

**NORTHERN OHIO RURAL
WATER DISTRICT**

INDEPENDENT AUDITOR'S REPORT

FOR THE YEAR ENDED DECEMBER 31, 2004



Mary Taylor, CPA
Auditor of State

Board of Trustees
Northern Ohio Rural Water District
2205 US Highway 20E
Norwalk, Ohio 44857

We have reviewed the *Independent Auditor's Report* of the Northern Ohio Rural Water District, Huron County, prepared by Varney, Fink & Associates, Inc., for the audit period January 1, 2004 through December 31, 2004. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The Northern Ohio Rural Water District is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

January 8, 2008

This Page is Intentionally Left Blank.

**NORTHERN OHIO RURAL WATER DISTRICT
FOR THE YEAR ENDED DECEMBER 31, 2004**

TABLE OF CONTENTS

| | |
|---|----|
| Independent Auditor's Report | 1 |
| Management's Discussion and Analysis..... | 3 |
| Statement of Net Assets | 7 |
| Statement of Revenues, Expenses and Changes in Net Assets..... | 8 |
| Statement of Cash Flows..... | 10 |
| Notes to the Financial Statements..... | 11 |
| Statement of Operating Expenses | 24 |
| Report on Internal Control Over Financial Reporting And On Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government</i> <i>Auditing Standards</i> | 25 |

This Page is Intentionally Left Blank.

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Northern Ohio Rural Water

We have audited the accompanying financial statements of Northern Ohio Rural Water, Huron County (the District), as of and for the year ended December 31, 2004, 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 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Northern Ohio Rural Water as of December 31, 2004, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 9, during the year ended December 31, 2004, the District adopted Accounting Standards Board Statements No. 34, and No. 38.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2007, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

INDEPENDENT AUDITOR'S REPORT (continued)

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

The Statement of Operating Expenses on page 24 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquires of management regarding the methods of measurement and presentation of the supplementary information and express no opinion on it.



VARNEY, FNK & ASSOCIATES, INC.
Certified Public Accountants

November 21, 2007

NORTHERN OHIO RURAL WATER

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2004

Unaudited

This discussion and analysis, along with the accompanying financial reports of Northern Ohio Rural Water (NORW), is designed to provide our customers, bondholders, creditors and other interested parties with a general overview of NORW and its financial activities.

Overview of Basic Financial Statements:

NORW is described in Note 1, Summary of Significant Accounting Policies, on page ten (10). The Basic Financial Statements are presented using the accrual basis of accounting as further described in the above-mentioned note. The **Statement of Net Assets** includes all of NORW's Assets and Liabilities. This statement provides information about the nature and amounts of investments in resources (assets) owned by NORW, and obligations owed by NORW (liabilities) on December 31. NORW's net assets (equity) are the difference between assets and liabilities. The **Statement of Revenues, Expenses and Changes in Net Assets** provides information on NORW's operations over the period and the revenue collected from user fees, charges and late fees, and other income. Revenues are reported when earned and expenses are reported when incurred. The **Statement of Cash Flows** provides information about NORW's cash receipts and cash disbursements. It summarizes the net changes in cash resulting from operating, investing, and financing activities.

Table I summarizes the Net Assets of the District.

| | TABLE I | | | |
|--|----------------------|----------------------|-------------------|-----------------|
| | <u>2004</u> | <u>2003</u> | <u>Change</u> | <u>% Change</u> |
| Current and Other Assets | \$ 2,010,932 | \$ 1,499,874 | \$ 511,058 | 34% |
| Capital Assets | 26,322,264 | 25,838,888 | 483,376 | 2% |
| Total Assets | <u>\$ 28,333,196</u> | <u>\$ 27,338,762</u> | <u>\$ 994,434</u> | 4% |
| Liabilities | \$ 3,299,842 | \$ 5,636,422 | \$ (2,336,580) | -41% |
| Long-term | 24,124,098 | 20,779,220 | 3,344,878 | 16% |
| Total Liabilities | <u>27,423,940</u> | <u>26,415,642</u> | <u>1,008,298</u> | 4% |
| Invested in Capital Assets, Net of Related Debt | 414,541 | | | |
| Restricted for Bonds Payable | 40,994 | | | |
| Unrestricted | 453,721 | | | |
| Total Net Assets | <u>909,256</u> | <u>923,120</u> | <u>(13,864)</u> | -2% |
| Total Liabilities and Net Assets | <u>\$ 28,333,196</u> | <u>\$ 27,338,762</u> | <u>\$ 994,434</u> | 4% |

- The Total assets of NORW exceeded liabilities on 12/31/04 by \$909,256.
- The District's net assets decreased \$13,864 in 2004.

NORTHERN OHIO RURAL WATER
MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2004

Unaudited

Table II summarizes the changes in Revenue and Expenses and the resulting change in Net Assets.

| | TABLE II | | | |
|------------------------|-------------------|-------------------|--------------------|-----------------|
| | <u>2004</u> | <u>2003</u> | <u>Change</u> | <u>% Change</u> |
| Operating Revenue | \$ 4,738,594 | \$ 4,171,729 | \$ 566,865 | 14% |
| Operating Expenses | <u>3,365,644</u> | <u>3,603,004</u> | <u>(237,360)</u> | -7% |
| Income from Operations | 1,372,950 | 568,725 | 804,225 | 141% |
| Non-Operating Revenue | \$ 173,814 | \$ 52,376 | \$ 121,438 | 232% |
| Non-Operating Expenses | <u>1,560,628</u> | <u>1,452,256</u> | <u>108,372</u> | 7% |
| | (1,386,814) | (1,399,880) | 13,066 | -1% |
| Change in Net Assets | (13,864) | (831,155) | 817,291 | -98% |
| Beginning Net Assets | <u>923,120</u> | <u>1,754,275</u> | <u>(831,155)</u> | -47% |
| Ending Net Assets | <u>\$ 909,256</u> | <u>\$ 923,120</u> | <u>\$ (13,864)</u> | -2% |

- The District's Operating Revenues increased by \$566,865 (14%) with Operating Expenses decreased \$237,360 (-7%).

Significant Events and Expenditures During the Year:

Effective July 1, 2004, water rates were increased to bulk and residential customers. This rate increase was the result of board action taken in June 2004 part of which was to offset the increase in the price of water purchased from Erie County and the City of Elyria (the water purchase providers) to NORW. A second rate increase was to take place effective January 1, 2005. Revenues increased in 2004 as a result of this rate increase.

NORW and Erie County have a case in the Sixth Circuit Court of Appeals in Cincinnati regarding water line service area territorial issues. NORW and the City of Norwalk also have a case in federal court in Cleveland regarding water line service area territorial issues.

NORW has applied for funding from USDA, Rural Development Authority for line extensions into Green Creek Township, Riley Township, and Sandusky Township, all of which are located in Sandusky County.

NORW has authorized GRW Engineering to begin work on the pilot plan for the water treatment plant at the Erie Industrial Park.

NORTHERN OHIO RURAL WATER
MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2004

Unaudited

Capital Assets:

Tabel III summarizes the changes in capital assets for the year ended December 31, 2004.

| | TABLE III | | | |
|-----------------------------------|------------------|---------------|-------------|----------|
| | 2004 | 2003 | Change | % Change |
| Capital assets, nondepreciable: | | | | |
| Land | \$ 480,339 | \$ 470,339 | \$ 10,000 | 2% |
| Easements | 197,175 | 193,484 | 3,691 | 2% |
| Current construction | 1,529,585 | 706,800 | 822,785 | 116% |
| Capital assets, depreciable: | | | | |
| Buildings | 561,690 | 346,332 | 215,358 | 62% |
| Tanks, stations, and lines | 31,041,268 | 30,517,619 | 523,649 | 2% |
| Furniture and fixtures | 166,330 | 145,103 | 21,227 | 15% |
| Vehicles & distribution equipment | 1,590,767 | 1,567,986 | 22,781 | 1% |
| Total before depreciation | 35,567,154 | 33,947,663 | 1,619,491 | 5% |
| Accumulated depreciation | (9,244,890) | (8,108,775) | (1,136,115) | 14% |
| Net capital assets | \$ 26,322,264 | \$ 25,838,888 | \$ 483,376 | 2% |

NORW has \$35,567,154 invested in its system (before depreciation) at December 31, 2004. This amount includes additions of \$796,706 during the year ended December 31, 2004 and current construction in progress in the amount of \$822,785.

The increase in water tanks is a result of construction of a new tank located on Hartland Center Road in the amount of \$185,048, as well as the rehabilitation of a storage tank at the same location in the amount of \$185,500.

The increase in water lines in the amount of \$145,457 is the result of the Hartland Center Road, Strecker Road and Berlin Heights projects as well as the water rate studies.

The Board also approved the construction of a new service garage in the amount of \$215,358 to house machinery and equipment, which will allow NORW to maintain and prolong the lives of the equipment rather than leaving equipment outside and exposed to changing weather.

NORW purchased and installed a computer network system in the office in the amount of \$17,217. The network system will increase the efficiency of the operating system and allow for document and information sharing between office personnel.

NORW also purchased a lawn mower in the amount of \$12,000 for maintenance of the facility and various tank locations. Various trailer and dump truck repairs and a snow plow purchase were also made in the amount of \$8,946 and \$881, respectively.

NORTHERN OHIO RURAL WATER

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2004

Unaudited

See Note 1, Summary of Significant Accounting Policies, Paragraph F, Capital Assets, for further details of the various additions to capital assets.

Long-Term Debt:

Table IV summarizes long-term debt for the year ended December 31, 2004.

| | TABLE IV | | | |
|--------------------------|----------------------|----------------------|-------------------|-----------------|
| | <u>2004</u> | <u>2003</u> | <u>Change</u> | <u>% Change</u> |
| Long-term debt | | | | |
| OWDA Notes | \$ 21,507,545 | \$ 21,431,535 | \$ 76,101 | 0% |
| FirstMerit Bank note | 35,354 | 47,599 | (12,245) | 26% |
| Rural development bonds | <u>3,365,824</u> | <u>3,224,028</u> | <u>141,796</u> | <u>4%</u> |
| Long-term debt | 24,908,723 | 24,703,162 | 205,561 | 1 % |
| Less: Current maturities | <u>(784,625)</u> | <u>(733,914)</u> | <u>(50,711)</u> | <u>-7%</u> |
| Net total long-term debt | <u>\$ 24,124,098</u> | <u>\$ 23,969,248</u> | <u>\$ 154,850</u> | <u>1 %</u> |

See Note 3 of the financial statements for details of issuance and retirement of debt in 2004.

Contact Information:

Questions regarding this report and requests for additional information should be forwarded to Northern Ohio Rural Water, P.O. Box 96, Collins, Ohio 44826.

NORTHERN OHIO RURAL WATER

STATEMENT OF NET ASSETS

December 31, 2004

ASSETS

CURRENT ASSETS: (Note 1)

| | |
|---|------------------|
| Cash and cash equivalents | \$ 1,338,283 |
| Receivables: | |
| Trade (net of allowance for doubtful accounts of \$5,363) | 249,831 |
| Inventory | 374,173 |
| Prepaid expenses | 6,651 |
| Total current assets | <u>1,968,938</u> |

NONCURRENT ASSETS:

| | |
|--|-------------------|
| Restricted cash (Note 11) | 40,994 |
| Capital assets, nondepreciable: (Note 1) | |
| Land | 480,339 |
| Easements | 197,175 |
| Current construction | 1,529,585 |
| Capital assets, depreciable: (Note 1) | |
| Buildings | 561,690 |
| Tanks, stations, and lines | 31,041,268 |
| Furniture and fixtures | 166,330 |
| Vehicles and distribution equipment | 1,590,767 |
| | <u>35,567,154</u> |
| Less: Accumulated depreciation | 9,244,890 |
| | <u>26,322,264</u> |
| Total noncurrent assets | <u>26,363,258</u> |

OTHER ASSET:

| | |
|--------------------|----------------------|
| Organization costs | 1,000 |
| | <u>\$ 28,333,196</u> |

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

NORTHERN OHIO RURAL WATER

STATEMENT OF NET ASSETS

December 31, 2004

CURRENT LIABILITIES:

CURRENT LIABILITIES:

| | | |
|--|----|----------------|
| Accounts payable | \$ | 602,037 |
| Projects and retainage payable | | 109,277 |
| Tenant deposits | | 55,200 |
| Accrued expenses: | | |
| Wages | | 11,374 |
| Compensated absences (Note 1) | | 31,704 |
| Payroll taxes | | 35,114 |
| Interest | | 671,511 |
| Note payable - Line of credit (Note 8) | | 999,000 |
| Current portion of long-term debt | | <u>784,625</u> |
| Total current liabilities | | 3,299,842 |

NONCURRENT LIABILITIES: (Note 3)

| | | |
|-----------------------|--|-------------------|
| Notes payable | | 21,542,899 |
| Bonds payable | | <u>3,365,824</u> |
| | | 24,908,723 |
| Less: Current portion | | <u>784,625</u> |
| | | 24,124,098 |
| Total liabilities | | <u>27,423,940</u> |

NET ASSETS:

| | | |
|---|----|-----------------------|
| Invested in capital assets, net of related debt | | 414,541 |
| Restricted for bonds payable | | 40,994 |
| Unrestricted | | <u>453,721</u> |
| NET ASSETS | \$ | <u><u>909,256</u></u> |

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

NORTHERN OHIO RURAL WATER

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Year Ended December 31, 2004

| | |
|-------------------------------|-------------------|
| OPERATING REVENUE: | |
| Water sales | \$ 4,406,832 |
| Tap fees | 331,762 |
| | <u>4,738,594</u> |
| OPERATING EXPENSES | <u>3,365,644</u> |
| INCOME FROM OPERATIONS | 1,372,950 |
| NON-OPERATING REVENUE: | |
| Discounts earned | 64 |
| EPA income | 10,419 |
| Hydrant maintenance fees | 1,150 |
| Interest income | 136 |
| Miscellaneous | 128,141 |
| Reconnection fees | 21,960 |
| Tower income | 11,944 |
| | <u>173,814</u> |
| | 1,546,764 |
| NON-OPERATING EXPENSES: | |
| Bank charges | 1,378 |
| Credit card fees | 149 |
| EPA expense | 9,774 |
| Interest expense | 1,549,327 |
| | <u>1,560,628</u> |
| CHANGES IN NET ASSETS | (13,864) |
| NET ASSETS, BEGINNING OF YEAR | <u>923,120</u> |
| NET ASSETS, END OF YEAR | <u>\$ 909,256</u> |

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

NORTHERN OHIO RURAL WATER

STATEMENT OF CASH FLOWS

Year Ended December 31, 2004

| | |
|--|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Cash received from customers | \$ 4,679,833 |
| Cash payments to suppliers for goods and services | (1,535,682) |
| Cash payments for employees and professional contractors for services | <u>(311,345)</u> |
| Net cash provided by operating activities | 2,832,806 |
| CASH FLOWS FROM NON-CAPITAL ACTIVITIES: | |
| Proceeds from developer, hydrant maintenance, and reconnection fees | 83,326 |
| Proceeds from discounts earned, EPA and tower income | 12,653 |
| Proceeds from insurance claims | 64,800 |
| Other non-operating revenue | <u>1,598</u> |
| Net cash provided by non-capital activities | 162,377 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | |
| Purchase of equipment and new construction | (1,554,462) |
| Proceeds from long-term debt | 939,339 |
| Repayment of long-term debt | (733,778) |
| Proceeds from short-term debt | 1,316,961 |
| Repayment of short-term debt | (851,165) |
| Interest paid on debt | <u>(1,614,356)</u> |
| Net cash used in capital and related financing activities | (2,497,461) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Interest earned | <u>136</u> |
| Net cash provided by investing activities | <u>136</u> |
| INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS | |
| | 497,858 |
| CASH AND CASH EQUIVALENTS - Beginning of period | |
| | <u>881,419</u> |
| CASH AND CASH EQUIVALENTS - End of period | |
| | <u>\$ 1,379,277</u> |
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | |
| Income from operations | \$ 1,372,950 |
| Adjustment to reconcile operating income to net cash provided by operating activities: | |
| Depreciation expense | 1,136,115 |
| Changes in assets and liabilities: | |
| (Increase) decrease in: | |
| Receivables | (58,761) |
| Inventory | 45,822 |
| Prepaid expenses | (261) |
| Increase (decrease) in: | |
| Accounts payable | 388,904 |
| Deferred tap deposits | 450 |
| Accrued expenses | (8,532) |
| Retainage payable | <u>(43,881)</u> |
| Net cash provided by operating activities | <u>\$ 2,832,806</u> |

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

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 1. Summary of Significant Accounting Policies:

Northern Ohio Rural Water, formerly known as Erie Huron County Rural Water Authority, a regional water district, is a political subdivision of the State of Ohio. The District was incorporated for the purpose of providing a water supply for domestic, industrial, and public use to users within and without the District. The District is exempt from federal income tax. The District operates under a Board of Trustees which consists of as many members as equals the total number of villages and townships within this regional water district. The following is a summary of significant accounting policies:

A. Introduction:

The financial statements of the District are prepared in accordance with Generally Accepted Accounting Principles (GAAP). The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. Proprietary funds and similar component units apply 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 GASB pronouncements, in which case, GASB prevails.

B. Basis of Accounting:

Northern Ohio Rural Water prepares its financial statements on an accrual basis. By virtue of its by-laws, the District is required to make appropriations in accordance with budgetary policies.

Proprietary funds 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 a proprietary fund's principal ongoing operations. The principal operating revenues of the District are charges to customers for water and taps. Operating expenses include the cost of the water and taps, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

C. Budgetary Process:

Budget - Thirty days before the end of each fiscal year, a proposed budget of estimated revenues and expenditures for the succeeding fiscal year is submitted to the Board of Trustees by the General Manager. The Board of Trustees then approves the budget in its original or amended form.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 1. Summary of Significant Accounting Policies (Continued):

Appropriations - After the budget is approved by the Board, the Board then makes appropriations of funds in accordance with said budget. Thereafter, the General Manager has the authority to authorize payment of any disbursement not to exceed \$25,000, provided there are sufficient funds appropriated and remaining in the account of the fund from which payment will be made. The Board may, from time-to-time, amend or supplement said appropriation of funds and may also transfer any part of an unencumbered balance of an appropriation of any fund to any purpose or object for which the appropriation for the current fiscal year has proved insufficient.

D. Inventory:

Inventory, which consists of raw materials, is stated at the lower of cost or market using the first-in, first-out (FIFO) method of accounting.

E. Capital Assets:

All capital expenditures are capitalized and depreciated regardless of cost. Capital assets, including major renewals and betterments, are reported at historical cost. Depreciation is provided on the straight-line method based on the estimated useful lives of the various classes of assets.

The ranges of estimated useful lives used in computing depreciation are as follows:

| | |
|--|------------|
| Water Lines and Water Tanks | 40 Years |
| Pump Stations | 20 Years |
| Buildings | 4-20 Years |
| Machinery, Equipment, and Office Furniture | 3-10 Years |

Fully depreciated assets still in active use are included in the gross amount of property and equipment, and the related allowance for depreciation is included as part of the total accumulated allowance for depreciation.

Maintenance, repairs, and minor renewals are charged against earnings when incurred.

Depreciation expense for the year ended December 31, 2004 was \$1,136,115.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 1. Summary of Significant Accounting Policies (Continued):

E. Capital Assets (Continued):

A summary of changes in capital assets for the year ended December 31, 2004, is as follows:

| | Balance December 31, 2003 | Additions | Deletions | Balance December 31, 2004 |
|-------------------------------------|---------------------------------|-------------|-----------|---------------------------------|
| Capital assets, nondepreciable: | | | | |
| Land | \$ 470,339 | \$ 10,000 | \$ -0- | \$ 480,339 |
| Easements | 193,484 | 3,691 | -0- | 197,175 |
| Current construction | 706,800 | 822,785 | -0- | 1,529,585 |
| Capital assets, depreciable: | | | | |
| Buildings | 346,332 | 215,358 | -0- | 561,690 |
| Tanks, stations, and lines | 30,517,619 | 523,649 | -0- | 31,041,268 |
| Furniture and fixtures | 145,103 | 21,227 | -0- | 166,330 |
| Vehicles and distribution equipment | 1,567,986 | 22,781 | -0- | 1,590,767 |
| Totals | 33,947,663 | 1,619,491 | -0- | 35,567,154 |
| Less accumulated depreciation | | | | |
| Buildings | (62,352) | (9,768) | -0- | (72,120) |
| Tanks, stations, and lines | (7,049,915) | (937,995) | -0- | (7,987,910) |
| Furniture and fixtures | (117,638) | (12,922) | -0- | (130,560) |
| Vehicles and distribution equipment | (878,870) | (175,430) | -0- | (1,054,300) |
| Total accumulated depreciation | (8,108,775) | (1,136,115) | -0- | (9,244,890) |
| Net capital assets | \$ 25,838,888 | \$ 483,376 | \$ -0- | \$ 26,322,264 |

F. Prepaid Expenses:

Prepaid expenses, which include insurance and postage, are amortized over their economic useful lives.

G. Tap Fees:

To receive service, customers are required to pay a tap fee which varies depending on when the deposit was made and the size of the meter. Fees are refundable in the event expansion does not occur in an area.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 1. Summary of Significant Accounting Policies (Continued):

H. Compensated Absences Payable:

Employees are granted vacation benefits in varying amounts to specified maximums depending on tenure with the District. After one year of service, employees are entitled to all accrued vacation leave upon termination.

Sick leave accumulates to employees at a rate of 4.6 hours for every 80 hours of service completed up to specified maximums. Upon an employee reaching 20 years of uninterrupted employment with the District, the employee shall be allowed to accumulate an unlimited total of sick leave days. Upon retirement, employees are entitled to 25% of their accumulated sick leave balance after ten years of uninterrupted service, or 100% of their accumulated sick leave balance after 20 years of uninterrupted service. In the event of the employee's death, 100% of their accumulated sick leave balance would be paid to the employee's life insurance beneficiary. Since the employees' accumulating rights to receive compensation for future absences are contingent upon the absences being caused by future illnesses or death, a liability for unused sick leave is not recorded in the financial statements, unless the employee has accumulated sick leave after 20 years of uninterrupted service, which would be paid in its entirety. The recorded accrued unused vacation for the year ended December 31, 2004 is \$31,704. The unrecorded estimated unused sick leave for the year ended December 31, 2004 was \$129,735.

I. Statement of Cash Flows:

For purposes of the Statement of Cash Flows, all liquid investments with a maturity of three months or less when purchased are considered cash equivalents.

J. Use of Estimates:

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 2. Equity in Pooled Cash and Investment:

Northern Ohio Rural Water maintains a cash and investment pool used by all funds. Each fund type's portion of this pool is displayed on the balance sheet as cash.

A. Legal Requirements:

Statutes require the classification of monies held by Northern Ohio Rural Water into three categories as follows:

Category 1 consists of "active" monies, those monies required to be kept in a "cash" or "near-cash" status for immediate use by the District treasury or in depository accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts.

Category 2 consists of "inactive" monies, those monies not required for use within the current two year period of designation of depositories. Inactive monies may be deposited or invested only as certificates of deposit maturing not later than the end of the current period of designation of depositories.

Category 3 consists of "interim" monies, those monies which are not needed for immediate use but which will be needed before the end of the current period of depositories.

B. Deposits:

At December 31, 2004, the carrying amount of the district deposits was \$1,379,277 and the bank balance was \$1,522,435.

Northern Ohio Rural Water maintains cash balances at three separate banks. Each bank was covered by federal depository insurance for up to \$100,000 per account, and pooled collateral whose market value covers 105% of public deposits held by the banks.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 3. Long-Term Debt:

A summary of long-term debt for the year ended December 31, 2004, is as follows:

| Description | Balance December 31, 2003 | Issued | Retired | Balance December 31, 2004 | Due Within One Year |
|--|---------------------------------|-------------------|------------------|---------------------------------|---------------------------|
| Northern Ohio Rural Water borrowed a total of \$26,123,863 from the Ohio Water Development Authority from January 1, 1992 through December 31, 2004 for the Fitchville, Crystal Rock, Green Creek, Baumhart Road line expansions, a new treatment plant, and tank rehabilitation and garage construction. These notes are being paid in semi-annual installments of \$1,059,088 due on January 1 st and July 1 st , including interest at rates from 3.98% to 7.66%. The maturity dates range from July 1, 2016 through January 1, 2027. | \$ 21,431,535 | \$ 763,543 | \$687,533 | \$ 21,507,545 | \$ 736,218 |
| Northern Ohio Rural Water borrowed \$119,000 from FirstMerit Bank on April 14, 1994 to purchase the administrative office building. The mortgage is being paid in equal monthly installments of \$1,145, including interest at a rate of 7.5%. The mortgage matures in September, 2007, and is secured by the building. | 47,599 | -0- | 12,245 | 35,354 | 12,407 |
| Water Resource Improvement Revenue Bonds, Series 2003 were issued through the United States Department of Agriculture (USDA) for the purpose of constructing various water resource projects. The total amount loaned is \$3,399,824, with an additional 700,176 available to be borrowed. The loan requires annual principal and interest payments at a rate of 5.00%, with a maturity date of December 2043. | 3,224,028 | 175,796 | 34,000 | 3,365,824 | 36,000 |
| | <u>\$ 24,703,162</u> | <u>\$ 939,339</u> | <u>\$733,778</u> | <u>\$ 24,908,723</u> | <u>\$ 784,625</u> |

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year December 31, 2004

Note 3. Long-Term Debt (Continued):

The annual debt service requirements to maturity, including principal and interest, for long-term debt as of December 31, 2004, are as follows:

| <u>Year Ending December 31,</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-------------------------------------|----------------------|---------------------|----------------------|
| 2005 | \$ 784,625 | \$ 1,478,113 | \$ 2,262,738 |
| 2006 | 838,365 | 1,427,307 | 2,265,672 |
| 2007 | 893,264 | 1,371,977 | 2,265,241 |
| 2008 | 946,212 | 1,312,275 | 2,258,487 |
| 2009 | 1,011,427 | 1,250,722 | 2,262,149 |
| 2010-2014 | 6,229,920 | 5,146,346 | 11,376,266 |
| 2015-2019 | 5,284,858 | 2,990,024 | 8,274,882 |
| 2020-2024 | 3,904,768 | 1,665,358 | 5,570,126 |
| 2025-2029 | 3,350,460 | 617,476 | 3,967,936 |
| 2030-2034 | 667,000 | 354,456 | 1,021,456 |
| 2035-2039 | 851,000 | 170,456 | 1,021,456 |
| 2040-2044 | 146,824 | 57,467 | 204,291 |
| Total | <u>\$ 24,908,723</u> | <u>\$17,841,977</u> | <u>\$ 42,750,700</u> |

Note 4. Insurance:

The District maintains comprehensive insurance coverage with private carriers for real property, building contents, and vehicles. Vehicle policies include liability coverage for bodily injury and property damage.

Settled claims have not exceeded commercial coverage in any of the past three years. There has not been a significant reduction of coverage from the prior year.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 5. Retirement Commitments:

A. Defined Benefit Pension Plans:

Northern Ohio Rural Water contributes to the Ohio Public Employees Retirement System (OPERS), a cost-sharing multiple-employer defined benefit pension plan operated by the State of Ohio. OPERS provides retirement, disability, survivor and post-retirement health care benefits to qualifying members. Health care benefits are not statutorily guaranteed. Chapter 145 of the Ohio Revised Code assigns the authority to establish and amend benefit provisions to the OPERS. OPERS issues a publicly available stand-alone financial report. That report may be obtained by writing to the OPERS at 277 East Town Street, Columbus, Ohio 43215-4642 or calling (614) 466-2085 or 1-800-222-PERS (7377). The State of Ohio accounts for the activities of the Retirement System, and the amount of that fund is not reflected in the accompanying financial statements.

Benefits fully vest upon reaching 5 years of service and are established by state statute. Employees may retire at any age with 30 years of service, at age 60 with a minimum of 5 years of credited service, and at age 55 with a minimum of 25 years of service. Those individuals retiring with less than 30 years of service or less than age 65 receive reduced retirement benefits. Eligible employees are entitled to a retirement benefit, payable monthly for life, equal to 2.2% of their final average salary for each year of credited service up to 30 years. Employees are entitled to 2.5% of their final average salary for each year of service in excess of 30 years. Final average salary is the employee's average salary over the highest 3 years of earnings.

The Ohio Revised Code provides statutory authority for employee and employer contributions. The rate set for employee contribution for 2004 is 8.50% and the employer contribution rate is 13.55% of covered payroll. The rates are the actuarially determined contribution requirements for OPERS. Required employer contributions are equal to 100% of the dollar amount billed to each employer and must be extracted from the employer's records. The difference between the total employer rate and the portion used to fund pension obligations is the amount used to fund the health care programs. Pension expense for the year ended December 31, 2004, 2003, and 2002 is \$121,176, \$129,343, and \$125,113, respectively.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 5. Retirement Commitments (Continued):

A. Defined Benefit Pension Plans (continued):

The "Pension Benefit Obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the OPERS System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among OPERS and employers.

Historical trend information showing the OPERS System's progress in accumulating sufficient assets to pay benefits when due is presented in the System's December 31, 2003 Comprehensive Annual Financial Report.

B. Post-Employment Benefits:

The Ohio Public Employees Retirement System provides post-retirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credits. Health care coverage for disability recipients and primary survivor recipients is available. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12. A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement health care. The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement health care through their contributions to OPERS. The employer contribution rate is 13.55% of covered payroll and 5.00% was the portion used to fund health care from January 1 through December 31, 2004.

An entry age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of unfunded actuarial accrued liability. The assumptions and calculations below were based on the System's latest Actuarial Review performed as of December 31, 2002. The investment assumption rate for 2002 was 8.00%. An annual increase of 4.00% compounded annually on active employee total payroll is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.00% base increase, were assumed to range from .50% to 6.30%. Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1.00% to 6.00% for the next 8 years. In subsequent years (9 and beyond) health care costs were assumed to increase at 4% (the

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 5. Retirement Commitments (Continued):

B. Post-Employment Benefits (Continued):

adjusted annually to reflect 25% of unrealized market appreciation or depreciation on investment assets.

OPEBs are advanced-funded on an actuarially determined basis. The number of active contributing participants in the State of Ohio was 364,881. The employer contributions made by Northern Ohio Rural Water used to fund postemployment benefits were \$44,714 for 2004. Ten billion dollars (\$10,000,000,000) represents the actuarial value of Retirement Systems' net assets available for OPEB at December 31, 2002. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method, was \$18.7 billion and \$8.7 billion, respectively.

On September 9, 2004 the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) with an effective date of January 1, 2007. The HCPP restructures OPERS' health care coverage to improve the financial solvency of the fund in response to skyrocketing health care costs.

Under HCPP, retirees eligible for health care coverage will receive a graded monthly allocation based on their years of service at retirement. The Plan incorporates a cafeteria approach, offering a broad range of health care options that allow benefit recipients to use their monthly allocation to purchase health care coverage customized to meet their individual needs. If the monthly allocation exceeds the cost of the options selected, the excess is deposited into a Retiree Medical Account that can be used to fund future health care expenses.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 6. Leasing Arrangements:

The District leases a copier under a 60-month operating lease which began in November 2004 and expires in October 2009. This lease requires rent in the amount of \$438 per month.

The following is a schedule of future minimum rental payments required under the above operating lease as of December 31, 2004:

| <u>Year Ending December 31,</u> | <u>Amount</u> |
|-------------------------------------|------------------|
| 2005 | \$ 5,256 |
| 2006 | 5,256 |
| 2007 | 5,256 |
| 2008 | 5,256 |
| 2009 | 4,380 |
| | <u>\$ 25,404</u> |

Office equipment lease expense for the year ended December 31, 2004 was \$5,959.

Note 7. Commitments:

A. Water Purchase Agreements:

The District's original and primary source of water has been the City of Elyria's water treatment plant located in northern Lorain County. On March 15, 1990, the District signed a 40-year water purchase agreement with the City of Elyria.

B. Water Supply Agreements:

On January 18, 1996, the District entered into a 25-year agreement with the Village of Wakeman to provide water at a monthly bulk rate. The agreed upon rate is \$2.60 per thousand gallons with a minimum daily purchase of 50,000 gallons and a maximum daily purchase of 250,000 gallons.

C. Tower Income:

The District has entered into three separate agreements for renting its antenna space to local companies on a month-to-month basis. The first agreement is with Radio Link Communications for \$135 per month, the second agreement is with Bender Communications for \$135 per month and the third agreement is with Metrocall (formerly Page Mart) for \$726 per month.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 8. Note Payable - Line of Credit:

At December 31, 2004, the district has a line of credit with Buckeye Community Bank of \$1,500,000, with \$700,000 unused. The line of credit requires monthly interest payments at the prime rate. The line of credit matures in April, 2005.

\$800,000

A note payable in the amount of \$199,000 is due to Buckeye Community Bank. The note requires monthly interest payments at 5.25% with a maturity date of January, 2005. The note is guaranteed by the United States Department of Agriculture (USDA).

199,000
\$999,000

Note 9. Financial Reporting Model:

The District has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and Statement No. 38, *Certain Financial Statement Note Disclosures*.

Note 10. Subsequent Event:

On June 20, 2006 the former General Manager of the Northern Ohio Rural Water District was sentenced to eight years in prison and ordered to pay restitution amounting to \$88,000 to the Northern Ohio Rural Water District for fraudulent activity that occurred from May 1997 through March 2005.

The Board is currently pursuing the former General Manager's retirement account for recovery of these funds. The likelihood of recovery is deemed probable. The Northern Ohio Rural Water District incurred \$85,000 in expenses for a special audit in relation to the aforementioned fraudulent activity. The Board is currently pursuing payment from two insurance companies with whom the District had policies in effect during the period of fraudulent activity.

The current insurance company made a payment of \$45,600 to the District in July of 2007, while the previous insurance company has denied the claim. The District is currently seeking legal action against both insurance companies. The likelihood of recovery is deemed unlikely.

The District has not recorded a receivable for either amount.

NORTHERN OHIO RURAL WATER

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

Note 11 Retricted Funds:

A. Bond Payment Fund:

This fund was created and will be maintained in the custody of the Issuer as a cash fund and shall be used for the payment of principal and interest on the bonds when due. The District is required by the bond agreement to make monthly payments to the fund of at least one-twelfth (1/12) of the amount due and payable with respect to the bonds on the next succeeding December 1.

B. Water System Debt Service Reserve Fund:

This fund was created in January 2004 and will be maintained in the custody of the Issuer as a cash fund and shall be used for the purpose of paying the cost of repairing or replacing any damage to the system which may be caused by an unforeseen catastrophe, and when necessary for the purpose of making payments of principal and interest on the bonds when due if the amount in the Bond Payment Fund is not sufficient to meet such payments. The District is required by the bond agreement to make monthly deposits equal to \$1,997.50 until there is \$239,700 accumulated in the fund, after which no further payments need to be made to the fund except to replace withdrawals therefrom.

NORTHERN OHIO RURAL WATER

STATEMENT OF OPERATING EXPENSES

Year Ended December 31, 2004

OPERATING EXPENSES:

| | |
|---------------------------------------|---------------------|
| Advertising | \$ 200 |
| Audit fees | 16,303 |
| Communication equipment | 23,258 |
| Depreciation | 1,136,115 |
| Distribution supplies | 131,336 |
| Dues and subscriptions | 3,934 |
| Electric pump station and tanks | 132,065 |
| Engineering fees | 3,096 |
| Gasoline | 33,848 |
| Insurance: | |
| General | 37,403 |
| Hospitalization | 142,590 |
| Legal and professional fees | 111,953 |
| Licenses and permits | 6,218 |
| Maintenance and repairs: | |
| Administrative building and equipment | 6,718 |
| Pump stations | 428 |
| Vehicles | 25,294 |
| Miscellaneous expense | 4,372 |
| Office equipment lease | 6,143 |
| Office supplies and expense | 40,184 |
| Payroll taxes | 21,133 |
| O.P.E.R.S. | 121,176 |
| Postage | 23,082 |
| Tap installations | 44,032 |
| Telephone | 16,318 |
| Travel and education expense | 18,328 |
| Utilities | 13,942 |
| Wages | 550,905 |
| Water purchased | 695,270 |
| | <u>\$ 3,365,644</u> |

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

**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 Trustees
Northern Ohio Rural Water, Huron County

We have audited the accompanying financial statements of the Northern Ohio Rural Water, Huron County (the District), as of and for the year ended December 31, 2004, have issued our report thereon dated November 21, 2007. As discussed in Note 9, during the year ended December 31, 2004, the District adopted Governmental Accounting Standards Board Statements No. 34, and No. 38. 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 the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the District, in a separate letter dated November 21, 2007.

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* (continued)

This report is intended solely for the information and use of management and the Board of Trustees and is not intended to be and should not be used by anyone other than those specified parties.



VARNEY, FINK & ASSOCIATES, INC.
Certified Public Accountants

November 21, 2007



Mary Taylor, CPA
Auditor of State

NORTHERN OHIO RURAL WATER DISTRICT

HURON COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
JANUARY 22, 2008**