

**EAST PENDLETON COUNTY
WATER DISTRICT
Falmouth, Kentucky**

**FINANCIAL STATEMENTS
December 31, 2013 and 2012**

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
East Pendleton County Water District
Falmouth, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the East Pendleton County Water District (the District) as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the District'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 internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 auditors' 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the East Pendleton County Water District, as of December 31, 2013 and 2012, and the respective changes in financial position, and 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

Management has omitted the Management Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with **Government Auditing Standards**, we have also issued our report dated March 25, 2014, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 the District's internal control over financial reporting and compliance.

Ray, Foley, Hensley & Company

Ray, Foley, Hensley & Company, PLLC

March 25, 2014

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENTS OF NET POSITION
December 31,

ASSETS	2013	2012
Current assets		
Cash	\$ 106,235	\$ 127,404
Accounts receivable customers, net	79,174	63,773
Grant receivable	35,000	-
Inventory	<u>16,874</u>	<u>15,991</u>
Total current assets	<u>237,283</u>	<u>207,168</u>
Restricted assets		
Cash	218,680	227,367
Cash - construction	163,313	184,959
Certificates of deposit	<u>251,224</u>	<u>249,401</u>
Total restricted assets	<u>633,217</u>	<u>661,727</u>
Capital assets		
Property, plant and equipment- Water	6,935,886	6,692,351
Less: accumulated depreciation- Water	(3,087,622)	(2,977,582)
Property, plant and equipment- Sewer	34,952	34,952
Less: accumulated depreciation- Sewer	(25,875)	(24,463)
Construction in progress	<u>44,010</u>	<u>-</u>
Total capital assets	<u>3,901,351</u>	<u>3,725,258</u>
Total assets	<u>\$ 4,771,851</u>	<u>\$ 4,594,153</u>
LIABILITIES AND NET POSITION		
Current liabilities		
Accounts payable	\$ 267,934	\$ 34,405
Taxes payable	3,875	3,712
Customer deposits	34,095	31,440
Accrued interest payable	18,760	19,768
Current portion of debt	<u>66,300</u>	<u>61,100</u>
Total current liabilities	<u>390,964</u>	<u>150,425</u>
Long-term debt		
KIA note payable	37,500	52,500
Bonds payable, net	<u>1,259,300</u>	<u>1,310,600</u>
Total long-term debt	<u>1,296,800</u>	<u>1,363,100</u>
Net position		
Net investment in capital assets	2,538,251	2,301,058
Restricted for debt service	243,291	251,216
Restricted for depreciation	226,613	225,367
Unrestricted	<u>75,932</u>	<u>302,987</u>
Total net position	<u>3,084,087</u>	<u>3,080,628</u>
Total liabilities and net position	<u>\$ 4,771,851</u>	<u>\$ 4,594,153</u>

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

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
for the years ended December 31,

	2013	2012
OPERATING INCOME		
Water sales	\$ 864,198	\$ 857,656
Sewer sales	20,212	21,478
Other revenue	<u>25,578</u>	<u>25,468</u>
 Total operating income	 <u>909,988</u>	 <u>904,602</u>
OPERATING EXPENSES		
Water purchases	216,876	217,013
Pumping	26,988	34,095
Operation	216,789	234,490
Maintenance	6,255	14,596
General and administrative	330,545	319,769
Sewer expenses	<u>15,523</u>	<u>5,128</u>
 Total operating expense	 <u>812,976</u>	 <u>825,091</u>
 Operating income before depreciation	 97,012	 79,511
 Depreciation expense	 <u>(111,452)</u>	 <u>(172,235)</u>
OPERATING (LOSS)	(14,440)	(92,724)
Non-operating income (expenses)		
Interest income	2,942	2,449
Gain on asset disposition	-	2,000
Interest expense related to debt	<u>(67,052)</u>	<u>(69,159)</u>
(LOSS) BEFORE CAPITAL CONTRIBUTIONS	(78,550)	(157,434)
Capital contributions		
Grants	52,968	8,791
Tap fees	<u>29,041</u>	<u>18,102</u>
 Change in net position	 3,459	 (130,541)
 Net position, beginning of year, restated	 <u>3,080,628</u>	 <u>3,211,169</u>
NET POSITION, END OF YEAR	<u><u>\$ 3,084,087</u></u>	<u><u>\$ 3,080,628</u></u>

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

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
for the years ended December 31,

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 859,587	\$ 903,009
Payments to suppliers	(133,886)	(370,924)
Payments for employee services and benefits	(444,634)	(449,198)
	<u>281,067</u>	<u>82,887</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Retirement of note principal	(61,100)	(58,400)
Interest paid	(67,052)	(69,159)
Proceeds from sale of fixed assets	-	2,000
Purchase of fixed assets	(287,545)	(28,191)
Tap fee	29,041	18,102
Grant proceeds	52,968	8,791
	<u>(333,688)</u>	<u>(126,857)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in certificates of deposit	(1,823)	(2,052)
Interest income	2,942	2,449
	<u>1,119</u>	<u>397</u>
NET (DECREASE) IN CASH	(51,502)	(43,573)
Cash, beginning of year	<u>539,730</u>	<u>583,303</u>
CASH, END OF YEAR	<u><u>\$ 488,228</u></u>	<u><u>\$ 539,730</u></u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating (loss)	\$ (14,440)	\$ (92,724)
Noncash items included in operating income		
Depreciation	111,452	172,235
Changes in assets and liabilities		
(Increase) decrease in accounts receivables	(15,401)	(1,593)
(Increase) decrease in other receivables	(35,000)	-
(Increase) decrease in inventory	(883)	(263)
Increase (decrease) in accounts payable	233,529	5,095
Increase (decrease) in other payables	(845)	(588)
Increase (decrease) in customer deposits	2,655	725
	<u>281,067</u>	<u>82,887</u>
Net cash provided by operating activities	<u><u>\$ 281,067</u></u>	<u><u>\$ 82,887</u></u>

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

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

1. ORGANIZATION AND ACCOUNTING POLICIES

The East Pendleton County Water District (the District) was created and organized as a public body corporate in Pendleton County, Kentucky, pursuant to Chapter 74 of the Kentucky Revised Statutes, by the Pendleton Fiscal Court to operate a water distribution system.

Reporting Entity

The East Pendleton County Water District's financial statements include the operations of all entities for which the District exercises oversight responsibility. Oversight responsibility includes, but is not limited to, financial interdependency, selection of the governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters. The only entity included in the financial statements is the general operations of the District.

There are no other entities that are subject to the District's oversight responsibility as indicated above.

Basis of Accounting

The District's financial statements are presented in conformity with the provisions of GASB Statement No. 34, ***Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments***.

The net position of the District is classified into three categories; net investment in capital assets, restricted and unrestricted. The restricted net assets consist of reserves for bond retirement and depreciation costs relating to the construction, replacement, extension, additions and/or improvements to the system in addition to customer deposits. These reserves are discussed in Note 3.

When both restricted and unrestricted resources are available for use, the District's Board of Commissioners makes a determination as to which resource should be used first.

The District applies all applicable financial FASB and AICPA pronouncements issued on or before November 30, 1989 that are not in conflict with applicable GASB pronouncements.

The accrual basis of accounting is utilized by the District. Under this method, revenues are recognized when earned and expenses are recognized when incurred.

The District reports all revenues and expenses as operating, except interest income, interest expense, amortization, gains and losses on disposal of assets, and capital contributions.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the District defines cash as cash on hand, cash in bank, money market funds in both unrestricted and restricted accounts, and certificates of deposit with an initial maturity of less than 90 days.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

1. ORGANIZATION AND ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable

The District's accounts receivable reserve represents its estimate of all uncollectible accounts. The reserve for both 2013 and 2012 totaled \$3,500.

Inventory

The District's inventory is composed of chemicals, equipment and supply-type items used for routine maintenance, repairs and new water lines. The inventory is stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment

Fixed assets are recorded at cost. Depreciation has been provided using the straight-line method over the estimated useful life of the asset, which ranges from 7 - 62.5 years. Land and land rights are not subject to depreciation. Interest costs during construction of fixed assets are capitalized as a part of the cost.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Management's Review of Subsequent Events

The District has evaluated and considered the need to recognize or disclose subsequent events through March 25, 2014, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the year ended December 31, 2013, have not been evaluated by the District.

2. CASH AND INVESTMENTS

The District's deposits and investments at December 31, 2013 were entirely covered by Federal Depository Insurance or by collateral held by the custodial banks in the District's name.

Under Kentucky Revised Statute 66.480 the District is allowed to invest in obligations of the U.S. Treasury and U.S. agencies, obligations of the Commonwealth of Kentucky and its agencies, insured savings and loans, or interest bearing deposits of insured national or state banks.

The table presented below is designed to disclose the level of custody credit risk assumed by the District, based upon how its deposits were insured or secured with collateral at December 31, 2013. The categories of credit risk are defined as follows:

- (1) Insured or registered, or securities held by the government or its agent in the government's name.
- (2) Uninsured and unregistered, with securities held by the counterpart's trust department or agent in the government's name.
- (3) Uninsured and unregistered, with securities held by the counterpart or by its trust department or agent but not in the government's name.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

2. CASH AND INVESTMENTS (CONTINUED)

Type of Deposit	Category			Total Bank Amount	Total Carrying Amount
	1	2	3		
Cash	\$ 489,833	\$ -	\$ -	\$ 489,833	\$ 488,228
Certificates of deposit	<u>251,224</u>	<u>-</u>	<u>-</u>	<u>251,224</u>	<u>251,224</u>
	<u>\$ 741,057</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 741,057</u>	<u>\$ 739,452</u>

The Statement of Cash Flows includes the following cash balances as shown on the Statements of Net Position:

	2013	2012
Cash	\$ 106,235	\$ 127,404
Restricted cash	218,680	227,367
Construction	<u>163,313</u>	<u>184,959</u>
	<u>\$ 488,228</u>	<u>\$ 539,730</u>

3. CAPITAL ASSETS

The following is a summary of capital asset activity during the year:

	Balance 12/31/2012	Additions	Disposals	Balance 12/31/2013
Capital assets not depreciated:				
Organizational costs	\$ 7,200	\$ -	\$ -	\$ 7,200
Water land	16,157	-	-	16,157
Sewer land	1,168	-	-	1,168
Construction in progress	<u>-</u>	<u>44,010</u>	<u>-</u>	<u>44,010</u>
Totals	<u>24,525</u>	<u>44,010</u>	<u>-</u>	<u>68,535</u>
Capital assets being depreciated:				
Water property and equipment	6,668,994	243,535	-	6,912,529
Sewer property and equipment	<u>33,784</u>	<u>-</u>	<u>-</u>	<u>33,784</u>
Totals	6,702,778	243,535	-	6,946,313
Less: accumulated depreciation	<u>3,002,045</u>	<u>111,452</u>	<u>-</u>	<u>3,113,497</u>
Net depreciable assets	<u>3,700,733</u>	<u>132,083</u>	<u>-</u>	<u>3,832,816</u>
Total capital assets, net	<u>\$ 3,725,258</u>	<u>\$ 176,093</u>	<u>\$ -</u>	<u>\$ 3,901,351</u>

Depreciation expense totaled \$111,452 and \$172,235, for the years ended December 31, 2013 and 2012, respectively.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

4. COMPLIANCE WITH BOND RESOLUTION

The bond resolution requires the District to maintain certain reserves as follows:

Reserve Fund – This reserve is to receive a monthly transfer of \$483 until a balance of \$58,000 is accumulated for all bond issues. In addition, this reserve is to receive all proceeds collected from potential customers to aid construction of extensions and any property damage insurance proceeds. Funds may be used only for the purpose of paying the cost of unusual or extraordinary maintenance and repairs not included in the budget and cost of constructing extensions or improvements to the system. The Reserve Fund balance totaled \$226,613 and \$225,367 at December 31, 2013 and 2012, respectively.

Bond and Interest Sinking Fund – This reserve is to receive a monthly transfer of 1/12 of the next interest due and 1/12 of the next principal due. In addition, this reserve is to receive any excess revenues at the close of each year after provision of anticipated operating expenses for a two-month period. This reserve can only be used to pay debt service on the bond issues. The Bond and Interest Sinking Fund balances totaled \$243,291 and \$251,216 at December 31, 2013 and 2012, respectively.

5. LONG-TERM DEBT

The following is a summary of the bonds and notes outstanding for the district for the years ended December 31:

Bonds and Notes	2013	2012
Refunding Revenue Bond, series 1998 - \$1,015,000, dated 8/01/98 with payments through 2025, bearing interest at rates from 4.2% to at 5.3%.	\$ 625,000	\$ 660,000
Kentucky Infrastructure Authority Loan - \$244,590 and restructured to \$155,000, dated 4/28/98 and restructured 08/01/04 with payments through 2017, bearing interest at rates from 3.1% - 5.25%.	52,500	67,500
USDA, Rural Development Bond – \$479,000, dated 4/10/02 with payments through 2042, bearing interest at a rate of 4.75%.	416,000	423,000
USDA, Rural Development Bond – \$195,000, dated 2/22/07 with payments through 2042, bearing interest at a rate of 4.125%.	178,200	180,900
USDA, Rural Development Bond – \$100,000, dated 2/22/07 with payments through 2044, bearing interest at a rate of 4.125%.	<u>91,400</u>	<u>92,800</u>
	1,363,100	1,424,200
Less: current portion of debt	<u>(66,300)</u>	<u>(61,100)</u>
Long-term debt	<u>\$ 1,296,800</u>	<u>\$ 1,363,100</u>

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

5. LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize all notes and leases outstanding as of December 31, 2013 are as follows:

Year Ending December 31,	Principle	Interest	Payment
2014	\$ 66,300	\$ 64,596	\$ 130,896
2015	67,500	61,388	128,888
2016	72,700	57,084	129,784
2017	65,300	53,909	119,209
2018	64,100	51,710	115,810
2019-2023	359,900	210,879	570,779
2024-2028	225,500	125,231	350,731
2029-2033	127,900	90,059	217,959
2034-2038	162,300	57,538	219,838
2039-2043	135,100	18,786	153,886
2044	<u>16,500</u>	<u>709</u>	<u>17,209</u>
	<u>\$ 1,363,100</u>	<u>\$ 791,889</u>	<u>\$ 2,154,989</u>

The following is a summary of changes in long-term debt:

	December 31, 2012	Additions	Retirements	December 31, 2013	Due Within One Year
Long-term debt	<u>\$ 1,424,200</u>	<u>\$ -</u>	<u>\$ (61,100)</u>	<u>\$ 1,363,100</u>	<u>\$ 66,300</u>

KIA Note

In January 2014, the District entered into a debt agreement with the Kentucky Infrastructure Authority in the amount of \$160,000. The terms of the note are 20 years, bearing interest at a rate of 2.75% for the life of the note, with the first payment due in 2014.

6. RETIREMENT PLAN

The East Pendleton County Water District is a participating employer of the County Employees' Retirement System (CERS). Under the provisions of Kentucky Revised Statute 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS.

The plan issues separate financial statements which may be obtained by request from Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, Kentucky 40601.

Plan Description – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of state legislature.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

6. RETIREMENT PLAN (CONTINUED)

Contributions – For the year ended December 31, 2013, plan members were required to contribute 5.00% of wages for non-hazardous job classifications. Employees hired after September 2008 are required to contribute an additional 1% to cover the cost of medical insurance that is proved through CERS. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contributions rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended December 31, 2013, participating employers contributed 19.55% through June 30 and 18.89% thereafter, of each non-hazardous employee's wages, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

The required contribution (employee and employer combined) and the actual percentage contributed for the District for the current and previous two years are as follows:

Year	Required Contribution	Percentage Contributed
2013	\$ 71,785	100%
2012	\$ 71,929	100%
2011	\$ 67,176	100%

7. RISK MANAGEMENT

The District 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. In addition to its general liability insurance, the District also carries commercial insurance for all other risks of loss such as worker's compensation and employee health and accident coverage. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

8. RESTATEMENT OF NET POSITION

The beginning net position has been restated to expense prior year bond issue cost. Effective for the year ending December 31, 2013, GASB Statement No. 65, requires recognizing bond issue costs as a current period expense. Prior guidance recognized the bond issue costs as an asset, which was systematically amortized over the life of the debt. GASB Statement No. 65 was applied retroactively. A reconciliation of the prior period ending net position to the current year beginning net position is as follows:

Beginning net position, 2012	\$ 3,253,130
Adjustment to amortization expense	(3,325)
Adjustment of remaining bond issue costs	<u>(38,636)</u>
Beginning net position, as restated, 2012	<u>\$ 3,211,169</u>

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

9. RECLASSIFICATIONS

Certain items in the financial statements have been reclassified in the prior year to match the current year presentation. The reclassification does not have any effect on previously reported change in cash.

10. SUBSEQUENT EVENT

Financial Reporting for Pension Plans

In June 2012, the GASB approved a pair of related Statements that reflect substantial improvements to the accounting and financial reporting of pensions by state and local governments and pension plans. Statement No. 67, Financial Reporting for Pension Plans, addresses financial reporting for state and local government pension plans.

The guidance contained in these Statements will change how governments calculate and report the costs and obligations associated with pensions in important ways. It is designed to improve the decision - usefulness of reported pension information and to increase the transparency, consistency, and comparability of pension information across governments. Under the pension standards now in effect, cost-sharing employers have not been required to present actuarial information about pensions. Instead, information has been required to be presented in the pension plan's own financial statements for all of the participating governments combined.

Through its research, the GASB concluded that the needs of users of information regarding cost-sharing employers do not differ significantly from those interested in single and agent employers. Therefore, the GASB believes it is important to give users of the financial statements of cost-sharing employers access to better, more transparent financial information. Consequently, under the new standards the GASB is requiring that cost-sharing governments report a net pension liability, pension expense, and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan.

Statement No. 67 will take effect for pension plans in fiscal years beginning after June 15, 2013, (that is, for years ended June 30, 2014, or later). The District is currently evaluating the effects of this statement on its financial statements. The potential liability for the year ending December 31, 2014, is not currently estimable.



Certified Public Accountants and Consultants

**INDEPENDENT AUDITORS' 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 Commissioners
East Pendleton County Water District
Falmouth, Kentucky

We have audited, in accordance with the 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 East Pendleton County Water District (the District), as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated March 25, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness (2013-1).

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 to those charged with governance.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the East Pendleton County Water District'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 or other matters that are required to be reported under **Government Auditing Standards**.

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 results 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.

Ray, Foley, Hensley & Company

Ray, Foley, Hensley & Company, PLLC
March 25, 2014

**EAST PENDLETON COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
DECEMBER 31, 2013**

FINDING 2013-1 (recurring)

The District is required to have internal controls in place that enable it to prepare complete financial statements, including note disclosures, in compliance with generally accepted accounting principles.

The District lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures.

Management engaged the auditor to prepare draft financial statements, including the related notes to the financial statements. Management reviewed, approved and accepted responsibility for the financial statements prior to their issuance.

We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements and ensure compliance with generally accepted accounting principles.

RESPONSE:

This is an ongoing finding. Management has determined that it is more cost effective to continue to engage the auditor to draft the financial statements and related notes.