

**Southeastern Water Association, Inc.**

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**Audited Financial Statements  
and Supplemental Information**

**for the years ended December 31, 2011 and 2010**



**Southeastern Water Association, Inc.**

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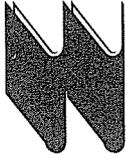
**Audited Financial Statements  
and Supplemental Information**

**for the years ended December 31, 2011 and 2010**

## C O N T E N T S

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## Independent Auditors' Report

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To the Board of Directors  
Southeastern Water Association, Inc.  
Somerset, Kentucky

We have audited the accompanying statements of financial position of Southeastern Water Association, Inc. (a nonprofit organization) as of December 31, 2011 and 2010, and the related statements of activities, 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southeastern Water Association, Inc. as of December 31, 2011 and 2010, and the changes in its net assets and 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 August 3, 2012, on our consideration of Southeastern Water Association Inc.'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,

To the Board of Directors  
Southeastern Water Association, Inc.  
Page 2

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* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying 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 not a required part of the financial statements. Such information 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 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 schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

Somerset, Kentucky  
August 3, 2012

A handwritten signature in black ink that reads "Wills + Company, PSC". The signature is written in a cursive, flowing style.

**Southeastern Water Association, Inc.**  
**Statements of Financial Position**  
**December 31, 2011 and 2010**

	2011	2010
<b>Assets</b>		
Current assets		
Cash	\$ 253,204	\$ 85,165
Accounts receivable, net	302,326	194,718
Inventory	50,205	50,833
Prepaid expenses	<u>38,552</u>	<u>29,842</u>
Total current assets	<u>644,287</u>	<u>360,558</u>
Restricted cash	1,682,518	553,390
Property and equipment, net	<u>23,724,606</u>	<u>20,081,273</u>
Total assets	<u>\$ 26,051,411</u>	<u>\$ 20,995,221</u>
<b>Liabilities and Net Assets</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 528,477	\$ 151,143
Accrued interest	82,687	38,190
Advance tap-on fees	33,215	32,699
Current portion of long-term debt	<u>174,046</u>	<u>165,904</u>
Total current liabilities	<u>818,425</u>	<u>387,936</u>
Non-current liabilities		
Loans payable to Rural Development	11,804,869	8,169,632
Loans payable to Capmark	<u>197,768</u>	<u>212,201</u>
Total non-current liabilities	<u>12,002,637</u>	<u>8,381,833</u>
Total liabilities	<u>12,821,062</u>	<u>8,769,769</u>
Net assets		
Unrestricted		
Membership fees	105,816	100,716
Tap-on fees	3,923,844	3,887,794
Donated capital - federal grants	7,718,253	7,619,333
Donated capital - other grants	1,340,404	1,347,357
Reserved under debt covenants	1,682,518	553,390
Other	<u>(1,540,486)</u>	<u>(1,283,138)</u>
Total net assets	<u>13,230,349</u>	<u>12,225,452</u>
Total liabilities and net assets	<u>\$ 26,051,411</u>	<u>\$ 20,995,221</u>

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

**Southeastern Water Association, Inc.**  
**Statements of Activities**  
**For the Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b>Operating revenues</b>		
Sales	\$ 3,689,183	\$ 2,582,370
Cost of water sold	<u>(1,234,072)</u>	<u>(1,299,656)</u>
Net revenues from water	<u>2,455,111</u>	<u>1,282,714</u>
 <b>General and administrative</b>		
Depreciation	725,047	723,634
Wages	298,205	287,656
Maintenance	85,792	68,318
Insurance expense	151,450	134,190
Other general and administrative	91,172	92,275
Customer billing	95,143	93,984
Directors' fees	43,000	48,000
Office expense	45,299	56,986
Bad debts	14,330	27,854
Professional fees	40,004	43,378
Tax and license	<u>33,541</u>	<u>32,279</u>
Total general and administrative	<u>1,622,983</u>	<u>1,608,554</u>
 Net income (loss) from operations	<u>832,128</u>	<u>(325,840)</u>
 <b>Non-operating revenues (expenses)</b>		
Capital contributions - federal grants	305,391	206,470
Capital contributions - other grants	220,013	226,966
Interest income	1,508	3,328
Gain (loss) on disposal of equipment	-	(1,508)
Interest expense	<u>(395,293)</u>	<u>(402,768)</u>
Total non-operating revenues (expenses)	<u>131,619</u>	<u>32,488</u>
 <b>Change in net assets</b>	 963,747	 (293,352)
 Unrestricted net assets - beginning	 12,225,452	 12,467,644
Transfer (to) from unrestricted net assets to reserved for debt covenants	(1,129,128)	10,243
Membership fees collected	5,100	4,390
Tap-on fees collected	36,050	46,770
Reserved for debt covenants	<u>1,129,128</u>	<u>(10,243)</u>
 <b>Ending Net Assets</b>	 <u>13,230,349</u>	 <u>12,225,452</u>

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

**Southeastern Water Association, Inc.**  
**Statements of Cash Flows**  
**For the Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities</b>		
Net income from operations	\$ 832,128	\$ (325,840)
Adjustments to reconcile net income from operations to net cash provided by operating activities		
Depreciation	725,047	723,634
Bad Debts	14,330	3,019
(Increase) decrease in		
Inventory	628	(10,089)
Accounts receivable	(121,938)	6,187
Prepaid expenses	(8,710)	1,219
Increase (decrease) in		
Accounts payable and accrued liabilities	377,334	8,432
Advance tap-on fees	516	516
Accrued interest	<u>44,497</u>	<u>(978)</u>
Net cash provided by operating activities	<u>1,863,832</u>	<u>406,100</u>
<b>Cash flows from investing activities</b>		
Interest income	1,508	3,328
Investment in (redemption of) certificates of deposit	-	169,116
Proceeds from sale of property	-	1,200
Cash payments for the purchase and construction of fixed assets	<u>(4,368,380)</u>	<u>(513,098)</u>
Net cash used by investing activities	<u>(4,366,872)</u>	<u>(339,454)</u>
<b>Cash flows from financing activities</b>		
Interest expense	(395,293)	(402,768)
Proceeds from federal grants	305,391	206,470
Proceeds from other grants	220,013	226,966
Proceeds from tap on and membership fees	41,150	51,159
Proceeds from long-term debt	3,797,152	-
Principal payments on long-term debt	<u>(168,206)</u>	<u>(164,658)</u>
Net cash provided by financing activities	<u>3,800,207</u>	<u>(82,831)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	1,297,167	(16,185)
<b>Cash and cash equivalents, beginning of year</b>	<u>638,555</u>	<u>654,740</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 1,935,722</u>	<u>\$ 638,555</u>
<b>Supplemental disclosures of cash flow information</b>		
Cash paid during the period for interest	<u>\$ 350,796</u>	<u>\$ 403,746</u>

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

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

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**1. Summary of Significant Accounting Policies**

Southeastern Water Association, Inc. (the Association) is a nonprofit organization, exempt under Internal Revenue Code Section 501(c)(12). The Association was formed as a result of an order by the Public Service Commission of Kentucky which required the merger of Nelson Valley Water Association, Inc., Tateville Water Association, Inc., Elihu-Rush Branch Water Association, Inc. and Barnesburg Water Association, Inc. The Association purchases water from the City of Somerset Water Service and distributes the water to residents of the Nelson Valley, Tateville, Elihu-Rush Branch and Barnesburg areas of Pulaski County, Kentucky. The accompanying financial statements are presented on the accrual basis of accounting.

The Association falls under the oversight and regulations of the Kentucky Public Service Commission and accordingly follows their prescribed Uniform System of Accounts.

**Accounts Receivable**

The Association extends credit to substantially all of its customers. Accounts receivable are stated at the face amount of the water bills, which approximates fair market value. Specific accounts deemed uncollectible are charged to bad debt upon evaluation by management. Evaluation factors include familiarity with the customer, credit history and the age of the unpaid bill.

**Allowance for Doubtful Accounts**

The Association maintains an allowance for doubtful accounts based on percentages applied to the various aging periods of accounts receivable. The accounts receivable balance at December 31, 2011 and 2010 is stated net of the allowance balance of \$34,953 and \$20,623, respectively.

**Inventory**

Inventory of the Association consists of supplies and materials for Association use. This inventory is valued at first-in, first-out cost, which approximates market.

**Property and Equipment**

Property and equipment with useful lives of more than one year are stated at historical cost. The costs of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized. Depreciation is computed using straight line over estimated useful lives ranging from 5 to 40 years.

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

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**1. Summary of Significant Accounting Policies**

**Advance Tap-On Fees**

The Association allows potential customers to pay tap-on fees in advance of construction of lines. Amounts paid in advance remain payable back to the customer until the customer receives water service. Upon receipt of water service the tap-on fee is reclassified to members' equity.

**Grants**

Grants received by the Association that are used to offset the acquisition, improvement or construction costs of the Association's property, facilities or equipment used to provide utility services to the public are recorded as non-operating revenue. Grant revenues are transferred at year end to the equity account Donated Capital.

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, designated members' equity and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

For purposes of the statement of cash flows, the Association considers cash in the bank and certificates of deposit with an original maturity of 90 days or less, both restricted and unrestricted, to be cash and cash equivalents.

**Advertising Costs**

Advertising costs are expensed when incurred. Advertising costs for the years ending December 31, 2011 and 2010 were \$0 and \$1,802, respectively.

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

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**2. Collateralization**

The Association held deposits at one bank. Accounts at an institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Cash at this institution exceeded FDIC insured limits. The amounts in excess of the FDIC limit totaled \$1,695,598 and \$402,326 at December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, the entire excess amount is collateralized with securities held in the name of the financial institution and pledged to the Association. Securities cannot be moved or redeemed without prior approval of the Association.

**3. Property and Equipment**

The cost of property and equipment at December 31, 2011 and 2010 is as follows:

	December 31, 2011	December 31, 2010
Transmission and distribution system	\$ 27,737,026	\$ 27,704,667
Construction work in process	4,351,948	30,740
Equipment	462,274	451,458
Land and land rights (nondepreciable)	40,902	36,902
Property and equipment	32,592,150	28,223,767
Less accumulated depreciation	(8,867,542)	(8,142,494)
Property and equipment, net	\$ 23,724,608	\$ 20,081,273

During the years ended December 31, 2011 and 2010, interest, on debt, of \$45,038 and \$0, respectively, was capitalized into construction work in process.

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

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**4. Long-Term Liabilities**

**Loans Payable to Rural Development**

Loans from Rural Development (RD) financed installation of distribution mains and water lines. Real estate and revenues sufficient to fund the annual debt service secure the loans. The loans require that a reserve account be maintained to cover the cost of repairing or replacing any damage, for making extensions or improvements and, if necessary, making principal and interest payments. The Association is required to make monthly deposits of \$2,209 into a depreciation reserve account until the balance reaches \$265,000. As of December 31, 2011 and 2010, the depreciation reserve account balance was \$442,904 and \$404,561 respectively. The total amount of restricted cash related to RD commitments at December 31, 2011 and 2010 was \$461,766 and \$423,347, respectively, including a debt service account.

The balances on the RD loans are as follows:

	<u>December 31,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>
2.375% loan dated February 2, 2011, payable in annual installments of \$160,799, including interest, through February 2, 2054, with interest only payable on February 2, 2012 and February 2, 2013.	\$ 3,797,152	\$ -
4.375% loan dated November 8, 2006, payable in annual installments of \$149,956, including interest, through November 8, 2046.	2,654,002	2,687,068
4.5% loan dated September 17, 2004, payable in annual installments of \$101,567, including interest, through September 17, 2044.	1,715,654	1,739,601
4.875% loan dated July 10, 2001, payable in annual installments of \$86,241, including interest, through July 10, 2041.	1,314,490	1,340,125
4.5% loan dated February 12, 1997, payable in annual installments of \$13,853, including interest, through February 12, 2039.	\$ 189,987	\$ 193,976

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

**4. Long-Term Liabilities**

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
4.5% loan dated February 12, 1997, payable in annual installments of \$9,562, including interest, through February 12, 2037.	\$ 121,338	\$ 123,915
5.0% loan dated February 12, 1997, payable in annual installments of \$63,306, including interest, through January 1, 2033.	747,245	768,291
5% loan dated February 12, 1997, payable in annual installments of \$46,499, including interest, through January 1, 2032.	497,899	512,180
4.5% loan dated September 14, 1995, payable in annual installments of \$7,536, including interest, through September 9, 2035.	95,868	98,099
4.5% loan dated September 14, 1995, payable in annual installments of \$13,133, including interest, through September 9, 2035.	183,402	187,703
5% loan dated September 14, 1995, payable in annual installments of \$34,426, including interest, through January 1, 2029.	377,638	392,562
5% loan dated October 17, 1991, payable in annual installments of \$22,294, including interest, through October 31, 2031.	<u>272,094</u>	<u>280,553</u>
	11,966,769	8,324,073
Less current portion	<u>(161,900)</u>	<u>(154,441)</u>
	<u>\$ 11,804,869</u>	<u>\$ 8,169,632</u>

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

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**4. Long-Term Liabilities**

The Association has a *Supplementary Payment Agreement* with RD in place in which loan payments are made in monthly installments. The monthly installments are adequate to cover the annual requirements of all outstanding RD loans.

**Loans Payable to Capmark**

Loans from Capmark, formerly GMAC Commercial Mortgage, financed installation of distribution mains and water line to customers. Assets and revenues sufficient to fund the annual debt service secure the loans.

The balances on the Capmark loans are as follows:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
5.0% loan dated January 1992, payable in annual installments of \$6,343, including interest, through January 2011.	\$ -	\$ 1,874
5.0% loan dated June 1996, payable in annual installments of \$14,693, including interest, through June 2024.	130,089	137,906
7.35% loan dated June 1996, payable in annual installments of \$14,693, including interest, through June 2024.	<u>79,825</u>	<u>83,884</u>
	209,914	223,664
Less current portion	<u>(12,146)</u>	<u>(11,463)</u>
	<u>\$ 197,768</u>	<u>\$ 212,201</u>

**Southeastern Water Association, Inc.**  
**Notes to Financial Statements**  
**For the Years Ended December 31, 2011 and 2010**

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**4. Long-Term Liabilities**

The following table shows estimated maturities of all long-term debt:

2012	\$ 174,046
2013	182,591
2014	257,478
2015	268,458
Later years	<u>11,294,110</u>
	<u>\$ 12,176,683</u>

Interest incurred on all debt during the years ended December 31, 2011 and 2010 totaled \$440,331 and \$402,768, respectively. During the years ended December 31, 2011 and 2010 interest of \$45,038 and \$0 was capitalized into work in process.

**5. Retirement Plan**

The Association adopted a simplified employee pension plan (SEP) in 1999. This discretionary plan covers substantially all employees. During 2011 and 2010 the Association made plan contributions calculated at 2% of gross wages for qualifying employees for total employer contributions of \$6,332 and \$13,730, respectively.

**6. Subsequent Events**

Subsequent events have been evaluated through July 31, 2012, which is the date the financial statements were available to be issued. Events occurring after that date have not been evaluated to determine whether a change in the financial statements would be required.

**Supplemental Schedule**

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**Southeastern Water Association, Inc.**  
**Schedule of Expenditure of Federal Awards**  
**for the years ended December 31, 2011 and 2010**

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Pass-Through Grantors Number	Program or Award Amount	2011 Expenditures
<u>Department of Agriculture</u>				
Passed through Rural Economic and Community Development Agency				
* RUS Loan	10.760	N/A	\$ 3,995,000	\$ 3,905,417
RUS Grant	10.760	N/A	\$ 1,655,000	<u>-</u>
Total Expenditure of Federal Awards				<u>\$ 3,905,417</u>

\* Denotes major program.

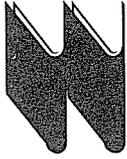
**Notes to Schedule of Expenditures of Federal Awards**

**1. Significant Accounting Policies**

The accompanying schedule of expenditures of federal awards is a summary of the Southeastern Water Association, Inc.'s federal award programs presented on the accrual basis of accounting in accordance with generally accepted accounting principles.

**2. Federal Loan Information**

At December 31, 2011 and 2010, the Association had outstanding balances on various Rural Economic and Community Development Agency loans totaling \$11,966,768.49 and \$8,324,072.30 respectively.



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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***

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To the Board of Directors  
Southeastern Water Association, Inc.  
Somerset, Kentucky

We have audited the financial statements of Southeastern Water Association, Inc. (a nonprofit organization) as of and for the years ended December 31, 2011 and 2010, and have issued our report thereon dated August 3, 2012. 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.

Internal Control Over Financial Reporting

Management of Southeastern Water Association Inc. is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audits, we considered Southeastern 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 Southeastern Water Association, Inc.'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 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 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.

Board of Directors  
Southeastern Water Association, Inc.  
Page 2

We noted certain matters that we have reported to management of Southeastern Water Association, in a separate letter dated August 3, 2012.

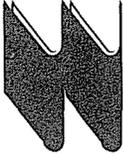
Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southeastern 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 audits and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Somerset, Kentucky  
August 3, 2012

A handwritten signature in black ink, appearing to read "J. H. Campbell, P.C.", with a stylized flourish at the end.



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**Independent Auditor's 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***

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To the Board of Directors  
Southeastern Water Association, Inc.  
Somerset, Kentucky

Compliance

We have audited the compliance of Southeastern Water Association, Inc. 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 Southeastern Water Association's major federal programs for the years ended December 31, 2011 and 2010. Southeastern Water Association, Inc.'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 Southeastern Water Association, Inc.'s management. Our responsibility is to express an opinion on Southeastern Water Association, Inc.'s compliance based on our audits.

We conducted our audits 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 Southeastern Water Association, Inc.'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 Southeastern Water Association, Inc.'s compliance with those requirements.

In our opinion, Southeastern Water Association, Inc. 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 years ended December 31, 2011 and 2010.

Internal Control Over Compliance

The management of Southeastern Water Association, Inc. is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Southeastern Water Association, Inc.'s internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our 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 Southeastern Water Association, Inc.'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 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.

We noted certain matters that we have reported to management of Southeastern Water Association, in a separate letter dated August 3, 2012.

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

Somerset, Kentucky  
August 3, 2012



**South Eastern Water Association, Inc.**  
**Schedule of Findings and Questioned Costs**  
**For the Year Ended December 31, 2011**

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**(A) Summary of Audit Results**

1. An unqualified opinion was issued on the financial statements of Southeastern Water Association, Inc. as of and for the year ended December 31, 2011.
2. No significant deficiencies relating to the audit of the financial statements are reported in the *Report on Internal Control over Financial Reporting and on Compliance and Other Matters on an audit of Financial Statements Performed in Accordance with Government Auditing Standards*.
3. The audit did not disclose any noncompliance which is material to the financial statements of Southeastern Water Association, Inc. as of and for the year ended December 31, 2011.
4. No significant deficiencies in internal control over major federal award programs were reported in the *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 auditor's report on compliance for the major federal award program for Southeastern Water Association, Inc. expresses an unqualified opinion on all major federal programs.
6. The audit did not disclose any findings that are required to be reported in accordance with Circular A-133.
7. The Association had the following major programs for the year ended December 31, 2011:

RUS Loan

8. The dollar threshold for distinguishing between Type A and Type B programs was \$300,000. The Association had the following Type A programs for the year ended December 31, 2011:

RUS Loan

9. The Association did not qualified as a low-risk auditee under OMB Circular A-133 *Audits of States, Local Governments and Non-Profit Organizations*.

**South Eastern Water Association, Inc.**  
**Summary Schedule of Prior Audit Findings**  
**For the Year Ended December 31, 2011**

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There were no findings noted during the prior period.