong conversion study in cooperation with Hardin County Water District No. 1 and Louisville Water Company. The study demonstrated in detail the affects of converting District water to a chloramines disinfectant system and of converting LWC water to a chlorine disinfectant system. The combined project team observed that LWC water performed very poorly with regard to disinfectant byproduct production when given a free chlorine residual. Conversely, District water that was given a chloramine residual performed better than current field observations. The study suggested that the distribution system of Hardin County Water District No. 2 would benefit from a chloramine system by observing a reduction in the current levels of disinfectant byproduct production. This benefit would be timely as the new EPA Stage II regulations which further restrict disinfectant byproduct level go into effect in 2014.

Water Operations

The District water treatment plant treated and delivered 1.83 billion gallons during the year. This was an increase of 3.4% from the 1.77 billion gallons delivered in 2010. Capacity utilization was an average of 65.3% as total gallons sold to customers finished at 1.54 billion gallons versus 1.49 billion gallons in 2010. The distribution leak percentage did see a slight improvement in 2011. The T&D department responded to 279 leaks in 2011 compared to 297 in 2010. The leak percentage landed at 13.4%, down from 13.6% in 2010.

The District had no violations for water quality or reporting requirements. We experienced favorable audits in all areas including: workers compensation audit, DOW audit, PSC inspection, fire safety inspection, bacteriological laboratory inspection, and the fluoride inspection. The District did not issue any boil water advisories during the year.

New meter installations dropped dramatically in 2011 following the height of BRAC activities from 2010. Distribution personnel installed 237 new meters during the year compared to 425 for 2010. The combination of new meters and steady occupancy resulted in a record active customer count of 16,791 at the end of the year compared to 16,741 at the end of 2010, a growth rate of less than 1%.

Hardin County Water District No. 2 Annual Report 2011

Quality Recognition

The District was once again humbled by the recognition throughout the year for our excellence in water quality. The District won first place in the Kentucky Rural Water Association "Best Tasting Water" contest in February. This was the second year in a row that we received this honor. Only one other water company has won the KRWA title two years in a row. Then in June, the District finished in first place at the Kentucky-Tennessee Chapter Water Taste Test Competition. We have won this title two out of the past three years.

No other water company has won both the KRWA and the AWWA titles in the same year. As such, Hardin County Water District No. 2 claimed the title of being Kentucky's "Undisputed Best Tasting Water Champion" for 2011.

Closing Remarks

Hardin County Water District No. 2 has had another banner year in the core areas of our operations and in our financial performance in 2011. During a year when we achieved the title of "Undisputed Best Tasting Water Champion" in Kentucky and we experienced a 3.4% increase in water volume, we also saw our overall costs come down by 4.5%. This unlikely scenario is attributed to the dedicated employees of the District who continuously work to be the best water professionals possible.

It has been a pleasure for the staff to bring these results to the Board of Commissioners for their consideration and review. On behalf of all the employees of the District, it has been a pleasure to provide the highest quality service to our customers for another year.



James R. Jeffries
General Manager

INDEPENDENT AUDITOR'S REPORT

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

We have audited the accompanying financial statements of Hardin County Water District No. 2 as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the 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 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 Hardin County Water District No. 2, as of December 31, 2011 and 2010, and the respective changes in financial position and cash flows, where applicable for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 20, 2012, on our consideration of Hardin County Water District No. 2's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 audits.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 10 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 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 principally 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 the 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.

Our audits were performed for the purpose of forming an opinion on the financial statements that collectively comprise Hardin County Water District No. 2's financial statements as a whole. The accompanying letter of transmittal and Schedules I, II and III are presented for purposes of additional analysis and are not a required part of the basic financial statements. Schedules I and II are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole. The letter of transmittal and Schedule III have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Stiles, Carter & Associates
Certified Public Accountants
February 20, 2012

REQUIRED SUPPLEMENTARY INFORMATION

**HARDIN COUNTY WATER DISTRICT NO. 2
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2011**

The discussion and analysis of Hardin County Water District No. 2's financial performance provides an overall review of the District's financial activities for the year ended December 31, 2011. The intent of this discussion and analysis is to review the District's financial performance as a whole. Readers should also review the basic financial statements and notes to the basic financial statements to enhance their understanding of the District's financial performance.

FINANCIAL HIGHLIGHTS

- The ending cash and investment balance for the District was \$19.2 million. The balance at December 31, 2010, was \$16.7 million. This reflects an increase in cash and investments during the year of \$2.5 million.
- The District continued the E-town Loop, Louisville Water Interconnection and Rineyville Sewer Projects and began the Nolin River and Intake projects.
- The District invested approximately \$1.1 million in capital assets during the year.

USING THIS ANNUAL REPORT

The basic financial statements report information about the District using full accrual accounting methods as utilized by similar business activities in the private sector. The basic financial statements include a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; a statement of cash flows; and notes to the basic financial statements.

The **statement of net assets** presents the financial position of the District on a full accrual historical cost basis. The statement presents information on all of the District's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the District is improving or deteriorating.

While the statement of net assets provides information about the nature and amount of resources and obligations at year-end, the **statement of revenues, expenses, and changes in fund net assets** presents the results of the District's activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the District's recovery of its costs. Rate setting policies use different methods of cost recovery not fully provided for by generally accepted accounting principles. The primary objectives of the rate model are to improve equity among customer classes and to ensure that capital costs are allocated on the basis of long-term capacity needs, ensuring that growth pays for growth.

The **statement of cash flows** presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The **notes to the basic 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.

ENTITY-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$47.7 million and \$44.4 million as of December 31, 2011 and 2010.

The largest portion of the District's net assets reflects its investment in infrastructure and capital assets (e.g., land, buildings, vehicles, equipment, transmission and distribution systems and construction in progress), less any related debt used to acquire those assets that is outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets.

(Table 1)
Summary of Net Assets
as of December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current and		
Other Assets	\$ 20,875,276	\$ 18,541,864
Capital Assets	<u>46,506,267</u>	<u>46,732,606</u>
Total Assets	<u>67,381,543</u>	<u>65,274,470</u>
Liabilities		
Long-term liabilities	18,322,622	19,224,343
Other Liabilities	<u>1,338,628</u>	<u>1,693,807</u>
Total Liabilities	<u>19,661,250</u>	<u>20,918,150</u>
Net Assets		
Invested in capital assets, net of related debt	28,131,995	27,305,632
Restricted for debt service	2,284,941	2,608,194
Unrestricted	<u>17,303,357</u>	<u>14,442,498</u>
Total Net Assets	<u>\$ 47,720,293</u>	<u>\$ 44,356,324</u>

Unrestricted net assets, the portion of net assets that can be used to finance day-to-day operations (without constraints established by debt covenants, enabling legislation or other legal requirements), increased by 20.1% from \$14.4 million to \$17.3 million at December 31, 2011. Restricted net assets decreased \$323 thousand (12.3%). Investment in governmental capital assets, net of related debt increased by \$817 thousand (2.9%).

(Table 2)
Changes in Net Assets
Years Ended December 31, 2011 and 2010

	2011	2010
OPERATING REVENUES:		
Water sales	\$ 8,119,565	\$ 8,139,065
Other operating income	311,805	323,644
Total operating revenues	8,431,370	8,462,709
OPERATING EXPENSES:		
Power purchased	413,071	407,418
Pumping and treatment labor	396,332	380,689
Purification supplies and expense	501,256	488,983
Transmission and distribution labor	1,147,028	1,138,286
Transmission and distribution supplies and expense	216,708	242,454
Transmission and distribution maintenance and repairs	45,507	55,323
Equipment rental	1,493	3,397
Transportation expense	170,367	151,316
Water treatment maintenance and expense	104,094	86,870
General and administrative expenses	1,536,027	1,692,919
Depreciation	1,589,067	1,762,676
Total operating expenses	6,120,950	6,410,331
OPERATING INCOME	2,310,420	2,052,378
NON-OPERATING REVENUES (EXPENSES):		
Investment income	1,085,665	283,473
Other income	104,028	157,063
Gain (loss) on disposal of assets	12,078	(173,259)
Interest expense on long-term debt	(744,100)	(840,346)
Interest expense on customer deposits	(1,678)	(1,626)
Amortization of bond discount and expense	(85,266)	(227,728)
TOTAL NON-OPERATING REVENUES (EXPENSES)	370,727	(802,423)
Capital contributions	682,822	1,733,116
Increase in net assets	\$ 3,363,969	\$ 2,983,071

Operating revenue was consistent as compared to the prior year. Total operating expenses decreased by 4.5% of which 2.0% was related to a decline in depreciation expense. Therefore, operating expenses decreased by 2.5%. Interest expense on long-term debt decreased 11.4%. The District continues to receive capital contributions through the State of Kentucky, the Federal government, other governments and individual developers.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2011 and 2010, the District had \$46.5 million and \$46.7 million invested in a variety of capital assets, as reflected in the following table:

(Table 3)
Capital Assets (Net of Depreciation)
as of December 31, 2011 and 2010

	2011	2010
Non-Depreciable Assets:		
Land and land rights	\$ 555,983	\$ 552,983
Depreciable Assets:		
Structures and improvements	2,118,003	2,203,108
Supply mains	926,663	970,762
Water treatment plant	7,605,711	7,829,121
Standpipes, tanks and foundations	4,435,750	4,597,031
Transmission and distribution mains	25,370,553	25,888,449
Services and meters	3,555,752	3,460,662
Hydrants	76,172	89,138
Office furniture and fixtures	49,004	55,484
Transportation equipment	458,679	370,276
Communication equipment	-	-
Other property and equipment	76,649	86,027
Capital assets in service	45,228,919	46,103,041
Construction in progress	1,277,348	629,569
Total capital assets, net of depreciation	<u>\$ 46,506,267</u>	<u>\$ 46,732,610</u>

(Table 4)
Changes in Capital Assets
Years Ended December 31, 2011 and 2010

	2011	2010
Beginning balance	\$ 46,732,610	\$ 45,898,989
Additions	1,380,198	4,944,048
Retirements	(17,474)	(2,347,751)
Depreciation	(1,589,067)	(1,762,676)
Ending balance	<u>\$ 46,506,267</u>	<u>\$ 46,732,610</u>

Debt

At December 31, 2011 and 2010, the District had \$18.9 million and \$20.2 million, in bonds and notes outstanding. A total of \$914 thousand is due within the 2012 calendar year.

(Table 5)
Outstanding Debt
as of December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenue bonds	<u>\$ 18,977,000</u>	<u>\$ 20,188,000</u>

District Challenges for the Future

The District continues to be financially sound. However, the current state and national financial climate requires the District to remain prudent.

The District will continue to use careful planning and monitoring of finances to provide quality services to its customers.

Contacting the District's Financial Management

This financial report is designed to provide our customers, investors and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives and spends. If you have questions about this report or need additional financial information, contact James Jeffries, General Manager, 360 Ring Road, Elizabethtown, Kentucky 42701, (270) 737-1056.

BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2STATEMENTS OF NET ASSETSDECEMBER 31, 2011 AND 2010

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,917,613	\$ 5,489,710
Investments	11,468,166	6,853,989
Accounts receivable, net	684,957	598,659
Prepaid insurance	-	42,874
Prepaid postage	37,935	-
State grants receivable	-	42,005
Materials and supplies	320,000	411,245
TOTAL CURRENT ASSETS	16,428,671	13,438,482
NONCURRENT ASSETS:		
Restricted cash and cash equivalents	2,807,847	3,379,355
Restricted investments	963,005	963,005
Bond discount	394,744	436,040
Deferred amount on bond refundings	281,009	324,982
Capital assets, net of accumulated depreciation	46,506,267	46,732,610
TOTAL NONCURRENT ASSETS	50,952,872	51,835,992
TOTAL ASSETS	67,381,543	65,274,474
<u>LIABILITIES</u>		
CURRENT LIABILITIES:		
Accounts payable	132,637	189,923
Construction projects payable	73,025	-
Accrued taxes	23,166	22,348
Accrued liabilities	51,659	44,076
Accrued vacation	82,600	79,229
Customer deposits	28,791	27,482
Customer advances for construction	33,250	119,749
Bonds payable	913,500	1,211,000
TOTAL CURRENT LIABILITIES	1,338,628	1,693,807
NONCURRENT LIABILITIES:		
Customer deposits	259,122	247,343
Bonds payable	18,063,500	18,977,000
TOTAL NONCURRENT LIABILITIES	18,322,622	19,224,343
TOTAL LIABILITIES	19,661,250	20,918,150
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	28,131,995	27,305,632
Restricted for debt service	2,284,941	2,608,194
Unrestricted	17,303,357	14,442,498
TOTAL NET ASSETS	\$ 47,720,293	\$ 44,356,324

See accompanying notes to financial statements.

HARDIN COUNTY WATER DISTRICT NO. 2STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETSYEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES:		
Water sales	\$ 8,119,565	\$ 8,139,065
Other operating income	311,805	323,644
TOTAL OPERATING REVENUES	8,431,370	8,462,709
OPERATING EXPENSES:		
Power purchased	413,071	407,418
Pumping and treatment labor	396,332	380,689
Purification supplies and expense	501,256	488,983
Transmission and distribution labor	1,147,028	1,138,286
Transmission and distribution supplies and expense	216,708	242,454
Transmission and distribution maintenance and repairs	45,507	55,323
Equipment rental	1,493	3,397
Transportation expense	170,367	151,316
Water treatment maintenance and expense	104,094	86,870
General and administrative expenses	1,536,027	1,692,919
Depreciation	1,589,067	1,762,676
TOTAL OPERATING EXPENSES	6,120,950	6,410,331
OPERATING INCOME	2,310,420	2,052,378
NON-OPERATING REVENUES (EXPENSES):		
Investment income	1,085,665	283,473
Other income	104,028	157,063
Gain (loss) on disposal of assets	12,078	(173,259)
Interest expense on long-term debt	(744,100)	(840,346)
Interest expense on customer deposits	(1,678)	(1,626)
Amortization of bond discount and expense	(85,266)	(227,728)
TOTAL NON-OPERATING REVENUES (EXPENSES)	370,727	(802,423)
CAPITAL CONTRIBUTIONS	682,822	1,733,116
CHANGE IN NET ASSETS	3,363,969	2,983,071
NET ASSETS, beginning of year	44,356,324	41,373,253
NET ASSETS, end of year	<u>\$ 47,720,293</u>	<u>\$ 44,356,324</u>

See accompanying notes to financial statements.

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 8,345,072	\$ 8,403,835
Payments to suppliers	(2,707,430)	(3,075,840)
Payments to employees	<u>(1,853,682)</u>	<u>(1,762,714)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	3,783,960	3,565,281
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Principal payments on bonds	(1,211,000)	(7,917,000)
Principal payments on notes	-	(1,872,307)
Proceeds from bonds	-	8,105,000
Acquisition of capital assets	(1,124,627)	(2,221,224)
Contributions in aid of construction	549,318	1,710,871
Interest on long-term debt	(744,100)	(840,346)
Sale of capital assets	29,006	33,210
Customer deposit interest	<u>(1,678)</u>	<u>(1,626)</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(2,503,081)	(3,003,422)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(4,982,586)	(7,960,857)
Proceeds from investments	963,005	9,907,494
Utility plant leased to others and other income	104,028	157,063
Investment income	<u>491,069</u>	<u>178,587</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	(3,424,484)	2,282,287
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,143,605)	2,844,146
CASH AND CASH EQUIVALENTS, beginning of year	<u>8,869,065</u>	<u>6,024,919</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 6,725,460</u>	<u>\$ 8,869,065</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:		
Interest paid during the year	<u>\$ 745,778</u>	<u>\$ 841,972</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 2,301,197	\$ 2,052,378
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	1,581,486	1,762,676
Provision for bad debts	15,065	74,917
(Increase) in accounts receivable	(86,298)	(58,874)
(Increase) decrease in prepaids	4,939	(9,886)
Decrease in tap fees receivable	-	20,050
(Decrease) in accounts payable	(57,286)	(123,773)
Increase (decrease) in customer deposits	13,085	(174,107)
Increase in accrued taxes payable	818	1,873
Increase in accrued liabilities	7,583	6,783
Increase in accrued vacation	<u>3,371</u>	<u>13,244</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 3,783,960</u>	<u>\$ 3,565,281</u>

See accompanying notes to financial statements.

NOTES TO BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

Brief history - The Hardin County Water District No. 2 was organized pursuant to the provisions of Kentucky Revised Statutes KRS 74.010 and KRS 44.020 in order to provide a water supply for the residents of Hardin County, Kentucky.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The District's financial statements are presented in accordance with the accrual basis of accounting. As allowed in Section P80 of Governmental Accounting Standards Board's (GASB) Codification of Governmental Accounting and Financial Reporting Standards, the District has elected not to apply to its proprietary activities Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee of Accounting Procedure issued after November 30, 1989. The District follows the accounting policies and procedures set forth by the National Association of Regulatory Utility Commissioners and the guidance provided by the American Water Works Association in *Water Utility Accounting* and is regulated by the Kentucky Public Service Commission.

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 and the accrual basis of accounting. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets (i.e., total assets net of total liabilities) are segregated into "invested in capital assets, net of related liabilities"; "restricted for debt service"; and "unrestricted" components. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

- (1) Accounts Receivable - The allowance method is used to record uncollectible accounts.- At December 31, 2011 and 2010, accounts receivable was stated net of an allowance for uncollectible accounts of \$80,000 and \$80,000. Bad debt expense for 2011 was \$15,065 and 2010 was \$74,917. The District does not believe there is any credit risk associated with these receivables due to the large customer base and small individual account balances.
- (2) Materials and supplies – Materials and supplies is composed of items used in the capital construction process.
- (3) Restricted Assets – Restricted assets consist of demand deposit savings accounts and certificates of deposit plus accrued interest. The cost basis approximates market value.

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- (4) Capital assets – Capital assets in service and construction in progress are recorded at cost, if purchased or constructed. Assets acquired through contributions from developers or other customers are capitalized at their estimated fair market value, if available, or at engineers' estimated fair market value or cost to construct at the date of the contribution. Maintenance and repairs, which do not significantly extend the value or life of property, plant and equipment, are expensed as incurred. The District has established a minimum capitalization policy of \$5,000.

Assets are depreciated on the straight-line method. Depreciation is calculated using the following estimated useful lives:

	<u>Years</u>
Source of supply equipment	15-50
Water treatment plant	10-40
Transmission and distribution systems	10-50
Equipment	3-20
Structures and improvements, including buildings	10-50
Office furniture, equipment and vehicles	3-20
Meters	10-20

- (5) Amortization - Bond discounts, expenses and deferred amounts on refundings are being amortized using the interest method over the life of each respective bond issue.
- (6) Cash Equivalents - For purposes of the statements of cash flows, the District considers all highly liquid debt instruments (including restricted assets) purchased with a maturity of three months or less to be cash equivalents.
- (7) Compensation for Future Absences - Accumulated vacation to be paid to employees is recorded as an expense and liability as the benefit is earned.
- (8) Claims and Judgments - These events and obligations are recorded on the accrual basis, when the event occurs and the obligation arises.
- (9) Revenues, Expenses and Rate Structure - Revenues and expenses are recognized on the accrual basis as earned or incurred. The District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Services are supplied to customers under a rate structure designed to produce revenues sufficient to provide for operating and maintenance costs, capital outlay, debt service, reserves and debt service coverage. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.
- (10) Capital Contributions - Contributions are recognized in the Statement of Revenues, Expenses and Changes in Fund Net Assets when earned. Contributions include capacity fees, capital grants, and other supplemental support by other utilities and industrial customers and federal, state and local grants in support of system improvements.

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- (11) Long-term obligations are reported at face value, net of applicable premiums and discounts. Premiums and discounts, issuance costs, and gains or losses on advance refundings and defeasances are deferred and amortized over the life of the bonds.
- (12) Restricted assets are used to fund appropriations only after unrestricted resources are depleted except for appropriations related to a project/debt requirement for which the assets are restricted.
- (13) 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 liabilities; restricted for debt service; 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 for debt service 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, less any related liabilities. Unrestricted consists of all other net assets not included in the above categories.
- (14) Use of Estimates - Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of 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.

NOTE B - DEPOSITS AND INVESTMENTS*DEPOSITS*

Custodial Credit Risk—Deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned or that the District will not be able to recover collateral securities in the possession of an outside party. As of December 31, 2011 and 2010, \$7,724,384 and \$6,126,926 of the District's bank balance of \$6,626,926 and \$8,474,384 was exposed to custodial credit risk. For 2011 and 2010, of the amount exposed to custodial credit risk, the entire amount was collateralized by securities held by the pledging financial institution.

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE B – DEPOSITS AND INVESTMENTS (CONTINUED)*INVESTMENTS*

At December 31, 2011 and 2010, the District had the following investments and maturities:

	<u>12/31/2011</u> <u>Fair Value</u>	<u>Average Credit</u> <u>Quality/Ratings</u>	<u>Maturities</u>
Bond Mutual Funds	\$ 3,370,108	Unrated	6.3 years average
Bond Mutual Funds	1,098,568	Unrated	9.4 years average
Bond Mutual Funds	5,209,451	Unrated	14.1 years average
Bond Mutual Funds	1,790,041	Unrated	25.5 years average
Treasury Money Market Fund	1,113,137	Unrated	Less than 1 year
Total Investments	<u>\$ 12,581,305</u>		

	<u>12/31/2010</u> <u>Fair Value</u>	<u>Average Credit</u> <u>Quality/Ratings</u>	<u>Maturities</u>
Bond Mutual Funds	\$ 3,727,598	Unrated	13.88 years average
Bond Mutual Funds	3,126,391	Unrated	5.6 years average
Treasury Money Market Fund	1,428,999	Unrated	Less than 1 year
Total Investments	<u>\$ 8,282,988</u>		

The funds listed above are not rated. The individual investments within the funds are rated no lower than BBB.

*Investment Policies**District Policy*

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Generally, the District's investing activities are under the custody of the District Commissioners. Investing policies comply with the State Statutes. Kentucky Revised Statute 66.480 defines the following items as permissible investments:

- Obligations of the United States and of its agencies and instrumentalities;
- Obligations of any corporation of the United States Government;
- Obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or a United States government agency;
- Uncollateralized certificates of deposit issued by any bank or savings and loan institution rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- Certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation or similar entity or which are collateralized, to the extent uninsured, by any obligations, including surety bonds, permitted by KRS 41.240(4)
- Bankers' acceptances for banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE C – DEPOSITS AND INVESTMENTS (CONTINUED)INVESTMENTS (CONTINUED)

- Commercial paper rated in the highest category by a nationally recognized rating agency;
- Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities;
- Securities issued by a state or local government, or any instrumentality of agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a nationally recognized rating agency; and
- Shares of mutual funds, each of which shall have the following characteristics:
 1. The mutual fund shall be an open-end diversified investment company registered under the Federal Investment Company Act of 1940, as amended;
 2. The management company of the investment company shall have been in operation for at least five (5) years; and
 3. All of the securities in the mutual fund shall be eligible investments pursuant to this section.

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. The District policy provides that, to the extent practicable, investments are matched with anticipated cash flows. Investments are diversified to minimize the risk of loss resulting from over-concentration of assets in a specific maturity period, a single issuer, or an individual class of securities. **Concentration of Credit Risk** is the risk of loss attributed to the magnitude of the District's investment in a single issuer. U.S. Government securities and investments in mutual funds are excluded from this risk. The District does not have more than 5% or more of investments subject to the concentration of credit risk disclosure in any one issuer.

Custodial Credit Risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District did not have any investments in securities at December 31, 2011 and 2010.

NOTE D - RESTRICTED CASH

The District has restricted cash for various purposes including debt service, future construction and customer deposits. The following schedule represents restricted cash at December 31, 2011 and 2010:

<u>Restricted For</u>	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Debt service	\$ 1,171,804	\$ 1,179,195
Depreciation fund	266,121	450,018
Escrow	20,237	21,183
Construction	896,461	998,541
Customer deposits	303,092	289,797
	<u>\$ 2,657,715</u>	<u>\$ 2,938,734</u>

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE E – CAPITAL ASSETS

Capital assets are recorded at cost. Capital asset activity for the year ended December 31, 2011 follows.

	Balance at December 31, 2010	Additions	Retirements	Balance at December 31, 2011
Non-Depreciable Assets:				
Land and land rights	\$ 552,983	\$ 4,000	\$ (1,000)	\$ 555,983
Depreciable Assets:				
Structures and improvements	3,170,489	-	(11,118)	3,159,371
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	10,983,191	-	(4,091)	10,979,100
Standpipes, tanks and foundations	6,404,603	-	-	6,404,603
Transmission and distribution mains	33,342,865	158,361	-	33,501,226
Services and meters	5,226,216	354,014	(72,878)	5,507,352
Hydrants	310,058	7,539	(9,859)	307,738
Office furniture and fixtures	368,651	14,927	(52,824)	330,754
Transportation equipment	1,066,679	193,578	(91,901)	1,168,356
Communication equipment	55,270	-	-	55,270
Other property and equipment	350,687	-	(1,400)	349,287
Capital assets in service	63,595,657	732,419	(245,071)	64,083,005
Construction in progress	629,569	647,779	-	1,277,348
Total capital assets	64,225,226	1,380,198	(245,071)	65,360,353
Less accumulated depreciation for:				
Structures and improvements	967,381	79,592	(5,605)	1,041,368
Supply mains	793,203	44,099	-	837,302
Water treatment plant	3,154,070	221,718	(2,399)	3,373,389
Standpipes, tanks and foundations	1,807,572	161,281	-	1,968,853
Transmission and distribution mains	7,454,416	676,257	-	8,130,673
Services and meters	1,765,554	258,185	(72,139)	1,951,600
Hydrants	220,920	19,461	(8,815)	231,566
Office furniture and fixtures	313,167	15,409	(46,826)	281,750
Transportation equipment	696,403	104,473	(91,199)	709,677
Communication equipment	55,270	-	-	55,270
Other property and equipment	264,660	8,592	(614)	272,638
Total accumulated depreciation	17,492,616	1,589,067	(227,597)	18,854,086
Net capital assets	\$ 46,732,610	\$ (208,869)	\$ (17,474)	\$ 46,506,267

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

NOTE E – CAPITAL ASSETS (CONTINUED)

Capital asset activity for the year ended December 31, 2010 follows.

	Balance at December 31, 2009	Additions	Retirements	Balance at December 31, 2010
Non-Depreciable Assets:				
Land and land rights	\$ 552,983	\$ -	\$ -	\$ 552,983
Depreciable Assets:				
Structures and improvements	3,170,489	-	-	3,170,489
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	10,983,191	-	-	10,983,191
Standpipes, tanks and foundations	5,766,203	638,400	-	6,404,603
Transmission and distribution mains	30,223,140	3,119,725	-	33,342,865
Services and meters	5,286,319	441,471	(501,574)	5,226,216
Hydrants	292,279	17,779	-	310,058
Office furniture and fixtures	343,778	24,873	-	368,651
Transportation equipment	994,745	161,254	(89,320)	1,066,679
Communication equipment	55,270	-	-	55,270
Other property and equipment	272,411	85,957	(7,681)	350,687
Capital assets in service	59,704,773	4,489,459	(598,575)	63,595,657
Construction in progress	2,310,847	454,589	(2,135,867)	629,569
Total capital assets	62,015,620	4,944,048	(2,734,442)	64,225,226
Less accumulated depreciation for:				
Structures and improvements	887,165	80,216	-	967,381
Supply mains	749,104	44,099	-	793,203
Water treatment plant	2,932,040	222,030	-	3,154,070
Standpipes, tanks and foundations	1,647,622	159,950	-	1,807,572
Transmission and distribution mains	6,835,001	619,415	-	7,454,416
Services and meters	1,553,703	501,541	(289,690)	1,765,554
Hydrants	208,054	12,866	-	220,920
Office furniture and fixtures	292,698	20,469	-	313,167
Transportation equipment	685,746	99,977	(89,320)	696,403
Communication equipment	55,270	-	-	55,270
Other property and equipment	270,228	2,113	(7,681)	264,660
Total accumulated depreciation	16,116,631	1,762,676	(386,691)	17,492,616
Net capital assets	\$ 45,898,989	\$ 3,181,372	\$ (2,347,751)	\$ 46,732,610

During the years ended December 31, 2011 and 2010, the District capitalized \$0 and \$88,453 of interest and expensed \$745,778 and \$841,972 of interest.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE F – LONG-TERM OBLIGATIONS

The construction costs of the District's water facilities have been financed by issuance of revenue bonds authorized under Kentucky Revised Statutes and a short-term loan with Rural Development that was converted to permanent financing in 2010. All assets of the District are pledged as collateral for these bonds. Information relating to the outstanding bond issues is summarized below:

<u>Issue</u>	<u>Interest Rate</u>	<u>Face Amount</u>	<u>Bonds Due 12/31/2011</u>	<u>Bonds Due 12/31/2010</u>
2002 Series C	2.0% - 3.75%	\$3,020,000	\$1,180,000	\$1,545,000
2003 Series	3.5% - 4.625%	4,485,000	3,365,000	3,525,000
2004 Series A	2.0% - 4.0%	2,940,000	2,245,000	2,355,000
2005 Series A	4.375%	2,990,000	2,815,000	2,853,000
2005 Series B	4.1%	1,775,000	1,435,000	1,560,000
2007 Series A	4.00%	2,480,000	2,452,000	2,480,000
2010 Series A	2.0% - 4.125%	5,625,000	5,485,000	5,625,000

On December 18, 2007, the District entered into an interim financing agreement with the Kentucky Rural Water Finance Corporation to borrow up to \$2,480,000 for its Phase IV project. The loan initially carried an interest rate of 4.125%. The rate was changed to 3.7% in January 2009 and 2.9% in January 2010. The District borrowed \$758,538 during 2010, \$941,967 during 2009 and \$171,802 during 2008. The loan was converted to the 2007A bond issue in 2010.

On July 28, 2010, the District issued \$5,625,000 in Refunding Revenue Bonds with an average interest rate of 3.71 percent to advance refund \$5,810,000 of outstanding 1999 Series A revenue bonds with an average interest rate of 4.63 percent. The refunding was an advance refunding. The net proceeds of \$5,477,414 (after \$147,586 in cost of issuance and bond discount which was deposited in the bond payment fund) were used to purchase U.S. Government securities. These securities were deposited in an irrevocable trust to call the bonds on July 29, 2010.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$51,092. This difference, reported in the accompanying government-wide financial statements as a deduction from bonds payable, is being charged to operations through the year 2020 using the effective-interest method.

The District completed the refunding to reduce its total debt service payments over the next 20 years by \$918,727 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$535,029.

The District requires new customers to provide a \$60 deposit for initial water service. Current customers in good standing who add additional service locations are not required to pay an additional deposit.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE F – LONG-TERM OBLIGATIONS (CONTINUED)

Long-term liability activity for the year ended December 31, 2011, was as follows:

	Balance at December 31, 2010	Additions	Reductions	Balance at December 31, 2011	Amount Due Within One Year
Bonds and notes payable:					
Revenue bonds	\$ 20,188,000	\$ -	\$ (1,211,000)	\$ 18,977,000	\$ 913,500
Notes payable	-	-	-	-	-
Total bonds and notes payable	20,188,000	-	(1,211,000)	18,977,000	913,500
Other liabilities:					
Customer deposits	274,825	21,005	(7,920)	287,910	28,791
Accrued vacation	79,229	82,600	(79,229)	82,600	82,600
Customer advances for construction	119,749	10,000	(96,499)	33,250	33,250
Total other liabilities	473,803	113,605	(183,648)	403,760	144,641
Long-term liabilities	\$ 20,661,803	\$ 113,605	\$ (1,394,648)	\$ 19,380,760	\$ 1,058,141

Long-term liability activity for the year ended December 31, 2010, was as follows:

	Balance at December 31, 2009	Additions	Reductions	Balance at December 31, 2010	Amount Due Within One Year
Bonds and notes payable:					
Revenue bonds	\$ 20,000,000	\$ 8,105,000	\$ (7,917,000)	\$ 20,188,000	\$ 1,211,000
Notes payable	1,113,769	758,538	(1,872,307)	-	-
Total bonds and notes payable	21,113,769	8,863,538	(9,789,307)	20,188,000	1,211,000
Other liabilities:					
Customer deposits	448,932	71,073	(245,180)	274,825	27,482
Accrued vacation	65,985	13,244	-	79,229	7,923
Customer advances for construction	249,975	22,750	(152,976)	119,749	119,749
Total other liabilities	764,892	107,067	(398,156)	473,803	155,154
Long-term liabilities	\$ 21,878,661	\$ 8,970,605	\$ (10,187,463)	\$ 20,661,803	\$ 1,366,154

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE F – LONG-TERM OBLIGATIONS (CONTINUED)

Bond maturities and Sinking Fund requirements in each of the next five years and in five year increments thereafter are as follows at December 31, 2011:

Year	Principal	Revenue Bonds		Totals
		Interest		
2012	\$ 913,500	\$ 723,274	\$	1,636,774
2013	946,500	692,695		1,639,195
2014	980,000	660,509		1,640,509
2015	593,000	634,691		1,227,691
2016	616,000	615,148		1,231,148
2017-2021	3,502,000	2,719,199		6,221,199
2022-2026	4,004,000	1,973,020		5,977,020
2027-2031	3,267,000	1,257,246		4,524,246
2032-2036	1,600,500	719,319		2,319,819
2037-2041	1,326,500	396,372		1,722,872
2042-2046	980,000	144,268		1,124,268
2047-2048	248,000	10,080		258,080
Total	\$ 18,977,000	\$ 10,545,821	\$	29,522,821

Year	Sinking Fund Requirements
2012	\$ 1,636,774
2013	1,639,195
2014	1,640,509
2015	1,227,691
2016	1,231,148
2017-2021	6,221,199
2022-2026	5,977,020
2027-2031	4,524,246
2032-2036	2,319,819
2037-2041	1,722,872
2042-2046	1,124,268
2047-2048	258,080
Total	\$ 29,522,821

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010NOTE F – LONG-TERM OBLIGATIONS (CONTINUED)

Under covenants of the bond ordinances, certain funds have been established. These funds and their current financial requirements are presented as follows:

Revenue Fund

All receipts for services are deposited into this fund and, subsequently, disbursed into the following required funds:

Bond and Interest Redemption Funds

There is to be a monthly deposit of an amount equal to 1/12 of the next ensuing principal payment due and 1/6 of the next ensuing interest payment due for the 2002 Series C, 2003 Series, 2004 Series A, 2005 Series A and B issues, 2007 Series A and 2010 Series A.

Depreciation Fund

This fund receives, on a monthly basis, \$18,700. This fund also receives the proceeds from the sale of any property or equipment. This fund may be used to purchase new or replacement property and equipment.

Operation and Maintenance Fund

This fund receives, on a monthly basis, sufficient amounts to pay current expenses from the Revenue Fund after the above transfers have been made. This fund is used to pay operating expenditures. This account is funded until it reaches 2 months of forecasted operating expenses. Any surplus left may be added to the Bond and Interest Redemption Fund.

NOTE G - RETIREMENT PLAN

Plan Description - The District participates in the County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System's Board of Trustees. CERS provides benefits to its participants upon retirement. CERS issues a publicly available financial report that includes financial statements and required supplementary information for the retirement plan. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601 or by calling 502-564-4646.

Funding Policy - Plan members employed before September 1, 2008, are required to contribute 5% of their annual covered salary and those hired on or after September 1, 2008, are required to contribute 6% of their annual covered salary. The District is required to contribute at an actuarially determined rate. The rates at December 31, 2011, 2010 and 2009 were 18.96%, 16.93% and 16.16% of covered payroll. The contribution requirements of the District are established and may be amended by the Kentucky Retirement System's Board of Trustees. The District's contributions to CERS for the years ended December 31, 2011, 2010 and 2009 were \$327,116, \$283,410, and \$246,208. Employee contributions were \$92,045, \$86,210 and \$81,071 and covered payroll was \$1,815,074, \$1,700,409 and \$1,655,839. All payments were made to the retirement system in the amount of the annually required contributions.

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010(CONCLUDED)NOTE G - RETIREMENT PLAN (CONTINUED)

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

CERS also provides post-retirement health care coverage as follows:

For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>% Paid By Insurance Fund</u>	<u>% Paid By Member Through Payroll Deduction</u>
20 or more	100%	0%
15 - 19	75%	25%
10 - 14	50%	50%
4 - 9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation 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 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount.

NOTE H - CAPITAL CONTRIBUTIONS

The following schedule details the sources of capital contributions for the years ended December 31, 2011 and 2010:

<u>Source</u>	<u>2011</u>	<u>2010</u>
State of Kentucky	\$ 143,432	\$ 945,768
Federal Government	4,509	30,611
Tap Fees	154,800	275,400
Developers	380,081	174,048
Hardin County Fiscal Court	-	307,289
	<u>\$ 682,822</u>	<u>\$ 1,733,116</u>

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HARDIN COUNTY WATER DISTRICT NO. 2NOTES TO FINANCIAL STATEMENTSDECEMBER 31, 2011 AND 2010(CONCLUDED)NOTE I – RENTAL AGREEMENTS

The District has entered into agreements to lease space on its water towers to various telephone customers. Rental income during the years ended December 31, 2011 and 2010 was \$79,520 each year. The following schedule represents future payments to be received.

2012	\$62,310
2013	<u>24 840</u>
Total	<u>\$87,150</u>

NOTE J – COMMITMENTS

The District has entered into construction commitments toward its construction projects. Also, the District has received certain funding commitments from federal and state agencies for current and planned construction projects.

NOTE K – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The District was insured for workers' compensation, general liability and automobile liability coverage under a retrospectively rated commercial policy.

OTHER SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS
DECEMBER 31, 2011

	\$ 3,020,000 2002 SERIES C		\$ 4,485,000 2003 SERIES A	
	BOND	INTEREST	BOND	INTEREST
2012	\$ 380,000	\$ 36,445	\$ 75,000	\$ 146,609
2013	395,000	22,396	80,000	143,703
2014	405,000	7,594	80,000	140,703
2015			85,000	137,609
2016			90,000	134,283
2017			95,000	130,650
2018			95,000	126,779
2019			100,000	122,733
2020			105,000	118,479
2021			110,000	114,018
2022			115,000	109,349
2023			120,000	104,263
2024			130,000	98,638
2025			135,000	92,675
2026			140,000	86,488
2027			145,000	80,075
2028			155,000	73,325
2029			165,000	66,022
2030			170,000	58,275
2031			180,000	50,181
2032			190,000	41,625
2033			200,000	32,606
2034			110,000	25,438
2035			115,000	20,234
2036			120,000	14,800
2037			125,000	9,134
2038			135,000	3,122
2039				
2040				
2041				
2042				
2043				
2044				
2045				
2046				
2047				
2048				
	<u>\$ 1,180,000</u>	<u>\$ 66,435</u>	<u>\$ 3,365,000</u>	<u>\$ 2,281,816</u>

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HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2011

(CONTINUED)

	\$ 2,940,000 2004 SERIES A		\$ 2,990,000 2005 SERIES A		\$ 1,775,000 2005 SERIES B	
	BOND	INTEREST	BOND	INTEREST	BOND	INTEREST
2012	\$ 115,000	\$ 82,420	\$ 39,500	\$ 123,156	\$ 70,000	\$ 57,400
2013	115,000	78,826	41,500	121,428	75,000	54,428
2014	125,000	74,926	43,000	119,612	80,000	51,250
2015	125,000	70,708	45,000	117,732	85,000	47,868
2016	135,000	66,158	47,000	115,762	85,000	44,383
2017	145,000	61,113	49,000	113,706	90,000	40,795
2018	155,000	55,563	51,000	111,562	95,000	37,003
2019	160,000	49,575	53,500	109,332	105,000	32,903
2020	170,000	43,140	56,000	106,990	105,000	28,598
2021	175,000	36,413	58,500	104,540	115,000	24,088
2022	190,000	29,200	61,000	101,982	120,000	19,270
2023	200,000	21,400	63,500	99,312	130,000	14,145
2024	215,000	13,100	66,500	96,534	135,000	8,713
2025	220,000	4,400	69,000	93,626	145,000	2,973
2026			72,000	91,006		
2027			75,500	87,456		
2028			78,500	84,154		
2029			82,000	80,718		
2030			85,500	77,132		
2031			89,500	73,390		
2032			93,500	69,476		
2033			97,500	65,384		
2034			101,500	61,118		
2035			106,000	56,678		
2036			111,000	52,040		
2037			115,500	47,184		
2038			120,500	42,132		
2039			126,000	36,860		
2040			131,500	31,346		
2041			137,000	25,594		
2042			143,000	19,600		
2043			149,500	13,344		
2044			155,500	6,804		
2045						
2046						
2047						
2048						
	<u>\$ 2,245,000</u>	<u>\$ 686,942</u>	<u>\$ 2,815,000</u>	<u>\$ 2,556,690</u>	<u>\$ 1,435,000</u>	<u>\$ 463,817</u>

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HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2011

(CONTINUED)

	\$ 2,480,000 2007 SERIES A		\$ 5,625,000 2010 SERIES A	
	BOND	INTEREST	BOND	INTEREST
2012	\$ 29,000	\$ 97,500	\$ 205,000	\$ 179,744
2013	30,000	96,320	210,000	175,594
2014	32,000	95,080	215,000	171,344
2015	33,000	93,780	220,000	166,994
2016	34,000	92,440	225,000	162,122
2017	36,000	91,040	230,000	156,288
2018	37,000	89,580	235,000	149,894
2019	39,000	88,060	245,000	142,987
2020	40,000	86,480	250,000	135,250
2021	42,000	84,840	260,000	126,800
2022	44,000	83,120	265,000	117,940
2023	46,000	81,320	275,000	108,656
2024	47,000	79,460	290,000	98,588
2025	49,000	77,540	300,000	87,707
2026	51,000	75,540	310,000	76,075
2027	54,000	73,440	325,000	63,772
2028	56,000	71,240	340,000	50,676
2029	58,000	68,960	345,000	36,976
2030	60,000	66,600	360,000	22,876
2031	63,000	64,140	380,000	7,838
2032	66,000	61,560		
2033	68,000	58,880		
2034	71,000	56,100		
2035	74,000	53,200		
2036	77,000	50,180		
2037	80,000	47,040		
2038	84,000	43,760		
2039	87,000	40,340		
2040	91,000	36,780		
2041	94,000	33,080		
2042	98,000	29,240		
2043	102,000	25,240		
2044	106,000	21,080		
2045	111,000	16,740		
2046	115,000	12,220		
2047	120,000	7,520		
2048	128,000	2,560		
	<u>\$ 2,452,000</u>	<u>\$ 2,252,000</u>	<u>\$ 5,485,000</u>	<u>\$ 2,238,121</u>

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HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE I - BOND AND INTEREST REQUIREMENTS
DECEMBER 31, 2011
(CONCLUDED)

		<u>TOTAL ALL ISSUES</u>	
		<u>BOND</u>	<u>INTEREST</u>
2012	\$	913,500	\$ 723,274
2013		946,500	692,695
2014		980,000	660,509
2015		593,000	634,691
2016		616,000	615,148
2017		645,000	593,592
2018		668,000	570,381
2019		702,500	545,590
2020		726,000	518,937
2021		760,500	490,699
2022		795,000	460,861
2023		834,500	429,096
2024		883,500	395,033
2025		918,000	358,921
2026		573,000	329,109
2027		599,500	304,743
2028		629,500	279,395
2029		650,000	252,676
2030		675,500	224,883
2031		712,500	195,549
2032		349,500	172,661
2033		365,500	156,870
2034		282,500	142,656
2035		295,000	130,112
2036		308,000	117,020
2037		320,500	103,358
2038		339,500	89,014
2039		213,000	77,200
2040		222,500	68,126
2041		231,000	58,674
2042		241,000	48,840
2043		251,500	38,584
2044		261,500	27,884
2045		111,000	16,740
2046		115,000	12,220
2047		120,000	7,520
2048		128,000	2,560
	\$	<u>18,977,000</u>	<u>\$ 10,545,821</u>

HARDIN COUNTY WATER DISTRICT NO. 2SCHEDULE II - GENERAL AND ADMINISTRATIVE EXPENSESYEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Salaries	\$ 700,591	\$ 645,457
Commissioner's salaries	30,250	30,250
Employee benefits	416,297	399,008
Materials and supplies	48,860	70,319
Professional fees	18,500	20,995
Insurance	69,562	102,542
Advertising	1,885	674
Provision for bad debts	15,065	74,917
Other general and administrative	251,821	348,757
	<u>\$ 1,552,831</u>	<u>\$ 1,692,919</u>

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE III - ORGANIZATION DATA

DECEMBER 31, 2011

WATER COMMISSIONERS

Michael Bell - Chairman
Morris Miller - Secretary/Treasurer
Cordell Tabb - Member
John Effinger - Member
Tim Davis - Member

ATTORNEY

Damon R. Talley - Hodgenville, Kentucky

GENERAL MANAGER

James Jeffries

CALENDAR YEAR

January 1 to December 31

INTERNAL CONTROL AND FISCAL COMPLIANCE

THEODORE C. STILES, CPA
BENJAMIN E. CARTER, CPA
JOHN R. ASHCRAFT, CPA
J. SCOTT KISSELBAUGH, CPA
BRIAN S. WOOSLEY, CPA
CHRIS R. CARTER, CPA



STILES, CARTER & ASSOCIATES, P.S.C.

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CARRIE A. GREY, CPA
MARK W. KENNEDY, CPA
PHILIP A. LOGSDON, CPA
J. ALTON PIKE, CPA

INDEPENDENT AUDITOR'S 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

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

We have audited the financial statements of the Hardin County Water District No. 2, as of and for the year ended December 31, 2011, and have issued our report thereon dated February 20, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Hardin County Water District No. 2'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 Hardin County Water District No. 2's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the 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 combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not define any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified *certain deficiencies in internal control over financial reporting*, described in the accompanying schedule of findings and responses as item 2011-01 that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hardin County Water District No. 2'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*.

Hardin County Water District No. 2's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Hardin County Water District No. 2's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the commissioners, management, federal agencies, and the Kentucky Public Service Commission and is not intended to be and should not be used by anyone other than those specified parties.



Certified Public Accountants
February 20, 2012

SCHEDULE OF FINDINGS AND RESPONSES

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE OF FINDINGS AND RESPONSES
FOR THE YEAR ENDED DECEMBER 31, 2011

SIGNIFICANT DEFICIENCIES

REFERENCE NUMBER 2011-01 FINANCIAL STATEMENT PRESENTATION

Criteria: The District's management is responsible for establishing and maintaining internal controls over the application of transactions and the preparation of financial statements.

Condition: As part of the audit we noted that significant adjustments were not identified by the District's internal control.

Cause: The District did not make all necessary adjustments when closing the year.

Effect: The financial statements required adjustment of significant items.

Recommendation: We recommend District management and financial personnel continue to increase their awareness and knowledge of all procedures and processes involved in preparing financial statements and develop internal control policies to ensure proper financial statement presentation.

Management Response: Management will improve operations to ensure that necessary adjustments are made in accordance with the normal closing process.