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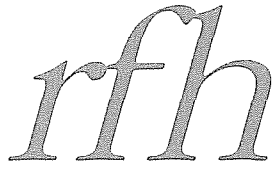
**EAST PENDLETON COUNTY  
WATER DISTRICT  
Falmouth, Kentucky**

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**FINANCIAL STATEMENTS  
December 31, 2012 and 2011**

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# Ray, Foley, Hensley & Company, PLLC

Certified Public Accountants and Consultants

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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 business-type activities of the East Pendleton County Water District (the District) as of and for the years ended December 31, 2012 and 2011, 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 opinions 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 of 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.

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## **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 the East Pendleton County Water District, as of December 31, 2012 and 2011, and the respective changes in financial position, and cash flows thereof for the year 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 21, 2013 on our consideration of the East 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 the East Pendleton County Water District's internal control over financial reporting and compliance.

*Ray, Foley, Hensley & Company*

Ray, Foley, Hensley & Company, PLLC  
March 21, 2013

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

<b>ASSETS</b>	<b>2012</b>	<b>2011</b>
<b>Current assets</b>		
Cash	\$ 127,404	\$ 128,070
Accounts receivable customers, net	63,773	62,180
Inventory	<u>15,991</u>	<u>15,728</u>
Total current assets	<u>207,168</u>	<u>205,978</u>
<b>Restricted assets</b>		
Cash	227,367	236,225
Cash - construction	184,959	219,008
Certificates of deposit	<u>249,401</u>	<u>247,349</u>
Total restricted assets	<u>661,727</u>	<u>702,582</u>
<b>Capital assets</b>		
Property, plant and equipment- Water	6,692,351	6,681,889
Less: accumulated depreciation- Water	(2,977,582)	(2,823,734)
Property, plant and equipment- Sewer	34,952	34,197
Less: accumulated depreciation- Sewer	<u>(24,463)</u>	<u>(23,050)</u>
Total capital assets	<u>3,725,258</u>	<u>3,869,302</u>
<b>Other assets</b>		
Bond closing costs	<u>38,636</u>	<u>41,961</u>
Total assets	<u>\$ 4,632,789</u>	<u>\$ 4,819,823</u>
<b>LIABILITIES AND NET POSITION</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 34,405	\$ 29,310
Taxes payable	3,712	3,345
Customer deposits	31,440	30,715
Accrued interest payable	19,768	20,723
Current portion of debt	<u>61,100</u>	<u>58,400</u>
Total current liabilities	<u>150,425</u>	<u>142,493</u>
<b>Long-term debt</b>		
KIA note payable	52,500	67,500
Bonds payable, net	<u>1,310,600</u>	<u>1,356,700</u>
Total long-term debt	<u>1,363,100</u>	<u>1,424,200</u>
<b>Net position</b>		
Invested in capital assets, net of related debt	2,301,058	2,386,702
Restricted for debt service	251,216	259,900
Restricted for depreciation	225,367	223,674
Unrestricted	<u>341,623</u>	<u>382,854</u>
Total net position	<u>3,119,264</u>	<u>3,253,130</u>
Total liabilities and net position	<u>\$ 4,632,789</u>	<u>\$ 4,819,823</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,

	<b>2012</b>	<b>2011</b>
<b>OPERATING INCOME</b>		
Water sales	\$ 857,656	\$ 838,285
Sewer sales	21,478	21,197
Other revenue	<u>25,468</u>	<u>26,352</u>
Total operating income	<u>904,602</u>	<u>885,834</u>
<b>OPERATING EXPENSES</b>		
Water purchases	217,013	207,352
Pumping	34,095	34,287
Operation	239,618	240,662
Maintenance	14,596	18,043
General and administrative	<u>319,769</u>	<u>305,368</u>
Total operating expense	<u>825,091</u>	<u>805,712</u>
Operating income before depreciation	79,511	80,122
Depreciation expense	(172,235)	(178,689)
Amortization expense	<u>(3,325)</u>	<u>(3,325)</u>
Total depreciation and amortization expense	<u>(175,560)</u>	<u>(182,014)</u>
<b>OPERATING (LOSS)</b>	(96,049)	(101,892)
Non-operating income (expenses)		
Interest income	2,449	5,787
Gain on asset disposition	2,000	4,728
Interest expense related to debt	<u>(69,159)</u>	<u>(77,550)</u>
<b>(LOSS) BEFORE CAPITAL CONTRIBUTIONS</b>	(160,759)	(168,927)
Capital contributions		
Grants	8,791	-
Tap fees	<u>18,102</u>	<u>15,352</u>
Change in net position	(133,866)	(153,575)
Net position, beginning of year	<u>3,253,130</u>	<u>3,406,705</u>
<b>NET POSITION, END OF YEAR</b>	<u>\$ 3,119,264</u>	<u>\$ 3,253,130</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,

	<b>2012</b>	<b>2011</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 903,009	\$ 916,336
Payments to suppliers	(370,924)	(374,935)
Payments for employee services and benefits	<u>(449,198)</u>	<u>(431,981)</u>
<b>Net cash provided by operating activities</b>	<u>82,887</u>	<u>109,420</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Retirement of note principal	(58,400)	(74,800)
Interest paid	(69,159)	(79,068)
Proceeds from sale of fixed assets	2,000	5,000
Purchase of fixed assets	(28,191)	(73,719)
Tap fee	18,102	15,352
Grant proceeds	<u>8,791</u>	<u>-</u>
<b>Net cash (used in) capital and related financing activities</b>	<u>(126,857)</u>	<u>(207,235)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Investment in certificates of deposit	(2,052)	(3,406)
Interest income	<u>2,449</u>	<u>5,787</u>
<b>Net cash provided by investing activities</b>	<u>397</u>	<u>2,381</u>
<b>NET (DECREASE) IN CASH</b>	(43,573)	(95,434)
Cash, beginning of year	<u>583,303</u>	<u>678,737</u>
<b>CASH, END OF YEAR</b>	<u>\$ 539,730</u>	<u>\$ 583,303</u>
<b>Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:</b>		
Operating (loss)	\$ (96,049)	\$ (101,892)
Noncash items included in operating income		
Depreciation	172,235	178,689
Amortization	3,325	3,325
Fees	-	(180)
Changes in assets and liabilities		
(Increase) decrease in accounts receivables	(1,593)	20,752
(Increase) decrease in other receivables	-	9,750
(Increase) decrease in inventory	(263)	(260)
Increase (decrease) in accounts payable	5,095	(982)
Increase (decrease) in other payables	(588)	(1,282)
Increase (decrease) in customer deposits	<u>725</u>	<u>1,500</u>
<b>Net cash provided by operating activities</b>	<u>\$ 82,887</u>	<u>\$ 109,420</u>

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

**EAST PENDLETON COUNTY WATER DISTRICT**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**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; invested in capital assets net of related debit, 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, 2012 and 2011**

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**1. ORGANIZATION AND ACCOUNTING POLICIES, continued**

**Accounts Receivable**

The District's accounts receivable reserve represents its estimate of all uncollectible accounts. The reserves for both 2012 and 2011 were \$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. 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.

**2. CASH AND INVESTMENTS**

The East Pendleton County Water District's deposits and investments at December 31, 2012 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, 2012. 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, 2012 and 2011**

**2. CASH AND INVESTMENTS, continued**

Type of Deposit	Category			Total Bank Amount	Total Carrying Amount
	1	2	3		
Cash	\$ 544,216	\$ -	\$ -	\$ 544,216	\$ 539,730
Certificates of Deposit	<u>249,401</u>	<u>-</u>	<u>-</u>	<u>249,401</u>	<u>249,401</u>
	<u>\$ 793,617</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 793,617</u>	<u>\$ 789,131</u>

The proprietary fund type Statement of Cash Flows includes cash with the following restrictions:

	2012	2011
Cash	\$ 127,404	\$ 128,070
Cash – construction	184,959	219,008
Restricted cash	<u>227,367</u>	<u>236,225</u>
	<u>\$ 539,730</u>	<u>\$ 583,303</u>

**3. CAPITAL ASSETS**

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

	Balance 12/31/11	Additions	Disposals	Balance 12/31/12
Capital assets not depreciated:				
Organizational costs	\$ 7,200	\$ -	\$ -	\$ 7,200
Water land	16,157	-	-	16,157
Sewer land	<u>1,168</u>	<u>-</u>	<u>-</u>	<u>1,168</u>
Totals	<u>24,525</u>	<u>-</u>	<u>-</u>	<u>24,525</u>
Capital assets that are depreciated:				
Water property & equipment	6,658,532	27,436	(16,974)	6,668,994
Sewer property & equipment	<u>33,029</u>	<u>755</u>	<u>-</u>	<u>33,784</u>
Totals	6,691,561	28,191	(16,974)	6,702,778
Less: accumulated depreciation	<u>2,846,784</u>	<u>172,235</u>	<u>16,974</u>	<u>3,002,045</u>
Totals	<u>3,844,777</u>	<u>(144,044)</u>	<u>-</u>	<u>3,700,733</u>
Capital assets, net	<u>\$ 3,869,302</u>	<u>\$ (144,044)</u>	<u>\$ -</u>	<u>\$ 3,725,258</u>

Depreciation expense totaled \$172,235 and \$178,689, for the years ended December 31, 2012 and 2011, respectively.

**EAST PENDLETON COUNTY WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2012 and 2011**

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**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 has a balance of \$225,367 and \$223,674 at December 31, 2012 and 2011, 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 \$251,216 and \$259,900 at December 31, 2012 and 2011, 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:

<b>Bonds and Notes</b>	<b>2012</b>	<b>2011</b>
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%.	\$ 660,000	\$ 695,000
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%.	67,500	80,000
USDA, Rural Development Bond – \$479,000, dated 4/10/02 with payments through 2042, bearing interest at a rate of 4.75%.	423,000	430,000
USDA, Rural Development Bond – \$195,000, dated 2/22/07 with payments through 2042, bearing interest at a rate of 4.125%.	180,900	183,500
USDA, Rural Development Bond – \$100,000, dated 2/22/07 with payments through 2044, bearing interest at a rate of 4.125%.	<u>92,800</u>	<u>94,100</u>
	1,424,200	1,482,600
Less: current portion of debt	<u>(61,100)</u>	<u>(58,400)</u>
Long-term debt	<u>\$ 1,363,100</u>	<u>\$ 1,424,200</u>

**EAST PENDLETON COUNTY WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2012 and 2011**

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**5. LONG TERM DEBT, continued**

The annual requirements to amortize all notes and leases outstanding as of December 31, 2012 are as follows:

Year Ending December 31,	Principle	Interest	Payment
2013	\$ 61,100	\$ 67,362	\$ 128,462
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
2018-2022	346,700	227,464	574,164
2023-2027	281,100	139,095	420,195
2028-2032	122,100	95,614	217,714
2033-2037	154,000	64,649	218,649
2038-2042	156,300	26,033	182,333
2043-2044	<u>31,100</u>	<u>2,054</u>	<u>33,154</u>
	<u>\$ 1,424,200</u>	<u>\$ 859,248</u>	<u>\$ 2,283,448</u>

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

	December 31, 2011	Additions	Retirements	December 31, 2012	Due Within One Year
Long-term debt	<u>\$ 1,482,600</u>	<u>\$ -</u>	<u>\$ (58,400)</u>	<u>\$ 1,424,200</u>	<u>\$ 61,100</u>

**EAST PENDLETON COUNTY WATER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2012 and 2011**

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**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.

Contributions – For the year ended December 31, 2012, 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, 2012, participating employers contributed 18.96% through June 30 and 19.55% 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:

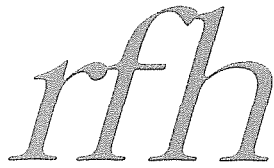
<u>Year</u>	<u>Required Contribution</u>	<u>Percentage Contributed</u>
2012	\$ 71,929	100%
2011	\$ 67,176	100%
2010	\$ 58,108	100%

**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. SUBSEQUENT EVENTS**

The District has evaluated and considered the need to recognize or disclose subsequent events through March 21, 2013, 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, 2012, have not been evaluated by the District.



# Ray, Foley, Hensley & Company, PLLC

Certified Public Accountants and Consultants

**EAST PENDLETON COUNTY WATER DISTRICT  
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**

## INDEPENDENT AUDITORS' REPORT

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in **Government Auditing Standards** issued by the Comptroller General of the United States, the financial statements of the business-type activities of the East Pendleton County Water District (the District) as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the East Pendleton County Water District's basic financial statements, and have issued our report thereon dated March 21, 2013.

### 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 auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the 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 preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses we identified certain deficiencies in internal control that we consider to be 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 deficiencies described in the accompanying schedule of findings and responses to be material weaknesses (2012-1).

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 by those charged with governance.

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**EAST PENDLETON COUNTY WATER DISTRICT  
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 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 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***.

**The East Pendleton County Water District's Response to Findings**

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

**Purpose of this Report**

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

*Ray, Foley, Hensley & Company*  
Ray, Foley, Hensley & Company, PLLC  
March 21, 2013

**EAST PENDLETON COUNTY WATER DISTRICT  
SCHEDULE OF FINDINGS AND RESPONSES  
DECEMBER 31, 2012**

**FINDING:**

2012-1 (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 and thus, does not have the internal control procedures required to take responsibility for the financial statements in conformity with generally accepted accounting principles.

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 or review the financial statements as prepared by the auditor *for 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.