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Southeastern Water Association, Inc.

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Audited Financial Statements
and Supplemental Information

for the years ended December 31, 2012 and 2011

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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Southeastern Water Association, Inc. which comprise the statements of financial position as of December 31, 2012 and 2011, and the related statements of activities and 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 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 audit. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend upon 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

To the Board of Directors
Southeastern Water Association, Inc.
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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 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 Southeastern Water Association, Inc. as of December 31, 2012 and 2011, and the changes in its net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

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, as required by Office of Management and Budget Circular A-133 , *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have issued our report on August 16, 2013 on our consideration of the 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

To the Board of Directors
Southeaster Water Association, Inc.
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financial reporting or on compliance and the results of that testing, 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 Association's internal control over financial reporting on compliance.



Somerset, Kentucky
August 16, 2013

Southeastern Water Association, Inc.
Statements of Financial Position
December 31, 2012 and 2011

	2012	2011
Assets		
Current assets		
Cash	\$ 515,909	\$ 253,204
Certificates of deposit, savings and money market	1,739,552	1,097,803
Accounts receivable, net	321,208	302,326
Inventory	65,350	50,205
Prepaid expenses	39,082	38,552
Total current assets	<u>2,681,101</u>	<u>1,742,090</u>
Restricted cash	630,459	584,715
Property and equipment, net	<u>24,189,248</u>	<u>23,724,606</u>
Total assets	<u>\$ 27,500,808</u>	<u>\$ 26,051,411</u>
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued liabilities	\$ 469,426	\$ 528,477
Accrued interest	122,936	82,687
Advance tap-on fees	32,690	33,215
Current portion of long-term debt	182,591	174,046
Total current liabilities	<u>807,643</u>	<u>818,425</u>
Non-current liabilities		
Loans payable to Rural Development	11,832,982	11,804,869
Loans payable to Capmark	184,431	197,768
Total non-current liabilities	<u>12,017,413</u>	<u>12,002,637</u>
Total liabilities	<u>12,825,056</u>	<u>12,821,062</u>
Net Assets		
Unrestricted		
Reserved by contract	630,459	584,715
Reserved by board	120,000	120,000
Membership fees	110,866	105,816
Tap-on fees	2,844,423	2,812,598
Other	10,970,004	9,607,220
Total net assets	<u>14,675,752</u>	<u>13,230,349</u>
Total liabilities and net assets	<u>\$ 27,500,808</u>	<u>\$ 26,051,411</u>

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

Southeastern Water Association, Inc.
Statements of Activities and Changes in Net Assets
For the Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenues		
Sales	\$ 3,813,256	\$ 3,689,183
Cost of water sold	<u>(1,362,603)</u>	<u>(1,234,072)</u>
Net revenues from water	<u>2,450,653</u>	<u>2,455,111</u>
 General and administrative		
Depreciation	729,675	725,047
Wages	302,453	298,205
Maintenance	91,954	85,792
Insurance expense	119,023	151,450
Other general and administrative	100,778	91,172
Customer billing	98,447	95,143
Directors' fees	36,650	43,000
Office expense	54,952	45,299
Bad debts	(4,215)	14,330
Professional fees	49,681	40,004
Tax and license	<u>37,014</u>	<u>33,541</u>
Total general and administrative	<u>1,616,412</u>	<u>1,622,983</u>
 Net income (loss) from operations	 <u>834,241</u>	 <u>832,128</u>
 Non-operating revenues (expenses)		
Capital contributions - federal grants	916,608	305,391
Capital contributions - other grants	76,621	220,013
Membership fees collected	5,050	5,100
Tap-on fees collected, net of amounts refunded	31,825	36,050
Interest income	7,340	1,508
Gain (loss) on disposal of equipment	1,500	-
Interest expense	<u>(427,782)</u>	<u>(395,293)</u>
Total non-operating revenues (expenses)	<u>611,162</u>	<u>172,769</u>
 Change in net assets	 1,445,403	 1,004,897
 Unrestricted net assets - beginning	 13,230,349	 12,225,452
 Ending Net Assets	 <u>14,675,752</u>	 <u>13,230,349</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, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Net income from operations	\$ 834,241	\$ 832,128
Adjustments to reconcile net income from operations to net cash provided by operating activities		
Depreciation	729,675	725,047
Bad Debts	(4,215)	14,330
(Increase) decrease in		
Inventory	(15,145)	628
Accounts receivable	(14,667)	(121,938)
Prepaid expenses	(530)	(8,710)
Increase (decrease) in		
Accounts payable and accrued liabilities	(59,051)	377,334
Advance tap-on fees	(525)	516
	<u>1,469,783</u>	<u>1,819,335</u>
Net cash provided by operating activities		
Cash flows from investing activities		
Interest income	7,340	1,508
Investment in (redemption of) certificates of deposit	(641,749)	(1,000,660)
Proceeds from sale of property	1,500	-
Cash payments for the purchase and construction of fixed assets	(1,140,945)	(4,323,342)
Interest expense capitalized into construction work in progress	(53,372)	(45,038)
	<u>(1,827,226)</u>	<u>(5,367,532)</u>
Net cash used by investing activities		
Cash flows from financing activities		
Cash paid for interest expense	(387,533)	(350,796)
Proceeds from federal grants	916,608	305,391
Proceeds from other grants	76,621	220,013
Proceeds from tap on and membership fees	36,875	41,150
Proceeds from long-term debt	197,848	3,797,152
Principal payments on long-term debt	(174,527)	(168,206)
	<u>665,892</u>	<u>3,844,704</u>
Net cash provided by financing activities		
Net increase (decrease) in cash and cash equivalents	308,449	296,507
Cash and cash equivalents, beginning of year	<u>837,919</u>	<u>541,412</u>
Cash and cash equivalents, end of year	<u>\$ 1,146,368</u>	<u>\$ 837,919</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	<u>\$ 440,905</u>	<u>\$ 395,834</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, 2012 and 2011

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.

Basis of Presentation

In accordance with accounting principles generally accepted in the United States, the Association is required to report information regarding its financial position and activities according to three classes of assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. Unrestricted net assets represent net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulation, even though their use may be limited in other respects, such as by contract or by board designation. Temporarily restricted net assets represent net assets subject to donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Association pursuant to those stipulations. Permanently restricted net assets represent net assets subject to donor-imposed restrictions, whereby the Association is only permitted to use the income earned by such position.

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.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

1. Summary of Significant Accounting Policies

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, 2012 and 2011 is stated net of the allowance balance of \$30,738 and \$34,953, 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.

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 Unrestricted Net Position - Tap-On-Fees.

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 Unrestricted Net Position-Other.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

1. Summary of Significant Accounting Policies

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, net position 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, 2012 and 2011 were \$1,613 and \$0, respectively.

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 \$2,648,145 and \$1,695,598 at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, 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.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

3. Property and Equipment

The cost of property and equipment at December 31, 2012 and 2011 is as follows:

	<u>December 31,</u> 2012	<u>December 31,</u> 2011
Transmission and distribution system	\$ 28,082,013	\$ 27,741,024
Construction work in process	5,165,894	4,351,948
Equipment	483,155	462,274
Land and land rights (nondepreciable)	<u>40,902</u>	<u>36,902</u>
Property and equipment	33,771,964	32,592,148
Less accumulated depreciation	<u>(9,582,716)</u>	<u>(8,867,542)</u>
Property and equipment, net	<u>\$ 24,189,248</u>	<u>\$ 23,724,606</u>

During the years ended December 31, 2012 and 2011, interest, on debt, of \$53,372 and \$45,038, respectively, was capitalized into construction work in process.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

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, 2012 and 2011, the depreciation reserve account balance was \$480,040 and \$442,904 respectively. The total amount of restricted cash related to RD commitments at December 31, 2012 and 2011 was \$595,640 and \$461,766, respectively, including a debt service account.

The balances on the RD loans are as follows:

	<u>December 31,</u> 2012	<u>December 31,</u> 2011
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.	\$ 3,995,000	\$ 3,797,152
4.375% loan dated November 8, 2006, payable in annual installments of \$149,956, including interest, through November 8, 2046.	2,619,459	2,654,002
4.5% loan dated September 17, 2004, payable in annual installments of \$101,567, including interest, through September 17, 2044.	1,690,607	1,715,654
4.875% loan dated July 10, 2001, payable in annual installments of \$86,241, including interest, through July 10, 2041.	1,287,577	1,314,490
4.5% loan dated February 12, 1997, payable in annual installments of \$13,853, including interest, through February 12, 2039.	185,815	189,987

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

4. Long-Term Liabilities, continued

	<u>December 31,</u> 2012	<u>December 31,</u> 2011
4.5% loan dated February 12, 1997, payable in annual installments of \$9,562, including interest, through February 12, 2037.	\$ 118,643	\$ 121,338
5.0% loan dated February 12, 1997, payable in annual installments of \$63,306, including interest, through January 1, 2033.	725,124	747,245
5% loan dated February 12, 1997, payable in annual installments of \$46,499, including interest, through January 1, 2032.	482,888	497,899
4.5% loan dated September 14, 1995, payable in annual installments of \$7,536, including interest, through September 9, 2035.	93,534	95,868
4.5% loan dated September 14, 1995, payable in annual installments of \$13,133, including interest, through September 9, 2035.	178,902	183,402
5% loan dated September 14, 1995, payable in annual installments of \$34,426, including interest, through January 1, 2029.	361,951	377,638
5% loan dated October 17, 1991, payable in annual installments of \$22,294, including interest, through October 31, 2031.	<u>263,202</u>	<u>272,094</u>
	12,002,702	11,966,769
Less current portion	<u>(169,720)</u>	<u>(161,900)</u>
	<u>\$ 11,832,982</u>	<u>\$ 11,804,869</u>

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

4. Long-Term Liabilities, continued

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:

	December 31, 2012	December 31, 2011
5.0% loan dated June 1983, payable in annual installments of \$14,693, including interest, through June 2023.	121,857	130,089
7.375% loan dated June 1983, payable in annual installments of \$10,225 including interest, through June 2023.	75,445	79,825
	197,302	209,914
Less current portion	(12,871)	(12,146)
	\$ 184,431	\$ 197,768

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2012 and 2011

4. Long-Term Liabilities, continued

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

2013	\$ 182,591
2014	257,478
2015	268,458
2016	279,942
Later years	<u>11,211,535</u>
	<u>\$ 12,200,004</u>

Interest incurred on all debt during the years ended December 31, 2012 and 2011 totaled \$481,154 and \$440,331, respectively. During the years ended December 31, 2012 and 2011 interest of \$53,372 and \$45,038 was capitalized into construction 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 2012 and 2011 the Association made plan contributions calculated at 2% of gross wages for qualifying employees for total employer contributions of \$5,721 and \$6,332, respectively.

6. Subsequent Events

Subsequent events have been evaluated through August 16, 2013, 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

Southeastern Water Association, Inc.
Schedule of Expenditure of Federal Awards
for the years ended December 31, 2012 and 2011

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Pass-Through Grantors Number	Program or Award Amount	2012 Expenditures
<u>Department of Agriculture</u>				
Passed through Rural Economic and Community Development Agency				
RUS Loan	10.760	N/A	\$ 3,995,000	\$ 197,848
* RUS Grant	10.760	N/A	\$ 1,655,000	<u>916,608</u>
Total Expenditure of Federal Awards				<u>\$ 1,114,456</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, 2012 and 2011, the Association had outstanding balances on various Rural Economic and Community Development Agency loans totaling \$12,002,701 and \$11,966,768 respectively.



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**Independent Auditor's Report on Internal Control over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Board of Directors
Southeastern Water Association, Inc.
Somerset, 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 Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of Southeastern Water Association, Inc. (a nonprofit organization) as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise Southeastern Water Association, Inc.'s basic financial statements, and have issued our report thereon dated August 16, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Southeastern 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 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. Accordingly, we do not express an opinion on the effectiveness of Southeastern 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.

Board of Directors
Southeastern Water Association, Inc.
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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. Given those 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southeastern 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*.

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 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.

Somerset, Kentucky
August 16, 2013

Nick + Company, PC



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**Independent Auditor's Report on Compliance For
Each Major Program and on Internal Control Over
Compliance Required By OMB Circular A-133**

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

Report on Compliance for Each Major Federal Program

We have audited Southeastern Water Association, Inc.'s compliance with the types of compliance requirements describe in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Southeastern Water Association, Inc.'s major federal programs for the years ended December 31, 2012 and 2011. 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.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Southeastern Water Association Inc.'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 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 on compliance for each major federal program. However, our audit does not provide a legal determination of Southeastern Water Association, Inc.'s compliance.

Opinion on Each Major Federal Program

In our opinion, Southeastern Water Association, Inc. 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 years ended December 31, 2012 and 2011.

Report on Internal Control Over Compliance

Management of Southeastern Water Association, Inc. 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 Southeastern Water Association, Inc.'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 the 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 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 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 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.

Board of Directors
Southeastern Water Association, Inc.
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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.

Somerset, Kentucky
August 16, 2013

Neil R. Casper, RSC

South Eastern Water Association, Inc.
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2012

(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, 2012.
2. No significant deficiencies relating to the audit of the financial statements are reported in the *Independent Auditor's 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, 2012.
4. No significant deficiencies in internal control over major federal award programs were reported in the *Independent Auditor's Report on Compliance For Each Major Program and on Internal Control Over Compliance Required By 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, 2012:

RUS Grant	CFDA Number 10.760
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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, 2012:

RUS Grant	CFDA Number 10.760
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9. The Association did not qualify 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, 2012

Condition: Two signatures are required on all checks. The Association uses signature stamps to sign all checks. After a list of disbursements are approved by the board, an individual (who is not a signatory on the checking account) stamps both signatures on the checks. The same individual has access to the cabinet where the stamps are locked.

Recommendation: Procedures should be implemented requiring only the signatories to have access to the stamps. The signatories should stamp the checks when the disbursements are approved for payment.

Current Status: Procedures were implemented to require one signatory to stamp the checks and another individual to stamp board member's signature on check after receiving board approval of disbursements. Individual only has access to one signature stamp.