

# Alexander, Toney & Knight PLLC

CERTIFIED PUBLIC ACCOUNTANTS

28 Court Street

Madisonville, Kentucky 42431

(270) 821-4824

FAX: (270) 825-4554

Email: atkcpas@yahoo.com

Larry R. Alexander, CPA  
Harold R. Toney, Jr., CPA  
Anthony Knight, CPA

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

## Independent Auditor's Report

To the Commissioners  
Muhlenberg County Water District Number 3  
Bremen, Kentucky

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Muhlenberg County Water District Number 3 as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## *Opinions*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Muhlenberg County Water District Number 3 as of December 31, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

## *Other Matters*

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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 of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 8, 2013, on our consideration of Muhlenberg County Water District Number 3's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Muhlenberg County Water District Number 3's internal control over financial reporting and compliance.

*Alexander, Toney : Knight PLLC*

Madisonville, Kentucky  
February 8, 2013

MUHLENBERG COUNTY WATER DISTRICT NUMBER 3  
Management's Discussion and Analysis  
December 31, 2012 and 2011

The discussion and analysis of the Muhlenberg County Water District Number 3's financial performance provides an overview and analysis of the District's financial activities for the years ended December 31, 2012 and 2011. It should be read in conjunction with the accompanying basic financial statements.

Financial Highlights for the Year 2012

- \* The District's net position increased \$77.7 thousand or 2.8% from \$2.739 million to \$2.816 million.
- \* Income before capital contributions was \$60.6 thousand for the year ended December 31, 2012.

Overview Of The Financial Statements

This report consists of this management's discussion and analysis, basic financial statements, and notes to the financial statements. The basic financial statements are reported using the full accrual basis of accounting.

Basic financial statements:

The Statements of Net Position include information on the District's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). In simple terms, this statement presents a snap-shot view of the assets the District owns, the liabilities it owes and the net difference. The net difference is further separated into amounts restricted for specific purposes and unrestricted amounts.

The Statements of Revenues, Expenses, and Changes in Fund Net Assets include the District's revenues and expenses for the years ended December 31, 2012 and 2011. This statement provides information on the District's operations and can be used to determine whether the District has recovered all of its actual and projected costs through user fees and other charges.

The Statements of Cash Flows include information on the District's cash receipts and payments and the changes in cash balances resulting from operating activities, investing activities, and financing activities.

The notes to the financial statements provide additional disclosures required by governmental accounting standards and provide information to assist the reader in understanding the District's financial condition.

## District Financial Analysis

A summary of the District's Statements of Net Position is presented below.

Table 1  
Condensed Statements of Net Position  
(in thousands)

	<u>2012</u>	<u>2011</u>	<u>dollar change</u>	<u>percent change</u>	<u>2010</u>	<u>dollar change</u>	<u>percent change</u>
Current assets	\$ 606.3	\$ 525.3	\$ 81.0	15.4%	\$ 516.5	\$ 8.8	1.7%
Capital assets	1,926.1	1,891.1	35.0	1.9%	1,947.0	( 55.9)	( 2.9%)
Other noncurrent assets	<u>388.3</u>	<u>382.6</u>	5.7	1.5%	<u>375.0</u>	7.6	2.0%
Total assets	<u>2,920.7</u>	<u>2,799.0</u>	121.7	4.3%	<u>2,838.5</u>	( 39.5)	( 1.4%)
Current liabilities	91.1	49.0	42.1	85.9%	181.7	( 132.7)	( 73.0%)
Long-term liabilities	<u>13.3</u>	<u>11.4</u>	1.9	16.7%	<u>33.4</u>	( 22.0)	( 65.9%)
Total liabilities	<u>104.4</u>	<u>60.4</u>	44.0	72.8%	<u>215.1</u>	( 154.7)	( 71.9%)
Net assets invested in capital assets, net of related debt	1,883.8	1,891.1	( 7.3)	( 0.4%)	1,947.0	( 55.9)	( 2.9%)
Unrestricted net assets	<u>932.5</u>	<u>847.5</u>	85.0	10.0%	<u>676.4</u>	171.1	25.3%
Total net assets	<u>\$2,816.3</u>	<u>\$2,738.6</u>	\$ 77.7	2.8%	<u>\$2,623.4</u>	\$ 115.2	4.4%

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 \$2.816 million at the close of the current year.

### 2011 to 2012

As shown in table 1, the District's total assets increased by \$121,700 from \$2,799,000 to \$2,920,700. Current assets increased \$81,000 primarily due to increases in cash and cash equivalents which increased \$63,900 and accounts receivable which increased \$13,950. Accounts receivable balance is higher as the District had a rate increase during the year. Capital assets increased \$35,000 primarily due to capital asset acquisitions outpacing depreciation expense.

The District's current liabilities increased \$42,100 due primarily to an increase of \$42,300 in construction projects payable as meters were acquired prior to year end but not yet paid.

The District's total net position increased \$77,700 due to the net effect of the increases in total assets and total liabilities referred to above.

2010 to 2011

As shown in table 1, the District's total assets decreased by \$39,500 from \$2,838,500 to \$2,799,000. Current assets increased \$8,800 primarily due to increases in accounts receivable which increased \$8,200. Accounts receivable balance is higher as the District had a rate increase during the year. Capital assets decreased \$55,900 primarily due to depreciation expense outpacing capital asset acquisitions.

The District's current liabilities decreased \$132,700 due primarily to a decrease of \$132,000 in construction projects payable. The District eliminated the payable partly upon receiving \$100,000 in grant monies from McLean County. Noncurrent liabilities decreased \$22,000 as accumulated compensated absences decreased \$21,900. The District changed its policy regarding accumulation of earned but unused vacation days. Accumulation is now limited to the annual anniversary date of each employee.

The District's total net position increased \$115,200 due to the net effect of the decreases in total assets and total liabilities referred to above. Net assets invested in capital assets net of related debt, a component of total net position, decreased \$55,900 reflecting the same decrease in capital assets.

A summary of the District's Statements of Revenues, Expenses and Changes in Net Position is presented below.

Table 2  
Condensed Statements of Revenues, Expenses and Changes in Net Position  
(in thousands)

	2012	2011	dollar change	percent change	2010	dollar change	percent change
Operating revenues	\$1,013.2	\$ 938.6	\$ 74.6	7.9%	\$ 889.8	\$ 48.8	5.5%
Nonoperating revenues	11.2	10.8	0.4	3.7%	13.6	( 2.8)	( 20.6%)
Total revenues	<u>1,024.4</u>	<u>949.4</u>	75.0	7.9%	<u>903.4</u>	46.0	5.1%
Operating expenses	963.7	939.0	24.7	2.6%	929.3	9.7	1.0%
Nonoperating expenses	0.0	0.0	( 0.0)	0.0%	0.0	( 0.0)	0.0%
Total expenses	<u>963.7</u>	<u>939.0</u>	24.7	2.6%	<u>929.3</u>	9.7	1.0%
Income (loss) before capital contributions	60.7	10.4	50.3	483.7%	( 25.9)	36.3	140.2%
Capital contributions	<u>17.0</u>	<u>104.8</u>	( 87.8)	( 83.8%)	<u>11.0</u>	93.8	852.7%
Changes in net position	77.7	115.2	( 37.5)	( 32.6%)	( 14.9)	130.1	873.2%
Beginning net position	<u>2,738.6</u>	<u>2,623.4</u>	115.2	4.4%	<u>2,638.3</u>	( 14.9)	( 0.6%)
Ending net position	<u>\$2,816.3</u>	<u>\$2,738.6</u>	\$ 77.7	2.8%	<u>\$2,623.4</u>	\$ 115.2	4.4%

## 2011 to 2012

As shown in table 2, the District's total revenues increased \$74,800. Water sales increased \$68,000 as the District had a 5.05% water rate increase during the year.

The District's total expenses increased \$24,700 from the prior year. Purchased water increased \$18,000. The District experienced high water loss early in 2012 which attributed to the increased water cost. Salaries and wages decreased \$13,700 due to employees being required to cash out accumulated compensated absences during 2011. Beginning in 2011, employees are now only allowed to accumulate one year of compensated absences and there was a significant higher amount cashed out in 2011. Materials and supplies increased \$17,000 as the District experienced a higher rate of repair work during the year. Contract services increased \$9,000 during the year due to building maintenance and increased water testing.

Capital contributions decreased \$87,800 due to a \$100,000 grant received from Muhlenberg County Fiscal Court in the prior year and not in 2012.

Changes in net position increased \$77,700 due to the net effect of the above changes.

## 2010 to 2011

As shown in table 2, the District's total revenues increased \$46,000. Water sales increased \$45,500 as the District had a 5.05% water rate increase during the year. Nonoperating revenues decreased \$2,800. Interest income decreased \$5,500 as interest rates dropped in 2011. Also fully depreciated meters were scrapped for \$2,648.

The District's total expenses increased \$9,700 from the prior year. Purchased water decreased \$16,000 as the District is taking a more aggressive approach toward water loss management. Salaries and wages increased \$19,700 due to employees being required to cash out accumulated compensated absences. Materials and supplies decreased \$14,500 as the District enforced a more strict budget to reduce expenses. Depreciation expense increased \$7,200 as a full year of depreciation was incurred on new capital assets installed in prior years.

Capital contributions increased \$93,800 due to a \$100,000 grant from Muhlenberg County Fiscal Court.

Changes in net position increased \$115,200 due to the net effect of the above changes.

## Capital Assets and Debt Administration

### Capital Assets

At December 31, 2012 the District had \$1,883,785 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net decrease (additions, retirements, depreciation) of \$7,281 from the prior year.

Significant additional expenditures during the year included normal additional expenditures on meters which totaled approximately \$63,700.

At December 31, 2011 the District had \$1,891,066 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net decrease (additions, retirements, depreciation) of \$55,957 from the prior year. The increase is primarily due to \$88,293 depreciation expense in 2011 and capital asset additions during the year totaling \$32,336.

Significant additions during the year included normal additional expenditures on meters which totaled approximately \$19,900.

A comparison of the District's capital assets over the past three years is presented in Note E of the financial statements.

#### Long-Term Debt

At December 31, 2012, the District had \$25,307, net reductions of \$68, in long-term liabilities which included customer deposits and accumulated compensated absences. There were no new borrowings.

At December 31, 2011, the District had \$25,375, net reductions of \$21,222, in long-term liabilities which included customer deposits and accumulated compensated absences. There were no new borrowings.

Additional information on the District's long-term debt can be found in Note F of the financial statements.

#### Currently Known Facts, Decisions, or Conditions

There are no currently known facts, decisions, or conditions that District management expects to have a significant effect on financial position or results of operations.

#### Requests For Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Muhlenberg County Water District Number 3, 4789 Main Street, Bremen, Kentucky 42325.

Muhlenberg County Water District Number 3  
Statement of Net Position  
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>Assets</u>		
Current assets		
Cash and cash equivalents	\$ 439,104	\$ 375,196
Accounts receivable	125,168	111,216
Other receivables	9,272	0
Material and parts inventory	24,903	31,207
Prepaid expenses	7,816	7,697
Total current assets	<u>606,263</u>	<u>525,316</u>
Noncurrent assets		
Restricted cash and cash equivalents	388,315	382,639
Capital assets:		
Nondepreciable	73,685	22,281
Depreciable, net of accumulated depreciation	<u>1,852,400</u>	<u>1,868,785</u>
Total noncurrent assets	<u>2,314,400</u>	<u>2,273,705</u>
Total assets	<u>2,920,663</u>	<u>2,799,021</u>
<u>Liabilities</u>		
Current liabilities payable from current assets		
Accounts payable	35,358	33,674
Construction project payable	42,300	0
Accrued taxes and other payables	1,409	1,324
Accumulated compensated absences	6,722	8,015
	<u>85,789</u>	<u>43,013</u>
Current liabilities payable from restricted assets		
Customer deposits	5,297	5,991
Accrued interest-customer deposits	0	9
	<u>5,297</u>	<u>6,000</u>
Total current liabilities	<u>91,086</u>	<u>49,013</u>
Long-term liabilities		
Customer deposits	<u>13,288</u>	<u>11,369</u>
Total noncurrent liabilities	<u>13,288</u>	<u>11,369</u>
Total liabilities	<u>104,374</u>	<u>60,382</u>
<u>Net Position</u>		
Invested in capital assets, net of related debt	1,883,785	1,891,066
Unrestricted	<u>932,504</u>	<u>847,573</u>
Total net position	<u>\$2,816,289</u>	<u>\$2,738,639</u>

The accompanying notes are an integral part of these statements.



Muhlenberg County Water District Number 3  
 Statement of Revenues, Expenses and Changes in Net Position  
 Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues		
Water sales	\$ 979,013	\$ 910,618
Other operating revenues	<u>34,171</u>	<u>28,022</u>
Total operating revenues	<u>1,013,184</u>	<u>938,640</u>
Operating expenses		
Purchased water	422,690	404,768
Salaries and wages	220,790	234,526
Depreciation	87,796	88,293
Employee benefits	74,546	81,917
Transportation	12,676	14,081
Contract services	30,396	21,155
Taxes	16,394	19,455
Purchased power	25,560	21,256
Materials and supplies	36,418	19,225
Insurance	15,149	14,685
Miscellaneous	18,006	16,060
Regulatory commission expense	1,646	1,360
Uncollectible accounts	<u>1,671</u>	<u>2,049</u>
Total operating expenses	<u>963,738</u>	<u>938,830</u>
Operating income (loss)	49,446	( 190)
Nonoperating revenues (expenses)		
Interest income	8,957	8,132
Interest expense	0	( 182)
Gains (losses) on sale of capital assets	<u>2,227</u>	<u>2,648</u>
Total nonoperating revenues (expenses)	<u>11,184</u>	<u>10,598</u>
Income (loss) before contributions	60,630	10,408
Capital contributions-state	9,272	100,000
Capital contributions-tap fees	6,025	1,950
Capital contributions-customers	<u>1,723</u>	<u>2,866</u>
Change in net position	77,650	115,224
Net position beginning of year	<u>2,738,639</u>	<u>2,623,415</u>
Net position end of year	<u>\$2,816,289</u>	<u>\$2,738,639</u>

The accompanying notes are an integral part of these statements.

Muhlenberg County Water District Number 3  
Statement of Cash Flows  
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>Cash flows from operating activities</u>		
Cash received from customers	\$ 963,390	\$ 900,331
Cash payments to suppliers for goods and services	( 658,046)	( 640,412)
Cash payments to employees for services	( 220,790)	( 234,526)
Other operating revenues	<u>34,171</u>	<u>28,022</u>
Net cash provided (used) by operating activities	118,725	53,415
<u>Cash flows from capital and related financing activities</u>		
Acquisition and construction of capital assets	( 69,289)	( 164,627)
Interest paid on customer deposits	( 9)	( 183)
Customer deposits collected	5,810	6,126
Customer deposits refunded	( 4,585)	( 5,356)
Capital contributions received from customers	7,748	4,816
Proceeds from grant	0	100,000
Gain on disposition of capital assets	2,227	2,648
Capital contributions refunded to customers	<u>0</u>	<u>( 1,502)</u>
Net cash provided (used) for capital and related financing activities	( 58,098)	( 58,078)
<u>Cash flows from investing activities</u>		
Interest earned on bank deposits	<u>8,957</u>	<u>8,132</u>
Net cash provided (used) for investing activities	8,957	8,132
Net increase (decrease) in cash and cash equivalents	69,584	3,469
Cash and cash equivalents at beginning of year	<u>757,835</u>	<u>754,366</u>
Cash and cash equivalents at end of year	<u>\$ 827,419</u>	<u>\$ 757,835</u>
	=====	=====
<u>Reconciliation of operating income to net cash provided (used) by operating activities</u>		
Operating income (loss)	\$ 49,446	(\$ 190)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	87,796	88,293
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	( 13,952)	( 8,238)
(Increase) decrease in other receivables	( 9,272)	1,786
(Increase) decrease in inventory	6,304	( 6,365)
(Increase) decrease in prepaid expenses	( 119)	( 185)
Increase (decrease) in accounts payable	( 270)	88
Increase (decrease) in accrued expenses	85	219
Increase (decrease) in compensated absences	<u>( 1,293)</u>	<u>( 21,993)</u>
Total adjustments	<u>69,279</u>	<u>53,605</u>
Net cash provided by operating activities	<u>\$ 118,725</u>	<u>\$ 53,415</u>
	=====	=====

The accompanying notes are an integral part of these statements.

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2012 and 2011

NOTE A - SUMMARY OF ACCOUNTING POLICIES

The accounting policies of the Muhlenberg County Water District Number 3 conform to Generally Accepted Accounting Principles (GAAP) as applicable to governments. The District applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989 unless those pronouncements conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements, in which case, GASB prevails. The following is a summary of the more significant policies:

1. The Financial Reporting Entity

Muhlenberg County Water District Number 3 (the "District") was created on April 24, 1967, under the provisions of Chapter 74 of the Kentucky Revised Statutes of the Commonwealth of Kentucky. The principal office of the District is located at Bremen, Kentucky. The District is composed of three commissioners who are appointed by the Muhlenberg County Judge Executive and provides water to its members in and around Muhlenberg County, Kentucky.

In evaluating how to define the government, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GASB Statement No. 14 - *The Financial Reporting Entity*.

2. Basis of Presentation, Measurement Focus, and Basis of Accounting

The accounts of the District are organized in accordance with the uniform system of accounts adopted by the Public Service Commission of Kentucky. Those accounts are organized on the basis of a proprietary fund type, specifically an enterprise fund. The activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the District's assets, liabilities, net assets, revenues, and expenses. Enterprise Funds account for activities 1) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or 2) that are required by laws or regulations that the activities costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or 3) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statements of net position. Net assets are required to be displayed in three components: 1) invested in capital assets, net of related debt, 2) restricted, and 3) unrestricted. Invested in capital assets, net of related debt is capital assets net of accumulated depreciation and reduced by outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Restricted net assets are those with constraints placed on their use by either: 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation. All net assets not otherwise classified as restricted, are shown as unrestricted. The statements of revenue, expenses, and changes in net position present increases (revenues) and decreases (expenses) in net assets.

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2012 and 2011

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The accounts of the District are maintained on the accrual basis of accounting. Its revenues are recognized when they are earned, and its expenses are recognized when they are incurred.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues and expenses of the District's enterprise fund are charges to customers for sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Unbilled water receivables for utility services provided through December 31 are included in the financial statements.

When both restricted and unrestricted resources are available for use, the District generally first uses restricted resources, then unrestricted resources as they are needed.

3. Cash and Cash Equivalents

All cash except for a small amount kept "on hand" is deposited in financial institutions. Deposits are interest bearing checking accounts and certificates of deposit. Unrestricted cash is available to be expended for normal operating expenses. Restricted cash is limited to payments of bond principal and interest, emergency capital improvements, and other designated purposes. Cash and cash equivalents are defined as being all monies on deposit in banks and investments with a maturity of 90 days or less.

4. Inventory

Inventory consists primarily of replacement parts and supplies. Inventory is stated at the lower of cost or market. Cost is determined primarily by the first-in, first-out method.

5. Capital Assets

Capital assets, which include property, plant, and equipment, are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. No interest was capitalized during the years ended December 31, 2012 and 2011.

Muhlenberg County Water District Number 3  
 Notes to Financial Statements  
 December 31, 2012 and 2011

---

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Capital assets of the District are depreciated using a straight-line method over the following estimated useful lives:

Structures, improvements and water system	10 to 65 years
Furniture, machinery and equipment	2 to 10 years
Vehicles	5 years

6. Restricted Net Assets

Restricted net assets are cash set aside for the repayment of debt in compliance with bond covenants and cash restricted for future operations in compliance with escrow reserve agreements. The District currently doesn't have any restricted net assets.

7. Long-Term Liabilities

Long-term debt is reported as liabilities in the statement of net assets. Long-term debt is reported at face value.

8. Uncollectible Accounts

All accounts receivable are considered by management to be collectible, therefore no provision for uncollectible accounts has been established. Uncollectible accounts are expensed using the direct write-off method.

9. Use of Estimates

The preparation of financial statements in accordance with accounting principals generally accepted in the United States requires management to make estimates that affect amounts reported in the financial statements during the reporting period. Actual results could differ from those estimates.

NOTE B - DEPOSITS

The District maintains deposits with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to law, the depository institution should pledge sufficient securities as collateral which, together with FDIC insurance, equals or exceeds the amount on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge of securities should be evidenced by an agreement that is (1) in writing, (2) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (3) an official record of the depository institution. This agreement, signed by both parties, must be sufficient to create an enforceable and perfected security interest in the collateral under Kentucky law.

Deposits are categorized to give an indication of risk assumed by the District at the end of the year. Category 1 includes deposits that are insured, Category 2 includes collateralized deposits held by the pledging institution's trust department or agent in the District's name, and Category 3 includes uncollateralized and uninsured deposits.

Muhlenberg County Water District Number 3  
 Notes to Financial Statements  
 December 31, 2012 and 2011

NOTE B - DEPOSITS continued

On December 31, 2012, the reconciled balance of the District's deposits totaled \$827,279 and the bank balances were \$836,881. Of the bank balances \$553,190 was covered by federal depository insurance (category 1). Also of the bank balances, \$283,691 was collateralized by additional securities held by the pledging depository institution's trust department or agent in the District's name (category 2).

On December 31, 2011, the reconciled balance of the District's deposits totaled \$757,835 and the bank balances were \$767,468. Of the bank balances \$517,936 was covered by federal depository insurance (category 1). Also of the bank balances, \$249,532 was collateralized by additional securities held by the pledging depository institution's trust department or agent in the District's name (category 2).

NOTE C - PREPAID EXPENSES

Prepaid expenses include prepaid insurance, which represents the amount of unexpired insurance, which the District had previously paid for at the balance sheet date.

At December 31, 2012, the District's prepaid expenses consisted of \$7,816 of insurance. At December 31, 2011, the District's prepaid expenses consisted of \$7,697 of insurance.

NOTE D - RESTRICTED CASH AND CASH EQUIVALENTS

The District has cash set aside for the repayment of debt (which has been fully paid), cash restricted for future operations, cash set aside for future capital assets, and cash set aside for repayment of customer deposits.

Restricted balances as of December 31 are as follows:

	2012	2011
Bond and interest redemption fund	\$ 72,831	\$ 71,875
Bond depreciation fund	289,111	285,631
Customer meter deposit fund	22,798	21,558
Construction fund	3,575	3,575
Totals	\$ 388,315	\$ 382,639

Muhlenberg County Water District Number 3  
 Notes to Financial Statements  
 December 31, 2012 and 2011

NOTE E - CAPITAL ASSETS

Capital asset activities for the years ended December 31, 2012 and 2011, were as follows:

	Balances 12/31/10	Transfers/ Additions	Transfers/ Retirements	Balances 12/31/11	Transfers/ Additions	Transfers/ Retirements	Balances 12/31/12
Business-type activities:							
Capital assets not being depreciated							
Land & land rights	\$ 22,281	\$ 0	\$ 0	\$ 22,281	\$ 0	\$ 0	\$ 22,281
Construction in progress	31,524	0	31,524	0	51,404	0	51,404
Total	53,805	0	31,524	22,281	51,404	0	73,685
Capital assets being depreciated							
Structures, improvements, & water system	3,057,124	57,850	9,112	3,105,862	66,099	16,965	3,154,996
Office furniture & equipment	42,917	3,167	0	46,084	1,805	0	47,889
Vehicles & equipment	79,548	0	0	79,548	0	0	79,548
Machinery & equipment	395,207	2,843	0	398,050	3,507	0	401,557
Total	3,574,796	63,860	9,112	3,629,544	71,411	16,965	3,683,990
Total capital assets	3,628,601	63,860	40,636	3,651,825	122,815	16,965	3,757,675
Less accumulated depreciation for:							
Structures, improvements, & water system	1,476,782	57,468	9,112	1,525,138	58,850	16,965	1,567,023
Office furniture & equipment	33,392	2,789	0	36,181	3,043	0	39,224
Vehicles & equipment	64,928	7,421	0	72,349	5,388	0	77,737
Machinery & equipment	106,476	20,615	0	127,091	20,515	0	147,606
Total accumulated depreciation	1,681,578	88,293	9,112	1,760,759	87,796	16,965	1,831,590
Total business-type activities capital assets, net	\$1,947,023	(\$ 24,433)	\$ 31,524	\$1,891,066	\$ 35,019	\$ 0	\$1,926,085

Muhlenberg County Water District Number 3  
 Notes to Financial Statements  
 December 31, 2012 and 2011

NOTE F - LONG-TERM LIABILITIES

Long-term liability activity

Long-term liability activity for the years ended December 31, 2012 and 2011, were as follows:

	Balances			Balances			Balances		Amounts
	<u>12/31/10</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/11</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/12</u>	<u>Due Within</u>	<u>One Year</u>
Customer Deposits	16,590	6,126	5,356	17,360	5,810	4,585	18,585	5,297	
Accumulated Compensated Absences	30,007	11,874	33,866	8,015	14,503	15,796	6,722	6,722	
Business-type Activities Long- Term Liabilities	\$ 46,597	\$ 18,000	\$ 39,222	\$ 25,375	\$ 20,313	\$ 20,381	\$ 25,307	\$ 12,019	

NOTE G - ACCUMULATED COMPENSATED ABSENCES

Effective March 2011 employees are no longer permitted to accumulate earned but unused vacation days beyond one year. The employees must use or cash out their yearly allotment of vacation time earned by the annual anniversary date of their employment.

NOTE H - EMPLOYEES' PENSION PLAN

Plan description

The District and covered employees contribute to the County Employers Retirement System (CERS), a cost-sharing, multiple-employer defined benefit plan administered by the Board of Trustees of the Kentucky Retirement Systems.

The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living adjustments are provided at the discretion of the State legislature. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of the Kentucky Retirement Systems.

The CERS financial statements and other supplementary information are contained in the publicly available annual financial report of the Kentucky Retirement Systems. Copies of the report are sent to each participating employer as well as distributed to legislative personnel, state libraries and other interested parties. Copies may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West 1260 Louisville Road, Frankfort, Kentucky 40601 or by calling 1-502-928-4646 or on the internet at [www.kyret.com](http://www.kyret.com).



Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2012 and 2011

NOTE H - EMPLOYEES' PENSION PLAN continued

Funding policy

Per Kentucky Revised Statute 61.565, normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board.

For the year ended December 31, 2012, plan members hired prior to September 1, 2008 were required to contribute 5% of their annual creditable compensation. Plan members hired subsequent to September 1, 2008 were required to contribute 6% of their annual creditable compensation.

The District is required to contribute at an actuarially determined rate. The District was required to contribute 19.55% of each employee's creditable compensation for the final six months of the year ended December 31, 2012. The District was required to contribute 18.96% of each employee's creditable compensation for the first six months of the year ended December 31, 2012 and for the final six months of the year ended December 31, 2011. The District was required to contribute 16.93% of each employee's creditable compensation for the first six months of the year ended December 31, 2011 and for the final six months of the year ended December 31, 2010. The District was required to contribute 16.16% of each employee's creditable compensation for the first six months of the year ended December 31, 2010. The District's contributions to CERS for the years ended December 31, 2012, 2011, and 2010 were \$35,971, \$36,920, and \$31,556, respectively.

NOTE I - RISK MANAGEMENT

The District is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. The District purchases commercial insurance for all risks of losses. Settlements resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE J - MAJOR SUPPLIER

The District purchases 100% of water resold from Central City, Kentucky.

NOTE K - GAINS (LOSSES) ON DISPOSITIONS OF ASSETS

2012

During 2012, the District scrapped fully depreciated meters for \$2,227.

2011

During 2011, the District scrapped fully depreciated meters for \$2,648.

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2012 and 2011

NOTE L - CONSTRUCTION IN PROGRESS AND CONSTRUCTION PROJECTS PAYABLE

The District incurred \$9,272 of cost related to the line relocation project on Clark Street. Engineering services have been performed and are estimated to be completed during 2013. These costs are considered construction in progress until the line relocation is completed. The District also owes an additional \$300 in engineering costs for services performed during December 2012. These costs are also included in construction in progress. During December 2012 the District received an order of 250 radio read meters with a cost of \$42,000. One of the meters was placed in service during December 2012 while the other 249 meters were not in service. \$42,000 of cost incurred with the purchase of the radio read meters is still payable at year end and \$41,832 of costs are in construction in progress.

NOTE M - CAPITAL CONTRIBUTIONS-STATE AND OTHER RECEIVABLES

The District has entered into an utility relocation contract with the Kentucky Transportation Cabinet, Department of Highways in regards to the line relocation project being performed on Clark Street. The District incurred and paid for \$9,272 of engineering costs during 2012 and this amount was reimbursed subsequent to year end.

This document was created by  
Smart PDF Tools  
To remove this message purchase the  
product at [www.smart-pdf-tools.com](http://www.smart-pdf-tools.com)

# Alexander, Toney & Knight PLLC

CERTIFIED PUBLIC ACCOUNTANTS

28 Court Street

Madisonville, Kentucky 42431

(270) 821-4824

FAX: (270) 825-4554

Email: atkcpas@yahoo.com

Larry R. Alexander, CPA  
Harold R. Toney, Jr., CPA  
Tony Knight, CPA

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

## 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 (for a Governmental Entity)*

To The Commissioners  
Muhlenberg County Water District Number 3  
Bremen, Kentucky

We have audited, 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, the financial statements of Muhlenberg County Water District Number 3 as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, and have issued our report thereon dated February 8, 2013.

### Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Muhlenberg County Water District Number 3's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Muhlenberg County Water District Number 3's internal control. Accordingly, we do not express an opinion on the effectiveness of Muhlenberg County Water District Number 3's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, as discussed below, that we consider to be significant deficiencies.

*Condition:* The internal control relating to receipts and disbursements is inadequate due to a lack of segregation of duties.

*Criteria:* Adequate segregation of duties is essential to an adequate internal control over financial reporting by allocating various duties among employees.

*Effect:* The lack of proper segregation of duties may permit errors or irregularities to go undetected.

*Cause:* There is a small number of accounting personnel. The cost versus benefit relationship prevents the District from hiring enough accounting personnel to properly segregate key accounting functions.

*Recommendation:* While the small number of employees that exist will never provide proper segregation of duties, the District should continually review job responsibilities for better accounting controls.

*Response:* The District concurs with the recommendation and will continually review job responsibilities to improve accounting controls when possible.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Muhlenberg County Water District Number 3'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*.

## **Muhlenberg County Water District Number 3's Response to Findings**

Muhlenberg County Water District Number 3's response to the findings identified in our audit is described above. Muhlenberg County Water District Number 3's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purposes.

Alexander, Toney & Knight PLLC

Madisonville, Kentucky

February 8, 2013