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**WESTERN ROCKCASTLE WATER
ASSOCIATION, INC.**

AUDITED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
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FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Western Rockcastle Water Association, Inc. was organized on May 30, 1972 as a non-profit organization in the State of Kentucky. The Association provides water to rural sections of Rockcastle, Garrard, and Lincoln Counties, and surrounding areas.

The Association presents this discussion and analysis of its financial performance during the years ended December 31, 2012 and 2011 to assist the reader in focusing on significant financial issues and concerns.

The Association's year end annual financial report consists of two parts - the management's discussion and analysis and the basic financial statements (which include notes to the financial statements). Also included are supplementary schedules that show information sent to the Public Service Commission related to our basic financial statements.

Financial Highlights

The Association's cash account decreased by \$25,793.

The assets of the Association exceeded its liabilities by \$3,905,107.

The Association's total equity capital decreased by \$35,745.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Association's basic financial statements.

This report also contains notes to the financial statements and supplementary information in addition to the basic financial statements themselves.

The financial statements present the financial picture of the Association from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets of the Association, including infrastructure, as well as all liabilities, including long-term debt.

The Balance Sheet presents all of the Association's assets and liabilities, with the difference between the two reported as "equity capital". Over time, increases or decreases in the Association's equity capital may serve as a useful indicator of whether the financial position of the Association is improving or deteriorating.

The Statement of Operations presents information showing how the Association's equity capital changed during the most recent fiscal year. All changes in equity capital are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected water bills and earned but unused vacation leave).

The financial statements can be found immediately following this discussion and analysis.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The Notes to the Financial Statements can be found immediately following the Statement of Cash Flow.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Financial Analysis of the Association Taken As a Whole

Equity may serve over time as a useful indicator of financial position. The Association's combined equity totaled \$3,905,107 at the end of 2012, compared to \$3,940,852 at the end of the previous year.

The largest portion of the Association's equity reflects its investment in capital assets such as land, buildings, equipment, and water lines, less any related debt used to acquire those assets that are still outstanding.

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Current Assets	\$ 787,434	\$ 867,934	\$ (80,500)
Non-Current Assets	<u>6,515,992</u>	<u>6,694,999</u>	<u>(179,007)</u>
Total Assets	<u>7,303,426</u>	<u>7,562,933</u>	<u>(259,507)</u>
Current Liabilities	481,044	625,573	(144,529)
Non-Current Liabilities	<u>2,917,275</u>	<u>2,996,508</u>	<u>(79,233)</u>
Total Liabilities	<u>3,398,319</u>	<u>3,622,081</u>	<u>(223,762)</u>
Invested in Equity Capital			
Retained Earnings, Deficit	3,328,539	3,415,363	(86,824)
Contributed Capital	1,758,717	1,758,718	(1)
Memberships	<u>(1,182,149)</u>	<u>(1,233,229)</u>	<u>51,080</u>
Total Equity Capital	<u>\$ 3,905,107</u>	<u>\$ 3,940,852</u>	<u>\$ (35,745)</u>

Summary of Changes in Equity Capital

Approximately 96 percent of the Association's total revenue came from charges for services, 5 percent came from various sources. The Association's expenses cover a range of services. The largest expenses were for water purchases. The Association's expenses exceeded revenues resulting in an operating loss of \$35,745.

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>	<u>Change</u>
OPERATING REVENUES			
Water sales	\$ 1,888,107	\$ 1,906,828	\$ (18,721)
Penalties and fees	74,894	49,456	25,438
Miscellaneous	18,932	45,450	(26,518)
	<u>1,981,933</u>	<u>2,001,734</u>	<u>(19,801)</u>
OPERATING EXPENSES			
Purchased water	685,327	700,044	(14,717)
Personnel costs	377,553	364,828	12,725
Directors fee	35,400	31,512	3,888
Office expense	33,027	36,061	(3,034)
Insurance	155,078	107,551	47,527
Transportation costs	35,294	32,564	2,730
Telephone and utilities	63,172	67,086	(3,914)
Materials, supplies, and plant expense	104,989	73,274	31,715
Professional services	16,400	27,037	(10,637)
Repairs and maintenance	51,137	50,131	1,006
Miscellaneous	10,232	25,697	(15,465)
Depreciation and bad debt	313,143	281,738	31,405
	<u>1,880,752</u>	<u>1,797,523</u>	<u>83,229</u>
Operating Income	<u>101,181</u>	<u>204,211</u>	<u>(103,030)</u>
NON-OPERATING REVENUE (EXPENSES)			
Interest income	3,016	2,607	409
Gain on sale of assets	-	3,500	(3,500)
Interest expense	(139,942)	(121,177)	(18,765)
	<u>(136,926)</u>	<u>(115,070)</u>	<u>(21,856)</u>
Total Non-Operating Revenues (Expenses)	<u>(136,926)</u>	<u>(115,070)</u>	<u>(21,856)</u>
Change in Operating Income Before Capital Contributions	<u>(35,745)</u>	<u>89,141</u>	<u>(124,886)</u>
Proceeds From Capital Contributions	<u>-</u>	<u>-</u>	<u>-</u>
CHANGE IN EQUITY CAPITAL	<u><u>\$ (35,745)</u></u>	<u><u>\$ 89,141</u></u>	<u><u>\$ (124,886)</u></u>

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Budgetary Highlights

No differences between the original budget and the final budget existed.

Capital Assets

The Association's capital assets as of December 31, 2012, amounts to \$10,364,438 net of accumulated depreciation of \$3,958,599 leaving a net book value of \$6,405,839. This investment in capital assets includes land, buildings improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total decrease in the Association's investment in capital assets for the current fiscal year was about 5% in terms of net book value. However, actual expenditures to purchase or construct capital assets were \$5,101 for the year.

Depreciation charges for the year totaled \$294,261. Additional information on the Association's capital assets policy can be found in Note 1 and Note 12 of the footnotes to the financial statements of this report.

Debt Administration

Western Rockcastle Water Association, Inc.'s total debt decreased by \$202,335 during the current fiscal year. Additional information on the Association's long-term debt obligations can be found in Note 9 of the Notes to the Financial Statements of this report.

Economic Factors and Next Year's Budgets and Rates

Inflationary trends in the region compare favorably to national indices. The unemployment rate for the Association compares favorably to the nation's average unemployment rate. Any economic slowdown could result in revenue forecasts having to be revised downward.

Currently, the Association does anticipate an increase in water rates. Future legislative changes, which cannot be anticipated or predicted, will shape future decisions and either increase or decrease options available to the Association to serve the community as a municipal power utility.

Request for Information

This financial report is designed to provide a general overview of Western Rockcastle Water Association, Inc.'s finances for all of the Association's customers, investors and creditors. This financial report seeks to demonstrate the Association's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Western Rockcastle Water Association, Inc.
Rockcastle, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of Western Rockcastle Water Association, Inc. as of December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Association's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I 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 Association'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 Association's internal control. Accordingly, I 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. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis of my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Western Rockcastle Water Association, Inc. as of December 31, 2012 and 2011, and the respective changes in financial position, and where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 4 be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by Government Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued my report dated April 10, 2013 on my consideration of the Western Rockcastle Water Association, Inc.'s internal control over financial reporting and on my 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 my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Western Rockcastle Water Association, Inc.'s internal control over financial reporting and compliance.

Sammy K. Lee, P.S.C.

Berea, Kentucky
April 10, 2013

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
STATEMENT OF NET POSITION
DECEMBER 31, 2012

ASSETS	<u>2012</u>	<u>2011</u>
Current Assets		
Cash and cash equivalents	\$ 110,788	\$ 200,730
Accounts receivable, less allowance for doubtful accounts of \$111,833 in 2012 and \$92,952 in 2011	336,490	277,417
Accounts receivable miscellaneous	1,185	6,135
Prepaid expenses	13,538	12,215
Materials and supplies inventory	25,945	25,945
Total Current Assets	<u>487,946</u>	<u>522,442</u>
Non-Current Assets		
Restricted Cash	409,641	345,492
Capital assets, net	6,405,839	6,694,999
Total Non-Current Assets	<u>6,815,480</u>	<u>7,040,491</u>
TOTAL ASSETS	<u><u>\$ 7,303,426</u></u>	<u><u>\$ 7,562,933</u></u>
 LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 107,430	\$ 128,527
Accrued expenses	14,343	21,096
Current portion of long-term debt	273,152	283,127
Accrued interest	86,119	88,912
Total Current Liabilities	<u>481,044</u>	<u>521,662</u>
Non-Current Liabilities		
Customer deposits	113,127	103,911
Long-term debt	2,804,148	2,996,508
Total Non-Current Liabilities	<u>2,917,275</u>	<u>3,100,419</u>
Total Liabilities	<u>3,398,319</u>	<u>3,622,081</u>
Net Position		
Invested in capital assets, net of related debt	3,328,539	3,415,363
Restricted	110,153	346,126
Unrestricted	466,415	179,363
Total Net Position	<u>3,905,107</u>	<u>3,940,852</u>
TOTAL LIABILITIES AND NET POSITION	<u><u>\$ 7,303,426</u></u>	<u><u>\$ 7,562,933</u></u>

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

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
STATEMENT OF REVENUES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
<u>OPERATING REVENUES</u>		
Water sales	\$ 1,888,107	\$ 1,906,828
Penalties and fees	74,894	49,456
Miscellaneous	<u>18,932</u>	<u>45,450</u>
Total Operating Revenues	<u>1,981,933</u>	<u>2,001,734</u>
<u>OPERATING EXPENSES</u>		
Water purchased	685,327	700,044
Personnel costs	377,553	364,828
Director's fee	35,400	31,512
Office expense	33,027	36,061
Insurance	155,078	107,551
Transportation costs	35,294	32,564
Telephone and utilities	63,172	67,086
Materials and supplies	104,989	73,274
Professional services	16,400	27,037
Repairs and maintenance	51,137	50,131
Miscellaneous	10,232	25,697
Depreciation and bad debt	<u>313,143</u>	<u>281,738</u>
Total Operating Expenses	<u>1,880,752</u>	<u>1,797,523</u>
Operating Income	<u>101,181</u>	<u>204,211</u>
<u>NON-OPERATING REVENUE (EXPENSES)</u>		
Interest income	3,016	2,607
Gain from sale of assets	-	3,500
Interest expense	<u>(139,942)</u>	<u>(121,177)</u>
Total Non-Operating Revenues (Expenses)	<u>(136,926)</u>	<u>(115,070)</u>
Change in Net Position	(35,745)	89,141
Net Position, Beginning	<u>3,940,852</u>	<u>3,851,711</u>
NET POSITION, ENDING	<u><u>\$ 3,905,107</u></u>	<u><u>\$ 3,940,852</u></u>

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

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 1,840,358	\$ 1,864,429
Cash received from other sources	17,608	89,866
Cash payments to suppliers for goods and services	(1,168,040)	(1,239,923)
Cash payments to employees	(371,719)	(363,490)
Net cash provided by operating activities	<u>318,207</u>	<u>350,882</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of assets	(5,101)	(660,241)
Cash received from grants	-	76,490
Proceeds from issue of bonds and notes	-	500,396
Principal paid on bonds and notes	(106,962)	(95,443)
Cash paid on capital leases	(94,788)	(9,662)
Interest paid on debt	(137,149)	(121,177)
Net cash used by capital and related financing activities	<u>(344,000)</u>	<u>(309,637)</u>
Net increase (decrease) in cash and cash equivalents	(25,793)	41,245
Cash and cash equivalents at December 31, 2011	<u>546,222</u>	<u>504,977</u>
CASH AND CASH EQUIVALENTS AT DECEMBER 31, 2012	<u>\$ 520,429</u>	<u>\$ 546,222</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	<u>\$ 101,181</u>	<u>\$ 204,211</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	294,262	263,751
Bad debt expense	18,881	19,068
Gain from sale of assets	-	(3,500)
Changes in assets and liabilities:		
(Increase) decrease in customer accounts receivable	(81,110)	(158,953)
(Increase) decrease in other accounts receivable	4,950	(4,958)
(Increase) decrease in prepaid expenses	(1,323)	(82)
Increase (decrease) in accounts payable	(21,097)	4,291
Increase (decrease) in accrued expenses	(6,753)	14,856
Increase (decrease) in customer deposits	9,216	12,198
Total Adjustments	<u>217,026</u>	<u>146,671</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 318,207</u>	<u>\$ 350,882</u>

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Western Rockcastle Water Association, Inc. (the Association) was incorporated as a non-profit organization in the State of Kentucky. The Association is regulated by the Kentucky Public Service Commission pursuant to KRS 278.040. The Association provides water to the rural sections of Rockcastle, Garrard, Lincoln Counties, and surrounding areas.

Basis of Accounting

The Association prepares its financial statements using the accrual basis. The accrual basis recognizes income when earned, regardless of when payment is received, and recognizes expenses when incurred regardless of when paid. This method of accounting is in accordance with Generally Accepted Accounting Principles in the United States of America.

Measurement Focus and Financial Statement Presentation

The Association, under ASC 958-205, requires reporting amounts for a not-for-profit organization's total assets, liabilities, and net assets in a Statement of Financial Position; reporting the change in an organizations net position in a Statement of Activities; and reporting change in its cash and cash equivalents in a Statement of Cash Flows. ASC 958-205 also requires net position be displayed in three classes: unrestricted, temporarily restricted, and permanently restricted. The Association is a not-for-profit organization, however due to USDA reporting requirements the Association has to prepare their financial statements in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) as applied to governmental units.

The basic financial statements of the Association are prepared in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards, which along with subsequent GASB pronouncements, constitutes GAAP for governmental units. The Association's financial statements apply Financial Accounting Standards Board (FASB) statements and interpretations issued on or after November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

The Association's Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position display information about the Association as a whole. The statements distinguish between business-type and governmental activities. The Association does not have any governmental activities.

Cash and Cash Equivalents

Cash and cash equivalents are short-term, interest bearing, highly liquid investments with the original maturities of three months or less.

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable

Accounts receivable represent water charges due at year-end and are considered fully collectible by the Association with an allowance for doubtful amounts taken into consideration. The doubtful amounts are based on collection experience and a will be charged to operations when that determination is made. If amounts previously written off are collected, they will be credited to income when received. The allowance for doubtful accounts for the years ended December 31, 2012 and 2011 are \$111,833 and \$92,952, respectively.

The Association estimates its unbilled revenues from water sales. The estimated amount is based on amounts billed during the subsequent months following the close of the fiscal year.

Prepaid Assets

Payments that will benefit periods beyond the fiscal year are recorded as prepaid items. A current asset for the prepaid amount is recorded at the time of the purchase, and an expenditure/expense is reported in the year in which services are consumed.

Material and Supply Inventory

Material and supply inventory are stated at cost.

Capital Assets

Capital assets are recorded at cost less accumulated depreciation, or, if contributed property, at their estimated fair value at the time of contribution. Capital asset additions costing less than \$500 are charged to expense as purchases are made. The sale or disposal of capital assets is recorded by removing the asset's cost and related accumulated depreciation from the accounts and charging the resulting gain or loss to income.

Depreciation is provided for using the straight-line method over the estimated useful lives of the asset. The estimated useful lives are as follows:

Water and sewer system utility plants	20 - 40 years
Buildings and improvements	10 - 20 years
Trucks and equipment	5 - 10 years
Office equipment	5 - 7 years

Accounts Payable

Accounts payable represent expenses incurred in the current year to be paid in the subsequent year. The majority of the Association's payables are to vendors for the purchase of water.

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Customer Deposits

The Association collects and holds, in a separate bank account, a deposit from customers to ensure collection of its water charges.

Long-Term Debt and Costs

The Association's long-term debt is reported as liabilities. Loan discount and issue costs are amortized over the term of the respective loans outstanding.

Net Position

The composition of the Association's Net Position is classified as follows:

- Net investment in capital assets – Composed of capital assets, net of accumulated depreciation, further reduced by outstanding debt balances attributable to the construction, acquisition, or improvements of those assets and any unamortized debt cost or premium.
- Restricted – Composed of constraints imposed by grantors, contributors, creditors, or laws and regulations.
- Unrestricted – Composed of net position that do not meet the definition of "restricted" or net "investment in capital assets".

Use of Estimates

Management uses estimates and assumptions in preparing financial statements in accordance with Generally Accepted Accounting Principles in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities and the reported revenues and expenses. Accordingly, actual results could differ from those estimates.

Compensated Absences

The Association allows its employees to accumulate unused sick leave and vacation leave.

NOTE 2 – RESTRICTED CASH

The Association includes all funds required for other debt service, and funds related to specific projects, or customer accounts to be restricted. At December 31, 2012, and 2011, restricted cash amounted to \$409,641, and 345,492 respectively. This includes restrictions of \$3,691, and \$1,551, respectively.

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011

NOTE 3 - INCOME TAXES

For income tax purposes, the Association was formed as a non-profit organization in the state of Kentucky. However, there is no IRS determination letter available that recognizes the Association as a non-profit organization with tax-exempt status, therefore, the Association may be subject to income taxes. No provision for income taxes can be determined and no provision has been recorded to these financial statements.

NOTE 4 - REVENUE BOND CASH MANAGEMENT AND CASH RESTRICTIONS

The Association bond covenants requires certain funds be maintained in order to meet the debt service requirements and to provide for unusual repairs and maintenance to the present system.

Operation and Maintenance Fund: An Operation and Maintenance Fund must be maintained, from which all costs of operating, maintaining, and insuring public water project shall be paid.

Sinking Fund: A Sinking Fund must be maintained by the Association to accumulate an amount equal to accrued interest and principal payments on outstanding bonds as they come due.

Refer to Note 6: Commitments and Contingencies with regard to possible violations of Bond Ordinance pertaining to cash.

NOTE 5 - DEPOSITS WITH FINANCIAL INSTITUTIONS

At December 31, 2012, the carrying amount of the Association's cash accounts (including Certificates of Deposit) both restricted and unrestricted was \$520,429, and the bank balance was \$565,975. All of the bank balances were fully collateralized by FDIC insurance, or by securities pledged at market.

Interest Rate Risk: Is the risk that changes in interest rates will adversely affect the fair value of an investment. The Association does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. Management believes the Association is not exposed to significant interest rate risk on investments.

Credit Risk: Is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Association does not have a policy regarding the types of authorized investments that would ensure preservation of assets, only Certificates of Deposit and money market accounts are permitted. Management believes the Association is not exposed to a significant credit risk.

Custodial Credit Risk: Is the risk that the Association's deposits may not be returned in the event of bank failure. The Association maintains its deposits with a financial institution insured by Federal Deposit Insurance Corporation (FDIC) or by securities pledged at market. As of December 31, 2012, all of the bank balances were fully collateralized by FDIC insurance, or by securities pledged at market.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011**

NOTE 5 - DEPOSITS WITH FINANCIAL INSTITUTIONS (CONTINUED)

Concentration of Credit Risk: Is the risk of loss attributed to the magnitude of investment in a single issuer. Management does not believe the Association is exposed to a significant concentration of credit risk.

Cash balances on hand as of December 31, 2012, consisted of the following:

Customer deposit	\$ 3,691
Debt service	253,018
Operations and maintenance	15,674
Revenue	63,167
Construction	15,007
Expansion project	12,614
Escrow	635
Reserve	<u>156,623</u>
	<u>\$ 520,429</u>

NOTE 6 - COMMITMENTS AND CONTINGENCIES

The Association receives funding from Federal, State, and Local government agencies. These funds are to be used for designated purposes only. For government agency grants, if based on the grantor's review, the funds are considered not to have been used properly for the intended purpose, the grantors may request a refund of monies advanced, or refuse to reimburse the Association for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the Association's grant programs is predicated upon the grantor's satisfaction that the funds provided are being spent as intended and the grantor's intent to continue their program.

NOTE 7 - ECONOMIC DEPENDENCY

The Association has entered into agreement with the City of Brodhead, Kentucky, Southern Madison Water District, and City of Mount Vernon, Kentucky to purchase additional water sources to accommodate its continued demand from existing customers. If the supply of water from the City of Brodhead, Mount Vernon, or Southern Madison Water District was reduced, the Association would have a difficult time producing water and meeting the needs of its customers.

NOTE 8 - LONG-TERM DEBT

Long-term debt consists of obligations to the United States Department of Agriculture, Rural Development, collateralized by a first lien on the net revenues and a mortgage on the utility plant and water distribution system. The bonds are payable in annual scheduled installments of principal and interest.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011**

NOTE 8 - LONG-TERM DEBT (CONTINUED)

The outstanding balances as of December 31, 2012 are as follows:

<u>Original Purchase Date</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Principal Outstanding</u>
1/12/1976	2016	5.000%	\$ 76,200
5/15/1996	2036	4.500%	304,055
3/30/1999	2039	4.500%	635,788
1/19/2001	2041	3.250%	499,979
3/4/2004	2044	4.500%	386,284
11/14/2006	2046	4.375%	119,270
1/26/2010	2050	4.000%	575,000
			<u>\$ 2,596,576</u>

Principal payments on the loans over the next five years are estimated as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2013	\$ 106,314
2014	106,314
2015	106,314
2016	106,314
2017	106,314
Thereafter	<u>2,065,006</u>
	<u>\$2,596,576</u>

Notes Payable

Notes payable consists of a loan in the original amount of \$364,572 from Kentucky Infrastructure Authority. The interest rate is 2.95% over the term of the note. Principal and interest payments are made bi-annually. The maturity date is July 1, 2014. Notes payable also consists of a loan in the original amount of \$11,791.86 from Ford Credit. The interest rate is 10.29% over the term of the note. Principal and interest payments are made monthly. The maturity date is March 23, 2012. Notes payable consists of a loan in the amount of \$12,750 from Town and Country Motors, Inc. The interest rate is 7.5% over the term of the note. The maturity date is December 30, 2012. Notes payable consists of a loan for \$85,000 from Water Systems Management, Inc. in 30 equal payments of \$2,833.

WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011

NOTE 8 - LONG-TERM DEBT (CONTINUED)

Payments on the loans over the next five years are estimated as follows:

<u>Year</u>	<u>Total</u>
2013	\$ 23,101
2014	13,467
2015	-
2016	-
2017	-
<u>Thereafter</u>	<u>\$ 36,568</u>

Capital Leases

The Association has entered into various leasing agreements for equipment. The terms of these leases are such that the Board has capitalized the leases as required by the lease topic of FASB ASC. The obligations are reported in the Statement of Operations.

The following is a schedule of future minimum lease payments for \$491,845 of assets (all equipment assets) capitalized under lease agreements, and the net present value of future minimum lease payments as of December 31, 2012 are estimated as follows:

<u>Year</u>	<u>Amount</u>
2013	\$ 130,568
2014	130,568
2015	130,568
2016	51,997
2017	<u>-</u>
Total minimum lease payments	443,701
Less amount representing interest	<u>(29,613)</u>
Present value of future minimum lease payments	<u>\$ 473,314</u>

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011**

NOTE 8 - LONG-TERM DEBT (CONTINUED)

Capital Leases - Continued

The following is a schedule of future minimum lease payments for \$45,000 of assets (all equipment assets) capitalized under lease agreements, and the net present value of future minimum lease payments as of December 31, 2012 are estimated as follows:

<u>Year</u>	<u>Amount</u>
2013	\$ 13,169
2014	13,169
2015	11,118
2016	-
2017	-
Total minimum lease payments	37,456
Less amount representing interest	<u>(3,672)</u>
Present value of future minimum lease payments	<u>\$ 33,784</u>

NOTE 9 - RISK MANAGEMENT

The Association is exposed to a variety of accidental losses, and has attempted to minimize its risk by carrying commercial insurance. There have been no significant reductions in coverage from coverage in the prior year. Therefore, the Association maintains adequate insurance coverage.

NOTE 10 - OTHER COMMITMENTS AND CONTINGENCIES

In connection with the construction of additional water lines, the Association has received various grants. Terms of the grants include repayment of the grant funds in the event of the Association's default on its representations and warranties as specified in the grant agreements.

NOTE 11 - CONCENTRATION OF CREDIT RISK

The Association sells water to residential, agricultural, and commercial customers in much of rural Rockcastle County and parts of Lincoln, Garrard and other surrounding counties, and is subject to the credit risks associated with serving that agricultural based area.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011**

NOTE 12 - CHANGES IN CAPITAL ASSETS

The following is a summary of changes in the capital assets for the year ended December 31, 2012:

Changes in Capital Assets				
	Balance 12/31/2011	Additions	Retirements	Balance 12/31/2012
Capital Assets				
Building & Land	\$ 1,693,162	\$ -	\$ -	\$ 1,693,162
Equipment	345,182	5,101	-	350,283
Other water system assets	8,229,004	-	-	8,229,004
Office furniture & equipment	91,989	-	-	91,989
Total	\$ 10,359,337	\$ 5,101	\$ -	\$ 10,364,438
Changes in Depreciation				
	Balance 12/31/2011	Additions	Retirements	Balance 12/31/2012
Capital Assets				
Building & Land	\$ 465,559	\$ 43,358	\$ -	\$ 508,917
Equipment	289,409	10,266	-	299,675
Other water system assets	2,857,207	228,847	-	3,086,054
Office furniture & equipment	52,163	11,790	-	63,953
Total	\$ 3,664,338	\$ 294,261	\$ -	\$ 3,958,599
Total Capital Assets, Net				\$ 6,405,839

NOTE 13 - DATE OF MANAGEMENT'S REVIEW

Subsequent events were evaluated through April 10, 2013, which is the date the financial statements were available to be issued.

NOTE 14 - RECLASSIFICATION AND RESTATEMENTS

Certain reclassifications have been made to the December 31, 2011 information to make them comparable to December 31, 2012.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2012 AND 2011**

NOTE 15 - IMPLEMENTATION OF NEW GASB STANDARD

The Association has implemented GASB No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, for the year ending December 31, 2012. The standard established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of net position.

SAMMY K. LEE, P.S.C.
Certified Public Accountant

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Member of Kentucky Society of CPA's

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

To the Board of Directors
Western Rockcastle Water Association, Inc.
Mt. Vernon, Kentucky 40456

I 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 the business-type activities of the Western Rockcastle Water Association, Inc. as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Western Rockcastle Water Association, Inc.'s basic financial statements and have issued my report thereon dated April 10, 2013.

Internal Control over Financial Reporting

In planning and performing my audit of the financial statements, I considered Western Rockcastle 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 my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Western Rockcastle Water Association, Inc.'s internal control.

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

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified. I did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses that I consider to be significant deficiencies as findings 2012-01 and 2012-02.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Western Rockcastle Water Association, Inc.'s financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my test disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2012-03.

Western Rockcastle Water Association, Inc.'s Response to Findings

Western Rockcastle Water Association, Inc.'s responses to findings identified in my audit are described in the accompanying schedule of findings and responses. Western Rockcastle Water Association, Inc.'s responses were not subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly I do not express an opinion on it.

Purpose of this Report

This report is intended solely to describe the scope of my testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Association'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 Association's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sammy K. Lee, P.S.C.

Berea, Kentucky
April 10, 2013

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND RESPONSES
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Finding 2012-01 Internal Control Over Financial Statements

Criteria:

A key component of internal control is to ensure the responsibility of management to establish and maintain internal controls in the financial reporting system and for the fair presentation of the financial position, results of operations, cash flows, and disclosures in the financial statements, in conformity with Generally Accepted Accounting Principles in the United States of America (GAAP).

Condition:

While conducting my audit procedures to gain an understanding of internal controls over financial reporting, I noted the absence of internal control in the following areas:

- The Association's internal control system lacks certain controls with respect to segregation of duties.
- The Association's internal control system does not reliably and consistently produce adjustments to bring the accounting records into alignment with U.S. Generally Accepted Accounting Principles (GAAP).
- The Association does not have a system of internal controls that would enable management to conclude that the financial statements and the related disclosures are complete and presented in accordance with generally accepted accounting principles in the United States of America. As such, management requested us to assist in identifying adjustments to the accounting records and to prepare a draft of the financial statements, including the related footnote disclosures. The outsourcing of this service is not unusual in companies of your size and is a result of management's cost benefit decision to use our accounting expertise rather than to incur internal resource costs.

Cause:

Due to the small number of administrative and clerical employees at the Association, there is an inherent limitation in its ability to segregate custodial duties from recordkeeping duties and its ability to prepare financial statements in accordance with Generally Accepted Accounting Principles of the United States.

Effect:

The lack of internal controls increases the risk that an error, either intentional or unintentional, will go undetected and the financial statements will contain material misstatements.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Finding 2012-01 Internal Control Over Financial Statements (Continued)

Recommendation:

Specific recommendations are:

If possible office employees should be rotated daily from the cash collections process to the posting of receipts in the billing system process, to segregate duties as much as possible.

Management should review the adequacy of the financial statement disclosures by reviewing and approving a disclosure checklist I provide to you.

Management should review all supporting documentation and explanations for journal entries I propose and approve the entries.

Management should reconcile general ledger amounts to draft financial statements by maintaining worksheets to support balance sheets amounts.

Views of Responsible Officials:

The Association will strive to implement compensating controls and procedures to correct the deficiency as noted in the finding. We understand these limitations, and are responsible for any outcomes.

Finding 2012-02 Internal Control over Cash Receipts

Criteria:

A key component of internal control is to ensure the responsibility of management to establish and maintain internal controls. Such as no one employee should have access to both physical assets and the related accounting records.

Condition:

While conducting my audit procedures to gain an understanding of internal controls, I noted that the Association does not have adequate segregation of duties involving bank reconciliations, cash receipts, and deposits. Areas of concern are the ability for one individual to bill, collect bills, adjust customer accounts, and reconcile receipts, in addition to, performing monthly bank reconciliations and making deposits.

Cause:

Due to the lack of proper internal controls being implemented, the Association does not properly segregate duties.

Effect:

The lack of internal controls increases the risk that an error, either intentional or unintentional, will go undetected and the financial statements may contain material misstatements.

**WESTERN ROCKCASTLE WATER ASSOCIATION, INC.
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Finding 2012-02 Internal Control over Cash Receipts (Continued)

Recommendation:

I recommend that a different individual performs each of the following tasks: collecting bills, adjusting customer accounts, reconciling receipts, and performing monthly bank reconciliations.

Management Response:

Management concurs with recommendations and plans to implement proper internal controls.

Finding 2012-03 Non-Profit Status

Criteria:

A non-profit organization is required to file the form 1024 with the Internal Revenue Service and receive approval from the IRS to their non-profit status. This is done in addition to registering with the Kentucky Secretary of State as a non-profit organization. Non-profit organizations are required to file an annual tax return with the IRS, only governmental entities are exempt from filing an annual tax return.

Condition:

While conducting my audit procedures, I reviewed the Association's tax status; I found the Association was formed as a non-profit organization under the laws of the State of Kentucky. Non-profits are required to file an annual tax return with the IRS. No tax returns have been filed to date. In addition, I find the Association may have not filed the appropriate forms with the IRS exempting them from income tax as a legal non-profit organization, therefore, subjecting the Association to regular corporate income tax regulations.

Cause:

The Association was formed and registered with the state of Kentucky and never applied for or registered as a non-profit organization with the IRS.

Effect:

Due to the uncertain tax status of the Association, there is a potential material effect on the financial statements which is not reflected in the financial statements, only disclosed in the notes to the financial statements.

Recommendation:

I recommend the Association seek legal advice.

Management Response:

Management concurs with recommendations and plans to handle the matter.