

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.

FINANCIAL STATEMENTS
AND
SUPPLEMENTAL INFORMATION

DECEMBER 31, 2012 AND 2011

Alexander & Company, PSC

Certified Public Accountants

RECEIVED

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**PUBLIC SERVICE
COMMISSION**

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.

**FINANCIAL STATEMENTS
AND
SUPPLEMENTAL INFORMATION**

DECEMBER 31, 2012 AND 2011

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.

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December 31, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

To the Members
East Daviess County Water Association, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of East Daviess County Water Association, Inc. (a nonprofit organization) which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income (loss), retained deficit, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of East Daviess County Water Association, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Insurance and Rates is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 15, 2013 on our consideration of East Daviess County Water Association'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering East Daviess County Water Association's internal control over financial reporting and compliance.

Alexander & Company CPAs PSC

Owensboro, Kentucky
March 15, 2013

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.

Balance Sheets

December 31, 2012 and 2011

	2012	2011
ASSETS		
UTILITY PLANT		
Water plant in service	\$ 11,520,457	\$ 11,454,975
Less: accumulated depreciation	(4,201,432)	(3,981,422)
TOTAL UTILITY PLANT - NET	7,319,025	7,473,553
RESTRICTED FUNDS		
Cash - reserve fund	457,487	429,466
Cash - construction fund	45	48
Cash - security deposit fund	17,710	13,932
TOTAL RESTRICTED FUNDS	475,242	443,446
CURRENT ASSETS		
Cash	449,550	492,369
Accounts receivable trade	149,812	152,689
Less: allowance for doubtful accounts	(7,181)	(11,469)
Other receivables	3,070	174
Inventory	81,807	51,317
Prepaid insurance	11,987	12,110
Other current assets	4,457	8,495
TOTAL CURRENT ASSETS	693,502	705,685
DEFERRED EXPENSE		
Unamortized debt expense	3,944	4,377
TOTAL ASSETS	\$ 8,491,713	\$ 8,627,061

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

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Balance Sheets
December 31, 2012 and 2011

	2012	2011
LIABILITIES AND OTHER CREDITS		
RETAINED DEFICIT	\$ (293,177)	\$ (346,862)
LONG-TERM DEBT, net of current portion	1,676,364	1,905,540
CURRENT LIABILITIES		
Accounts payable - trade	47,072	39,758
Accounts payable - RWRA	14,895	16,610
Current portion of long-term debt	165,423	160,191
Accrued taxes	3,511	3,451
Accrued interest	11,793	13,312
Customer deposits	18,840	14,940
Accrued payroll and payroll taxes	3,971	9,832
TOTAL CURRENT LIABILITIES	265,505	258,094
TOTAL LIABILITIES	1,941,869	2,163,634
CONTRIBUTIONS		
Federal grants	1,807,300	1,807,300
State and local grants	2,343,641	2,343,641
Contributions in aid	2,692,080	2,659,348
TOTAL CONTRIBUTIONS	6,843,021	6,810,289
TOTAL LIABILITIES AND OTHER CREDITS	\$ 8,491,713	\$ 8,627,061

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

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Statements of Income (Loss)
Years ended December 31, 2012 and 2011

	2012	2011
OPERATING REVENUE		
Water sales	\$ 1,434,522	\$ 1,432,351
Miscellaneous service revenue	80,923	86,408
TOTAL OPERATING REVENUES	1,515,445	1,518,759
OPERATING EXPENSES		
Bad debts	6,192	10,786
Depreciation and amortization	272,088	274,872
Directors' fees	12,750	12,750
Engineering	1,679	-
Insurance	109,024	127,238
Legal and accounting	25,054	23,615
Miscellaneous	22,377	27,343
Office supplies and postage	41,271	34,639
Payroll taxes and fringe benefits	34,232	36,346
PSC assessment	2,664	2,399
Repairs	84,991	193,424
Salaries and wages	302,851	336,019
Telephone	8,164	6,996
Transportation	29,762	37,248
Utilities	31,509	28,064
Water purchased	392,930	402,963
Water testing	2,942	3,000
TOTAL OPERATING EXPENSES	1,380,480	1,557,702
INCOME (LOSS) FROM OPERATIONS	134,965	(38,943)
OTHER INCOME (EXPENSE)		
Loss on disposal of assets	(9,124)	(24,374)
Interest earned on investments	4,729	5,463
Interest expense	(76,885)	(83,827)
TOTAL OTHER EXPENSE	(81,280)	(102,738)
NET INCOME (LOSS)	\$ 53,685	\$ (141,681)

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

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Statements of Retained Deficit
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
RETAINED DEFICIT, BEGINNING OF YEAR	\$ (346,862)	\$ (205,181)
NET INCOME (LOSS)	<u>53,685</u>	<u>(141,681)</u>
RETAINED DEFICIT, END OF YEAR	<u>\$ (293,177)</u>	<u>\$ (346,862)</u>

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

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.

Statements of Cash Flows

Years ended December 31, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 53,685	\$ (141,681)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	272,088	274,872
Loss on disposal of assets	9,124	24,374
(Increase) decrease in:		
Accounts receivable	2,877	26,758
Other receivable	(2,896)	(5)
Reserve for bad debts	(4,288)	(10,996)
Prepaid insurance	123	351
Inventory	(30,490)	(1,256)
Grant receivables	-	305
Other assets	4,038	-
Increase (decrease) in:		
Accounts payable	5,598	(40,537)
Accrued taxes payable	60	(338)
Accrued interest	(1,519)	(498)
Customer deposits	3,900	3,840
Accrued payroll taxes	(5,861)	1,630
	306,439	136,819
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for the purchase of property	(137,242)	(148,343)
Transfers from (to) reserves and restricted funds	(31,796)	79,886
Proceeds from the sale of property	10,991	4,390
	(158,047)	(64,067)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	(223,944)	(153,018)
Contribution in aid of construction	32,733	76,680
	(191,211)	(76,338)
DECREASE IN CASH AND CASH EQUIVALENTS	(42,819)	(3,586)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	492,369	495,955
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 449,550	\$ 492,369

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

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Notes to Financial Statements
December 31, 2012 and 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

East Daviess County Water Association, Inc. (the "Water Association") is a water utility which operates in rural sections of Daviess, Hancock, and Ohio Counties of Kentucky, and its sales are primarily to residential customers.

Estimates

Management uses estimates and assumptions in preparing these financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Regulation

The Water Association's utility operations are subject to regulation with respect to rates, service, maintenance of accounting records and various other matters by the Commonwealth of Kentucky Public Service Commission. The Water Association's accounting policies recognize the financial effects of the ratemaking and accounting practices and policies of the Public Service Commission which conform to generally accepted accounting principles in all material respects.

Operating Revenue

Operating revenue is recognized upon completion of monthly meter readings. At the end of each month water services which have been rendered from the latest meter reading to the end of the month are unbilled.

Inventory

Inventory consists of materials and supplies which are stated at lower of cost (determined on the first-in, first-out basis) or market.

Utility Plant

Utility plant is stated at original cost (cost of the property to whomever first devoted it to public service.) The cost of labor for additions to the utility plant constructed by the Water Association's employees is not capitalized. It is the Water Association's policy to capitalize property or equipment over \$500.

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Notes to Financial Statements
December 31, 2012 and 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Depreciation

Depreciation expense is computed on the straight-line method. Depreciation expense for 2012 and 2011 was \$272,088 and \$274,872, respectively. Estimated useful lives of major components of the utility plant in service are as follows:

Water reservoirs	50 years
Water pumps and equipment	40 years
Land improvements	25 years
Service equipment	10 years
Water lines and meters	50 years

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consists of water sales to residential, commercial, industrial, agricultural and other customers. The allowance for doubtful accounts is computed based on the aging of outstanding accounts receivable and historical collections experience and represents in management's opinion, an adequate allowance to provide for probable uncollectible accounts.

Amortization of Debt Discount and Expense

The Water Association uses the bond retirement method to amortize debt discount and expense.

Statements of Cash Flows

For purposes of the Statements of Cash Flows, the Water Association considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Cash paid for interest for 2012 and 2011 was \$ 78,404 and \$ 84,325, respectively.

Impairment of Long-Lived Assets

Management periodically evaluates whether events or circumstances have occurred that indicate that excess of cost over net assets acquired and other long-lived assets may not be recoverable or that the remaining useful life may warrant revision. When such events or circumstances are present, management assess the recoverability of long-lived assets by determining whether the carrying value will be recovered through the expected future cash flows. In the event the sum of the expected future cash flows resulting from the use of the asset is less than the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. To date, no such impairment has been recognized.

EAST DAVIESS COUNTY WATER ASSOCIATION, INC
Notes to Financial Statements
December 31, 2012 and 2011

NOTE B - RESTRICTED FUNDS

Funds are restricted as follows: (1) Reserve fund cash is restricted pursuant to loan agreements with the U.S. Department of Agriculture, Rural Development and US Bank as described in Note D; (2) Construction fund cash represents cash advanced by the U.S. Department of Agriculture, Rural Development and other grantors which is restricted for construction projects; and (3) Security deposit fund cash consists of security deposits paid by customers.

NOTE C - LONG-TERM DEBT

	2012	2011
Long-term debt consists of the following:		
Note payable to U.S. Department of Agriculture, Rural Development with interest at the rate of 4.375% per annum, due in annual installments of \$31,228, including interest through August 7, 2046.	\$ 466,163	\$ 538,998
Note payable to US Bank with interest at the rate of 3.71% per annum, due in monthly installments of \$17,175, including interest through July 7, 2020.	1,375,624	1,526,733
	1,841,787	2,065,731
Less: Current portion	165,423	160,191
	\$ 1,676,364	\$ 1,905,540

US Bank and U.S. Department of Agriculture, Rural Development hold mortgages on substantially all assets of the Water Association.

The Water Association's loan agreements include various covenants, including a provision that it will not borrow any money from any source or enter into any contract agreement or incur any other liabilities in connection with making extensions or improvements to the facility, exclusive of normal maintenance, without obtaining the prior written consent of the Mortgagees. The cash reserve fund associated with the U.S. Department of Agriculture, Rural Development loan is fully funded. US Bank does not require a reserve fund for their loan. The Reserve Fund shall be used and disbursed only for the purpose of paying the cost of repairing or replacing any damage to the facility which may be caused by unforeseen catastrophe, for making extensions or improvements to the facility with the prior written approval of the U.S. Department of Agriculture, Rural Development, and when necessary, for the purpose of making debt service payments on the U.S. Department of Agriculture, Rural Development note in the event funds are not available from current operating funds.

EAST DAVIESS COUNTY WATER ASSOCIATION, INC
Notes to Financial Statements
December 31, 2012 and 2011

NOTE C - LONG-TERM DEBT (continued)

Maturities of notes payable are as follows:

<u>Year Ended December 31</u>	<u>Amount</u>
2013	\$ 165,423
2014	171,715
2015	178,246
2016	185,026
2017	191,499
Thereafter	<u>949,878</u>
	<u>\$ 1,841,787</u>

NOTE D - UTILITY PLANT

The major classes of Utility Plant at December 31, 2012 and 2011 consist of the following:

	<u>2012</u>	<u>2011</u>
Pumping system	\$ 426,102	\$ 424,555
Transmission and distribution system	10,395,143	10,344,996
General plant	<u>699,212</u>	<u>685,424</u>
	<u>\$ 11,520,457</u>	<u>\$ 11,454,975</u>

NOTE E - INCOME TAX STATUS

The Water Association maintains the tax position that it is exempt from federal and state income taxes and, accordingly, no provision for such taxes has been made. The Water Association did not pay any interest or penalty as a result of its tax position. The tax years 2010 through 2012 remain subject to examination by the Internal Revenue Service.

NOTE F - CONTRIBUTIONS

	<u>Government Grants</u>	<u>Other</u>	<u>Total</u>
Balance, December 31, 2010	\$ 4,043,541	\$ 2,619,354	\$ 6,662,895
Add: Tap-on fees and memberships	-	20,150	20,150
Reimbursed line costs	-	19,844	19,844
Government grants	<u>107,400</u>	<u>-</u>	<u>107,400</u>
Balance, December 31, 2011	<u>\$ 4,150,941</u>	<u>\$ 2,659,348</u>	<u>\$ 6,810,289</u>

EAST DAVIESS COUNTY WATER ASSOCIATION, INC
Notes to Financial Statements
December 31, 2012 and 2011

NOTE F - CONTRIBUTIONS (continued)

	Government Grants	Other	Total
Balance, December 31, 2011	\$ 4,150,941	\$ 2,659,348	\$ 6,810,289
Add: Tap-on fees and memberships	-	29,560	29,560
Reimbursed line costs	-	3,172	3,172
Government grants	-	-	-
Balance, December 31, 2012	<u>\$ 4,150,941</u>	<u>\$ 2,692,080</u>	<u>\$ 6,843,021</u>

NOTE G - SUPPLIER

The Water Association purchases either directly or indirectly all of its water for resale from the City Utility Commission of the City of Owensboro, Kentucky operating as Owensboro Municipal Utilities (OMU). Purchases for the years ended December 31, 2012 and 2011 were \$ 392,930 and \$ 402,963, respectively.

NOTE H - CONCENTRATION OF CREDIT RISK

At December 31, 2012 and 2011, the Water Association's bank balance of cash and cash equivalents totaled \$ 966,648 and \$ 961,725, respectively. Of the total cash balance at December 31, 2012 and 2011, \$ 500,000 and \$ 499,375, respectively, was covered by Federal depository insurance with \$465,460 and \$462,350, respectively, covered by collateral held by the banks. Of the total bank deposits at December 31, 2012 and 2011, \$ 1,188 and \$ 0, respectively, was not covered by Federal depository insurance or by collateral held by the banks.

NOTE I - COMPENSATED ABSENCES

Employees are entitled to paid vacation and paid sick days, depending on job classification, length of service, and other factors. It is impracticable to estimate the amount of compensation for future absences, and accordingly, no liability has been recorded in the accompanying financial statements. The Association does not accrue compensation for paid vacation because the amount is considered immaterial. The Association's policy is to record compensated absences when actually paid to employees.

NOTE J - FAIR VALUE MEASUREMENTS

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

EAST DAVIESS COUNTY WATER ASSOCIATION, INC
Notes to Financial Statements
December 31, 2012 and 2011

NOTE J - FAIR VALUE MEASUREMENTS (continued)

The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

- Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in an active market. This level includes common stocks, corporate bonds or mutual funds based on the closing price reported in the active market where the securities are traded.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, inputs that are derived principally from or corroborated by observable market data by correlation, or other means.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Liabilities itemized below were measured at fair value during the year ended using the market approach.

Fair values of liabilities measured on a recurring basis at December 31, 2012 and 2011 are as follows:

	Fair Value Measurements at Reporting Date Using			
Fair Value	Quoted Prices In Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<u>December 31, 2012</u>				
Long-term debt	\$ 1,841,787	\$ –	\$ 1,841,787	\$ –
<u>December 31, 2011</u>				
Long-term debt	\$ 2,065,731	\$ –	\$ 2,065,731	\$ –

NOTE K – SUBSEQUENT EVENTS

The Water Association did not have any subsequent events through March 15, 2013, which is the date the financial statements were issued requiring recording or disclosure in the financial statements for the year ended December 31, 2012.

SUPPLEMENTAL INFORMATION

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Schedule of Insurance
December 31, 2012

<u>Coverage</u>	<u>Amount of Coverage</u>
Workmen's Compensation	\$ 500,000 per occurrence
General Liability	\$ 1,000,000/3,000,000
Property and Contents	\$ 3,244,000
Employee Dishonesty	\$ 250,000
Owned Automobile Liability Bodily injury and property damage	\$ 1,000,000 per accident
Umbrella Coverage	\$ 2,000,000/2,000,000

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Schedule of Rates
December 31, 2012

Tap-on Fees

Charge

5/8" x 3/4" Meter
 All larger meters

\$ 650
 Actual Cost

Monthly rates

5/8" Meter

First 2,000 gallons
 Next 4,000 gallons
 Next 44,000 gallons
 Over 50,000 gallons

\$13.97 (Minimum Bill)
 4.66 per 1,000 gallons
 3.71 per 1,000 gallons
 3.01 per 1,000 gallons

3/4" Meter

First 3,000 gallons
 Next 3,000 gallons
 Next 44,000 gallons
 Over 50,000 gallons

\$18.63 (Minimum Bill)
 4.66 per 1,000 gallons
 3.71 per 1,000 gallons
 3.01 per 1,000 gallons

1" Meter

First 6,000 gallons
 Next 44,000 gallons
 Over 50,000 gallons

\$32.61 (Minimum Bill)
 3.71 per 1,000 gallons
 3.01 per 1,000 gallons

1-1/2" Meter

First 10,000 gallons
 Next 40,000 gallons
 Over 50,000 gallons

\$47.45 (Minimum Bill)
 3.71 per 1,000 gallons
 3.01 per 1,000 gallons

2" Meter

First 20,000 gallons
 Next 30,000 gallons
 Over 50,000 gallons

\$84.55 (Minimum Bill)
 3.71 per 1,000 gallons
 3.01 per 1,000 gallons



**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
East Daviess County Water Association, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of East Daviess County Water Association, Inc. (a nonprofit organization) as of and for the year ended December 31, 2012 and the related notes to the financial statements and have issued our report thereon dated March 15, 2013.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Association's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as 12-3 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany schedule of findings and responses as 12-1 and 12-2 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether East Daviess County Water Association, Inc.'s financial statements are free from 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 that are required to be reported under *Government Auditing Standards*.

Association's Response to Findings

East Daviess County Water Association's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. The Association's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

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

Alexander & Company CPAs PSC

Owensboro, Kentucky
March 15, 2013

EAST DAVIESS COUNTY WATER ASSOCIATION, INC.
Schedule of Findings and Responses
Year Ended December 31, 2012

SUMMARY OF AUDITORS' RESULTS

1. An unqualified opinion was issued on the financial statements for the year ended December 31, 2012.
2. Three significant deficiencies in the internal control were disclosed during the audit. One of the deficiencies was deemed a material weakness.
3. The audit did not disclose any noncompliance which was material to the financial statements.

FINDINGS – FINANCIAL STATEMENT AUDIT

12-1 Significant Deficiency:

Segregation of Duties: The small size of the Association's bookkeeping staff limits the extent of the separation of duties. Presently, the Association's bookkeeper's responsibilities include cash disbursements functions, billing, preparing the bank reconciliations and accounting functions. There has been significant improvement in the segregation of duties regarding the cash receipts function. However, the segregation of duties, which is the basic premise of a good internal control structure, is not adequate.

Association's Response: Due to the limited number of personnel, management believes that an adequate segregation of duties is not achievable and that the costs of correcting the weakness would exceed the benefits that would be derived.

12-2 Significant Deficiency:

Internal Control Over Financial Disclosures: The Association does not have defined monitoring controls in place to identify and assess disclosures in the financial statements.

Association's Response: Due to the limited number of personnel, management believes that the cost of the hiring and/or training someone to update the disclosures would not be cost effective at this time.

12-3 Material Weakness:

Adjusting Journal Entries: During the course of our engagement, we proposed several audit adjustments in an amount that was material to the financial statements. The Association needs to improve the controls in place over the processing and recording of transactions to ensure that the financial statements are not materially misstated. We recommend that the bookkeeper review the prior year-end audit journal entries and prior year comparative amounts during the current year to identify accounts that may need adjustment prior to year-end. The bookkeeper has made significant improvement in this area in the last year.

Association's Response: The bookkeeper will continue to review prior year journal entries to identify accounts that may need to be adjusted and will make those adjustments before year end.