

PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

MAR 06 2013

RECEIVED

EXAMINED BY _____

Judy Water Association, Inc.

* * * *

Financial Statements and
Independent Auditor's Report
December 31, 2012 and 2011

TABLE OF CONTENTS

| <u>Description</u> | <u>Page #</u> |
|---|---------------|
| Independent Auditor's Report | 1-2 |
| Statements of Financial Position | 3-4 |
| Statements of Activities | 5 |
| Statements of Changes in Net Assets | 6-7 |
| Statements of Cash Flows | 8 |
| Notes to the Financial Statements | 9-13 |
| Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> | 14-15 |

FAULKNER, KING & WENZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS

HARVEY K. FAULKNER, CPA
JOSEPH C. KING, CPA
JOHN M. WENZ, CPA

P.O. BOX 285
117 WEST HIGH STREET
MT. STERLING, KY 40353
(859) 498-1836 FAX: (859) 498-2116

EUGENE C. WEATHERS, III, CPA
KAREN S. TRENT, CPA
LANA J. McCANN, CPA
ERICA M. SNOWDEN, CPA
JENNIFER L. TACKETT, CPA

Independent Auditor's Report

To the Board of Directors
Judy Water Association, Inc.

Report on the Financial Statements

We have audited the accompanying statements of financial position of Judy Water Association, Inc., as of December 31, 2012 and 2011, and the related statements of activities, changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

Judy Water Association, Inc.

Page 2

evaluating the overall presentation of the financial statements.

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

Opinion

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, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 28, 2013 on our consideration of Judy 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, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Judy Water Association, Inc.'s internal control over financial reporting and compliance.

Faulkner, King & Wenz, PSC

Mt. Sterling, Kentucky

February 28, 2013

LIABILITIES AND NET ASSETS

| | <u>2012</u> | <u>2011</u> |
|---|-----------------------------|-----------------------------|
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 47,781 | \$ 32,294 |
| Taxes and benefits payable | 12,043 | 11,457 |
| Water deposits payable | 9,132 | 8,882 |
| Accrued interest payable | 51,506 | 57,668 |
| Current portion of long-term debt | <u>28,591</u> | <u>40,376</u> |
| TOTAL CURRENT LIABILITIES | <u>149,053</u> | <u>150,677</u> |
| LONG-TERM LIABILITIES | | |
| Long-term debt | <u>1,707,120</u> | <u>2,183,622</u> |
| TOTAL LIABILITIES | <u>1,856,173</u> | <u>2,334,299</u> |
| NET ASSETS | | |
| Unrestricted net assets - general | (1,010,677) | (1,167,492) |
| Unrestricted net assets - contributed capital | 5,802,697 | 5,783,947 |
| Temporarily restricted net assets | <u>232,216</u> | <u>484,971</u> |
| TOTAL NET ASSETS | <u>5,024,236</u> | <u>5,101,426</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 6,880,409</u> | <u>\$ 7,435,725</u> |

JUDY WATER ASSOCIATION, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

| | 2012 | 2011 |
|--|--------------------|---------------------|
| OPERATING INCREASES IN UNRESTRICTED NET ASSETS | | |
| Water sales | \$1,259,376 | \$1,172,501 |
| Miscellaneous income | 4,299 | 5,530 |
| | 1,263,675 | 1,178,031 |
| OPERATING DECREASES IN UNRESTRICTED NET ASSETS | | |
| Water purchased | 435,957 | 391,531 |
| Supplies | 53,940 | 42,683 |
| Salaries and payroll taxes | 278,405 | 269,133 |
| Retirement | 28,204 | 27,604 |
| Contract labor | 10,850 | 7,841 |
| Directors fees | 18,000 | 18,068 |
| Office supplies | 10,676 | 8,223 |
| Data processing fees | 9,652 | 6,997 |
| Testing | 2,295 | 1,930 |
| Insurance | 43,175 | 44,244 |
| Telephone and utilities | 18,894 | 18,669 |
| Professional services | 11,315 | 12,108 |
| General expense | 7,603 | 6,308 |
| Regulation expense | 0 | 1,830 |
| Repairs and maintenance | 20,679 | 23,776 |
| Meals and entertainment | 8,797 | 8,285 |
| Bad debt and leak adjustments | 4,215 | 4,871 |
| Postage | 8,351 | 8,437 |
| | 971,008 | 902,538 |
| TOTAL OPERATING DECREASES IN UNRESTRICTED NET ASSETS | | |
| OPERATING INCREASE IN UNRESTRICTED NET ASSETS BEFORE DEPRECIATION | 292,667 | 275,493 |
| Depreciation | (290,722) | (294,946) |
| | 1,945 | (19,453) |
| OPERATING INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS | | |
| NONOPERATING INCREASES (DECREASES) IN UNRESTRICTED NET ASSETS | | |
| Interest income | 6,533 | 10,208 |
| Interest expense | (104,418) | (107,267) |
| | (97,885) | (97,059) |
| NET DECREASE IN UNRESTRICTED NET ASSETS | \$ (95,940) | \$ (116,512) |

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 | \$ 175,000 | \$ 5,202,938 |
| | | | | | | (116,512) |
| - | - | - | - | - | - | - |
| | | | | | | 15,000 |
| 100,000 | 1,000,000 | 150,000 | 1,434,032 | 485,000 | 175,000 | 5,101,426 |
| | | | | | | (95,940) |
| - | - | - | - | - | - | - |
| | | | | | | 18,750 |
| <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>\$ 5,024,236</u> |

**JUDY WATER ASSOCIATION, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Operating increase (decrease) in unrestricted net assets | \$ 1,945 | \$ (19,453) |
| Adjustments to reconcile operating change in unrestricted net assets to net cash provided by operating activities: | | |
| Depreciation expense | 290,722 | 294,946 |
| Provision for bad debts | 4,215 | 4,871 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (3,217) | (614) |
| Unbilled water revenue | (3,900) | (512) |
| Prepaid expenses and other current assets | (302) | 976 |
| Accounts payable | 15,487 | (48,872) |
| Taxes and benefits payable | 586 | (2,194) |
| Water deposits payable | 250 | 1,670 |
| CASH PROVIDED BY OPERATING ACTIVITIES | <u>305,786</u> | <u>230,818</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Acquisition and construction of capital assets | (40,645) | (38,875) |
| Proceeds from sale of fixed assets | - | 4,000 |
| Interest paid on RD loans | (110,580) | (109,288) |
| Principal payments on borrowings | (488,287) | (39,621) |
| Proceeds from tap-on fees | 18,750 | 15,000 |
| CASH USED FOR FINANCING ACTIVITIES | <u>(620,762)</u> | <u>(168,784)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest income received | 6,575 | 10,311 |
| CASH PROVIDED BY INVESTING ACTIVITIES | <u>6,575</u> | <u>10,311</u> |
| NET (DECREASE) INCREASE IN CASH | <u>(308,401)</u> | <u>72,345</u> |
| CASH AT BEGINNING OF YEAR | <u>1,100,511</u> | <u>1,028,166</u> |
| CASH AT END OF YEAR | <u>\$ 792,110</u> | <u>\$ 1,100,511</u> |
| CASH CONSISTS OF: | | |
| Cash - unrestricted | \$ 559,894 | \$ 615,540 |
| Cash - temporarily restricted | 232,216 | 484,971 |
| | <u>\$ 792,110</u> | <u>\$ 1,100,511</u> |

JUDY WATER ASSOCIATION, INC
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011

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 \$290,722 and \$294,946 for the years ended December 31, 2012 and 2011, respectively.

JUDY WATER ASSOCIATION, INC
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2012 AND 2011

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 \$3,038 and \$2,618 in 2012 and 2011, respectively.

The following table presents the balance in the allowance for doubtful accounts as of December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|------------------------|------------------------|------------------------|
| Allowance for Doubtful | | |
| Accounts: | | |
| Beginning balance | \$ 2,618 | \$ 2,152 |
| Net Charge-offs | (3,795) | (4,405) |
| Provision | <u>4,215</u> | <u>4,871</u> |
| Ending balance | <u><u>\$ 3,038</u></u> | <u><u>\$ 2,618</u></u> |

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 February 28, 2013. The Association has never been audited by the Internal Revenue Service (IRS). However, the tax years of 2009 forward could be subject to examination by the IRS or other applicable tax jurisdictions.

JUDY WATER ASSOCIATION, INC
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2012 AND 2011

Note 2 - Utility Plant in Service

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

| | <u>2012</u> | <u>2011</u> |
|-------------------------------------|--------------------|--------------------|
| Water towers | \$ 653,992 | \$ 653,992 |
| Transmission and distribution mains | 7,115,001 | 7,115,001 |
| Meters and meter installations | <u>1,091,607</u> | <u>1,065,711</u> |
| Total cost | <u>\$8,860,600</u> | <u>\$8,834,704</u> |

Note 3 - Long-Term Debt

Long-term debt at December 31, 2012 and 2011 consists of the following:

| | <u>2012</u> | | <u>2011</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, paid off December 18, 2012 | \$ -0- | \$ -0- | \$ 15,282 | \$ 446,291 |
| 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. | 18,753 | 1,073,019 | 16,424 | 1,093,208 |
| 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>9,838</u> | <u>634,101</u> | <u>8,670</u> | <u>644,123</u> |
| | <u>\$ 28,591</u> | <u>\$1,707,120</u> | <u>\$ 40,376</u> | <u>\$2,183,622</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.

JUDY WATER ASSOCIATION, INC
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2012 AND 2011

Note 3 - Long-Term Debt - Continued

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> |
|--|--------------------|--------------------|---------------------|
| 2013 (included in current liabilities) | \$ 28,591 | \$ 81,957 | \$ 110,548 |
| 2014 | 29,948 | 80,600 | 110,548 |
| 2015 | 31,369 | 79,179 | 110,548 |
| 2016 | 32,856 | 77,692 | 110,548 |
| 2017 | 34,416 | 76,132 | 110,548 |
| Later years | <u>1,578,531</u> | <u>1,107,901</u> | <u>2,686,432</u> |
| Total | <u>\$1,735,711</u> | <u>\$1,503,461</u> | <u>\$ 3,239,172</u> |

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 maintain a balance of \$121,200 and \$159,600 for the years ended December 31, 2012 and 2011, respectively. 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, 2012 and 2011 were \$340,847 and \$338,205, respectively.

Debt service reserve account - Required deposits of \$12,409 for 2012 and 2011, 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 2012. The balances in this reserve account were \$4,558 and \$322,462 as of December 31, 2012 and 2011, respectively. The Association plans to transfer excess funds from the depreciation reserve account to fully fund this reserve, which was depleted by its December 18, 2012 payoff of the 1990 loan.

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 \$468 and \$2,909 as of December 31, 2012 and 2011, 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.

JUDY WATER ASSOCIATION, INC
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011

Note 5 - Commitments and Contingencies - Continued

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.

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, 2012 and 2011 covered by the SEP. The employer contributed 15% of gross wages in 2012 and 2011. The Association's contribution was \$28,204 and \$27,604 for the years ended December 31, 2012 and 2011, respectively.

Note 9 - Cash and Cash Equivalents

The Association's deposits and investments at December 31, 2012 were entirely covered by federal depository insurance or by collateral held by the custodial banks in the Association's name.

Note 10 - Reclassifications

Certain reclassifications have been made to the 2011 financial statement presentation to correspond to the current year's format. Total equity and net income are unchanged due to these reclassifications.

Note 11 - Subsequent Events

Subsequent events for Judy Water Association, Inc. have been evaluated through February 28, 2013, which is the date the financial statements were available to be issued.

FAULKNER, KING & WENZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS

HARVEY K. FAULKNER, CPA
JOSEPH C. KING, CPA
JOHN M. WENZ, CPA

P.O. BOX 285
117 WEST HIGH STREET
MT. STERLING, KY 40353
(859) 498-1836 FAX: (859) 498-2116

EUGENE C. WEATHERS, III, CPA
KAREN S. TRENT, CPA
LANA J. McCANN, CPA
ERICA M. SNOWDEN, CPA
JENNIFER L. TACKETT, CPA

REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Independent Auditor's Report

To the Board of Directors
Judy Water Association, Inc.

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Judy Water Association, Inc., which comprise the statement of financial position as of December 31, 2012, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 28, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Judy Water Association, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Judy Water Association, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Judy Water Association, Inc.'s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described on the next page.

Finding: 2012-1

- 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 from 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 Findings

Judy Water Association, Inc.'s response to the findings identified in our audit is described in the paragraph above. Judy Water Association, Inc.'s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Faulkner, King & Wenz, PSC

Mt. Sterling, Kentucky
February 28, 2013