

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

**FINANCIAL STATEMENTS
December 31, 2014 and 2013**

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Ray, Foley, Hensley & Company, PLLC

Certified Public Accountants and Consultants

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, 2014 and 2013, 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, 2014 and 2013, 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 20, 2015, 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 20, 2015

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

	2014	2013
OPERATING INCOME		
Water sales	\$ 1,085,105	\$ 864,198
Sewer sales	20,542	20,212
Other revenue	<u>30,787</u>	<u>25,578</u>
 Total operating income	 <u>1,136,434</u>	 <u>909,988</u>
OPERATING EXPENSES		
Water purchases	217,868	216,876
Pumping	33,590	26,988
Operation	233,609	216,789
Maintenance	8,543	6,255
General and administrative	324,092	330,545
Sewer expenses	<u>15,232</u>	<u>15,523</u>
 Total operating expense	 <u>832,934</u>	 <u>812,976</u>
 Operating income before depreciation	 303,500	 97,012
Depreciation expense	<u>(107,194)</u>	<u>(111,452)</u>
OPERATING INCOME (LOSS)	196,306	(14,440)
Non-operating income (expenses)		
Interest income	2,621	2,942
Interest expense related to debt	<u>(68,180)</u>	<u>(67,052)</u>
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS	130,747	(78,550)
Capital contributions		
Grants	32,207	52,968
Tap fees	<u>16,860</u>	<u>29,041</u>
Change in net position	179,814	3,459
Net position, beginning of year	<u>3,084,087</u>	<u>3,080,628</u>
NET POSITION, END OF YEAR	<u>\$ 3,263,901</u>	<u>\$ 3,084,087</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,**

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 1,172,856	\$ 859,587
Payments to suppliers	(626,167)	(133,886)
Payments for employee services and benefits	<u>(445,133)</u>	<u>(444,634)</u>
Net cash provided by operating activities	<u>101,556</u>	<u>281,067</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Retirement of note principal	(73,396)	(61,100)
Interest paid	(69,120)	(67,052)
Proceeds from issuance of note	160,000	-
Purchase of fixed assets	(82,256)	(287,545)
Tap fees	16,860	29,041
Grant proceeds	<u>32,207</u>	<u>52,968</u>
Net cash (used in) capital and related financing activities	<u>(15,705)</u>	<u>(333,688)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in certificates of deposit	(1,945)	(1,823)
Interest income	<u>2,621</u>	<u>2,942</u>
Net cash provided by investing activities	<u>676</u>	<u>1,119</u>
NET INCREASE (DECREASE) IN CASH	86,527	(51,502)
Cash, beginning of year	<u>488,228</u>	<u>539,730</u>
CASH, END OF YEAR	<u>\$ 574,755</u>	<u>\$ 488,228</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 196,306	\$ (14,440)
Noncash items included in operating income		
Depreciation	107,194	111,452
Changes in assets and liabilities		
(Increase) decrease in accounts receivables	1,422	(15,401)
(Increase) decrease in other receivables	35,000	(35,000)
(Increase) decrease in inventory	(1,826)	(883)
Increase (decrease) in accounts payable	(238,066)	233,529
Increase (decrease) in other payables	256	(845)
Increase (decrease) in customer deposits	<u>1,270</u>	<u>2,655</u>
Net cash provided by operating activities	<u>\$ 101,556</u>	<u>\$ 281,067</u>

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

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

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 County 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.

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

Basis of Accounting

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 5.

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 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.

Accounts Receivable

The District's accounts receivable reserve represents its estimate of all uncollectible accounts. The reserve for both 2014 and 2013 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.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

1. ORGANIZATION AND ACCOUNTING POLICIES (CONTINUED)

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 20, 2015, 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, 2014, have not been evaluated by the District.

2. CASH AND INVESTMENTS

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.

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. In order to anticipate market changes and provide a level of security for all funds, the collateralization level shall be one hundred percent of the market value of the principal, plus accrued interest.

The District's deposits and investments at December 31, 2014 were entirely covered by Federal Depository Insurance or by collateral held by the custodial banks in the District's name.

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, 2014. The categories of credit risk are defined as follows:

- (1) Insured or collateralized with securities held by the government or by its agent in the government's name.
- (2) Collateralized with securities held by the pledging financial institution's trust department or agent in the government's name.
- (3) Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution, 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, 2014 and 2013**

2. CASH AND INVESTMENTS (CONTINUED)

Type of Deposit	Category			Total Bank Amount	Total Carrying Amount
	1	2	3		
Cash	\$ 578,211	\$ -	\$ -	\$ 578,211	\$ 574,755
Certificates of deposit	<u>253,169</u>	<u>-</u>	<u>-</u>	<u>253,169</u>	<u>253,169</u>
	<u>\$ 831,380</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 831,380</u>	<u>\$ 827,924</u>

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

	2014	2013
Cash	\$ 208,124	\$ 106,235
Restricted cash	268,496	218,680
Construction	<u>98,135</u>	<u>163,313</u>
	<u>\$ 574,755</u>	<u>\$ 488,228</u>

3. CAPITAL ASSETS

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

	Balance 12/31/2013	Additions	Disposals	Balance 12/31/2014
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>44,010</u>	<u>-</u>	<u>44,010</u>	<u>-</u>
Totals	<u>68,535</u>	<u>-</u>	<u>44,010</u>	<u>24,525</u>
Capital assets being depreciated:				
Water property and equipment	6,912,529	126,266	-	7,038,795
Sewer property and equipment	<u>33,784</u>	<u>-</u>	<u>-</u>	<u>33,784</u>
Totals	6,946,313	126,266	-	7,072,579
Less: accumulated depreciation	<u>3,113,497</u>	<u>107,194</u>	<u>-</u>	<u>3,220,691</u>
Net depreciable assets	<u>3,832,816</u>	<u>19,072</u>	<u>-</u>	<u>3,851,888</u>
Total capital assets, net	<u>\$ 3,901,351</u>	<u>\$ 19,072</u>	<u>\$ 44,010</u>	<u>\$ 3,876,413</u>

Depreciation expense totaled \$107,194 and \$111,452, for the years ended December 31, 2014 and 2013, respectively.

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013**

4. 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	2014	2013
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%.	\$ 585,000	\$ 625,000
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%.	37,500	52,500
USDA, Rural Development Bond – \$479,000, dated 4/10/02 with payments through 2042, bearing interest at a rate of 4.75%.	408,000	416,000
USDA, Rural Development Bond – \$195,000, dated 2/22/07 with payments through 2042, bearing interest at a rate of 4.125%.	175,300	178,200
USDA, Rural Development Bond – \$100,000, dated 2/22/07 with payments through 2044, bearing interest at a rate of 4.125%.	90,000	91,400
Kentucky Infrastructure Authority Loan - \$160,000, dated 4/22/2014 with payments through 2033, bearing interest at 2.75%.	<u>153,904</u>	<u>-</u>
	1,449,704	1,363,100
Less: current portion of debt	<u>(73,765)</u>	<u>(66,300)</u>
Long-term debt	<u>\$ 1,375,939</u>	<u>\$ 1,296,800</u>

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013**

4. LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize all bonds and notes outstanding as of December 31, 2014 are as follows:

Year Ending December 31,	Principle	Interest	Payment
2015	\$ 73,765	\$ 65,577	\$ 139,342
2016	79,138	61,100	140,238
2017	71,917	57,747	129,664
2018	70,900	55,365	126,265
2019	71,288	52,184	123,472
2020-2024	412,050	207,821	619,871
2025-2029	213,504	122,930	336,434
2030-2034	174,242	86,611	260,853
2035-2039	169,600	50,147	219,747
2040-2044	<u>113,300</u>	<u>12,535</u>	<u>125,835</u>
	<u>\$ 1,449,704</u>	<u>\$ 772,017</u>	<u>\$ 2,221,721</u>

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

	December 31, 2013	Additions	Retirements	December 31, 2014	Due Within One Year
Long-term debt	<u>\$ 1,363,100</u>	<u>\$ 160,000</u>	<u>\$ (73,396)</u>	<u>\$ 1,449,704</u>	<u>\$ 73,765</u>

5. COMPLIANCE WITH BOND RESOLUTIONS

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 insurance proceeds from property damage. 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 \$227,387 and \$226,613 at December 31, 2014 and 2013, 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 \$293,878 and \$243,291 at December 31, 2014 and 2013, respectively.

Maintenance and Replacement Reserve – This reserve is to receive an amount equal to ten percent of the amount of loan payments until the amount on deposit is equal to five percent of the original principal amount of the loan. Funds may be used for extraordinary maintenance expenses related to the water tank painting project or for the costs of replacing worn or obsolete portions of the project. At December 31, 2014 the required balance in this reserve was \$400, and the Maintenance and Replacement Reserve totaled \$400.

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013**

6. LEASE COMMITMENTS

The District leases office equipment under a non-cancellable operating lease agreement. Rental expense for the years ended December 31, 2014 and 2013 was \$1,614 and \$1,575, respectively. Future minimum lease payments including applicable taxes and fees for operating leases at December 31, 2014 are as follows:

December 31,	
2015	\$ 1,546
2016	1,546
2017	<u>258</u>
Total lease payments	<u>\$ 3,349</u>

7. 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.

Contributions – For the year ended December 31, 2014, 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 contribution rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended December 31, 2014, participating employers contributed 18.89% through June 30 and 17.67% 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
2014	\$ 70,395	100%
2013	\$ 71,785	100%
2012	\$ 71,929	100%

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

8. 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.

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. GASB 68

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. Statement No. 68, Accounting and Financial Reporting for Pensions, addresses financial reporting for state and local government employers whose employees are provided with pensions through pension plans that are covered under statement No. 67.

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. 68 will take effect for pension plans in fiscal years beginning after June 15, 2014, (that is, for years ended June 30, 2015, or later). The District is currently evaluating the effects of this statement on its financial statements. The District's potential unfunded liability based on June 30, 2014 plan financial statements, is estimated to be approximately \$568,000. The actual liability for December 31, 2015, could be considerably different due to changes in system assumptions and liabilities.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2014 and 2013

11. SUBSEQUENT EVENT

On October 14, 2014, the District authorized the sale of \$895,000 of Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds, Series 2015B.

The Series 2015B Bonds are being issued for the purposes of refunding, redeeming and discharging the District's Waterworks Refunding Revenue Bonds, Series 1998 and Series 2001.

The Series 2015B Bonds were delivered on February 19, 2015.



Ray, Foley, Hensley & Company, PLLC

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, 2014, 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 20, 2015.

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 (2014-001).

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 20, 2015

**EAST PENDLETON COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
DECEMBER 31, 2014**

FINDING 2014-001 (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.