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Jackson County Water Association, Incorporated
Tyner, Kentucky

Independent Auditors' Report
And Financial Statements
For the Years Ended
December 31, 2012 and 2011

Jackson County Water Associaton, Incorporated
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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying statement of net position of Jackson County Water Association, Incorporated (a nonprofit organization) as of December 31, 2012, and the related statements of revenues, expenses, and changes in net position and cash flows for the year 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Jackson County Water Association, Incorporated, as of December 31, 2012, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted the Management'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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Jackson County Water Association, Incorporated's basic financial statements. 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 basic 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 basic 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 basic financial statements or to the basic 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 basic financial statements as a whole.

The financial statements of Jackson County Water Association, Incorporated as of December 31, 2011, were audited by other auditors whose report dated March 29, 2012, expressed an unmodified opinion on those statements.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 1, 2013 on our consideration of the Jackson County Water Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Jackson County Water Association's internal control over financial reporting and compliance.

Christian Sturgeon & Associates, PSC

Christian Sturgeon & Associates, PSC
London, Kentucky

April 1, 2013



	<u>2012</u>	<u>2011</u>
Liabilities		
Current Liabilities		
Current portion of long-term debt	280,691	211,988
Accounts payable	39,401	67,053
Accrued interest payable	19,741	19,741
Accrued salaries and taxes payable	33,712	28,570
Customer deposits	9,900	10,500
Total Current Liabilities	<u>383,445</u>	<u>337,852</u>
Noncurrent Liabilities		
Long-term debt, less current portion included in current liabilities	<u>7,104,920</u>	<u>7,386,860</u>
Total Noncurrent Liabilities	<u>7,104,920</u>	<u>7,386,860</u>
Total Liabilities	<u>7,488,365</u>	<u>7,724,712</u>
Net Position		
Net investment in capital assets	12,210,220	11,442,677
Restricted for:		
Capital projects	439,009	660,760
Debt service	335,962	345,882
Other purposes	17,123	17,755
Unrestricted	4,280,410	3,859,570
Total Net Position	<u>\$ 17,282,724</u>	<u>\$ 16,326,644</u>

Jackson County Water Association, Incorporated
 Statements of Revenues, Expenses and Changes in Net Position
 For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Revenues		
Water sales	\$ 2,117,436	\$ 2,113,021
Other operating income	<u>181,249</u>	<u>183,291</u>
Total Operating Revenues	<u>2,298,685</u>	<u>2,296,312</u>
Operating Expenses		
Salaries and benefits	639,566	606,886
Purchased power	174,276	184,440
Contracted services	19,694	16,754
Insurance	235,253	206,543
Transportation	37,353	35,861
Administration and general	80,997	82,119
Maintenance and water treatment	254,652	242,834
Depreciation	697,919	581,937
Bad debt expense	26,729	27,060
Miscellaneous expense	<u>25,732</u>	<u>29,671</u>
Total Operating Expenses	<u>2,192,171</u>	<u>2,014,105</u>
Operating Income	<u>106,514</u>	<u>282,207</u>
Non-operating Revenues (Expenses)		
Interest expense	(256,138)	(190,127)
Interest income	22,425	31,315
Grant revenue	1,087,274	965,081
Line relocation	(14,320)	-
Miscellaneous non-operating income	<u>10,325</u>	<u>2,392</u>
Total Non-operating Revenues (Expenses)	<u>849,566</u>	<u>808,661</u>
Change in Net Position	956,080	1,090,868
Net Position, Beginning of Year	16,326,644	15,207,211
Restatement (Note 9)	-	28,565
Net Position, Beginning of Year as Restated	<u>16,326,644</u>	<u>15,235,776</u>
Net Position, End of Year	<u>\$ 17,282,724</u>	<u>\$ 16,326,644</u>

Jackson County Water Association, Incorporated
 Statements of Cash Flows
 For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flows From Operating Activities		
Receipts from customers	\$ 2,295,236	\$ 2,266,843
Payments to employees	(634,424)	(606,239)
Payments to suppliers	(866,681)	(794,768)
Payments for other activities	(25,732)	(29,671)
Net Cash Provided by Operating Activities	<u>768,399</u>	<u>836,165</u>
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of property and equipment	(1,252,225)	(4,779,594)
Proceeds from advance on long-term debt	-	3,597,000
Principal payments on debt	(213,237)	(205,667)
Interest payments on debt	(256,138)	(182,776)
State and federal grants	1,009,280	965,081
Line relocations	(14,320)	-
Other receipts/(payments)	10,325	2,392
Net Cash Used by Capital and Related Financing Activities	<u>(716,315)</u>	<u>(603,564)</u>
Cash Flows From Investing Activities		
Interest on investments	23,259	20,639
Net Cash Provided by Investing Activities	<u>23,259</u>	<u>20,639</u>
Net Increase in Cash and Cash Equivalents	75,343	253,240
Cash and Cash Equivalents at Beginning of Year	<u>2,166,119</u>	<u>1,912,879</u>
Cash and Cash Equivalents at End of Year	<u>\$ 2,241,462</u>	<u>\$ 2,166,119</u>
Supplemental Disclosures		
Interest paid on long-term debt	<u>\$ 256,138</u>	<u>\$ 190,127</u>
Reconciliation of Cash at End of Year		
Cash and cash equivalents	\$ 1,449,368	\$ 1,141,722
Restricted cash and cash equivalents	792,094	1,024,397
Total Cash at End of Year	<u>\$ 2,241,462</u>	<u>\$ 2,166,119</u>

Jackson County Water Association, Incorporated
 Statements of Cash Flows (Continued)
 For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities:		
Operating income	\$ 106,514	\$ 282,207
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	697,919	581,937
Changes in operating assets and liabilities		
(Increase) decrease in accounts receivable	(5,312)	(47,536)
Decrease (increase) in unbilled accounts receivable	2,463	17,817
(Increase) decrease in inventories	(7,725)	(9,999)
Decrease (increase) in prepaid expenses	(2,350)	(2,525)
Increase (decrease) in accounts payable	(27,652)	13,367
(Decrease) increase in accrued expenses	5,142	647
(Decrease) increase in customer deposits	(600)	250
	\$ 768,399	\$ 836,165
Net Cash Provided by Operating Activities	\$ 768,399	\$ 836,165

Jackson County Water Association, Incorporated
Notes to Financial Statements
December 31, 2012 and 2011

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 Position and Statement of Revenues, Expenses and Changes in Net Position 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, 2012 and 2011

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, 2012 and 2011, the allowance for doubtful accounts was \$15,253 and \$12,633, respectively.

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 represent payments to vendors that benefit future reporting periods and are reported on the consumption basis.

Jackson County Water Association, Incorporated
Notes to Financial Statements (Continued)
December 31, 2012 and 2011

Note 1 – Significant Accounting Policies (Continued)

Capital Assets

Property 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

Income Taxes

The Association has received notification from the Internal Revenue Service that it qualifies as a 501(c)(4) 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 relates to uncertain tax positions and has evaluated its tax positions taken for all open years. Currently, the 2012, 2011, 2010, and 2009 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.

Any interest and penalties recognized associated with a tax position are classified as current in 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

In 2012, the Association adopted new accounting guidance, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Amounts have been reclassified in the 2011 financial statements to conform to the new presentation.

Net position is comprised of the various net earnings from operating income, non-operating revenues and expenses, and capital contributions. Net position is classified in the following three components:

Net investment in capital assets – This component of net position 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 position 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.

Jackson County Water Association, Incorporated
Notes to Financial Statements (Continued)
December 31, 2012 and 2011

Note 1 – Significant Accounting Policies (Continued)

Net Assets (Continued)

Unrestricted net assets – This component of net position consists of net amounts of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the net investment in capital assets or the restricted component of net position.

Note 2 – Restricted Assets

The Association considers 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, 2012 and 2011 restricted cash amounted to \$792,094 and \$1,024,397, respectively. This includes restrictions for customer deposits of \$17,123 and \$17,755, respectively, and restrictions for debt service of \$335,962 and \$345,882, respectively. This also includes \$439,009 and \$660,760 restricted for capital projects at December 31, 2012 and 2011, respectively.

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 were 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, 2012, the balance in this account totaled \$439,009.

Note 3 – 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, 2012 and 2011, \$2,254,645 and \$2,232,924, respectively, of the Association's bank balances of \$4,566,343 and \$4,512,092 were exposed to custodial credit risk as follows:

	<u>2012</u>	<u>2011</u>
Uninsured and uncollateralized	\$ -	\$ -
Uninsured and repurchase agreements held by bank	2,254,645	2,232,924
Uninsured and repurchase agreements held by bank's trust department not in the Association's name	-	-
Total	<u>\$ 2,254,645</u>	<u>\$ 2,232,924</u>

Jackson County Water Association, Incorporated
Notes to Financial Statements (Continued)
December 31, 2012 and 2011

Note 4 – Capital Assets

Below is a summary of capital assets transactions for the year ended December 31, 2012:

	Balance Dec. 31, 2011	Additions	Deductions	Balance Dec. 31, 2012
Land and land rights	\$ 323,485	\$ -	\$ -	\$ 323,485
Source of supply and pumping	479,349	56,199	-	535,548
Water treatment	6,631,546	-	-	6,631,546
Transmission and distribution	17,926,706	850,510	-	18,777,216
General plant and transportation	1,247,065	56,537	-	1,303,602
Construction in progress	230,227	519,205	230,227	519,205
Total at Historical Costs	<u>26,838,378</u>	<u>1,482,451</u>	<u>230,227</u>	<u>28,090,602</u>
Less: accumulated depreciation				
Land and land rights	-	-	-	-
Source of supply and pumping	333,173	13,007	-	346,180
Water treatment	1,563,101	165,830	-	1,728,931
Transmission and distribution	5,110,377	452,142	-	5,562,519
General plant and transportation	790,202	66,939	-	857,141
Total accumulated depreciation	<u>7,796,853</u>	<u>697,918</u>	<u>-</u>	<u>8,494,771</u>
Property and Equipment - Net	<u>\$ 19,041,525</u>	<u>\$ 784,533</u>	<u>\$ 230,227</u>	<u>\$ 19,595,831</u>

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

	Balance Dec. 31, 2010	Additions	Deductions	Balance Dec. 31, 2011
Land and land rights	\$ 323,485	\$ -	\$ -	\$ 323,485
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	4,827,530	-	17,926,706
General plant and transportation	1,234,527	12,538	-	1,247,065
Construction in progress	293,528	4,764,228	4,827,529	230,227
Total at Historical Costs	<u>22,058,784</u>	<u>9,607,123</u>	<u>4,827,529</u>	<u>26,838,378</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	4,773,260	337,117	-	5,110,377
General plant and transportation	723,843	66,359	-	790,202
Total accumulated depreciation	<u>7,214,916</u>	<u>581,937</u>	<u>-</u>	<u>7,796,853</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, 2012 and 2011

Note 5 – Long-Term Debt

The following is a summary of long-term debt transactions for the year ended December 31, 2012:

	<u>Balance</u> <u>Dec. 31, 2011</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2012</u>	<u>Due Within</u> <u>One Year</u>
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through September 2017	\$ 158,092	-	\$ (24,734)	\$ 133,358	\$ 25,910
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through February 2024	82,030	-	(4,907)	77,123	5,227
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through April 2024	49,583	-	(2,927)	46,656	3,108
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through January 2030	856,562	-	(29,866)	826,696	31,463
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through July 2035	807,903	-	(19,454)	788,449	20,527
2.45% note payable to the Kentucky Infrastructure Authority; due in annual installments, including interest, through June 2015	379,862	-	(105,249)	274,613	107,843

Jackson County Water Association, Incorporated
Notes to Financial Statements (Continued)
December 31, 2012 and 2011

Note 5 – Long-Term Debt (Continued)

	<u>Balance</u> <u>Dec. 31, 2011</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2012</u>	<u>Due Within</u> <u>One Year</u>
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through June 2043	1,666,816	-	(26,100)	1,640,716	25,713
2.5% note payable to the United States Department of Agriculture-Rural Development; payments to begin in 2013.	<u>3,598,000</u>	<u>-</u>	<u>-</u>	<u>3,598,000</u>	<u>60,900</u>
	<u>\$ 7,598,848</u>	<u>\$ -</u>	<u>\$ (213,237)</u>	<u>\$ 7,385,611</u>	<u>\$ 280,691</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, 2012, 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 began in 2012.

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, 2011:

	<u>Balance</u> <u>Dec. 31, 2010</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2011</u>	<u>Due Within</u> <u>One Year</u>
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
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

Jackson County Water Association, Incorporated
Notes to Financial Statements (Continued)
December 31, 2012 and 2011

Note 5 – Long-term Debt (Continued)

	<u>Balance</u> <u>Dec. 31, 2010</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>Dec. 31, 2011</u>	<u>Due Within</u> <u>One Year</u>
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 2045	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 after raw water line extension project is complete.	1,000	\$ 3,597,000	-	3,598,000	-
	<u>\$ 4,207,515</u>	<u>\$ 3,597,000</u>	<u>\$ (205,667)</u>	<u>\$ 7,598,848</u>	<u>\$ 211,988</u>

Jackson County Water Association, Incorporated
Notes to Financial Statements (Continued)
December 31, 2012 and 2011

Note 5 – Long-term Debt (Continued)

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

<u>Year Ended</u> <u>December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	191,878	214,709	406,587
2018-2022	954,991	968,691	1,923,682
2023-2027	1,097,972	774,182	1,872,154
2028-2032	1,079,372	564,847	1,644,219
2033-2037	974,679	387,419	1,362,098
2038-2042	978,375	233,825	1,212,200
2043-2047	693,004	92,623	785,627
2048-2050	407,146	18,461	425,607
	<u>\$ 7,385,611</u>	<u>\$ 4,198,038</u>	<u>\$ 11,583,649</u>

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 2012, 2011, and 2010 were \$20,562, \$18,624 and \$19,489, respectively.

Note 7 – 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 8 – Subsequent Events

Date of Management Evaluation

Management of the Association has evaluated subsequent events through April 1, 2013, the date on which the financial statements were available to be issued.

Note 9 – Prior Period Adjustment

Net position and inventories were restated at January 1, 2011 to correct the amount of prior year's inventories which had been cumulatively understated by \$28,565.

Jackson County Water Association, Incorporated
Schedule of Expenditures of Federal Awards
For the Year Ended December 31, 2012

<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 Water and Waste Water Loan and Grant Program	10.760	\$752,824

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.



Independent Auditors' 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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Audit Standards* issued by the Comptroller General of the United States, the financial statements of the Jackson County Water Association, Incorporated as of and for the year ended December 31, 2012 and the related notes to the financial statements, which collectively comprise the Jackson County Water Association's basic financial statements, and have issued our report thereon dated April 1, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Jackson County Water Association, Incorporated'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Jackson County Water Association, Incorporated's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses. (See items 2012-1 and 2012-2)

Compliance and Other Matters

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

Jackson County Water Association's Response to Findings

Jackson County Water Association, Incorporated's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Jackson County Water Association, Incorporated'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 results 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 on 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.

Christian Sturgeon & Associates, PSC

Christian Sturgeon & Associates, PSC
London, Kentucky

April 1, 2013



Independent Auditors' Report On Compliance For Each
Major Program And On Internal Control Over Compliance
Required by OMB Circular A-133

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

Report on Compliance for Each Major Federal Program

We have audited the 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 the Jackson County Water Association, Incorporated's major federal programs for the year ended December 31, 2012. Jackson County Water Association, Incorporated's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of Jackson County Water Association, Incorporated's major federal programs based on our audit of the types of compliance requirements referred to above. 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 on compliance for each major federal program. However, our audit does not provide a legal determination of Jackson County Water Association, Incorporated's compliance.

Opinion on Each Major Federal Program

In our opinion, Jackson County Water Association, Incorporated complied, in all material respects, with the types of 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, 2012.

Report on Internal Control Over Compliance

Management of Jackson County Water Association, Incorporated is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Jackson County Water Association, Incorporated's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for purpose of expressing an opinion on compliance for each major federal program 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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Christian Sturgeon & Associates, PSC

Christian Sturgeon & Associates, PSC
London, Kentucky

April 1, 2013

Jackson County Water Association, Incorporated
Schedule Of Findings And Questioned Costs
Year Ended December 31, 2012

A. Summary of Audit Results

1. The auditors' report expresses an unmodified 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 Independent Auditors' 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 material weaknesses related to the audit of major program discussed in the Independent Auditors' Report on Compliance for Each Major Program And On Internal Control Over Compliance Required by OMB Circular A-133.
5. The auditors' report on compliance for the major federal award program for Jackson County Water Association, Incorporated expresses an unmodified 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, 2012

A. Findings – Financial Statement Audit

2012-1

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 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.

2012-2

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, 2012

<u>Original Finding Number</u>	<u>Major Program</u>	<u>Current Status</u>
2011-1	Financial Statement Finding	Unresolved
2011-2	Financial Statement Finding	Unresolved