

**HENRY COUNTY
PUBLIC SERVICE AUTHORITY**

FINANCIAL REPORT

June 30, 2006 and 2005

**HENRY COUNTY
PUBLIC SERVICE AUTHORITY**

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INTRODUCTORY SECTION

**HENRY COUNTY
PUBLIC SERVICE AUTHORITY
DIRECTORY OF PRINCIPAL OFFICIALS**

June 30, 2006

MEMBERS OF THE BOARD

	Jim McInerney, Chairman	
Gerry Lawicki		Kathy Rea
Tommy Slaughter		David Stovall
Mary Rae Carter		

INDEPENDENT AUDITORS

Brown, Edwards & Company, L.L.P.

ATTORNEYS

Daniel, Medley, and Kirby, PC

AquaLaw, PLC

FINANCIAL SECTION

**Financial Section contains the
Basic Financial Statements.**

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Henry County Public Service Authority
Collinsville, Virginia

We have audited the accompanying basic financial statements of the Henry County Public Service Authority (the "Authority") as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Authority's 2005 financial statements which were audited by other auditors whose report, dated September 29, 2005, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and *Specifications for Audits of Authorities, Boards and Commissions* issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards and specifications 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2006, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards* we have also issued our report dated October 5, 2006, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 3a through 3e 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 the presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The introductory and other information sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of the Authority. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and other information sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion or other form of assurance on them.

The tables shown in the Other Information Section are presented for purposes of additional analysis and are not a required part of the basic financial statements and have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
October 5, 2006

Management's Discussion & Analysis

This section presents management's discussion and analysis of the Authority's financial condition and activities for the year ended June 30, 2006. This information should be read in conjunction with the financial statements.

Financial Highlights

Management believes the Authority's financial position is adequate. The Authority was in compliance with all debt covenants required by bond agreements. The following are key financial highlights:

- The Authority treated 0.809 billion gallons of wastewater. That represents an 3.37% decrease over fiscal year 2005.
- The Authority's customers had 1.106 billion gallons of treated raw water available to them. That amount was a decrease of .36% over fiscal year 2005, and included water treated by the City of Martinsville, Virginia and the City of Eden, North Carolina and purchased by the Authority for our customers.
- On a comparable basis, the debt service coverage was 1.87 compared to 1.53 last year. Adjusting for the allowable cash reserve available at the beginning of 2005 and 2006, the debt service exceeded the 1.2 required by the Financing Agreement under the Series 2001 Water and Sewer Revenue Refunding Bonds.
- The Authority received grant funds of \$4.4 million from various granting agencies. These funds were used to construct the Fieldale water line connection and the conversion of the Upper Smith River Wastewater Treatment plant to a pump station. These improvements were complete at June 30, 2006. Grant funds were also used for the Fairystone water extension, which was not complete at June 30, 2006.
- Total assets at year-end were \$88.4 million and net assets exceeded liabilities by \$45.8 million. Of the total net assets, \$3.0 million was unrestricted and was available to support short-term operations. Total assets increased from fiscal year-end 2005 to 2006 in the amount of \$3.5 million and total unrestricted net assets increased by \$2.0 million. Total net assets increased from fiscal year-end 2005 to 2006 in the amount of \$4.4 million.
- Water and Sewage disposal charges of \$8.9 million increased over fiscal year 2005 by \$0.3 million or 3.7%.
- Payments from Henry County of \$0.4 million represented their contribution toward the fire protection costs incurred by the Authority.
- Operating revenues excluding the County's payment for the year was \$9.8 million, compared to \$9.5 million for fiscal year 2005, or an increase of 3.2%.
- Operating expenses before depreciation were \$5.9 million, compared to \$6.1 million for fiscal year 2005 or a decrease of 3.3%.

Required Financial Statements

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

The balance sheet includes all of the Authority's assets and liabilities and provides information about the nature and amount of investments in resources (assets) and obligations to Authority creditors (liabilities). It also provides the basis for computing rate of return, evaluation the capital structure of the Authority and assessing the liquidity and financial flexibility of the Authority.

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in fund net assets. This statement measures the success of the Authority's operations over the past year and can be used to determine whether the Authority successfully recovered all its costs through its charges for water and sewage disposal. The Authority's rates are based on projected operating costs and are adjusted as needed to meet operating expenses and the required debt ratio.

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

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

Summary of Organization and Business

The Henry County Public Service Authority is a public body organized and created under the Virginia Water and Waste Authorities Act of the *Code of Virginia* of 1950 as amended. The Henry County Board of Supervisors created the Authority in 1965. The purpose of the Authority is to "acquire, construct, improve, extend, operate and maintain a water and sewage disposal system."

The Authority is governed by six citizen members appointed by the Henry County Board of Supervisors to four-year staggered terms.

In 1974, the Authority and neighboring City of Martinsville (the "City") signed a service agreement in which the Authority would purchase sewage treatment from the City. In 1982, the Authority signed a service agreement with the City to purchase water treatment from the City. These agreements require the Authority to share in the annual operating costs of the plants in proportion to its actual use as measured by the volume of water used and sewage it contributed. It also allowed for the Authority to purchase capacity rights into the water and sewer plants at an agreed upon price.

The Authority's infrastructure assets consist of one water treatment plant (owned by Henry County and leased to the Authority), approximately 320 miles of water lines and 238 miles of interceptor sewers, and several pump stations. The collection system, consisting of mains and laterals, is owned and maintained by the Authority. The last remaining waste water plant was converted to a pumping station and was completed in December 2005.

The Authority has no taxing power. The revenues of the Authority are derived from water and sewage disposal charges based on metered and unmetered water consumption of the Authority's users of the system.

Financial Analysis

The following comparative condensed financial statements and other selected information provides key financial data and indicators for management, monitoring and planning.

Condensed Balance Sheets (In Millions of Dollars)

	<u>2006</u>	<u>2005</u>	<u>\$ Change</u>	<u>% Change</u>
Current assets	\$ 4.43	\$ 3.57	\$ 0.86	24.09%
Restricted assets	6.83	7.95	(1.12)	(14.09)
Plant and equipment, net	75.99	72.04	3.95	5.48
Unamortized bond issue costs	1.19	1.34	(0.15)	(11.19)
Total assets	\$ 88.44	\$ 84.90	\$ 3.54	4.17%
Current liabilities	\$ 3.00	\$ 2.95	\$ 0.05	1.69%
Long-term liabilities	39.69	40.54	(0.85)	2.10
Total liabilities	42.69	43.49	(0.80)	1.84
Invested in capital assets – net of related liabilities	35.87	32.41	3.46	10.68
Restricted	6.83	7.95	(1.12)	(14.09)
Unrestricted	3.05	1.05	2.00	190.48
Total net assets	45.75	41.41	4.34	10.48
Total liabilities and net assets	\$ 88.44	\$ 84.90	\$ 3.54	4.17%

Condensed Statements of Revenues, Expenses and Changes in Net Assets (In Millions of Dollars)

	<u>2006</u>	<u>2005</u>	<u>\$ Change</u>	<u>% Change</u>
Operating revenue	\$ 10.21	\$ 9.87	\$ 0.34	3.44%
Non-operating revenues – other	0.38	0.32	0.06	18.75
Total revenue	10.59	10.19	0.40	3.93
Depreciation expense	2.76	2.76	-	-
Other operating expenses	5.86	6.08	(0.22)	3.62
Non-operating expenses	2.02	2.09	(0.08)	3.35
Total expenses	10.64	10.93	(0.29)	2.65
Contributed capital	4.40	1.18	3.22	272.88
Change in net assets	4.35	0.44	3.91	888.64
Beginning net assets	41.40	40.96	0.44	1.07
Ending net assets	\$ 45.75	\$ 41.40	\$ 4.35	10.51%

Other Selected Information

	<u>2006</u>	<u>2005</u>	<u>\$ Change</u>	<u>% Change</u>
Employees at year end	48	49	(1.00)	(2.04)%
Raw water treated (millions of gallons)	1,106.13	1,110.36	(4.23)	(0.38)%
Average daily water consumption (millions of gallons)	3.03	3.04	(.01)	(.33)%
Wastewater treated (millions of gallons)	808.75	836.93	(28.18)	(3.37)%
Average daily sewage flow (millions of gallons)	2.22	2.29	(.07)	(3.06)%
Number active water connections	12,313	12,238	75	.61%
Number active sewer connections	7,364	7,307	57	.78%
Revenue from largest customer	\$ 374,628	\$ 312,804	\$ 61,824	19.76%
Percent of total billings	4.20%	3.64%	0.56%	
Revenue from ten largest customers	\$ 1,237,220	\$ 1,164,091	\$ 73,129	6.28%
Percent of total billings	13.88%	13.55%	0.33%	

Rates for normal water and sewer customers:

From July 2005 through May 2006 the minimum charge for up to 6,000 gallons of consumption was \$24. Each additional 1,000 gallons consumed was an additional charge of \$4.08 per 1,000. These were the same rates used in 2005. Effective June 2006, a new rate structure was implemented. Residential customers are now charged a minimum monthly consumption charge of \$26 for service up to 4,000 gallons of consumption and an additional \$4.00 per additional 1,000 gallons used. Non-residential customers are now charged a minimum consumption charge of \$39 for service up to 4,000 gallons of consumption and an additional \$6.00 per additional 1,000 gallons used. Institutional customers are now charged a minimum consumption charge of \$59.50 for service up 6,000 gallons of consumption and an additional \$7.00 per additional 1,000 gallons used.

General Trends and Significant Events

The Authority's service area in Henry County has the potential for growth. The County is over two hundred years old and has available land that continues to be developed. Growth from new development is not expected to significantly increase the Authority's water and sewage disposal revenues in any given year.

It is anticipated that the small growth trend in customer connections will continue to increase as the amount of undeveloped land is developed.

Financial Condition

The Authority's financial condition remained good at year end with adequate liquid assets and a reasonable level of unrestricted net assets. The current financial condition, staff capabilities, operating plans and upgrade plans to meet future water quality requirements are well balanced and under control.

Total assets increased by \$3.5 million or 4.18%, while net assets increased by \$4.4 million. A substantial portion of the net assets change resulted from capital construction grants received.

Accounts receivable-net, at year end were approximately \$0.9 million compared to \$0.7 million for fiscal year 2005. The reserve for bad debts was equal to all accounts over 90 days past due. The receivable balance left included \$0.9 million that was current or 96.5%. The bad debt charge for 2006 and 2005 was \$0.4 million.

Results of Operations

The Authority's revenues from operations fall into four main categories: 1) Water and sewage disposal charges to customers in Henry County which are based upon metered and unmetered water consumption which is billed monthly. 2) Miscellaneous revenue including penalties, Henry County shared expense reimbursements, and other revenue. 3) Construction grants revenues. 4) Non-operating revenues including interest, gain on sale of investments and other revenue. Revenues from the four main categories totaled \$15 million or 36% over fiscal year 2005.

Debt

At year end, the Authority had \$41.3 million in long-term debt with \$1.9 million coming due in 2007. There was one new borrowing during the year of \$1.03 million and principal payments on outstanding long-term debt were \$1.99 million. More detailed information about the Authority's long-term debt is presented in Note 5 to the financial statements.

One area that demonstrates the Authority's financial ability to pay current debt service (principal and interest) is seen in its debt service coverage, which is currently 1.87. The financing agreement covenant requires the Authority to establish rates, fees and other charges for the use of and for services furnished by the Authority and collection procedures so that in each fiscal year net revenues and available cash reserves are not less than 1.2 times the debt service (principal and interest) for the fiscal year. Cash reserves available were \$2.6 million and \$2.2 million for 2006 and 2005, respectively. The following table calculates the debt service coverage for fiscal years 2006 and 2005, including the available cash reserves:

	<u>2006</u>	<u>2005</u>	<u>% Change</u>
Unrestricted operating revenue	\$ 10.21	\$ 9.87	3.44%
Unrestricted investment income	0.38	0.32	18.75%
Total revenue	10.59	10.19	3.93%
Total operating expenses (less depreciation)	5.86	6.08	(3.61)%
Net revenue	4.73	4.11	15.09%
Unrestricted cash	2.23	1.50	48.67%
Available for debt service	<u>\$ 6.96</u>	<u>\$ 5.61</u>	<u>24.06%</u>
Annual debt service	<u>\$ 3.72</u>	<u>\$ 3.67</u>	<u>1.36%</u>
Debt service coverage	<u>\$ 1.87</u>	<u>\$ 1.53</u>	<u>22.22%</u>

Final Comments

Fiscal year 2006 continued the trend of improved financial performance by the Authority. This improvement is needed in order for the Authority to maintain flexibility in future borrowing decisions, ensuring that there is an appropriate reserve for operating expenses, expansion, and that resources are available to provide for the effects of time and usage on the significant investment in equipment.

Contacting the Authority's Financial Manager

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Henry County Public Service Authority's General Manager, P.O. Box 69, Collinsville, VA 24078.

BASIC FINANCIAL STATEMENTS

HENRY COUNTY PUBLIC SERVICE AUTHORITY

BALANCE SHEETS
June 30, 2006 and 2005

	2006	For Comparative Purposes Only 2005
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 2,612,586	\$ 2,231,596
Accounts receivable, net (Note 3)	951,988	759,795
Unbilled revenue	452,858	374,219
Due from other governments	332,839	116,159
Inventory	75,786	84,527
Total current assets	<u>4,426,057</u>	<u>3,566,296</u>
Noncurrent assets:		
Restricted investments (Notes 2 and 5)	6,832,741	7,949,065
Capital assets: (Note 4)		
Nondepreciable	5,518,087	985,259
Depreciable, net	70,475,838	71,053,170
Unamortized bond issue costs (Note 5)	1,193,925	1,341,969
Total noncurrent assets	<u>84,020,591</u>	<u>81,329,463</u>
Total assets	<u>\$ 88,446,648</u>	<u>\$ 84,895,759</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 457,849	\$ 386,889
Interest payable	252,209	259,208
Accrued expenses	10,895	3,376
Customer deposits	376,294	310,558
Current maturities of long-term liabilities (Note 5)	1,906,291	1,994,624
Total current liabilities	<u>3,003,538</u>	<u>2,954,655</u>
Long-term liabilities (Note 5)	39,692,494	40,540,198
Total noncurrent liabilities	<u>39,692,494</u>	<u>40,540,198</u>
Commitments and contingencies (Note 10)	-	-
Total liabilities	<u>42,696,032</u>	<u>43,494,853</u>
NET ASSETS		
Invested in capital assets, net of related debt	35,872,370	32,409,097
Restricted for:		
Debt covenants	6,832,741	7,949,065
Unrestricted	3,045,505	1,042,744
Total net assets	<u>45,750,616</u>	<u>41,400,906</u>
Total liabilities and net assets	<u>\$ 88,446,648</u>	<u>\$ 84,895,759</u>

HENRY COUNTY PUBLIC SERVICE AUTHORITY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET ASSETS

For the Years Ended June 30, 2006 and 2005

	2006	For Comparative Purposes Only 2005
OPERATING REVENUES		
Water and sewer charges	\$ 8,913,922	\$ 8,592,726
Fire protection fees-Henry County	406,800	406,800
Connection fees	70,361	84,947
Miscellaneous	818,466	784,716
Total operating revenues	<u>10,209,549</u>	<u>9,869,189</u>
OPERATING EXPENSES		
Water and sewer treatment	2,811,535	3,242,408
Depreciation	2,757,877	2,764,511
Maintenance-transmission and collection lines	944,622	845,830
Administration	723,953	660,781
Bad debts	362,460	440,088
Customer service	333,806	318,174
Engineering and mapping	248,097	217,864
Maintenance-vehicle and equipment	159,012	106,521
Management information systems	112,758	102,120
Meter reading	126,491	95,445
Safety	43,816	48,506
Total operating expenses	<u>8,624,427</u>	<u>8,842,248</u>
Operating income	<u>1,585,122</u>	<u>1,026,941</u>
NON-OPERATING REVENUES (EXPENSES)		
Interest income	379,168	316,859
Interest expense	<u>(2,015,079)</u>	<u>(2,084,752)</u>
Total non-operating revenues (expenses)	<u>(1,635,911)</u>	<u>(1,767,893)</u>
Loss before contributions	<u>(50,789)</u>	<u>(740,952)</u>
CAPITAL CONTRIBUTIONS (Note 6)	<u>4,400,499</u>	<u>1,183,210</u>
Change in Net Assets	4,349,710	442,258
Net Assets-beginning of year	<u>41,400,906</u>	<u>40,958,648</u>
Net Assets-end of year	<u>\$ 45,750,616</u>	<u>\$ 41,400,906</u>

The Notes to Financial Statements are an integral part of these statements.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2006 and 2005

	2006	For Comparative Purposes Only 2005
	<u>2006</u>	<u>2005</u>
OPERATING ACTIVITIES		
Cash received from customers	\$ 9,641,993	\$ 9,579,603
Cash paid for goods and services	(3,095,268)	(2,838,137)
Cash paid to employees	(2,293,015)	(2,649,338)
Net cash provided by operating activities	<u>4,253,710</u>	<u>4,092,128</u>
CAPITAL AND RELATED FINANCING ACTIVITIES		
Contributed capital from Henry County	-	400,000
Governmental grant revenue	4,183,819	810,133
Purchase of capital assets	(6,713,373)	(734,325)
Bond proceeds received	1,030,000	1,275,000
Bond principal payments	(1,994,624)	(1,864,129)
Bond interest payments	(1,874,034)	(1,914,225)
Bond issue cost payments	-	(47,846)
Net cash used in capital and related financing activities	<u>(5,368,212)</u>	<u>(2,075,392)</u>
INVESTING ACTIVITIES		
Interest received	355,708	294,652
Net change in investments	<u>1,139,784</u>	<u>(1,610,806)</u>
Net cash provided by (used in) investing activities	<u>1,495,492</u>	<u>(1,316,154)</u>
Net increase in cash and cash equivalents	380,990	700,582
CASH AND CASH EQUIVALENTS		
Beginning	<u>2,231,596</u>	<u>1,531,014</u>
Ending	<u>\$ 2,612,586</u>	<u>\$ 2,231,596</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,585,122	\$ 1,026,941
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,757,877	2,764,511
Bad debts	362,460	440,088
Change in assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(554,653)	(404,484)
Inventory	8,741	5,874
Unbilled revenue	(78,639)	5,603
Increase in:		
Accounts payable	70,960	122,642
Customer deposits	65,736	109,295
Accrued expenses	36,106	21,658
Net cash provided by operating activities	<u>\$ 4,253,710</u>	<u>\$ 4,092,128</u>

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 1. Summary of Significant Accounting Policies

Organization and nature of activities:

The Henry County Public Service Authority (the "Authority") was formed in 1965 under the provisions of the Virginia Water and Sewer Authorities Act, Code of Virginia (1950), as amended. The Authority provides water and sewer services to communities in Henry County, Virginia (the "County"). The Authority is governed by a six member Board of Directors who are appointed for four-year staggered terms by the Board of Supervisors of the County. Since the Board of Supervisors cannot impose its will on the Authority and since there is no potential financial benefit or burden in the relationship, the County is not financially accountable for the Authority. Accordingly, the Authority is not considered a component unit of the County.

Measurement focus and basis of accounting:

The Authority's financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the Authority's financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Authority also has the option of following subsequent private-sector guidance, subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for water and sewer sales. Operating expenses include the cost of water and sewer treatment, maintenance, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash and cash equivalents:

Cash and cash equivalents consists of cash on hand; demand, savings or money market accounts; and certificates of deposit or short-term investments with purchased maturities of three months or less.

Unbilled revenue:

Unbilled revenue consists of amounts earned as of year end, but not yet billed because billing dates do not coincide with year end.

Allowance for doubtful accounts:

The Authority has calculated its allowance for doubtful accounts using historical collection data and specific account analysis of all accounts greater than or equal to ninety days aged.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

Inventory:

Inventory consists of grinder pumps, parts, and supplies on hand at year end, reported at the lower of cost (first-in, first-out) or market. Inventory is generally used for construction and for operation and maintenance work, and is not held for resale.

Investments:

Investments are carried at fair value.

Capital assets:

Capital assets are recorded at original cost at the time of acquisition. Donated assets are recorded at their fair market value on the date donated. Repair and maintenance items are expensed when incurred. Depreciation is provided on the straight-line method over the following estimated useful lives:

Buildings and structures	50 years
Sewer system equipment	40-50 years
Water system equipment	40 years
Other equipment	5-20 years

Capitalization of interest:

Interest expense applicable to indebtedness used to construct facilities is capitalized during the period of construction as part of the cost of such facilities. Other interest costs are treated as nonoperating expenses. Interest capitalized for 2006 and 2005, was \$57,340 and \$33,271, respectively.

Compensated absences:

The vacation policy provides for the accumulation of earned vacation leave, depending on years of service with a maximum accumulation of 240 hours. The sick leave policy provides for sick leave to be earned at the rate of eight hours per month of service with a maximum accumulation of 720 hours. Accumulated vacation is paid at 100%, and sick leave is paid at 25%, upon termination of employment. These amounts are accrued when incurred.

Revenues:

The Authority records water and sewer revenues as billed to its customers principally on a monthly basis. Fees charged for the privilege of connecting to the system are credited to income.

Use of estimates:

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

Budgets:

The Authority adopts an annual budget for informative and fiscal planning purposes only. The budget is not intended to be a legal control on expenses. Budgets are adopted on the accrual basis of accounting with the exception that depreciation and amortization are not budgeted.

Amortization:

Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Amortization of bond premiums or discounts is included in interest expense. Amortization of bond issuance costs is recorded as amortization expense. Bonds payable are reported net of the applicable bond premium or discount. The deferred amount resulting from bond refunding is amortized over the shorter of the life of the new bond issue or the refunded issue. Bonds payable are reported net of the deferred amount on refunding.

Net assets:

Net assets are the difference between assets and liabilities. Net assets invested in capital assets represent capital assets, less accumulated depreciation, less any outstanding debt related to the acquisition, construction or improvement of those assets.

Note 2. Deposits and Investments

Deposits:

At year end the Authority's deposits with banks were \$2,778,596. Of the bank's balances, \$233,906 was covered by federal depository insurance, and \$1,609,525 was collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-440 *et. seq.* of the *Code of Virginia*. \$935,165 was not held in an account collateralized in accordance with the Public Deposits Act; however, subsequent to year end the account was properly collateralized.

Under the provisions of the Virginia Security for Public Deposits Act, banks holding public deposits in excess of the amounts insured by federal depository insurance must pledge collateral in the amount of 50% of excess deposits to a collateral pool in the name of the State Treasury Board. Savings institutions are required to collateralize 100% of deposits in excess of federal depository insurance limits. The State Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Virginia Security for Public Deposits Act and for notifying local governments and authorities of compliance by banks and savings institutions.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 2. Deposits and Investments (Continued)

Investments:

Statutes authorize the Authority to invest in obligations of the United States or agencies thereof; obligations of the Commonwealth of Virginia or political subdivisions thereof; commercial paper rated A-1 by Standard and Poor's Corporation or P-1 by Moody's Commercial Paper Record; banker's acceptances, repurchase agreements, the State Treasurer's Local Government Investment Pool (LGIP) and the State Non-Arbitrage Program (SNAP).

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity</u>	<u>Rating</u>
U.S. Treasuries	\$ 5,179,192	5 months or less	AAA
Certificates of deposit	<u>1,576,000</u>	2007	N/A
	<u>\$ 6,755,192</u>		

Interest Rate Risk – As a means of limiting its exposure to fair value losses arising from rising interest rates, the Authority purchases investments having a maturity not greater than two years from the date of purchase.

Credit Risk – In accordance with State statutes, the Authority authorized investments in obligations of the United States and agencies thereof, commercial paper, repurchase agreements which are collateralized with securities that are approved for direct investment, and LGIP.

Concentration of Credit Risk – The Authority places no limit on the amount that may be invested in any one issuer. More than 20% of the Authority's investments are in certificates of deposit from a single bank.

Debt Service Forward Delivery Agreements:

The Authority entered into two Debt Service Forward Delivery Agreements dated May 10, 2002 (one for the Debt Service Fund and one for the Debt Service Reserve Fund) maturing November 15, 2019. Monthly, the Authority transfers cash to the bond trustee in exchange for U.S. Treasury obligations which are held by the bond trustee. These obligations mature in accordance with the debt service payment schedule.

Note 3. Accounts Receivable

Subsequent to year end, the Authority, with authorization of the Board, wrote off all receivables from fiscal year 2005 and older, effective as of June 30, 2006. These receivables had previously been reserved through an allowance for doubtful accounts. Included in these written off accounts were accounts receivable from bankrupt organizations, Pillowtex and Active Wear, Inc., who had balances at June 30, 2006 of \$176,278 and \$393,294, respectively. The Authority's allowance for doubtful accounts at June 30, 2006 and 2005 was \$33,075 and \$963,170, respectively.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 4. Capital Assets

Capital asset activity for the year is as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not depreciated				
Land	\$ 297,985	\$ -	\$ -	\$ 297,985
Construction in progress:				
Water:				
Chestnut Knob	21,300	-	-	21,300
Eagle Lane	1,170	-	-	1,170
Fairystone State Park	20,200	922,984	-	943,184
	<u>42,670</u>	<u>922,984</u>	<u>-</u>	<u>965,654</u>
Sewer:				
Plant conversions	333,897	1,035,146	1,369,043	-
NW County	100,286	4,154,162	-	4,254,448
USR conversion	210,421	535,719	746,140	-
	<u>644,604</u>	<u>5,725,027</u>	<u>2,115,183</u>	<u>4,254,448</u>
Total construction in progress	<u>687,274</u>	<u>6,648,011</u>	<u>2,115,183</u>	<u>5,220,102</u>
Total capital assets, not depreciated	<u>985,259</u>	<u>6,648,011</u>	<u>2,115,183</u>	<u>5,518,087</u>
Capital assets, depreciated				
Buildings	96,976	-	-	96,976
Water and sewer system	108,438,798	2,136,781	-	110,575,579
Leasehold improvements	670,298	-	-	670,298
Trucks and autos	1,480,843	43,764	-	1,524,607
Office equipment	431,023	-	13,361	417,662
Total capital assets, depreciated	<u>111,117,938</u>	<u>2,180,545</u>	<u>13,361</u>	<u>113,285,122</u>
Less accumulated depreciation for:				
Buildings	92,857	-	-	92,857
Water and sewer system	37,836,494	2,652,682	-	40,489,176
Leasehold improvements	335,675	45,120	-	380,795
Trucks and autos	1,411,143	37,303	-	1,448,446
Office equipment	388,599	22,772	13,361	398,010
Total accumulated depreciation	<u>40,064,768</u>	<u>2,757,877</u>	<u>13,361</u>	<u>42,809,284</u>
Total capital assets depreciated, net	<u>71,053,170</u>	<u>(577,332)</u>	<u>-</u>	<u>70,475,838</u>
Total capital assets, net	<u>\$ 72,038,429</u>	<u>\$ 6,070,679</u>	<u>\$ 2,115,183</u>	<u>\$ 75,993,925</u>

(Continued)

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 5. Long-Term Liabilities

The following is a summary of the Authority's long-term liability activity for the year:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
2000 VRL Fund	\$ 425,120	\$ -	\$ (29,700)	\$ 395,420	\$ 29,700
2000 Water	1,235,145	-	(15,402)	1,219,743	16,109
2000-A Water	819,188	-	(10,022)	809,166	10,482
2001 Water and Sewer Refunding	37,625,000	-	(1,730,000)	35,895,000	1,800,000
2004-B Water and Sewer Refunding	1,275,000	-	(45,000)	1,230,000	50,000
2005-A Sewer	-	1,030,000	-	1,030,000	-
Less deferred amounts:					
2001 refunding	(995,878)	-	110,900	(884,978)	-
Imputed interest on 2000 VRL Fund	(124,087)	-	14,868	(109,219)	-
Unamortized premium on 2001 Water and Sewer Refunding	2,012,592	-	(289,617)	1,722,975	-
Unamortized premium on 2004-B Water and Sewer	8,024	-	(651)	7,373	-
Total	42,280,104	1,030,000	(1,994,624)	41,315,480	1,906,291
Compensated absences	254,718	80,069	(51,482)	283,305	-
Total long-term liabilities	\$ 42,534,822	\$ 1,110,069	\$ (2,046,106)	\$ 41,598,785	\$ 1,906,291

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 5. Long-Term Liabilities (Continued)

	Interest Rates	Date Issued	Final Maturity	Amount of Original Issue	Installment Payments	Installment Period	Balance June 30, 2006
Bonds:							
Virginia Revolving Loan Fund	0.000%	06/16/2000	2019	\$ 594,000	\$ 14,850	Semi-Annual	\$ 395,420
Water Facility Revenue	4.500%	01/28/2000	2039	\$ 1,282,840	5,889	Monthly	1,219,743
Water Facility Revenue	4.500%	06/14/2000	2040	\$ 847,400	3,890	Monthly	809,166
Water and Sewer Revenue Refunding	3.00 - 5.500%	11/15/2001	2019	\$ 42,470,000	1,565,000 - 3,540,000	Annual	35,895,000
Water and Sewer Revenue	2.35 - 4.475%	11/17/2004	2024	\$ 1,275,000	45,000 - 90,000	Annual	1,230,000
Sewer Facility Revenue	4.125%	07/14/2005	2045	\$ 1,030,000	4,481	Monthly	1,030,000
							<u>\$ 40,579,329</u>

The annual requirements to amortize bond principal and related interest are as follows:

Fiscal Year	2000 Bonds		2001 Bonds		2004 Bonds		2005 Bonds	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2007	\$ 56,291	\$ 104,875	\$ 1,800,000	\$ 1,841,462	\$ 50,000	\$ 45,936	\$ -	\$ -
2008	57,513	102,864	1,890,000	1,749,213	50,000	44,761	10,524	38,767
2009	58,790	100,758	1,990,000	1,652,212	50,000	43,524	11,943	41,829
2010	60,127	98,550	2,095,000	1,550,088	50,000	42,161	12,445	41,327
2011	61,525	96,238	2,200,000	1,442,712	50,000	40,674	12,968	40,804
2012-2016	330,944	442,441	12,845,000	5,348,994	290,000	174,638	73,490	195,370
2017-2021	326,802	367,141	13,075,000	1,389,988	350,000	110,791	90,292	178,568
2022-2026	285,888	300,852	-	-	340,000	30,417	110,935	157,925
2027-2031	357,874	228,866	-	-	-	-	136,298	132,562
2032-2036	447,985	138,755	-	-	-	-	167,459	101,401
2037-2041	380,590	31,657	-	-	-	-	205,744	63,116
2042-2046	-	-	-	-	-	-	197,902	17,110
	<u>\$ 2,424,329</u>	<u>\$ 2,012,997</u>	<u>\$ 35,895,000</u>	<u>\$ 14,974,669</u>	<u>\$ 1,230,000</u>	<u>\$ 532,902</u>	<u>\$ 1,030,000</u>	<u>\$ 1,008,779</u>

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 5. Long-Term Liabilities (Continued)

Required escrow funds for debt service, repairs and replacements, and operating needs were as follows:

Operating funds reserve	\$ 1,000,000
Replacement reserve	400,000
Debt service – 2000 RUS bonds	176,000
Debt service – 2001 bonds	5,179,192
Debt service – accrued interest	<u>77,549</u>
	<u>\$ 6,832,741</u>

The Authority is required to maintain a debt service coverage ratio of 120% (as defined in the bond Master Trust Agreement and related amendments) and to periodically obtain a consulting engineer's report to determine amounts needed to escrow for future repairs, replacements and operating needs. The Authority received the most recent report in June 2006. The management of the Authority believes it is in compliance with all requirements.

Revenue bonds require all revenues and receipts derived by the Authority to be pledged as security for the bonds. In addition, a security interest in all accounts receivable for services is granted to the issuer of the bonds.

Note 6. Capital Contributions

Capital contributions represent proceeds from federal, state, and local agencies for the following capital projects:

Northwest sewer project	\$ 2,934,923
USR Conversion to pump station	562,941
Other sewer and water system projects	<u>902,635</u>
	<u>\$ 4,400,499</u>

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 7. Operating Leases

The Authority leases its office space from the County for a fifteen year term commencing November 1, 1997 and ending on October 31, 2012. The lease is renewable annually for one year terms thereafter. In lieu of rent, the Authority renovated a portion of the building for the County's and Authority's use. These improvements are shown as leasehold improvements are being depreciated over the life of the lease. (See Note 4.)

In addition, the Authority leases the water treatment plant from the County. The plant, with a cost of \$1,642,595, accumulated depreciation of \$727,917, and annual depreciation of \$40,440 is recorded on the County's financial statements. The Authority is responsible for all maintenance and operations of the plant. No payments are required. The Authority is required to retain funds in an Expansion and Replacement Fund to be applied to reasonable and necessary expenses for construction, replacement, repair, additions and/or extensions to the water and waste water facilities of the Authority. All disbursements from this fund must first be approved by the County. The lease continues until all debts of the Authority relating to water facility improvements, have been satisfied.

Note 8. Retirement Plan

The Authority contributes to the Virginia Retirement System ("VRS"), an agent and cost-sharing multiple-employer, defined benefit pension plan administered by the Virginia Retirement System (the "System").

All full-time, salaried, permanent employees of participating employers must participate in the VRS. Benefits vest after five years of service. Employees are eligible for an unreduced retirement benefit at age 65 with five years of service (age 60 with five years for participating local law enforcement officers, firefighters, and sheriffs) and at age 50 with 30 years of service for participating employees (age 50 with 25 years for participating local law enforcement officers, firefighters, and sheriffs) payable monthly for life in an amount equal to 1.7% of their average final compensation (AFC) for each year of credited service. AFC is defined as the highest consecutive 36 months of reported compensation. Benefits are actuarially reduced for retirees who retire prior to becoming eligible for full retirement benefits. In addition, retirees qualify for annual cost of living increases beginning in their second year of retirement. Participating local law enforcement officers, firefighters and sheriffs may receive a monthly benefit supplement if they retire prior to age 65. The VRS also provides death and disability benefits. Title 51.1 of the *Code of Virginia* (1950), as amended, assigns the authority to establish and amend benefit provisions to the General Assembly of Virginia.

The System issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for VRS. A copy of that report may be downloaded from the VRS website at <http://www.varetire.org/PDF/2004AnnuRept.pdf> or obtained by writing to the VRS at P.O. Box 2500, Richmond, VA 23218-2500.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 8. Retirement Plan (Continued)

Funding policy

Plan members are required by Title 51.01 of the Code of Virginia (1950), as amended, to contribute 5% of their annual salary to the VRS. This 5% member contribution has been assumed by the Authority. In addition, the Authority is required to contribute the remaining amounts necessary to fund its participation in the VRS using the actuarial basis specified by the Code of Virginia and approved by the VRS Board of Trustees. The Authority's contribution rate for the fiscal year ended June 30, 2006 was 5% of annual covered payroll.

Annual pension cost

For the fiscal year ended June 30, 2006, the Authority's annual pension cost of \$97,418 was equal to the Authority's required and actual contributions. The required contribution was determined as part of the June 30, 2005 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.50% investment rate of return, (b) projected salary increases ranging from 3.50% to 5.73% per year, and (c) 2.50% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 2.50%. The actuarial value of the Authority's assets is equal to the modified market value of assets. This method was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five year period. The valuated actuarial accrued liability is being amortized at a level percentage of payroll on an open basis within a period of 30 years.

Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2006	\$ 97,418	100%	\$ -
June 30, 2005	\$ 81,861	100%	\$ -
June 30, 2004	\$ 75,500	100%	\$ -

Analysis of Funding Progress for Defined Benefit Pension Plan

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded (Overfunded) Actuarial Accrued Liability (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
June 30, 2005	\$ 5,943,663	\$ 5,970,608	\$ 26,945	99.55%	\$ 1,749,626	1.54%
June 30, 2004	\$ 5,786,414	\$ 4,816,094	\$ (970,320)	120.15%	\$ 1,790,460	(54.19)%
June 30, 2003	\$ 5,631,477	\$ 4,106,632	\$ (1,524,845)	137.13%	\$ 1,288,508	(118.33)%

HENRY COUNTY PUBLIC SERVICE AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 9. Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority joined together with other local governments in the Virginia Municipal League Pool, a public entity risk pool currently operating as a common risk management and insurance program for participating local governments. The Authority pays an annual premium to the pool for substantially all of its insurance coverage. In the event of a loss creating a deficit or depletion of all available excess insurance, the pool may assist all members in the proportion that the premium of each bears to the total premiums of all members in the year in which such deficit occurs. The settled claims for 2006 and 2005 did not exceed insurance.

Note 10. Commitments and Contingencies

Special purpose grants are subject to audit to determine compliance with their requirements. Authority officials believe that if any refunds are required, they will be immaterial.

Note 11. Water and Sewer Purchases

In 1974, the Authority and neighboring City of Martinsville ("City") signed a service agreement in which the Authority would purchase water and sewage treatment from the City and share in the annual operating costs of the plants in proportion to its actual use as measured by the volume of water used and sewage it contributed. It also allowed for the Authority to purchase capacity rights into the water and sewer plants at an agreed upon price.

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**OTHER
SUPPLEMENTARY INFORMATION**

SCHEDULE 1

HENRY COUNTY PUBLIC SERVICE AUTHORITY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2006

Federal Grantor/Program Title	Federal CFDA Number	Federal Expenditures
Direct payments:		
United States Department of Agriculture:		
Water and Waste Disposal Systems for Rural Communities	10.760	\$ 2,934,923
Environmental Protection Agency:		
Surveys, Studies, Investigations, and Special Purpose Grant	66.606	<u>562,941</u>
		<u>\$ 3,497,864</u>

Note: This schedule is prepared on the accrual basis of accounting.

HENRY COUNTY PUBLIC SERVICE AUTHORITY

SCHEDULE OF REVENUES AND EXPENSES – BUDGET TO ACTUAL
NON-GAAP BUDGETARY BASIS
Year End June 30, 2006

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Operating Revenues				
Metered water sales	\$ 5,075,064	\$ 5,075,064	\$ 5,254,066	\$ 179,002
Waste water service charges	3,541,424	3,541,424	3,659,856	118,432
Miscellaneous	719,541	719,541	818,466	98,925
Fire protection fees-Henry County	406,800	406,800	406,800	-
Connection fees	62,000	62,000	70,361	8,361
Total operating revenues	9,804,829	9,804,829	10,209,549	404,720
Operating Expenses				
Water and sewer treatment	2,600,635	2,639,930	2,811,535	(171,605)
Depreciation	-	-	2,757,877	(2,757,877)
Maintenance-transmission and collection lines	886,002	889,190	944,622	(55,432)
Administration	734,744	747,029	723,953	23,076
Bad debts	440,600	440,600	362,460	78,140
Customer service	349,843	353,968	333,806	20,162
Engineering and mapping	247,466	255,016	248,097	6,919
Maintenance-vehicle and equipment	115,035	115,460	159,012	(43,552)
Management information systems	115,039	115,039	112,758	2,281
Meter reading	126,010	131,554	126,491	5,063
Safety	52,511	52,511	43,816	8,695
Total operating expenses	5,667,885	5,740,297	8,624,427	(2,884,130)
NON-OPERATING REVENUES (EXPENSES)				
Capital contributions	4,267,279	4,267,279	4,400,499	133,220
Interest income	292,666	292,666	379,168	86,502
Interest expense	(2,122,009)	(2,122,009)	(2,015,079)	106,930
Total non-operating revenue	2,437,936	2,437,936	2,764,588	326,652
Change in Net Assets	\$ 6,574,880	\$ 6,502,468	\$ 4,349,710	\$(2,152,758)

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OTHER INFORMATION SECTION

TABLE 1

HENRY COUNTY PUBLIC SERVICE AUTHORITY

REVENUES BY SOURCE
Last Ten Fiscal Years

Fiscal Years Ended June 30	Water	Sewer	Other	Investment Earnings	Grants	Connection Fees	Totals
2006	\$ 5,254,066	\$ 3,659,856	\$ 1,225,266	\$ 379,168	\$ 4,400,499	\$ 70,361	\$14,989,216
2005	\$ 5,094,668	\$ 3,498,058	\$ 1,191,516	\$ 316,859	\$ 783,210	\$ 84,947	\$10,969,258
2004	\$ 4,939,862	\$ 4,250,583	\$ 1,132,135	\$ 199,727	\$ 1,488,583	\$ 59,147	\$12,070,037
2003	\$ 4,189,439	\$ 4,686,546	\$ 1,693,295	\$ 260,059	\$ 992,572	\$ 83,007	\$11,904,918
2002	\$ 3,462,773	\$ 4,572,001	\$ 1,407,514	\$ 571,937	\$ 446,298	\$ 167,894	\$10,628,417
2001	\$ 3,437,210	\$ 4,948,698	\$ 1,338,592	\$ 1,091,396	\$ 2,587,502	\$ 566,138	\$13,969,536
2000	\$ 3,385,289	\$ 4,966,913	\$ 1,108,373	\$ 645,475	\$ 703,364	\$ 100,043	\$10,909,457
1999	\$ 3,486,451	\$ 5,169,727	\$ 880,088	\$ 765,179	\$ -	\$ 305,192	\$10,606,637
1998	\$ 3,402,458	\$ 5,111,736	\$ 801,720	\$ 1,312,408	\$ -	\$ 300,292	\$10,928,614
1997	\$ 3,330,403	\$ 5,118,617	\$ 733,905	\$ 1,223,101	\$ -	\$ 296,324	\$10,702,350

TABLE 2

EXPENSES BY FUNCTION
Last Ten Fiscal Years

Fiscal Years Ended June 30	System Maintenance	Treatment	Engineering and Mapping	Administration and Other	Depreciation	Amortization and Interest	Totals
2006	\$ 1,103,634	\$ 2,811,535	\$ 248,097	\$ 1,703,284	\$ 2,757,877	\$ 2,015,079	\$10,639,506
2005	\$ 952,351	\$ 3,242,408	\$ 217,864	\$ 1,665,114	\$ 2,764,511	\$ 2,084,752	\$10,927,000
2004	\$ 1,008,133	\$ 2,782,206	\$ 278,196	\$ 2,091,757	\$ 2,892,934	\$ 2,158,290	\$11,211,516
2003	\$ 972,538	\$ 2,933,592	\$ 273,849	\$ 1,724,074	\$ 2,923,447	\$ 2,304,502	\$11,132,002
2002	\$ 789,699	\$ 3,474,946	\$ 336,496	\$ 1,678,482	\$ 2,763,101	\$ 2,530,653	\$11,573,377
2001	\$ 1,128,922	\$ 3,318,017	\$ 322,318	\$ 1,770,134	\$ 2,515,714	\$ 2,950,705	\$12,005,810
2000	\$ 1,047,571	\$ 3,104,415	\$ 319,834	\$ 1,753,077	\$ 2,393,070	\$ 2,938,606	\$11,556,573
1999	\$ 924,006	\$ 3,349,291	\$ 157,232	\$ 1,420,825	\$ 2,368,110	\$ 3,028,216	\$11,247,680
1998	\$ 1,026,082	\$ 3,412,078	\$ 226,112	\$ 1,457,535	\$ 2,218,696	\$ 3,071,861	\$11,412,364
1997	\$ 889,348	\$ 2,817,127	\$ 251,854	\$ 1,569,840	\$ 2,233,601	\$ 3,141,660	\$10,903,430

TABLE 3

HENRY COUNTY PUBLIC SERVICE AUTHORITY
REVENUE BOND DEBT SERVICE COVERAGE
Last Ten Fiscal Years

Fiscal Years Ended June 30	Unrestricted Cash Beginning of year	Gross Revenues	Direct Operating Expenses**	Net Available	Principal	Amortization and Interest	Totals	Coverage
2006	\$ 2,231,596	\$10,588,717	\$ 5,866,550	\$ 6,953,763	\$ 1,830,124	\$ 1,890,236	\$ 3,720,360	1.87
2005	\$ 1,497,720	\$10,186,048	\$ 6,077,737	\$ 5,606,031	\$ 1,724,006	\$ 1,950,806	\$ 3,674,812	1.53
2004	\$ 621,729	\$10,581,454	\$ 6,160,292	\$ 5,042,891	\$ 1,662,939	\$ 1,972,999	\$ 3,635,938	1.39
2003	\$ 56,656	\$10,912,346	\$ 5,904,053	\$ 5,064,949	\$ 1,616,918	\$ 2,096,251	\$ 3,713,169	1.36
2002	\$ -	\$10,182,119	\$ 5,979,624	\$ 4,202,495	\$ 1,257,122	\$ 2,530,653	\$ 3,787,775	1.11
2001	\$ -	\$13,969,536	\$ 6,539,391	\$ 7,430,145	\$ 1,191,708	\$ 2,950,705	\$ 4,142,413	1.79
2000	\$ -	\$10,909,457	\$ 6,224,957	\$ 4,684,500	\$ 1,110,000	\$ 2,938,606	\$ 4,048,606	1.16
1999	\$ -	\$10,509,520	\$ 5,851,354	\$ 4,658,166	\$ 1,050,000	\$ 3,028,216	\$ 4,078,216	1.14
1998	\$ -	\$10,928,614	\$ 6,121,807	\$ 4,806,807	\$ 995,000	\$ 3,071,861	\$ 4,066,861	1.18
1997	\$ -	\$10,702,350	\$ 5,528,169	\$ 5,174,181	\$ 945,000	\$ 3,141,660	\$ 4,086,660	1.27

** Excluding depreciation, interest, and amortization.

Note: Beginning with fiscal year 2003, net available funds include unrestricted cash, and interest expense excludes amortization of bond issuance costs to reflect to proper calculation of the debt service coverage as contained in bond covenants.

TABLE 4

HENRY COUNTY PUBLIC SERVICE AUTHORITY

SCHEDULE OF INSURANCE IN FORCE

June 30, 2006

Type Coverage (Insurer)	Liability Limits	
Commercial General Liability (Virginia Municipal Liability Pool)	\$ 1,000,000	Each Occurrence Limit
	\$ 2,000,000	General Aggregate Limit
	\$ 2,000,000	Products/Completed Operations Aggregate Limit
	\$ 100,000	Fire Damage Limit
Primary Automobile Liability (Virginia Municipal Liability Pool)	\$ 10,000	Medical Expense Limit
	\$ 25,000	Bodily Injury Per Person
	\$ 50,000	Bodily Injury Per Accident
	\$ 20,000	Property Damage Per Accident
	\$ 1,000,000	Per Occurrence
Automobile Uninsured Motorists (Virginia Municipal Liability Pool)	\$ 25,000	Bodily Injury Per Person
	\$ 50,000	Bodily Injury Per Accident
	\$ 20,000	Property Damage Per Accident
	\$ 10,000	Automobile Medical Payments
Automobile Physical Damage (Virginia Municipal Liability Pool)	Actual	Comprehensive
	Actual	Collision
	\$ 250	Deductible/Comprehensive
	\$ 500	Deductible/Collision
Umbrella Liability (Virginia Municipal Liability Pool)	\$ 2,000,000	Per Occurrence
Commercial Property Coverage (Virginia Municipal Liability Pool)	\$ 32,581,634	Blanket Real & Personal Property
	\$ 100,000	Extra Expense (Monthly Limit)
	\$ 1,000	Deductible
Commercial Inland Marine Coverage (Virginia Municipal Liability Pool)	\$ 770,007	Contractor's Equipment
Boiler & Machinery Coverage (Virginia Municipal Liability Pool)	\$ 4,100,000	Direct Damage (Per Accident)
	\$ 100,000	Refrigerant
	\$ 100,000	Ammonia Contamination
	\$ 100,000	Expediting Expenses
	\$ 100,000	Hazardous Substances
	\$ 100,000	Consequential Damage (Per Accident)
	\$ 100,000	Computer
	\$ 100,000	Perishable Goods
	\$ 250,000	Demolition & ICC
	\$ 250,000	Newly Acquired Location
Public Employees Dishonesty Coverage (Virginia Municipal Liability Pool)	\$ 1,000,000	Aggregate Amount
Worker's Compensation (Virginia Municipal Group Self Insurance Association)	Statutory	State Statutory Provision
	\$ 1,000,000	Employer's Liability Limit
Public Official Liability (Commonwealth of Virginia - Division of Risk Management)	\$ 1,000,000	Limit of Liability
	\$ 1,000	Deductible
Permit Bond (US Fidelity & Guaranty Co.)	\$ 100,000	Bond Amount

TABLE 5

HENRY COUNTY PUBLIC SERVICE AUTHORITY
RAW WATER PRODUCTION BY SOURCE (In Million Gallons)
Last Ten Fiscal Years

Fiscal Year Ended	City of Martinsville/ Eden	Marrowbone	Philpott	Wells	Total
2006	398.84 **	-	688.30	18.99	1,106.13
2005	414.55 **	-	677.90	17.91	1,110.36
2004	416.44 **	-	671.90	162.62	1,250.96
2003	-	102.31	629.42	172.10	903.83
2002	-	177.72	619.51	195.55	992.78
2001	-	198.41	641.25	175.13	1,014.79
2000	-	209.73	632.42	164.06	1,006.21
1999	-	196.67	615.64	163.62	975.93
1998	-	170.53	532.41	143.28	846.22
1997	-	174.92	591.75	147.49	914.16

Source: Reports prepared by the Authority and submitted to the Virginia Department of Health

** The Marrowbone substation was closed in fiscal year 2003 and the water is now being purchased from the City of Martinsville. The Authority also purchases water from the City of Eden to supply the Sandy Level community.

TABLE 6

WASTE WATER TREATMENT BY PLANT
(In Millions Gallons)
Last Ten Fiscal Years

Fiscal Year Ended	City of Martinsville	Koehler	Lower Smith River	Total
2006	715.87 **	-	92.88	808.75
2005	599.37 **	-	237.56	836.93
2004	445.66 **	205.00	381.10	1,031.76
2003	-	1,011.76	404.13	1,415.89
2002	-	803.00	660.10	1,463.10
2001	-	962.16	856.50	1,818.66
2000	-	1,016.35	983.59	1,999.94
1999	-	903.41	810.34	1,713.75
1998	-	1,052.75	875.36	1,928.11
1997	-	1,142.26	881.60	2,023.86

Note: Does not include waste treatment in lagoon systems.

Source: Reports prepared by the Authority and submitted to the Virginia Department of Environmental Quality.

** The Koehler Wastewater Plant was closed in November 2003 and the sewer treatment is now being purchased from the City of Martinsville. The Lower Smith River Plant was converted to a pumping station in December 2005 and the sewer treatment is now being purchased from the City of Martinsville.

TABLE 7

HENRY COUNTY PUBLIC SERVICE AUTHORITY

DEMOGRAPHIC STATISTICS

Last Ten Fiscal Years

Fiscal Year Ended	Population (1)	Per Capita Income (2)	Median Age (3)	High School Grad. Rate (4)	School Enrollment (5)	Unemployment Rate (6)
2006	55,100	24,527	39.3	71.0%	7,628	4.8%
2005	55,100	23,309	39.3	74.0%	7,701	7.0%
2004	55,600	23,144	39.3	67.0%	7,805	14.0%
2003	56,500	21,447	39.3	66.7%	8,189	13.3%
2002	57,332	21,032	39.3	64.9%	8,371	13.8%
2001	57,930	30,843	*	53.9%	8,597	6.8%
2000	55,600	30,843	*	53.9%	8,982	6.2%
1999	55,627	*	*	53.9%	8,981	6.0%
1998	56,300	*	*	*	9,096	4.0%
1997	56,400	28,385	*	*	9,052	3.1%

Sources:

- (1) U.S. Census, 1990 and 2000; figures are adjusted estimates prepared by the University of Virginia Weldon Cooper Center for Public Service.
- (2) Bureau of Economic Analysis. Figures are for Martinsville & Henry County combined; Henry County only figures not available; information based on latest available data.
- (3) U. S. Census, 2000; figures for other years are unavailable.
- (4), (5) Henry County Public Schools.
- (6) Virginia Employment Commission.

* Information is not available

TABLE 8

HENRY COUNTY PUBLIC SERVICE AUTHORITY

LIST OF TEN LARGEST CUSTOMERS
Year Ended June 30, 2006

<u>Customer</u>	<u>Business</u>	<u>Amount</u>	<u>Percent of Total Billings</u>
C.P. Films, Inc.	Manufacturing	\$ 374,628	4.20 %
Henry County Schools	Public School System	191,631	2.15 %
Stanley Furniture Company	Manufacturing	126,739	1.42 %
King's Grant	Retirement Community	105,049	1.18 %
Scrub Board/Bobby Nickelston	Laundries & Car Wash	90,835	1.02 %
Bassett Mirror Company	Manufacturing	90,228	1.01 %
Bassett Furniture Industries	Manufacturing	80,831	0.91 %
County of Henry	Local Government	67,760	0.76 %
Mechanical Development Co	Rental Properties	56,185	0.63 %
Knauss Snack Food Co. LLC	Manufacturing	53,334	0.60 %
TOTAL		\$ 1,237,220	13.88 %

HENRY COUNTY PUBLIC SERVICE AUTHORITY

MISCELLANEOUS STATISTICAL DATA

As of June 30, 2006

Type of Entity	Independent authority created pursuant to the <i>Virginia Water and Sewer Authorities Act</i> , Section 15.2-5100, <i>Code of Virginia</i> (1950), as amended.	
Date of Incorporation	1965	
Selected Information:		
	Number of Employees	48
	Number of Active Water Connections	12,313
	Number of Active Sewer Connections	7,364
	Miles of Water Lines	320
	Miles of Sewer Lines	238
	Number of Fire Hydrants	1,376
	Water Treatment Plant Capacity	4 MGD
	City of Martinsville Purchased Water Capacity	2 MGD
	Sewer Treatment Plant Capacity	6 MGD
	City of Martinsville Purchased Sewer Capacity	4 MGD
	Average Daily Water Consumption	3.03 MGD
	Average Daily Sewage Flow	2.22 MGD
Bond Rating:	AAA	
Minimum Consumption Charge Per Service (Sewer charges are based on water consumption)	<u>July 2005 to May 2006</u> All customers charged a minimum monthly consumption charge of \$24.00 per service for up to 6,000 gallons consumption. <u>Effective June 2006</u> Residential customers charged a minimum monthly consumption charge of \$26.00 per service for up to 4,000 gallons consumption. Non-Residential customers charged a minimum monthly consumption charge of \$39.00 per service for up to 4,000 gallons consumption. Institutional customers charged a minimum monthly consumption charge of \$59.50 per service for up to 6,000 gallons consumption.	
Additional Consumption	The following charges apply to each 1,000 gallons, or fractions thereof, of water consumed above mentioned minimums: <u>July 2005 to May 2006</u> All customers - \$4.08 per additional 1,000 gallons <u>Effective June 2006</u> Residential customers - \$4.00 per additional 1,000 gallons Non-Residential customers - \$6.00 per additional 1,000 gallons Institutional customers - \$7.00 per additional 1,000 gallons	
Exceptions	The Authority reserves the right to negotiate contracts for service charges with industrial users.	

COMPLIANCE SECTION

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

To the Board of Directors
Henry County Public Service Authority

We have audited the basic financial statements of Henry County Public Service Authority as of and for the year ended June 30, 2006 and have issued our report thereon dated October 5, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Specifications for Audits of Authorities, Boards, and Commissions* issued by the Auditor of Public Accounts of the Commonwealth of Virginia.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority'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 assurance 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. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the Authority in a separate letter dated October 5, 2006.**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards*, which is described in the accompanying schedule of findings and questioned costs as Item 06-2.**

This report is intended solely for the information of the audit committee, management, Board of Directors, state and federal awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
October 5, 2006

— Providing Professional Business Advisory & Consulting Services —

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH *OMB CIRCULAR A-133***

To the Board of Directors
Henry County Public Service Authority

Compliance

We have audited the compliance of the Henry County Public Service Authority with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2006. The Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and *OMB Circular A-133* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Henry County Public Service Authority complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2006. However, the results of our auditor's procedures disclosed an instance of noncompliance with these requirements, which are required to be reported in accordance with *OMB Circular A-133* and which is described in the accompanying schedule of findings and questioned costs as Item 06-1.

Internal Control over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with *OMB Circular A-133*.

Our consideration of the internal control over compliance 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 noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program 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 compliance and its operation that we consider to be material weaknesses.**

This report is intended solely for the information of the audit committee, management, Board of Directors, state and federal awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, S. L. P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
October 5, 2006

HENRY COUNTY PUBLIC SERVICE AUTHORITY

SUMMARY OF COMPLIANCE MATTERS

June 30, 2006

As more fully described in the Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*, we performed tests of the Authority's compliance with certain provisions of the laws, regulations, contracts, and grants shown below.

STATE COMPLIANCE MATTERS

Code of Virginia

Cash and Investment Laws

Conflicts of Interest Act

Local Retirement Systems

Procurement Laws

Uniform Disposition of Unclaimed Property Act

LOCAL COMPLIANCE MATTERS

Authority By-Laws

FEDERAL COMPLIANCE MATTERS

Compliance Supplement for Single Audits of State and Local Governments

Provisions and conditions of agreements related to federal programs selected for testing.

HENRY COUNTY PUBLIC SERVICE AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2006

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an **unqualified opinion** on the financial statements.
2. **No reportable conditions** relating to the audit of the financial statements were reported in the Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.
3. **No instances of noncompliance** material to the financial statements were disclosed.
4. **No reportable conditions** relating to the audit of the major federal award programs were reported in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with *OMB Circular A-133*.
5. The auditor's report on compliance for the major federal award programs expresses an **unqualified opinion**.
6. The audit disclosed **one audit finding relating to major programs**.
7. The program tested as major was:

<u>Name of Program:</u>	<u>CFDA #</u>
Water and Waste Disposal Systems for Rural Communities	10.760

8. The **threshold for** distinguishing Type A and B programs was **\$300,000**.
9. Henry County Public Service Authority, Virginia was determined to be a **low-risk auditee**.

B. FINDINGS – FINANCIAL STATEMENT AUDIT

None.

C. FINDINGS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

06-1. Submission of Single Audit Reporting Package

Condition:

The June 30, 2005 reporting package Single Audit was not submitted to the Single Audit Clearinghouse.

Recommendation:

The Authority should ensure that all previous and future reporting packages are properly submitted.

Management's Response:

Management will work with their previous auditor to submit the appropriate reporting packages.

HENRY COUNTY PUBLIC SERVICE AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2006

D. FINDINGS AND QUESTIONED COSTS – COMMONWEALTH OF VIRGINIA

06-2. Section 2.2-44 Code of Virginia: Virginia Security for Public Deposits Act

Condition:

One cash account was not designated as public funds as required by state law and funds may not be properly insured or collateralized.

Recommendation:

The Authority should notify all financial institutions utilized that the funds are public deposits.

Management's Response:

Subsequent to year end, the account was properly designated as public.