

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

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Judy Water Association, Inc.

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Financial Statements and
Independent Auditor's Report
December 31, 2011 and 2010

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Independent Auditor's Report

To the Board of Directors
Judy Water Association, Inc.

We have audited the accompanying statements of financial position of Judy Water Association, Inc. as of December 31, 2011 and 2010, and the related statements of activities, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of Judy Water Association, Inc.'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 audit 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 Judy Water Association, Inc. as of December 31, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 25, 2012 on our consideration of Judy Water Association, Inc.'s internal control over financial reporting and 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 should be considered in assessing the results of our audit.

Faulkner, King & Wenz, PSC

January 25, 2012

LIABILITIES AND NET ASSETS

	<u>2011</u>	<u>2010</u>
CURRENT LIABILITIES		
Accounts payable	\$ 32,294	\$ 81,166
Taxes and benefits payable	11,457	13,651
Water deposits payable	8,882	7,212
Accrued interest payable	57,668	59,689
Current portion of long-term debt	<u>40,376</u>	<u>38,164</u>
 TOTAL CURRENT LIABILITIES	 <u>150,677</u>	 <u>199,882</u>
 LONG-TERM LIABILITIES		
Long-term debt	<u>2,183,622</u>	<u>2,225,455</u>
 TOTAL LIABILITIES	 <u>2,334,299</u>	 <u>2,425,337</u>
 NET ASSETS		
Unrestricted net assets - general	(1,167,492)	(887,576)
Unrestricted net assets - contributed capital	5,783,947	5,768,947
Temporarily restricted net assets	<u>484,971</u>	<u>321,567</u>
 TOTAL NET ASSETS	 <u>5,101,426</u>	 <u>5,202,938</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 7,435,725</u>	 <u>\$ 7,628,275</u>

JUDY WATER ASSOCIATION, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
OPERATING INCREASES IN UNRESTRICTED		
NET ASSETS		
Water sales	\$1,167,630	\$1,189,391
Miscellaneous income	5,530	7,464
	<u>1,173,160</u>	<u>1,196,855</u>
OPERATING DECREASES IN UNRESTRICTED		
NET ASSETS		
Water purchased	391,531	413,435
Supplies	42,683	29,846
Salaries and payroll taxes	269,133	251,803
Retirement	27,604	27,604
Contract labor	7,841	9,863
Directors fees	18,068	20,576
Office supplies	8,223	7,339
Data processing fees	6,997	6,976
Testing	1,930	2,259
Insurance	44,244	38,918
Telephone and utilities	18,669	20,035
Professional services	12,108	12,122
General expense	6,308	5,880
Regulation expense	1,830	1,743
Repairs and maintenance	23,776	25,312
Meals and entertainment	8,285	8,670
Bad debt and leak adjustments	0	489
Postage	8,437	7,896
	<u>897,667</u>	<u>890,766</u>
TOTAL OPERATING DECREASES IN UNRESTRICTED		
NET ASSETS	<u>897,667</u>	<u>890,766</u>
OPERATING INCREASE IN UNRESTRICTED		
NET ASSETS BEFORE DEPRECIATION	275,493	306,089
Depreciation	<u>(294,946)</u>	<u>(294,711)</u>
OPERATING (DECREASE) INCREASE IN UNRESTRICTED		
NET ASSETS	<u>(19,453)</u>	<u>11,378</u>
NONOPERATING INCREASES (DECREASES) IN		
UNRESTRICTED NET ASSETS		
Interest income	10,208	16,594
Interest expense	<u>(107,267)</u>	<u>(115,371)</u>
	<u>(97,059)</u>	<u>(98,777)</u>
NET DECREASE IN		
UNRESTRICTED NET ASSETS	<u>\$ (116,512)</u>	<u>\$ (87,399)</u>

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

**JUDY WATER ASSOCIATION, INC.
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Contributed Capital Members	Contributed Capital Rural Development	Contributed Capital Bourbon Co. Project
Balances, January 1, 2010	\$ (908,768)	\$ 430,158	\$ 934,302	\$ 1,002,300	\$ 479,063
Net change in unrestricted net assets	(87,399)				
Transfer to temporarily restricted net assets	108,591	(108,591)			
Contributions	-	-	9,250	-	-
Balances, December 31, 2010	(887,576)	321,567	943,552	1,002,300	479,063
Net change in unrestricted net assets	(116,512)				
Transfer to temporarily restricted net assets	(163,404)	163,404			
Contributions	-	-	15,000	-	-
Balances, December 31, 2011	<u>\$ (1,167,492)</u>	<u>\$ 484,971</u>	<u>\$ 958,552</u>	<u>\$ 1,002,300</u>	<u>\$ 479,063</u>

The accompanying notes are an integral part of the financial statements

Contributed Capital Montgomery Co. Fiscal Court	CDBG Grant Bourbon Co. Project	KIA Radio Read/Hydrant Grants	Grants Bourbon Co. Project	Tobacco Grants	KIA HB 608 Grant	Total
\$ 100,000	\$ 1,000,000	\$ 150,000	\$ 1,434,032	\$ 485,000	\$ -	\$ 5,106,087
						(87,399)
						-
-	-	-	-	-	175,000	184,250
100,000	1,000,000	150,000	1,434,032	485,000	175,000	5,202,938
						(116,512)
						-
-	-	-	-	-	-	15,000
<u>\$ 100,000</u>	<u>\$ 1,000,000</u>	<u>\$ 150,000</u>	<u>\$ 1,434,032</u>	<u>\$ 485,000</u>	<u>\$ 175,000</u>	<u>\$ 5,101,426</u>

JUDY WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating (decrease) increase in unrestricted net assets	\$ (19,453)	\$ 11,378
Adjustments to reconcile operating change in unrestricted net assets to net cash provided by operating activities:		
Depreciation expense	294,946	294,711
Changes in operating assets and liabilities:		
Accounts receivable	4,257	(6,759)
Unbilled water revenue	(512)	(4,101)
Prepaid expenses and other current assets	976	(2,587)
Accounts payable	(48,872)	46,091
Taxes and benefits payable	(2,194)	3,084
Water deposits payable	1,670	(545)
	230,818	341,272
CASH PROVIDED BY OPERATING ACTIVITIES		
CASH FLOWS FROM FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(38,875)	(183,604)
Proceeds from sale of fixed assets	4,000	-
Interest paid on RD loans	(109,288)	(122,719)
Principal payments on borrowings	(39,621)	(297,969)
Proceeds from tap-on fees	15,000	9,250
Proceeds from grants	-	175,000
	(168,784)	(420,042)
CASH USED FOR FINANCING ACTIVITIES		
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income received	10,311	16,590
	10,311	16,590
CASH PROVIDED BY INVESTING ACTIVITIES		
NET INCREASE (DECREASE) IN CASH	72,345	(62,180)
CASH AT BEGINNING OF YEAR	1,028,166	1,090,346
CASH AT END OF YEAR	\$ 1,100,511	\$ 1,028,166
CASH CONSISTS OF:		
Cash - unrestricted	\$ 615,540	\$ 706,599
Cash - temporarily restricted	484,971	321,567
	\$ 1,100,511	\$ 1,028,166

JUDY WATER ASSOCIATION, INC
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

Note 1 - Significant Accounting Policies

Introduction:

Judy Water Association, Inc. is a water utility which operates in Montgomery County and parts of Bourbon, Bath, Clark, and Nicholas counties in Kentucky, and its sales are primarily to residential customers. The Association was incorporated March 6, 1972 as a nonstock, nonprofit corporation formed under the provisions of Chapter 273 of the Kentucky Revised Statutes (KRS). The Association began providing water services to customers in 1991.

Regulation Requirements:

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

Basis of Accounting:

The accrual basis of accounting is used for financial statement reporting purposes.

Basis of presentation:

Financial statement presentation follows the recommendations of the ASC 958-205-05 (formerly Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations"). Under ASC 958-205-05, the Association is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. Accordingly, all net assets of the Association have been recorded as unrestricted or temporarily restricted.

Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Association considers all highly liquid debt instruments purchased with a maturity of one year or less to be cash equivalents.

Property, plant and equipment:

Property, plant and equipment are stated at original cost. The cost of repairs and maintenance is charged to the proper expense account as incurred. Property replacements are capitalized and retirements are charged to the proper plant account and depreciation provision. The thresholds for capitalization are:

Buildings and grounds	\$5,000
Building improvements	\$5,000
Water systems	\$5,000
Land	\$5,000
Vehicles and equipment	\$1,000

Depreciation:

Depreciation is applied on the straight-line method over the estimated useful life of the asset and is recognized in accordance with ASC 958-360-05 (formerly SFAS No. 93, "Recognition of Depreciation by Not-for-Profit Organizations"). The range of useful lives used in computing depreciation is:

<u>Classification</u>	<u>Range of lives</u>
Buildings and grounds	20-40 years
Building improvements	20-40 years
Water systems	10-30 years
Office equipment	7-10 years
Other equipment	7 years
Vehicles	5 years

Total depreciation expense was \$294,946 and \$294,711 for the years ended December 31, 2011 and 2010, respectively.

JUDY WATER ASSOCIATION, INC
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2011 AND 2010

Note 1 - Significant Accounting Policies (Continued)

Purchased Water Costs:

Water purchases are charged to expense as delivered to the distribution system. The Association has been economically dependent on Mt. Sterling Water and Sewer System as the primary supplier of water. The Association purchases water from Mt. Sterling Water and Sewer System and City of North Middletown.

Contributed Capital:

Water tap-on fees and grant proceeds from Rural Development, the Department of Housing and Urban Development, the Bourbon County Fiscal Court, the Montgomery County Fiscal Court and other sources are accounted for as contributed capital and were used in financing capital improvements to the water system.

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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Account Receivable:

Accounts receivable are stated at the amounts management expects to collect from outstanding charges for water sales less an allowance for doubtful accounts of \$2,618 and \$2,152 in 2011 and 2010, respectively.

Capitalized interest:

The Association follows the policy of capitalizing interest as a component of construction cost.

Income Tax Status:

The Association is a nonprofit tax-exempt organization as prescribed by Internal Revenue Code, Section 501 c (12). Accordingly, the financial statements include no provision for income taxes.

The Accounting Standards Codification (ASC) 740-10-50, (formerly the Financial Accounting Standards Board Interpretation (FIN 48), *Accounting for Uncertainty in Income Taxes*) requires entities to disclose known or anticipated positions of income tax uncertainty. The Association is not aware of any uncertain income tax positions as of January 25, 2012. The Association has never been audited by the Internal Revenue Service (IRS). However, the tax years of 2008 forward could be subject to examination by the IRS or other applicable tax jurisdictions.

Note 2 - Utility Plant in Service

The cost of Water System assets is summarized below by major categories:

	2011	2010
Water towers	\$ 653,992	\$ 653,992
Transmission and distribution mains	7,115,001	7,115,001
Meters and meter installations	<u>1,065,711</u>	<u>1,057,296</u>
Total cost	<u>\$8,834,704</u>	<u>\$8,826,289</u>

JUDY WATER ASSOCIATION, INC
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

Note 3 - Long-Term Debt

Long-term debt at December 31, 2011 and 2010 consists of the following:

	<u>2011</u>		<u>2010</u>	
	<u>Current</u>	<u>Noncurrent</u>	<u>Current</u>	<u>Noncurrent</u>
Rural Development, dated October 19, 1990, annual payment due each October 19, with interest rate of 5%, total interest and principal payment of \$38,361, final payment due October 19, 2030	\$ 15,282	\$ 446,291	\$ 13,824	\$ 461,869
Rural Development, dated June 14, 2000, annual payment due each June 14, with interest rate of 5%, total interest and principal payment of \$73,342, final payment due June 14, 2040.	16,424	1,093,208	15,913	1,109,995
Rural Development, dated March 18, 2004, annual payment due each March 18, with interest rate of 4.250%, total interest and principal payment of \$37,206, final payment due March 18, 2044.	<u>8,670</u>	<u>644,123</u>	<u>8,427</u>	<u>653,591</u>
	<u>\$ 40,376</u>	<u>\$2,183,622</u>	<u>\$ 38,164</u>	<u>\$2,225,455</u>

The above loans are secured by a statutory mortgage lien on the water supply and distribution system as well as all present and future contract rights, accounts receivable, and general intangibles of the Association and is subject to early redemption by the Association prior to maturity. The loan agreements also outline various compliance requirements.

Installments due for principal and interest for each of the next five years and in total are as follows:

Years ended December 31	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012 (included in current liabilities)	\$ 40,376	\$ 108,533	\$ 148,909
2013	44,559	104,350	148,909
2014	46,714	102,195	148,909
2015	48,971	99,938	148,909
2016	51,340	97,569	148,909
Later years	<u>1,992,038</u>	<u>1,343,188</u>	<u>3,335,226</u>
Total	<u>\$2,223,998</u>	<u>\$1,855,773</u>	<u>\$ 4,079,771</u>

JUDY WATER ASSOCIATION, INC
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

Note 4 - Special Funds and Restrictions

The debt agreements with Rural Development require the following accounts be maintained by the utility as long as any outstanding debt remains:

General account - All operating funds received shall be deposited in this account. Funds will be used for operating and maintenance expenses and will be transferred to other accounts as needed.

Funded depreciation reserve account - This account was required to be established in the first month of the first full fiscal year after the water facility became operational and also used for the current Bourbon County expansion project. The Association was required to deposit \$320 plus \$325 plus \$685, totaling \$1,330, monthly until the reserve reached a balance of \$38,400 plus \$39,000 plus \$82,200, totaling \$159,600. These funds may be used for debt service or for unusual repairs or improvements if proper approvals are obtained and no funds are available in the general account. The balances as of December 31, 2011 and 2010 were \$338,205 and \$334,392, respectively.

Debt service reserve account - Required deposits of \$12,409 and \$13,876 for 2011 and 2010, respectively, were to be made monthly into this account. Funds were to be used to make payments on Rural Development notes payable some of which were paid off in 2010. The balances in this reserve account were \$322,462 and \$130,179 as of December 31, 2011 and 2010, respectively.

Construction Project accounts - Amounts received and deposited into these accounts will be used to fund all expenditures related to the Cecil Road - Rogers Mill Project. These accounts had balances of \$2,909 and \$31,788 as of December 31, 2011 and 2010, respectively.

Note 5 - Commitments and Contingencies

Grants:

The Association has received grants from Rural Development in connection with the construction of water lines. These grants require the fulfillment of certain conditions as set forth in the terms of the grant. Management is not aware of any violations of these conditions.

Water Purchase Contract:

Judy Water Association has entered into an agreement with the Mount Sterling Water and Sewer Commission whereby the Commission will provide potable treated water to the Association. The agreement was amended August 8, 2004 for a term of 42 years and Judy Water Association is to receive up to 15 million gallons of water per month.

Note 6 - Concentration of Credit Risk

The Association sells water to residential, agricultural, and commercial customers in much of rural Montgomery County and parts of Bourbon, Bath, Clark, and Nicholas counties, in Kentucky, and is subject to the credit risks associated with serving an agricultural based area.

JUDY WATER ASSOCIATION, INC
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

Note 7 - Risk Management

The Association 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 Association also carries commercial insurance for all other risks of losses such as workers compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

Note 8 - Pension Plan

Judy Water Association, Inc. established a simplified employee pension plan (SEP) in 2005 covering all employees. The Association can contribute a minimum of 3% of gross wages and a maximum of 15% of gross wages. The contribution percentage is determined by the Board of Directors.

The Association had a total of 6 employees at December 31, 2011 and 2010 covered by the SEP. The employer contributed 15% of gross wages in 2011 and 2010. The Association's contribution was \$27,604 and \$27,604 for the years ended December 31, 2011 and 2010, respectively.

Note 9 - Cash and Cash Equivalents

The Association's deposits and investments at December 31, 2011 were not entirely covered by federal depository insurance or by collateral held by the custodial banks in the Association's name. The Association was under insured by \$88,205. Subsequent to year end the Association reinvested funds into the CDARS program and, therefore, was sufficiently insured.

Note 10 - Subsequent Events

Subsequent events for Judy Water Association, Inc. have been evaluated through January 25, 2012, which is the date the financial statements were available to be issued.

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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 Directors
Judy Water Association, Inc.

We have audited the financial statements of Judy Water Association, Inc. as of and for the year ended December 31, 2011, and have issued our report thereon dated January 25, 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 Judy Water Association, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

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.

Our consideration of the internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified the deficiency in internal control over financial reporting, described on the next page, that we consider to be a significant deficiency in internal control over financial reporting. 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.

Finding: 2011-1

- Condition: While management is certainly knowledgeable in regard to the numbers reported in the financial statements, identifying and applying new authoritative guidance in regard to information reported in the notes to those statements is outside the scope of management's training and experience.
- Management Response and Corrective Action Plan: It does not appear that it would be economically feasible for our organization to enlarge its staff or contract an individual with appropriate skill and knowledge in applying new authoritative guidance. Thus, it is important that our Board provide oversight and independent review functions.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Judy Water Association, Inc.'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*.

Judy Water Association, Inc.'s response to the findings identified in our audit is described in the paragraph above. We did not audit Judy Water Association, Inc.'s response and, accordingly, we express no opinion on it

This report is intended solely for the information and use of management, the Board of Directors, others within the organization, Rural Development, 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.

Faulkner, King & Wenz, PSC

January 25, 2012