

PENDLETON COUNTY WATER DISTRICT

P.O. BOX 232, FALMOUTH, KY 41040 (859) 654-6964 FAX (859) 654-7032
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May 20, 2014

RECEIVED

MAY 21 2014

PUBLIC SERVICE
COMMISSION

Public Service Commission
P.O. Box 615
Frankfort, KY 40602

RE: 2013 Audit Report

To Whom It May Concern:

Please find enclosed a copy of our 2013 Audit Report.

If you have any questions, please feel free to contact me.

Sincerely,



William Jones
Manager

WJ/cbw

EQUAL OPPORTUNITY PROVIDER

PENDLETON COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

For the Years Ended December 31, 2013 and 2012



Van Gorder, Walker & Co., Inc.
Certified Public Accountants

PENDLETON COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

For the Years Ended December 31, 2013 and 2012

PENDLETON COUNTY WATER DISTRICT

FINANCIAL STATEMENTS

December 31, 2013 and 2012

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PENDLETON COUNTY WATER DISTRICT

BOARD OF COMMISSIONERS

December 31, 2013 and 2012

L.R. Faulkner, Jr., Chairman

Dave Boden, Vice-Chairman

Brent Moore, Treasurer

Larry "Rick" Adams, Secretary

Joe Strange, Commissioner

Of Counsel

Jeff Dean, Pendleton County Attorney

Administration

William Jones, General Manager



Van Gorder, Walker & Co., Inc.
Certified Public Accountants

Charles A. Van Gorder, CPA
John P. Walker, CPA, MBA
Lori A. Owen, CPA
John R. Chamberlin, CPA, MBA
Members of AICPA & KyCPA
Licensed in Kentucky & Ohio

Independent Auditor's Report

To the Board of Commissioners
Pendleton County Water District

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Pendleton County Water District (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.

-Auditor's 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

-Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of 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

Accounting principles generally accepted in the United States of America require that the *Management's Discussion and Analysis* on pages 5–9 be presented to supplement the basic financial statements. Such 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. We 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 we obtained during our audits of the basic financial statements. We 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 Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise Pendleton County Water District's basic financial statements. The supplementary schedules on page 24 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplemental schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2014 on our consideration of Pendleton County Water 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 Pendleton County Water District's internal control over financial reporting and compliance.



Van Gorder, Walker & Co., Inc.
Erlanger, Kentucky
April 14, 2014

PENDLETON COUNTY WATER DISTRICT

P.O. BOX 232, FALMOUTH, KY 41040 (859) 654-6964 FAX (859) 654-7032
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Our discussion and analysis of the District's financial performance provides an overview of the District's financial activities for the year ended December 31, 2013. The information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The assets of the District exceeded its liabilities at the close of the most recent year by \$8,722,896 (net position). This was an increase of \$201,346 in comparison to the prior year. The change is mainly attributable to an increase in water revenue as a result of a rate increase and an increase in contributed capital from a grant and the expiration of an obligation to refund tap fees on the Pendleton Acres development.
- At the end of the current year, unrestricted net position was \$1,377,145.

USING THIS ANNUAL REPORT

The financial statements presented herein include all of the activities of the District as prescribed in GASB Statements No. 34. The financial statements include a statement of net position, statement of revenues, expenses and changes in net position and statement of cash flows, notes to the financial statements and a supplemental schedule. These statements show the condition of the District's finances and the sources of income and the funds expended.

Basis of Accounting

The District's financial statements are prepared using the accrual basis of accounting.

The Statements of Net Position and Revenues, Expenses and Changes in Net Position

In the Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position, we report the District's activities.

- The District charges rates for water consumption to customers to cover all or most of the cost of certain services it provides.

SUMMARY OF NET POSITION

Table 1 provides a summary of the District's net position at December 31, 2013 and 2012.

**Table 1
Net Position**

	<u>2013</u>	(Restated) <u>2012</u>
Current Assets	\$ 406,931	\$ 361,177
Restricted Assets	1,368,434	1,240,950
Noncurrent Assets	<u>8,853,694</u>	<u>8,944,358</u>
Total Assets	<u>10,629,059</u>	<u>10,546,485</u>
Current Liabilities	111,783	179,845
Liabilities Payable from Restricted Assets	119,345	116,590
Long Term Liabilities	<u>1,675,035</u>	<u>1,728,500</u>
Total Liabilities	<u>1,906,163</u>	<u>2,024,935</u>
Net Position:		
Invested in Capital Assets, Net of Related Debt	7,116,659	7,060,070
Restricted	229,092	223,000
Unrestricted	<u>1,377,145</u>	<u>1,238,480</u>
Total Net Position	<u>\$ 8,722,896</u>	<u>\$ 8,521,550</u>

The District's net position for 2013 increased 2.4% or \$201,346 as compared to a .14% or \$12,195 increase in the previous year. This increase is primarily due to an increase in water sales and contributed capital.

The largest portion of the District's net position (81.5%) reflects its investment in capital assets (e.g. land, buildings, infrastructure, machinery and equipment), less any related debt used to acquire those assets still outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investments in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate the debt.

An additional portion of the District's net position (2.6%) is considered to be restricted. This amount represents resources that are subject to external restrictions on how they may be used.

The unrestricted net position may be used to meet the District's ongoing obligations to customers and creditors.

SUMMARY OF CHANGES IN NET POSITION

Revenues

Water revenues increased 5.9% from 2012 to 2013. The increase was a result of a rate increase that went into effect with the May billing for April 2013 water usage.

Water Costs

Water costs increased \$3,250 or .8% from 2012 to 2013. Water consumption remained approximately the same in 2013 as it was in 2012 so water costs did not vary much between years.

Operation and Maintenance Expense

Operation and maintenance expense increased \$15,545 or 2.5% from 2012 to 2013. This increase was primarily due to increases in employee salaries and benefits.

Investment Income

Investment income decreased \$1,809 from 2012 to 2013. This number reflects the decrease in interest rates at financial institutions.

Capital Contributions

Capital contributions increased \$137,371 from 2012 to 2013. The obligation to refund tap fees for the Pendleton Acres development expired in 2013 and the remaining balance of \$99,288 was recognized as income. Also the District received a grant from the Pendleton County Airport Board for a water line project

The following schedule compares the revenues and expenses for the current year and the previous year.

Table 2
Changes in Net Position

	<u>2013</u>	(Restated) <u>2012</u>
Operating Revenues:		
Water Sales	\$1,293,773	\$1,212,467
Forfeited Discounts	24,140	21,992
Miscellaneous Services Revenues	22,182	31,074
Total Operating Revenues	<u>1,340,095</u>	<u>1,265,533</u>
Operating Expenses:		
Water Purchased	390,515	387,265
Operation and Maintenance Expense	639,203	623,658
Depreciation	221,788	221,979
Total Operating Expenses	<u>1,251,506</u>	<u>1,232,902</u>
Net Operating Profit/(Loss)	<u>88,589</u>	<u>32,631</u>
Non-Operating Income(Expenses)		
Investment Income	6,973	8,782
Loss on Disposition of Assets	218	0
Interest on Long-Term Debt	(80,443)	(86,074)
Debt Issue Costs	(9,908)	0
Amortization of Bond Premium	1,690	0
Net Non-Operating Expenses	<u>(81,470)</u>	<u>(77,292)</u>
Income/(Loss) Before Capital Contributions	7,119	(44,661)
Capital Contributions	<u>194,227</u>	<u>56,856</u>
Change in Net Position	201,346	12,195
Net Position – January 1	8,521,550	8,525,857
Prior Period Adjustment	<u>0</u>	<u>(16,502)</u>
Net Position – December 31	<u>\$8,722,896</u>	<u>\$8,521,550</u>

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At December 31, 2013, the District had \$8,853,694 invested in capital assets including land, buildings, water systems, equipment, and vehicles, as reflected in the following schedule. This represents a net decrease (additions less retirements and depreciation) of \$90,664. During 2013 depreciation expense exceeded the cost of new assets put into service resulting in a decrease in the amount invested in capital assets during 2013.

Table 3 Summarizes the District's capital assets at the end of 2013 as compared to 2012.

Table 3
Capital Assets at Year End

	<u>2013</u>	<u>2012</u>
Land	\$ 63,176	\$ 63,176
Transmission Lines & Equipment	12,262,518	12,160,074
Furniture & Fixtures	57,752	67,022
Machinery & Equipment	318,435	304,989
Buildings & Improvements	<u>326,312</u>	<u>326,312</u>
Subtotal	13,028,193	12,921,573
Accumulated Depreciation	<u>(4,184,499)</u>	<u>(3,977,215)</u>
Total Capital Assets	<u>\$ 8,853,694</u>	<u>\$ 8,944,358</u>

Debt Outstanding

Table 4 illustrates the District's outstanding debt at the end of 2013 compared to 2012.

Table 4
Outstanding Debt at Year End

	<u>2013</u>	<u>2012</u>
Bond Payable Obligations	\$1,681,500	\$1,745,000
Capitalized Lease	33,000	40,000
Developer Refunds	<u>0</u>	<u>99,288</u>
Total	<u>\$1,714,500</u>	<u>\$1,884,288</u>

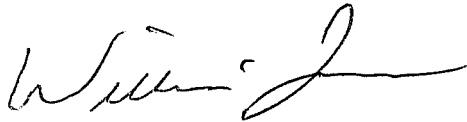
At year-end, the District had \$1,714,500 in outstanding notes and bonds compared to \$1,884,288 last year. This is a decrease of \$169,788 or 9%. The decrease is due to two events that occurred during 2013. The obligation to refund tap fees for the Pendleton Acres development expired in 2013 and the remaining balance of \$99,288 was removed from debt and recognized as income. In addition, the District refunded all of the \$229,000 in Kentucky Rural Water Finance Corporation Revenue Bonds, Series 2001A bearing interest at 5.099% by issuing \$215,000 of Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds, Series 2013C bearing interest at 2.3% to 4.%. These bonds were issued at a premium of \$24,225 which is being amortized over the life of the bonds. The District will achieve substantial interest cost savings as a result of this refunding.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The District's budget for 2014 calls for a 2% increase in operating revenues. Most of this increase is due to the rate increase that occurred during 2013. Since the first billing at the increased rates did not go out until May of 2013, the months of January through April of 2014 should show increased water revenues over the 2013 amounts. Operating expenses are expected to increase by 4.4%. The District expects an increase in employee salaries and benefits due to an increase in the number of employees for the year. Both the general manager and the office manager will retire during 2014 and the District has hired additional personnel early in the year for training purposes in the hopes that this will result in a smooth transition. In addition, the cost of operating supplies are expected to increase due to an aging infrastructure and abnormally low maintenance costs during 2013.

FINANCIAL CONTACT

This financial report is designed to provide our customers and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District Administrative Office at 331 Highway 330 West, Falmouth, Kentucky 41040.

A handwritten signature in black ink, appearing to read "William Jones", written in a cursive style.

William Jones, General Manager
Pendleton County Water District

PENDLETON COUNTY WATER DISTRICT STATEMENTS OF NET POSITION December 31, 2013 and 2012
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(Restated)

ASSETS	<u>2013</u>	<u>2012</u>
Current Assets		
Cash and cash equivalents	\$ 191,644	\$ 161,819
Accounts receivable	150,525	138,580
Inventories	42,788	41,511
Prepays	21,667	18,901
Accrued interest income	307	366
Total Current Assets	<u>406,931</u>	<u>361,177</u>
Restricted Assets		
Improvement, repair, and replacement	1,070,806	945,964
Depreciation reserve	203,164	201,566
Bond sinking fund	57,284	56,793
Customer deposits	37,180	36,627
Total Restricted Assets	<u>1,368,434</u>	<u>1,240,950</u>
Capital Assets		
Land, building, transmission system, equipment, and vehicles	13,028,193	12,921,573
Less: accumulated depreciation	(4,174,499)	(3,977,215)
Total Capital Assets, net of depreciation	<u>8,853,694</u>	<u>8,944,358</u>
TOTAL ASSETS	<u>10,629,059</u>	<u>10,546,485</u>
LIABILITIES		
Current Liabilities		
Accounts payable	58,980	59,834
Accrued and withheld liabilities	52,803	20,723
Developer refunds - current portion	-	99,288
Total Current Liabilities	<u>111,783</u>	<u>179,845</u>
Current Liabilities Payable From Restricted Assets		
Revenue bonds - current portion	55,000	49,500
Lease obligation - current portion	7,000	7,000
Customer deposits	35,021	34,345
Accrued interest payable	22,324	25,745
Total Current Liabilities Payable From Restricted Assets	<u>119,345</u>	<u>116,590</u>
Long-Term Liabilities		
Bonds	1,626,500	1,695,500
Capital lease payable	26,000	33,000
Unamortized premium on debt	22,535	-
Total Long-Term Liabilities	<u>1,675,035</u>	<u>1,728,500</u>
TOTAL LIABILITIES	<u>1,906,163</u>	<u>2,024,935</u>
NET POSITION		
Invested in capital assets, net of related debt	7,116,659	7,060,070
Restricted	229,092	223,000
Unrestricted	1,377,145	1,238,480
TOTAL NET POSITION	<u>\$ 8,722,896</u>	<u>\$ 8,521,550</u>

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

PENDLETON COUNTY WATER DISTRICT STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION For the Years Ended December 31, 2013 and 2012

	<u>2013</u>	<i>(Restated)</i> <u>2012</u>
OPERATING REVENUES		
Water revenue	\$ 1,317,913	\$ 1,234,459
Other service revenues	<u>22,182</u>	<u>31,074</u>
TOTAL OPERATING REVENUES	<u>1,340,095</u>	<u>1,265,533</u>
OPERATING EXPENSES		
Water purchased	390,515	387,265
Operations, maintenance, and administrative expenses	639,203	623,658
Depreciation	<u>221,788</u>	<u>221,979</u>
TOTAL OPERATING EXPENSES	<u>1,251,506</u>	<u>1,232,902</u>
OPERATING PROFIT	<u>88,589</u>	<u>32,631</u>
NON-OPERATING INCOME (EXPENSE)		
Investment income	6,973	8,782
Gain on disposal of assets	218	-
Interest on long-term obligations	(80,443)	(86,074)
Debt issuance cost	(9,908)	-
Amortization of bond premium	<u>1,690</u>	<u>-</u>
NET NON-OPERATING EXPENSES	<u>(81,470)</u>	<u>(77,292)</u>
NET INCOME (LOSS)	7,119	(44,661)
CAPITAL CONTRIBUTIONS	<u>194,227</u>	<u>56,856</u>
CHANGE IN NET POSITION	201,346	12,195
NET POSITION, JANUARY 1	8,521,550	8,525,857
PRIOR PERIOD ADJUSTMENT	<u>-</u>	<u>(16,502)</u>
NET POSITION, DECEMBER 31	<u>\$ 8,722,896</u>	<u>\$ 8,521,550</u>

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

PENDLETON COUNTY WATER DISTRICT STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2013 and 2012
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	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from customers	\$ 1,328,150	\$ 1,244,176
Paid to suppliers for goods and services	(675,608)	(605,104)
Paid to or on behalf of employees for services	(326,927)	(406,622)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>325,615</u>	<u>232,450</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition and construction of fixed assets	(131,616)	(123,077)
Proceeds from sale of fixed assets	710	-
Interest received on investments	7,032	8,691
NET CASH USED BY INVESTING ACTIVITIES	<u>(123,874)</u>	<u>(114,386)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on long term debt	(56,500)	(53,500)
Interest paid on long term debt	(83,547)	(86,767)
Contributed capital received	28,323	33,106
Grant proceeds	66,616	23,750
Decrease in restricted cash	(127,484)	(94,254)
Increase in customer deposits	676	587
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(171,916)</u>	<u>(177,078)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	29,825	(59,014)
CASH AND CASH EQUIVALENTS-BEGINNING OF YEAR	<u>161,819</u>	<u>220,833</u>
CASH AND CASH EQUIVALENTS-END OF YEAR	<u>\$ 191,644</u>	<u>\$ 161,819</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 88,589	\$ 32,631
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	221,788	221,979
Change in operating assets and liabilities		
Increase in receivables	(11,945)	(21,357)
Increase in inventories	(1,277)	(8,168)
Increase in prepaid assets	(2,766)	(259)
Increase (Decrease) in accounts payable	(854)	6,381
Increase in other accrued liabilities	32,080	1,243
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 325,615</u>	<u>\$ 232,450</u>
SUPPLEMENTAL INFORMATION		
Interest paid	<u>\$ (83,547)</u>	<u>\$ (86,767)</u>

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

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

NOTE 1 – GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES

The Pendleton County Water District (District) is a water utility, which provides service to residential and commercial customers in Pendleton County, Kentucky. The District was created by the Pendleton County Fiscal Court under the provisions of chapter 74 of the Kentucky Revised Statutes ("KRS") in 1958. The District's current service area includes parts of Pendleton, Campbell, and Grant Counties.

Regulatory Requirements

The District is subject to the regulatory authority of the Kentucky Public Service Commission ("PSC") pursuant to KRS 278.040.

Basis of Accounting

The District's financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. The District applies all Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) Opinions of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The District has adopted GASB Statements 60 through 65, and related interpretations issued through June 30, 2013.

Statement No. 65 – *Items Previously Reported as Assets and Liabilities* – Disallows the amortization of bond issuance costs over the life of the bond. Bond issuance costs must now be expensed in the period incurred. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

Statement No. 64 – *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53* – Not applicable to Pendleton County Water District.

Statement No. 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* – Requires the District to report any amortized deferred refunding costs on defeased bonds separately as a Deferred Outflow of Resources, instead of reporting this amount net of the related bond liability. This statement is not applicable to the Pendleton County Water District at this time.

Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* – This Statement incorporates in GASB's authoritative literature certain accounting and financial reporting guidance that is included in pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements.

Statement No. 61 – *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34* – This Statement modifies Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local*

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

Governments, to add certain requirements for inclusion of component units in the financial reporting entity.

Statement No. 60 – Accounting and Financial Reporting for Service Concession Arrangements – Not applicable to Pendleton County Water District.

All activities of the District are accounted for within a single proprietary (enterprise) reporting entity. Proprietary entities are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expense, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net position. Net position (i.e., total assets net of total liabilities) is segregated into “invested in capital assets, net of related liabilities”; “restricted”; and “unrestricted” components.

Cash Equivalents

For purposes of the statements of net position and statements of cash flows, the District considers all unrestricted highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Budgets

In accordance with Kentucky Revised Statute 65.065, the District is required to submit a balanced budget to the Pendleton County Fiscal Court prior to December 1. The budget includes proposed expenditures and the means of financing them for the upcoming year. Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. Expenditures may not legally exceed budgeted appropriations at the fund level. All appropriations lapse at fiscal year end.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined under the First-In, First-Out (FIFO) method. Market is determined on the basis of estimated realizable market values.

Distribution System, Building, and Equipment

Property, plant, transmission lines and equipment are recorded at cost and depreciated over their estimated useful lives using the straight line method. Upon sale or retirement, the cost and related accumulated depreciation are removed from the respective accounts and the resulting gain or loss is included in the “Non-Operating Income (Expense)” portion of the Statements of Revenues, Expenses, and Changes in Net Position.

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

Construction in Progress

Capitalizable costs incurred on projects which are not in use or ready for use at year end are held as "Construction in Progress". When the related asset is ready for use, related costs are transferred to the related asset account.

Capital Contributions

In conformity with the provisions of Governmental Accounting Standards Board Statement No. 33 – *Accounting and Financial Reporting for Non-Exchange Transactions*, amounts related to customer contributions in aid of construction have been reported as other income in the District's income statement. These contributions represent customer tap-in fees and other contributions to recover the costs of extensions of the distribution system. The District also includes estimated cost figures for those lines contributed by outside contractors.

During 2013 and 2012 these contributions consisted of the following:

Source	2013	2012
Tap in fees and construction costs paid by new customers	\$ 127,611	\$ 33,106
Construction funding from Pendleton County Fiscal Court	27,645	23,750
Airport Board Grant	38,971	-
Total	<u>\$ 194,227</u>	<u>\$ 56,856</u>

Income Tax Status

The District is exempt from federal and state income taxes since it is a governmental entity. Accordingly, the financial statements include no provision for income taxes.

Use of Estimates

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Operating Revenues and Non-operating Revenues

Revenues have been classified as operating and non-operating. Operating revenues are those revenues that are directly generated from the sale of water to customers. Non-operating revenues are those revenues that arise from the overall function of the entity. Examples of non-operating revenues are grant revenues, sales of fixed assets and interest income.

NOTE 2 – DEPOSITS AND INVESTMENTS

Deposits consist of checking and savings accounts. They are carried at cost, which approximates market value. The carrying amount of deposits is separately displayed on the statement of net position as "Cash and Cash Equivalents" and "Restricted Assets". At December 31, 2013 and 2012, the bank balances were \$191,644 and \$161,819, respectively, which were the same as the carrying amount. The District has amounts on deposit with three banks in excess of FDIC insured amounts. The banks have pledged collateral to cover such excess amounts.

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

Funds in excess of current expenses or obligations of the District are invested in certificates of deposit issued by, or other interest bearing accounts of, banks that are insured by the Federal Deposit Insurance Corporation.

Effective January 1, 1998, investments are reported at fair value which is determined using the selected basis. Short term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair market value.

The District's investments are categorized to give an indication of the level of risk assumed by the District at December 31, 2013.

The categories are described as follows:

Category 1 - Insured and registered, with securities held by the entity or its agent in the entity's name;

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name;

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name.

	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	<u>Carrying Cost</u>	<u>Cost</u>
Deposits	\$ 191,644	\$ -	\$ -	\$ 191,644	\$ 191,644
Investments	<u>1,340,626</u>	<u>-</u>	<u>27,808</u>	<u>1,368,434</u>	<u>1,368,434</u>
Total	<u>\$ 1,532,270</u>	<u>\$ -</u>	<u>\$ 27,808</u>	<u>\$ 1,560,078</u>	<u>\$ 1,560,078</u>

In accordance with GASB 40, the District has \$27,808 in bond sinking funds held in investments in federally backed US Treasury Obligations rated AAA/Aaa. The market risk on these investments is negligible.

NOTE 3 – RESTRICTED NET POSITION

Net position is comprised of net earnings from operating and non-operating revenues, expenses and contributions of capital. Net position is classified in the following three components: invested in capital assets, net of related debt; restricted; and unrestricted. Invested in capital assets, net of related debt consists of all capital assets net of accumulated depreciation and reduced by outstanding debts, that is attributable to the acquisition, construction and improvement of those assets. The restricted portion of net position consists of assets, net of related liabilities, for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. The unrestricted

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

portion of net position consists of all other assets, net of related liabilities, not included in the above categories.

Included in the restricted portion of net position at December 31,

	2013	2012
Depreciation Reserve Fund	\$ 175,320	\$ 170,880
Bond Sinking Fund	53,772	52,120
Total Restricted Net Position	<u>\$ 229,092</u>	<u>\$ 223,000</u>

NOTE 4 – UTILITY PLANT IN SERVICE

All property, plant and equipment, including infrastructure assets, are recorded at cost and depreciated over their estimated useful lives, using the straight-line method. Upon sale or retirement, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss included in the results of operations. Repair and maintenance charges, which do not increase the useful lives of the assets, are charged to income as incurred. Interest incurred on construction funding during the period of construction is capitalized and is added to the item under construction rather than charged to expense as incurred.

The property, plant and equipment accounts are summarized as follows:

Asset Type	Balance at December 31, 2012	Additions	Retirements	Balance at December 31, 2013
Land	\$ 63,176	\$ -	\$ -	\$ 63,176
Buildings and improvements	326,312	-	-	326,312
Construction in progress	-	-	-	-
Distribution reservoirs and standpipes	786,103	-	-	786,103
Furniture and fixtures	67,022	1,468	(10,738)	57,752
Hydrants	176,754	962	-	177,716
Meter system and installation	568,502	986	-	569,488
Other plant and misc. equipment	113,872	1,000	-	114,872
Pumping equipment	440,074	6,950	-	447,024
Services	692,019	18,083	-	710,102
Tools and equipment	18,702	9,395	-	28,097
Transmission mains	9,496,622	75,463	-	9,572,085
Transportation equipment	172,415	17,309	(14,258)	175,466
Subtotal	12,921,573	131,616	(24,996)	13,028,193
Accumulated depreciation	(3,977,215)	(221,788)	24,504	(4,174,499)
Capital Assets, net	<u>\$ 8,944,358</u>	<u>\$ (90,172)</u>	<u>\$ (492)</u>	<u>\$ 8,853,694</u>

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

NOTE 5 – BONDED INDEBTEDNESS

Water Works System Revenue Bonds, U.S. Department of Agriculture 1977

On May 26, 1978, the District sold \$263,000 of revenue bonds for the purpose of financing the costs of major water system facilities, which represent collateral on the bonds. All bonds mature on December 1st of each year beginning in 1980, ending in 2017. Interest is payable on June 1st and December 1st and principal is due in annual installments on December 1st through 2017.

The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2014	5.00%	\$ 13,000	\$ 2,750	\$ 15,750
2015	5.00%	13,000	2,100	15,100
2016	5.00%	14,000	1,450	15,450
2017	5.00%	15,000	750	15,750
Totals		<u>\$ 55,000</u>	<u>\$ 7,050</u>	<u>\$ 62,050</u>

Water Works System Revenue Bonds, U.S. Department of Agriculture 1997

On April 2, 1998, the District sold \$747,000 of revenue bonds for the purpose of financing the costs of major water system facilities, which represent collateral on the bonds. All bonds mature on December 1st of each year beginning in 2000 and ending in 2037. Interest is payable on June 1st and December 1st of each year and principal is due in annual installments on December 1st through 2037.

The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2014	5.125%	\$ 11,000	\$ 33,389	\$ 44,389
2015	5.125%	12,000	32,826	44,826
2016	5.125%	12,500	32,211	44,711
2017	5.125%	13,500	31,570	45,070
2018	5.125%	14,500	30,878	45,378
2019-2023	5.125%	89,500	142,143	231,643
2024-2028	5.125%	126,500	115,671	242,171
2029-2033	5.125%	178,000	78,310	256,310
2034-2037	5.125%	194,000	25,702	219,702
Totals		<u>\$ 651,500</u>	<u>\$ 522,700</u>	<u>\$ 1,174,200</u>

Kentucky Rural Water Finance Corporation Revenue Bonds, Series 2001A

On June 27, 2001, the District participated in the Kentucky Rural Water Finance Corporation's first Flexible Term Finance Program Remarketing wherein the proceeds of the revenue bonds issued were used to provide refunding and new money for twelve water systems throughout Kentucky. The District's share of the bond proceeds was \$374,000. The water systems represent collateral on the bonds. All bonds matured on January 1st of each year beginning in 2003 and ending in 2024. Interest was payable on January 1st and July 1st of each year and principal was

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

due in annual installments on January 1st through 2024. These bonds were refunded with the new 2013 bond issuance, noted below.

On March 27, 2013, The District entered into a loan agreement with the Kentucky Rural Water Finance Corporation for a promissory note in the amount of \$215,000. Concurrent with this loan agreement, the KRWFC issued Public Projects Refunding Revenue Bonds, Series 2013C which refunded the District's Series 2001A bond. The water systems represent collateral on the bonds. The note payable to the Kentucky Rural Water Finance Corporation contains principal and interest payments which mirror related KRWFC bond issues. Principal payments are due annually on January 1 beginning in 2014 and ending January 1, 2024. Interest is payable January 1 and July 1 of each year. These bonds were issued at a premium of \$24,225 which is being amortized over the life of the bonds. As of December 31, 2013, \$1,690 of the premium was amortized. The District achieves substantial interest cost savings under this program. The debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2014	2.300%	\$ 20,000	\$ 8,365	\$ 28,365
2015	3.300%	20,000	7,805	27,805
2016	3.300%	20,000	7,145	27,145
2017	4.300%	20,000	6,385	26,385
2018	4.300%	20,000	5,525	25,525
2019-2023	4.300%	100,000	13,827	113,827
2024	4.800%	15,000	360	15,360
Totals		<u>\$ 215,000</u>	<u>\$ 49,412</u>	<u>\$ 264,412</u>

Water Works System Revenue Bonds, U.S. Department of Agriculture 2004

On January 29, 2005, the District sold \$596,000 of revenue bonds for the purpose of financing the costs of major water system facilities, which represent collateral on the bonds. All bonds mature on January 1st of each year beginning in 2007, with debt service requirements beginning in 2006, and ending in 2044. Interest is payable on January 1st and July 1st of each year and principal is due in annual installments on January 1st through 2044. The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2014	4.50%	\$ 8,000	\$ 24,570	\$ 32,570
2015	4.50%	9,000	24,210	33,210
2016	4.50%	9,000	23,805	32,805
2017	4.50%	10,000	23,400	33,400
2018	4.50%	10,000	22,950	32,950
2019-2023	4.50%	59,000	107,415	166,415
2024-2028	4.50%	72,000	93,060	165,060
2029-2033	4.50%	90,000	75,375	165,375
2034-2038	4.50%	111,000	53,145	164,145
2039-2043	4.50%	137,000	25,785	162,785
2044	4.50%	31,000	1,395	32,395
Totals		<u>\$ 546,000</u>	<u>\$ 475,110</u>	<u>\$ 1,021,110</u>

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

Water Works System Revenue Bonds, U.S. Department of Agriculture 2010

On July 30, 2010, the District sold \$220,000 of revenue bonds for the purpose of financing the costs of major water system facilities, which represent collateral on the bonds. All bonds mature on January 1st of each year beginning in 2012, with debt service requirements beginning in 2010, and ending in 2049. Interest and principal are due in annual installments on January 1st through 2049.

The remaining debt service is as follows:

Year	Interest Rates	Principal Amount	Interest Amount	Total Debt Service
2014	3.50%	\$ 3,000	\$ 7,490	\$ 10,490
2015	3.50%	3,000	7,385	10,385
2016	3.50%	3,500	7,280	10,780
2017	3.50%	3,500	7,158	10,658
2018	3.50%	3,500	7,035	10,535
2019-2023	3.50%	19,500	33,233	52,733
2024-2028	3.50%	23,500	29,559	53,059
2029-2033	3.50%	27,500	25,184	52,684
2034-2038	3.50%	33,000	20,003	53,003
2039-2043	3.50%	39,500	13,773	53,273
2044-2048	3.50%	46,500	6,406	52,906
2049	3.50%	8,000	280	8,280
Totals		<u>\$ 214,000</u>	<u>\$ 164,786</u>	<u>\$ 378,786</u>

NOTE 6 – CAPITAL LEASE

In 1997, the District signed a capital sublease agreement for its office and storage facilities. The leased property of \$137,718 is included in buildings and improvements on the fixed asset summary in Note 4 and represents collateral on the lease. Amortization of the lease is included in depreciation expense. Accumulated amortization amounted to \$57,383 and \$53,940 at December 31, 2013 and 2012, respectively.

Future minimum lease payments are as follows:

Year	Rent Amount	Interest Amount	Total Lease Payment
2014	\$ 7,000	\$ 1,695	\$ 8,695
2015	8,000	1,190	9,190
2016	8,000	680	8,680
2017	10,000	53	10,053
Totals	<u>\$ 33,000</u>	<u>\$ 3,618</u>	<u>\$ 36,618</u>

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

NOTE 7 – DEVELOPER REFUNDS

During 2003, a developer installed waterlines within a subdivision that he owns. The District refunded \$887 to this developer (the actual cost of 50 feet of waterline) for each customer that bought a lot and connected to the waterline within ten years as of December 1, 2004. The total refund could have been \$115,245. As of December 31, 2012, eighteen customers had tapped into this line, leaving a balance of \$99,288. The refund period expired in December 2013; the entire remaining balance of \$99,288 is recognized as contributed capital at December 31, 2013.

NOTE 8 – INDEBTEDNESS SUMMARY

The changes in long-term indebtedness are as follows:

Debt Instrument	Balance at December 31, 2012	Additions	Retirements	Balance at December 31, 2013
Revenue bonds of 1977	\$ 67,000	\$ -	\$ (12,000)	\$ 55,000
Revenue bonds of 1997	662,000	-	(10,500)	651,500
Series 2001A bonds	245,000	-	(245,000)	-
Revenue bonds of 2004	554,000	-	(8,000)	546,000
Revenue bonds of 2010	217,000	-	(3,000)	214,000
Series 2013C bonds	-	215,000	-	215,000
Capitalized lease	40,000	-	(7,000)	33,000
Developer refunds	99,288	-	(99,288)	-
Subtotal	1,884,288	\$ 215,000	\$ (384,788)	1,714,500
Less: current portion of long-term debt	(155,788)			(62,000)
Total Long-Term Indebtedness	\$ 1,728,500			\$ 1,652,500

NOTE 9 – OPERATING LEASE

The District leases a copier under an operating lease that began in July 2008 and will remain in force until April 2013. Rental payments under this lease were \$618 and \$2,446 for 2013 and 2012, respectively. The District entered into an operating lease, for a new copier, beginning May 2013 and continuing through April 2018. Payments under this lease were \$1,663 in 2013. Future minimum lease payments are as follows:

Year	Lease Payments
2014	\$ 2,217
2015	2,217
2016	2,217
2017	2,217
2018	554
Totals	\$ 9,422

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

NOTE 10 – EMPLOYEE RETIREMENT SYSTEM

County Employees Retirement System

Employees who work an average of 100 hours per month participate in the County Employees Retirement System (CERS) of Kentucky. It is a cost sharing multiple-employer defined benefit pension plan created by and operated under Kentucky law. CERS covers substantially all regular full-time employees of each county and school board, and any additional 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 adjustments are provided at the discretion of the State Legislature. For the years ended December 31, 2013 and 2012, plan members were required to contribute 5% of their annual creditable compensation. Members hired on or after September 1, 2008 are required to contribute 6%. The additional 1% is considered a health insurance contribution. Employer contribution rates are actuarially determined. Such contribution rates are determined by the Board of Trustees of the Kentucky Retirement System. They may amend contribution rates as of the first day of July, if it is determined necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. From January until July 2013 the employer contribution rates were 19.55%. From July until December 2013, the employer rates were 18.89%. From January until July 2012 the employer contribution rates were 18.96%. From July until December 2012, the employer rates were 19.55%.

The District has made 100% of all required contributions for each of the years ended December 31, 2013, 2012, 2011, 2010, and 2009. Information about the contributions made by the District and the employees, as well as gross payroll and covered payroll follows:

	2013	2012	2011	2010	2009
Gross Payroll - All Employees	\$ 336,077	\$ 328,445	\$ 323,777	\$ 314,299	\$ 296,050
Gross Payroll - Covered Employees	312,977	304,445	300,177	291,099	261,530
Employee Contribution	15,649	15,522	15,242	14,555	13,077
Employer Contribution (expense)	60,129	58,641	53,817	48,244	38,892

NOTE 11 – ECONOMIC DEPENDENCY/CREDIT RISK

Pendleton County Water District is a government agency operating with one office in Falmouth, Kentucky. It grants credit to customers who are primarily local residents and businesses. The District receives all of its operating revenues from customers in Pendleton, Campbell, and Grant Counties in Kentucky.

NOTE 12 – CONCENTRATIONS

The District has agreements to purchase water from the City of Falmouth, Kentucky and the Northern Kentucky Water District through the year 2047. In June 2001, the District signed an agreement to purchase water on an "as needed" basis from the City of Williamstown, Kentucky. This contract is in force until June 2021.

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

NOTE 13 – CHANGE IN ACCOUNTING ESTIMATE

During 2012, the District, per recommendation from the Kentucky Public Service Commission, changed the useful lives of its transmission and distribution mains from 40 years to 75 years. This change has been applied prospectively beginning in 2012.

NOTE 14 – RECLASSIFICATION IN PRIOR YEAR STATEMENTS

The 2012 Statement of Revenues, Expenses and Changes in Net Position has been adjusted due to the requirements of GASB 65 (See NOTE 1) which disallows the amortization of bond issuance costs over the life of the bond. The Statement requires that all accounts be adjusted retroactively to the earliest period disclosed. Therefore, a prior period adjustment, reducing the net position by \$15,602, has been recorded; as if the bond issuance costs were expensed at the date the costs were incurred.

NOTE 15 – SUBSEQUENT EVENTS

The District instituted a rate increase, which was approved by the Kentucky Public Service Commission, subsequent to December 31, 2012. The increase took effect on the District's billing in May, 2013. The minimum bill amount varies based on meter size, and can fall between \$22 for the smallest and \$49 for the largest meter.

On January 7, 2014, the District signed an amended lease agreement in connection with the Water Works System Revenue Bonds, U.S. Department of Agriculture 1997 reducing both interest rates and payment amounts. The interest rate on the principal balance reduces from the current 5.0% to varying rates ranging from 1.3% to 2.3%. This amendment provides substantial savings to the District.

PENDLETON COUNTY WATER DISTRICT SCHEDULES OF OPERATIONS, MAINTENANCE AND ADMINISTRATIVE EXPENSES For the Years Ended December 31, 2013 and 2012
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	<u>2013</u>	<u>2012</u>
Operations, Maintenance and Administrative Expenses		
Salaries and wages - employees	\$ 311,404	\$ 284,442
Employee pension and benefits	104,913	99,423
Advertising	1,144	2,610
Bad debt expense	7,403	3,824
Commissioners' fees	23,100	24,000
Contractual services - accounting	19,000	22,375
Contractual services - other	20,787	18,162
Insurance - general and vehicle	17,730	16,386
Insurance - other	945	1,057
Insurance - workers' compensation	5,126	4,427
Maintenance	13,669	6,871
Materials and supplies	21,135	49,233
Miscellaneous	4,258	4,057
Purchased power	17,427	16,758
Regulatory commission	2,305	2,243
Rental of equipment	2,518	2,446
Taxes	24,379	23,090
Transportation	26,179	26,718
Utilities	15,781	15,536
	<u>639,203</u>	<u>623,658</u>
Total Operations, Maintenance and Administrative Expenses	<u>\$ 639,203</u>	<u>\$ 623,658</u>



Van Gorder, Walker & Co., Inc.
Certified Public Accountants

Charles A. Van Gorder, CPA
John P. Walker, CPA, MBA
Lori A. Owen, CPA
John R. Chamberlin, CPA, MBA
Members of AICPA & KyCPA
Licensed in Kentucky & Ohio

**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 Commissioners
Pendleton County Water District**

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 business-type activities of Pendleton County Water District as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements which collectively comprise Pendleton County Water District's basic financial statements and have issued our report thereon dated April 14, 2014..

Internal Control over Financial Reporting

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

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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described below, that we consider significant deficiencies.

Lack of Segregation of Duties

Condition: We noted that due to the size of the District and financial considerations, some of the executing and recording of transactions are performed by the same person.

Criteria: Segregation of duties is a necessary part of any system of internal control. Segregating the processes of authorizing, executing and recording transactions is essential.

Effect: Lack of segregation of duties could allow for receipts to be diverted away from the District and expenses not attributed to the District could be paid for from the District's cash account. The District has determined that the cost of mitigation is not justified when compared to the risk of the related transactions.

Recommendation: Due to the size of the District and other financial considerations, internal controls should be implemented, to the highest appropriate level, to segregate the duties of the personnel. Controls should then be monitored to ascertain that they are sufficient to reduce the risk of material misstatement to an acceptable level.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Pendleton County Water District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. Noncompliance 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 audits, 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.



Van Gorder, Walker & Co., Inc.
Erlanger, Kentucky
April 14, 2014