



Jackson County Water Association, Incorporated  
Tyner, Kentucky  
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Independent Auditors' Report  
And Financial Statements  
For the Years Ended  
December 31, 2011 and 2010

Jackson County Water Associaton, Incorporated  
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## Independent Auditors' Report

To the Commissioners  
Jackson County Water Association, Incorporated  
Tyner, Kentucky

We have audited the accompanying statements of net assets of Jackson County Water Association, Incorporated (a nonprofit organization) as of December 31, 2011 and 2010, and the related statements of revenues and expenses, changes in fund equity, and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Jackson County Water Association, Incorporated as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management has omitted the Management's 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2012, on our consideration of Jackson County Water Association, Incorporated'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Baldwin CPAs, PLLC*

Baldwin CPAs, PLLC  
March 27, 2012

Jackson County Water Association, Incorporated  
 Statements of Net Assets  
 December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 1,141,722	\$ 631,952
Investments	2,335,834	2,325,075
Accounts receivable, less allowance for doubtful accounts	190,188	142,652
Unbilled accounts receivable	133,885	151,702
Interest receivable	1,525	1,608
Inventories	131,896	121,897
Prepaid expense	21,819	19,294
<b>Total Current Assets</b>	<u>3,956,869</u>	<u>3,394,180</u>
<b>Noncurrent Assets</b>		
<b>Restricted Assets</b>		
Restricted cash and cash equivalents	<u>1,024,397</u>	<u>1,280,927</u>
<b>Total Restricted Assets</b>	<u>1,024,397</u>	<u>1,280,927</u>
<b>Capital Assets</b>		
Land and land rights	323,485	323,485
Source of supply and pumping	479,349	476,522
Water treatment	6,631,546	6,631,546
Transmission and distribution	17,926,706	13,099,177
General plant and transportation	1,247,065	1,234,527
Construction in progress	230,227	293,527
Less: accumulated depreciation	<u>(7,796,853)</u>	<u>(7,214,916)</u>
<b>Net Capital Assets</b>	<u>19,041,525</u>	<u>14,843,868</u>
<b>Total Noncurrent Assets</b>	<u>20,065,922</u>	<u>16,124,795</u>
<b>Total Assets</b>	<u>24,022,791</u>	<u>19,518,975</u>

See accompanying notes to financial statements.

	<u>2011</u>	<u>2010</u>
Liabilities		
Current Liabilities		
Current portion of long-term debt	211,988	204,768
Accounts payable	67,053	53,686
Accrued interest payable	19,741	12,390
Accrued salaries and taxes payable	28,570	27,923
Customer deposits	10,500	10,250
Total Current Liabilities	<u>337,852</u>	<u>309,017</u>
Noncurrent Liabilities		
Long-term debt, less current portion included in current liabilities	<u>7,386,860</u>	<u>4,002,747</u>
Total Noncurrent Liabilities	<u>7,386,860</u>	<u>4,002,747</u>
Total Liabilities	<u>7,724,712</u>	<u>4,311,764</u>
Net Assets		
Invested in capital assets, net of related debt	11,442,677	10,636,353
Restricted for:		
Capital projects	660,760	930,811
Debt service	345,882	335,802
Other purposes	17,755	14,314
Unrestricted	3,831,005	3,289,931
Total Net Assets	<u>\$ 16,298,079</u>	<u>\$ 15,207,211</u>

Jackson County Water Association, Incorporated  
 Statements of Revenues, Expenses and Changes in Net Assets  
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Water sales	\$ 2,113,021	\$ 1,647,163
Other operating income	<u>183,291</u>	<u>171,475</u>
Total Operating Revenues	<u>2,296,312</u>	<u>1,818,638</u>
Operating Expenses		
Salaries and benefits	606,886	587,645
Purchased power	184,440	167,152
Contracted services	16,754	14,500
Insurance	206,543	198,457
Transportation	35,861	28,345
Administration and general	82,119	67,823
Sewer maintenance and treatment	242,834	184,559
Depreciation	581,937	556,867
Bad debt expense	27,060	14,922
Miscellaneous expense	<u>29,671</u>	<u>28,510</u>
Total Operating Expenses	<u>2,014,105</u>	<u>1,848,780</u>
Operating Income (Loss)	<u>282,207</u>	<u>(30,142)</u>
Non-operating Revenues (Expenses)		
Interest expense	(190,127)	(189,587)
Interest income	31,315	43,469
Grant revenue	965,081	57,127
Line relocation	-	(12,115)
Gain (loss) on sale/abandonment of asset	-	647
Miscellaneous nonoperating income	<u>2,392</u>	<u>2,275</u>
Total Non-operating Revenues (Expenses)	<u>808,661</u>	<u>(98,184)</u>
Change in Net Assets	1,090,868	(128,326)
Net Assets, Beginning of Year	<u>15,207,211</u>	<u>15,335,537</u>
Net Assets, End of Year	<u>\$ 16,298,079</u>	<u>\$ 15,207,211</u>

Jackson County Water Association, Incorporated  
 Statements of Cash Flows  
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities		
Receipts from customers	\$ 2,266,843	\$ 1,760,620
Payments to employees	(606,239)	(587,649)
Payments to suppliers	(794,768)	(671,988)
Payments for other activities	(29,671)	(28,510)
Net Cash Provided by Operating Activities	<u>836,165</u>	<u>472,473</u>
Cash Flows From Noncapital and Related Financing Activities		
State grants	965,081	57,127
Line relocations	-	(12,115)
Net Cash Provided by Noncapital and Related Financing Activities	<u>965,081</u>	<u>45,012</u>
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of property and equipment	(4,779,594)	(367,140)
Proceeds from sale of capital assets	-	700
Proceeds from advance on long-term debt	3,597,000	1,000
Principal payments on debt	(205,667)	(206,076)
Interest payments on debt	(182,776)	(190,120)
Other receipts/(payments)	2,392	2,275
Net Cash Used by Capital and Related Financing Activities	<u>(1,568,645)</u>	<u>(759,361)</u>
Cash Flows From Investing Activities		
Interest on investments	20,639	11,571
Redemptions of investments	-	1,200,000
Net Cash Provided by Investing Activities	<u>20,639</u>	<u>1,211,571</u>
Net Increase in Cash and Cash Equivalents	253,240	969,695
Cash and Cash Equivalents at Beginning of Year	<u>1,912,879</u>	<u>943,184</u>
Cash and Cash Equivalents at End of Year	<u>\$ 2,166,119</u>	<u>\$ 1,912,879</u>
Supplemental Disclosures		
Interest paid on long-term debt	<u>\$ 190,127</u>	<u>\$ 189,587</u>
Reconciliation of Cash at End of Year		
Cash and cash equivalents	\$ 1,141,722	\$ 631,952
Restricted cash and cash equivalents (see Note 2)	1,024,397	1,280,927
Total Cash at End of Year	<u>\$ 2,166,119</u>	<u>\$ 1,912,879</u>

Jackson County Water Association, Incorporated  
 Statements of Cash Flows (Continued)  
 For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of Operating Income (Loss) to Net Cash		
Provided by Operating Activities:		
Operating income (loss)	\$ 282,207	\$ (30,142)
Adjustments to reconcile operating income (loss) to net cash		
Provided by operating activities		
Depreciation	581,937	556,867
Changes in operating assets and liabilities		
(Increase) decrease in accounts receivable	(47,536)	(834)
Decrease (increase) in unbilled accounts receivable	17,817	(55,134)
(Increase) decrease in inventories	(9,999)	(1,292)
Decrease (increase) in prepaid expenses	(2,525)	1,298
Increase (decrease) in accounts payable	13,367	3,764
(Decrease) increase in accrued expenses	647	(4)
(Decrease) increase in customer deposits	250	(2,050)
	<u>\$ 836,165</u>	<u>\$ 472,473</u>
Net Cash Provided by Operating Activities	<u>\$ 836,165</u>	<u>\$ 472,473</u>

Jackson County Water Association, Incorporated  
Notes to Financial Statements  
December 31, 2011 and 2010

Note 1 – Summary of Significant Accounting Policies

Reporting Entity

Jackson County Water Association, Incorporated, of Jackson County, Kentucky (“Association”) was created in 1970 under Chapter 273 of the Kentucky Revised Statutes and is exempt from income taxes under Section 501(c)(4) of the Internal Revenue Code. The Association is governed by a three person Board of Directors, which is appointed by the Jackson County Fiscal Court, and is regulated by the Kentucky Public Service Commission.

The Association, a nonprofit corporation, is a rural water utility system whose purpose is to establish, develop and operate a water supply and distribution system for its members and customers in Jackson and Rockcastle Counties, Kentucky. The Association’s primary source of revenue is from water sales to its members and customers, including public bodies and local businesses in its service area.

Basis of Accounting, Financial Presentation, and Measurement Focus

Not-for-profit organizations ordinarily present their financial statements in accordance with Accounting Standards Codification (ASC) 958-205. ASC 958-205 requires reporting amounts for a not-for-profit organization’s total assets, liabilities, and net assets in a statement of financial position; reporting the change in an organization’s net assets in a statement of activities; and reporting the change in its cash and cash equivalents in a statement of cash flows. ASC 958-205 also requires net assets be displayed in three classes – permanently restricted, temporarily restricted, and unrestricted.

The Association’s financial position, results of operations and cash flows are presented, along with relevant disclosures, in a format ordinarily used by entities similar to the Association in their organization and purpose. While this format differs in some respects from the guidance of ASC 958-205, management believes the presentation used enhances the relevance, understandability, and comparability of financial statements to those issued by similar organizations. The Association’s financial statements provide the basic information required by ASC 958-205, focus on the entity as a whole, and meet the common needs of external users of the Association’s financial statements.

The basic financial statements of the Association have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) as applied to governmental units. The Governmental Accounting Standards Board (“GASB”) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

The Association applies all relevant Governmental Accounting Standards Board (GASB) pronouncements, Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements, in which case, GASB prevails. In addition, the Association applies all applicable FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements to its business-type activities.

The Statement of Net Assets and Statement of Revenues, Expenses and Changes in Net Assets display information about the Association as a whole. These statements include all funds of the Association. The statements distinguish between governmental and business-type activities. The Association does not have any governmental activities.

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 1 – Summary of Significant Accounting Policies (Continued)

Basis of Accounting, Financial Presentation, and Measurement Focus – Continued

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating income reported by the Association includes revenues and expenses related to the continuing operation of water service for its customers. Principal operating revenues are charges to customers for services. Principal operating expenses are the costs of providing the services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

Cash and Cash Equivalents

The Association considers demand deposits and certificates of deposits with maturities of 90 days or less to be cash equivalents.

Investments

Investments consist of certificates of deposits with maturity dates of three months or more.

Accounts Receivable

Receivables include amounts due from customers for water services. These receivables are due at the time the services are billed. Billing is completed monthly and accounts are considered past due on the twenty first day after the end of each billing period. Accounts receivable are presented net of uncollectible accounts. The allowance amount is estimated using a percentage of accounts past due more than 30 days. At December 31, 2011 and 2010, the allowance for doubtful accounts was \$12,633 and \$8,809.

Unbilled Accounts Receivable

Estimated unbilled revenues from water sales are recognized at the end of each fiscal year on a pro rata basis. The estimated amount is based on billing during the month following the close of the fiscal year

Inventory and Prepaid Expenses

Inventory, consisting primarily of water treatment chemicals, pipe and replacement parts for the water distribution system, is stated at cost on the first-in, first-out basis. Prepaid expenses record payments to vendors that benefit future reporting periods and are reported on the consumption basis.

Capital Assets

Properties and equipment are recorded at cost. Depreciation is provided by the straight-line method over the estimated useful life of the depreciable property. The range of useful lives of assets is as follows:

<u>Asset Classification</u>	<u>Range of Lives</u>
Water purification	20 - 40 years
Transmission mains and accessories	40 years
Buildings	40 years
Equipment and vehicles	5 - 10 years

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 1 – Significant Accounting Policies - Continued

Income Taxes

The Association has received notification from the Internal Revenue Service that it qualifies as a 501(c)(3) tax exempt organization and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code and similar provisions of state law.

The Association has adopted Accounting Standards Codification (ASC) 740-10 as it related to uncertain tax positions. Any interest and penalties recognized associated with a tax position are classified as current on the Association's financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Net Assets

Net assets comprise the various net earnings from operating income, non-operating revenues and expenses, and capital contributions. Net assets are classified in the following three components:

Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted – This component of net assets consists of constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

Note 2 – Restricted Assets

The Association includes all sinking fund deposits, funds required for other debt service, and funds related to specific projects or customer accounts to be restricted. At December 31, 2011 and 2010 restricted cash amounted to \$1,024,397 and \$1,280,927, respectively. This includes restrictions for customer deposits of \$17,755 and \$14,314 and restrictions for debt service of \$345,882 and \$335,802, respectively. This also included \$660,760 restricted at December 31, 2011 for capital projects.

During 2009, the Association received a grant in the amount of \$1,200,000, from the Jackson County Empowerment Zone. These funds were held in a certificate of deposit and was restricted for the use of constructing a raw water line. Construction of this project began in 2010 and the funds were moved out of the certificate of deposit and into a checking account. At December 31, 2011, the balance in this account totaled \$660,760.

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 3 – Custodial Credit Risk – Deposits

*Custodial Credit Risk – Deposits.* Custodial credit risk is the risk that in the event of a bank failure, the Association's deposits may not be returned to it. The Association does not have a deposit policy for custodial credit risk. As of December 31, 2011 and 2010, \$2,321,834 and \$3,067,165, respectively, of the Association's bank balances of \$4,512,092 and \$4,248,476 were exposed to custodial credit risk as follows:

	<u>2011</u>	<u>2010</u>
Uninsured and uncollateralized	\$ -	\$ 2,752,165
Uninsured and repurchase agreements held by bank	2,321,834	315,000
Uninsured and repurchase agreements held by bank's trust department not in the Association's name	-	-
Total	<u>\$ 2,321,834</u>	<u>\$ 3,067,165</u>

Note 4 – Capital Assets

Below is a summary of capital assets transactions for the year ended December 31, 2011:

	<u>Balance</u> <u>Dec. 31, 2010</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>Dec. 31, 2011</u>
Land and land rights	\$ 323,484	\$ -	\$ -	\$ 323,484
Source of supply and pumping	476,522	2,827	-	479,349
Water treatment	6,631,546	-	-	6,631,546
Transmission and distribution	13,099,176	4,827,529	-	17,926,705
General plant and transportation	1,234,527	12,538	-	1,247,065
Construction in progress	293,528	4,764,229	4,827,529	230,228
Total at Historical Costs	<u>22,058,783</u>	<u>9,607,123</u>	<u>4,827,529</u>	<u>26,838,377</u>
Less: accumulated depreciation				
Land and land rights	-	-	-	-
Source of supply and pumping	320,542	12,631	-	333,173
Water treatment	1,397,271	165,830	-	1,563,101
Transmission and distribution	4,773,259	337,117	-	5,110,376
General plant and transportation	723,843	66,359	-	790,202
Total accumulated depreciation	<u>7,214,915</u>	<u>581,937</u>	<u>-</u>	<u>7,796,852</u>
Property and Equipment - Net	<u>\$ 14,843,868</u>	<u>\$ 9,025,186</u>	<u>\$ 4,827,529</u>	<u>\$ 19,041,525</u>

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 4 – Capital Assets - Continued

Below is a summary of capital assets transactions for the year ended December 31, 2010:

	Balance Dec. 31, 2009	Additions	Deductions	Balance Dec. 31, 2010
Land and land rights	\$ 323,484	\$ -	\$ -	\$ 323,484
Source of supply and pumping	444,289	32,233	-	476,522
Water treatment	6,631,546	-	-	6,631,546
Transmission and distribution	11,896,776	1,202,400	-	13,099,176
General plant and transportation	1,228,322	7,005	800	1,234,527
Construction in progress	1,168,024	327,904	1,202,400	293,528
Total at Historical Costs	<u>21,692,441</u>	<u>1,569,542</u>	<u>1,203,200</u>	<u>22,058,783</u>
Less: accumulated depreciation				
Land and land rights	-	-	-	-
Source of supply and pumping	308,204	12,338	-	320,542
Water treatment	1,231,084	166,187	-	1,397,271
Transmission and distribution	4,463,715	309,544	-	4,773,259
General plant and transportation	655,790	68,800	747	723,843
Total accumulated depreciation	<u>6,658,793</u>	<u>556,869</u>	<u>747</u>	<u>7,214,915</u>
Property and Equipment - Net	<u>\$ 15,033,648</u>	<u>\$ 1,012,673</u>	<u>\$ 1,202,453</u>	<u>\$ 14,843,868</u>

Note 5 – Long-Term Debt

The following is a summary of long-term debt transactions for the year ended December 31, 2011:

	Balance Dec. 31, 2010	Additions	Payments	Balance Dec. 31, 2011	Due Within One Year
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through September 2017	181,622	-	(23,530)	158,092	24,649
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through February 2024	86,699	-	(4,669)	82,030	4,973

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 5 – Long-Term Debt (Continued)

5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through April 2024	52,368	-	(2,785)	49,583	2,957
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through January 2030	884,975	-	(28,413)	856,562	29,931
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through July 2035	826,502	-	(18,599)	807,903	19,624
2.45% note payable to the Kentucky Infrastructure Authority; due in annual installments, including interest, through June 2015	482,579	-	(102,717)	379,862	105,249
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through June 2043	1,691,770	-	(24,954)	1,666,816	24,605
2.5% note payable to the United States Department of Agriculture-Rural Development; payments to begin in 2013.					
	<u>1,000</u>	<u>3,597,000</u>	<u>-</u>	<u>3,598,000</u>	<u>-</u>
	<u>\$ 4,207,515</u>	<u>\$ 3,597,000</u>	<u>\$ (205,667)</u>	<u>\$ 7,598,848</u>	<u>\$ 211,988</u>

During the year ended December 31, 2010, the Association entered into a loan agreement with the United States Department of Agriculture Rural Development, to construct a raw water line. The total amount of the loan is \$3,598,000. As of December 31, 2011, draws against this loan totaled \$3,598,000. The loan is to be repaid over forty years, at an interest rate not to exceed 2.5%. The Association will begin making payments on this note in 2013 and interest payments will begin in 2012.

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 5 – Long-Term Debt (Continued)

Real estate mortgages on the property of the Association are pledged as collateral on the long-term debt. In addition, revenues from the operations of the Association are pledged as collateral on the long-term debt, as described in Note 2.

The following is a summary of long-term debt transactions for the year ended December 31, 2010:

	<u>Balance</u> <u>Dec. 31, 2009</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2010</u>	<u>Due Within</u> <u>One Year</u>
5% note payable to the United States Department of Agriculture-Rural Development; due in monthly installments, including interest, through April 2010	\$ 7,685	\$ -	\$ (7,685)	\$ -	\$ -
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through September 2017	204,007	-	(22,385)	181,622	23,449
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through February 2024	91,140	-	(4,441)	86,699	4,731
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through April 2024	55,017	-	(2,649)	52,368	2,813
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through January 2030	912,005	-	(27,030)	884,975	28,747
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through July 2035	844,284	-	(17,782)	826,502	18,764

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 5 – Long-term Debt (Continued)

2.45% note payable to the Kentucky Infrastructure Authority; due in annual installments, including interest, through June 2015

582,825                      -                      (100,246)                      482,579                      102,717

4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through June 2045

1,715,628                      -                      (23,858)                      1,691,770                      23,547

2.5% note payable to the United States Department of Agriculture-Rural Development; payments to begin after raw water line extension project is complete.

\_\_\_\_\_ -                      \_\_\_\_\_ 1,000                      \_\_\_\_\_ -                      \_\_\_\_\_ 1,000                      \_\_\_\_\_ -

\$ 4,412,591    \$ 1,000    \$ (206,076)    \$ 4,207,515    \$ 204,768

The annual requirements to retire long-term debt are as follows:

<u>December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	211,988	257,681	469,669
2013	280,691	249,817	530,508
2014	290,177	240,396	530,573
2015	243,077	230,565	473,642
2016	194,249	222,503	416,752
2017-2021	941,235	1,004,328	1,945,563
2022-2026	1,071,068	815,063	1,886,131
2027-2031	1,111,380	604,563	1,715,943
2032-2036	997,120	421,298	1,418,418
2037-2041	947,941	264,258	1,212,199
2042-2046	772,988	114,703	887,691
2047-2050	536,934	30,544	567,478
	<u>\$ 7,598,848</u>	<u>\$ 4,455,719</u>	<u>\$ 12,054,567</u>

Jackson County Water Association, Incorporated  
Notes to Financial Statements (Continued)  
December 31, 2011 and 2010

Note 6 – Retirement Plan

The Association has a retirement plan which covers employees age eighteen or older who have completed twelve months of service. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. The Association makes contributions to the plan on the basis of up to 4% of the participant's compensation. Plan expenses incurred by the Association during 2011, 2010, and 2009 was \$18,624, \$19,489 and \$17,869, respectively.

Note 7 – Income Tax

Additionally, the Association has adopted ASC 740-10 as it related to uncertain tax positions for the year ended December 31, 2011 and has evaluated it's tax positions taken for all open years. Currently, the 2011, 2010, 2009, 2008, and 2007 tax years are open and subject to examination by the Internal Revenue Service. However, the Association is not currently under audit nor has the Organization been contacted by any of these jurisdictions.

Note 8 – Risk Management

The Association is exposed to various risks of loss related to limited torts; theft of, damage to, and destruction of assets; errors and omissions and natural disasters for which the Association carries commercial insurance. There have been no significant reductions in coverage for the year and settlements have not exceeded coverage in the past three years.

Note 9 – Pending Litigation

The Association is currently the defendant in a pending litigation involving the construction of a collapsed water tank. Although the outcome of the lawsuit is undeterminable, the Association's attorney believes that the Association has limited exposure to loss, of which, insurance would cover. Therefore, the pending litigation is not believed to have a material effect on the financial position of the Association.

Note 10 – Subsequent Events

Date of Management Evaluation

Management of the District has evaluated subsequent events through March 27, 2012 the date on which the financial statements were available to be issued. No events have occurred subsequent to the date of the financial statements that would require adjustment to or disclosure in the financial statements.

Jackson County Water Association, Incorporated  
Schedule of Expenditures of Federal Awards  
For the Year Ended December 31, 2011

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Agriculture Rural Development Direct Loan:		
Water and Waste Water Loan and Grant Program	10.760	\$ 4,320,354
U.S. Department of Health and Human Services Direct Loan:		
Kentucky Highlands Empowerment Zone Program	93.585	<u>270,050</u>
 Total		 <u>\$ 4,590,404</u>

Footnote to Schedule of Expenditures of Federal Awards

(1) Expenditures on this schedule are reflected on the accounting basis as reported in the financial statements.

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 Commissioners  
Jackson County Water Association, Incorporated  
Tyner, Kentucky

We have audited the financial statements of Jackson County Water Association, Incorporated (a nonprofit organization), as of and for the year ended December 31, 2011, and have issued our report thereon dated March 27, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Jackson County Water Association, Incorporated's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses. (See items 2011-1 and 2011-2)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Jackson County Water Association, Incorporated's financial statements are free of material misstatements, 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 and other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the commissioners, others within the organization, the Public Service Commission, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Baldwin CPAs, PLLC*

Baldwin CPAs, PLLC  
March 27, 2012

Independent Auditors' Report On Compliance With Requirements  
That Could Have A Direct And Material Effect On Each Major Program And On Internal  
Control Over Compliance In Accordance  
With OMB Circular A-133

To the Commissioners  
Jackson County Water Association, Incorporated  
Tyner, Kentucky

Compliance

We have audited Jackson County Water Association, Incorporated's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Jackson County Water Association, Incorporated's major federal programs for the year ended December 31, 2011. Jackson County Water Association, Incorporated's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Jackson County Water Association, Incorporated's management. Our responsibility is to express an opinion on Jackson County Water Association, Incorporated's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Jackson County Water Association, Incorporated's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Jackson County Water Association, Incorporated's compliance with those requirements.

In our opinion, Jackson County Water Association, Incorporated complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2011. The results of our auditing procedures did not disclose any instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133.

Internal Control Over Compliance

Management of Jackson County Water Association, Incorporated is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Jackson County Water Association, Incorporated's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an

opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Jackson County Water Association, Incorporated's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the commissioners, others within the entity, the Public Service Commission, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Baldwin CPAs, PLLC*

Baldwin CPAs, PLLC  
March 27, 2012

Jackson County Water Association, Incorporated  
Schedule Of Findings And Questioned Costs  
Year Ended December 31, 2011

A. Summary of Audit Results

1. The auditors' report expresses an unqualified opinion on the financial statements of Jackson County Water Association, Incorporated.
2. Two material weaknesses related to the audit of the financial statements were reported in the 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*.
3. There were no instances of noncompliance material to the financial statements of Jackson County Water Association, Incorporated.
4. There were no significant deficiencies related to the audit of major program discussed in the Independent Auditors' Report on Compliance with Requirements that Could have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133.
5. The auditors' report on compliance for the major federal awards program for Jackson County Water Association, Incorporated expresses an unqualified opinion.
6. There were no audit findings relative to the major federal award program for Jackson County Water Association, Incorporated.
7. The program tested as major was: CFDA#  
10.760  
Water and Waste Loan and Grant Program
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Jackson County Water Association, Incorporated did not qualify as a low-risk auditee.

Jackson County Water Association, Incorporated  
Schedule Of Findings And Questioned Costs  
Year Ended December 31, 2011

A. Findings – Financial Statement Audit

2011-1

**Criteria:**

As discussed in *Standards for Internal Control in the Federal Government* published by the General Accounting Office of the United States, internal control is an integral component of an organization's management that provides reasonable assurance that an objective of reliable financial reporting is being achieved. Organizations should implement procedures to ensure this objective is achieved.

**Condition:**

During the audit procedures performed, instances of this objective not being completely achieved were noted.

**Cause:**

The Association's limited internal resources prevents the preparation of financial statements and related note disclosures in accordance with Generally Accepted Accounting Principles.

**Effect:**

The Association was unable to prepare or review their financial statements and related note disclosures in accordance with Generally Accepted Accounting Principles.

**Views of responsible officials and planned corrective actions:**

The Association understands the responsibility related to financial reporting rests with management. The Association also understands the cost benefit concept with regard to this particular finding. The Association believes it is not cost effective to attempt to overcome this finding. Management has reviewed a draft of the financial statements and accepts responsibility for its contents.

2011-2

**Criteria:**

As discussed in *Standards for Internal Control in the Federal Government* published by the General Accounting Office of the United States, internal control is an integral component of an organization's management that provides reasonable assurance that an objective of reliable financial reporting is being achieved. Organizations should implement procedures to ensure this objective is achieved.

**Condition:**

During the audit procedures performed, instances of this objective not being completely achieved were noted.

**Cause:**

The size of the Association's office staff does not allow for proper segregation of duties in the areas of accounts receivable, cash receipts, and payroll.

**Effect:**

This condition creates a weakness in internal controls that could provide opportunity for misappropriation of funds that may not be detected.

**Views of responsible officials and planned corrective actions:**

The Association does not believe it is cost effective to hire additional staff to overcome this finding. The Association will consider implementing mitigating controls to reduce risk related to lack of segregation of duties.

Jackson County Water Association, Incorporated  
Summary of Prior Year Audit Findings  
Year Ended December 31, 2011

Status of Prior Year Audit Findings

No audit findings in the prior year.