Jackson County Water Association, Incorporated
Tyner, Kentucky
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Independent Auditors' Report
And Financial Statements
For the Years Ended
December 31, 2013 and 2012

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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 statements of net position of Jackson County Water Association, Incorporated (a nonprofit organization) as of December 31, 2013 and 2012, and the related statements of revenues, expenses, and changes in net position 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.

Auditors' 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 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, 2013 and 2012, and the respective changes in financial position, and cash flows thereof for the years 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 Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2014 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

March 28, 2014

Jackson County Water Association, Incorporated
Statements of Net Position
December 31, 2013 and 2012

	2013	2012
Assets		
Current Assets		
Cash and cash equivalents	$ 1,685,315	$ 1,449,368
Investments	2,335,834	2,335,834
Accounts receivable, less allowance for doubtful accounts	188,797	195,500
Unbilled accounts receivable	150,319	131,422
Grants receivable	-	77,994
Interest receivable	690	690
Inventories	247,617	168,186
Total Current Assets	4,608,572	4,358,994
Noncurrent Assets		
Restricted Assets		
Restricted cash and cash equivalents	803,171	792,094
Total Restricted Assets	803,171	792,094
Capital Assets		
Land and land rights	323,485	323,485
Source of supply and pumping	568,080	535,548
Water treatment	6,631,546	6,631,546
Transmission and distribution	18,671,333	18,772,867
General plant and transportation	1,412,504	1,304,648
Construction in progress	-	522,508
Less: accumulated depreciation	(8,845,133)	(8,494,771)
Net Capital Assets	18,761,815	19,595,831
Total Noncurrent Assets	19,564,986	20,387,925
Total Assets	24,173,558	24,746,919
Deferred Outflows of Resources		
Prepaid expenses	31,403	24,169
Total Deferred Outflows of Resources	31,403	24,169

See accompanying notes to financial statements.

	2013	2012
Liabilities		
Current Liabilities		
Current portion of long-term debt	290,177	280,691
Accounts payable	45,286	39,401
Accrued interest payable	13,035	19,741
Accrued salaries and taxes payable	33,287	33,712
Customer deposits	11,350	9,900
Total Current Liabilities	393,135	383,445
Noncurrent Liabilities		
Long-term debt, less current portion included in current liabilties	6,808,673	7,104,920
Total Noncurrent Liabilities	6,808,673	7,104,920
Total Liabilties	7,201,808	7,488,365
Net Position		
Net investment in capital assets	11,662,965	12,210,220
Restricted for:		
Capital projects	489,077	439,009
Debt service	294,480	335,962
Other purposes	19,614	17,123
Unrestricted	4,537,017	4,280,410
Total Net Position	$ 17,003,153	$ 17,282,724

Jackson County Water Association, Incorporated
Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended December 31, 2013 and 2012

	2013	2012
Operating Revenues		
Water sales	$ 2,193,821	$ 2,191,652
Other operating income	126,410	107,033
Total Operating Revenues	2,320,231	2,298,685
Operating Expenses		
Salaries and benefits	664,554	639,566
Purchased power	201,531	174,276
Contracted services	14,565	19,694
Insurance	263,279	235,253
Transportation	35,439	37,353
Administration and general	70,392	80,997
Maintenance and water treatment	224,380	254,652
Depreciation	728,425	697,919
Bad debt expense	26,158	26,729
Miscellaneous expense	24,397	25,732
Total Operating Expenses	2,253,120	2,192,171
Operating Income	67,111	106,514
Non-operating Revenues (Expenses)		
Interest expense	(247,552)	(256,138)
Interest income	13,808	22,425
Grant revenue	65,822	1,087,274
Line relocation	(3,060)	(14,320)
Gain (loss) on sale/abandonment of asset	(203,080)	-
Miscellaneous non-operating income	27,380	10,325
Total Non-operating Revenues (Expenses)	(346,682)	849,566
Change in Net Position	(279,571)	956,080
Net Position, Beginning of Year	17,282,724	16,326,644
Net Position, End of Year	$ 17,003,153	$ 17,282,724

See accompanying notes to financial statements.

Jackson County Water Association, Incorporated
Statements of Cash Flows
For the Years Ended December 31, 2013 and 2012

	2013	2012
Cash Flows From Operating Activities		
Receipts from customers	$ 2,283,329	$ 2,295,236
Payments to employees	(664,979)	(634,424)
Payments to suppliers	(890,366)	(866,681)
Payments for other activities	(24,397)	(25,732)
Net Cash Provided by Operating Activities	703,587	768,399
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of property and equipment	(106,319)	(1,252,225)
Principal payments on debt	(286,760)	(213,237)
Interest payments on debt	(254,258)	(256,138)
State and federal grants	143,816	1,009,280
Proceeds from sale of assets	8,830	
Line relocations	(3,060)	(14,320)
Other receipts/(payments)	27,380	10,325
Net Cash Used by Capital and Related Financing Activities	(470,371)	(716,315)
Cash Flows From Investing Activities		
Interest on investments	13,808	23,259
Net Cash Provided by Investing Activities	13,808	23,259
Net Increase in Cash and Cash Equivalents	247,024	75,343
Cash and Cash Equivalents at Beginning of Year	2,241,462	2,166,119
Cash and Cash Equivalents at End of Year	$ 2,488,486	$ 2,241,462
Supplemental Disclosures		
Interest paid on long-term debt	$ 254,258	$ 256,138
Reconciliation of Cash at End of Year		
Cash and cash equivalents	$ 1,685,315	$ 1,449,368
Restricted cash and cash equivalents	803,171	792,094
Total Cash at End of Year	$ 2,488,486	$ 2,241,462

See accompanying notes to the financial statements.

Jackson County Water Association, Incorporated
Statements of Cash Flows (Continued)
For the Years Ended December 31, 2013 and 2012

	2013	2012
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities:		
Operating income	$ 67,111	$ 106,514
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	728,425	697,919
Changes in operating assets and liabilities		
(Increase) decrease in accounts receivable	6,703	(5,312)
Decrease (increase) in unbilled accounts receivable	(18,897)	2,463
(Increase) decrease in inventories	(79,431)	(7,725)
Decrease (increase) in prepaid expenses	(7,234)	(2,350)
Increase (decrease) in accounts payable	5,885	(27,652)
(Decrease) increase in accrued expenses	(425)	5,142
(Decrease) increase in customer deposits	1,450	(600)
Net Cash Provided by Operating Activities	$ 703,587	$ 768,399

See accompanying notes to the financial statements.

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 seven directors that are elected by members of the Association.

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.

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, 2013 and 2012, the allowance for doubtful accounts was $15,985 and $15,253, 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.

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:

Asset Classification	Range of Lives
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 2013, 2012, 2011, and 2010 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 Position

The Association has adopted accounting guidance, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. 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 restricted assets less liabilities and deferred inflows of resources related to those assets. Restricted assets are those with limits on their use that are externally imposed 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.

Note 1 – Significant Accounting Policies (Continued)

Net Position (Continued)

Unrestricted – 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, 2013 and 2012 restricted cash amounted to $803,171 and $792,094, respectively. This includes restrictions for customer deposits of $19,614 and $17,123, respectively, and restrictions for debt service of $294,480 and $335,962, respectively. This also includes $489,077 and $439,009 restricted for capital projects at December 31, 2013 and 2012, respectively.

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, 2013 and 2012, $2,254,645 and $2,232,924, respectively, of the Association's bank balances of $4,814,345 and $4,566,343 were exposed to custodial credit risk as follows:

	2013	2012
Uninsured and uncollateralized	$ -	$ -
Uninsured and repurchase agreements held by bank, and sweep account balances secured by Federal Home Loan Bank	2,282,141	2,232,924
Uninsured and repurchase agreements held by bank's trust department not in the Association's name	-	-
Total	$ 2,282,141	$ 2,232,924

Note 4 – Capital Assets

Below is a summary of capital assets transactions for the year ended December 31, 2013:

	Balance Dec. 31, 2012	Additions	Deductions	Balance Dec. 31, 2013
Land and land rights	$ 323,485	$ -	$ -	$ 323,485
Source of supply and pumping	535,548	32,532	-	568,080
Water treatment	6,631,546	-	-	6,631,546
Transmission and distribution	18,772,867	485,137	586,671	18,671,333
General plant and transportation	1,304,648	107,856	-	1,412,504
Construction in progress	522,508	-	522,508	-
Total at Historical Costs	28,090,602	625,525	1,109,179	27,606,948
Less: accumulated depreciation				
Land and land rights	-	-	-	-
Source of supply and pumping	346,180	13,911	-	360,091
Water treatment	1,728,931	164,804	-	1,893,735
Transmission and distribution	5,562,519	467,271	(378,063)	5,651,727
General plant and transportation	857,141	82,439	-	939,580
Total accumulated depreciation	8,494,771	728,425	(378,063)	8,845,133
Property and Equipment - Net	$ 19,595,831	$ (102,900)	$ 1,487,242	$ 18,761,815

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	846,161	-	18,772,867
General plant and transportation	1,247,065	57,583	-	1,304,648
Construction in progress	230,227	522,508	230,227	522,508
Total at Historical Costs	26,838,378	1,482,451	230,227	28,090,602
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	7,796,853	697,918	-	8,494,771
Property and Equipment - Net	$ 19,041,525	$ 784,533	$ 230,227	$ 19,595,831

Note 5 – Long-Term Debt

The following is a summary of long-term debt transactions for the year ended December 31, 2013:

	Balance Dec. 31, 2012	Additions	Payments	Balance Dec. 31, 2013	Due Within One Year
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through September 2017	$ 133,358	$ -	$ (26,000)	$ 107,358	$ 27,235
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through February 2024	77,123	-	(5,159)	71,964	5,494
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through April 2024	46,656	-	(3,077)	43,579	3,267
5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through January 2030	826,696	-	(31,395)	795,301	33,072
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through July 2035	788,449	-	(20,348)	768,101	21,469
2.45% note payable to the Kentucky Infrastructure Authority; due in annual installments, including interest, through June 2015	274,613	-	(107,843)	166,770	110,502

Note 5 – Long-Term Debt (Continued)

	Balance Dec. 31, 2012	Additions	Payments	Balance Dec. 31, 2013	Due Within One Year
4.5% notes payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through June 2043	1,640,716	-	(27,300)	1,613,416	26,868
2.5% note payable to the United States Department of Agriculture-Rural Development; payments to begin in 2013	3,598,000	-	(65,639)	3,532,361	62,270
	$ 7,385,611	$ -	$ (286,761)	$ 7,098,850	$ 290,177

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, a described in Note 2.

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

	Balance Dec. 31, 2011	Additions	Payments	Balance Dec. 31, 2012	Due Within One Year
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

Note 5 – Long-term Debt (Continued)

	Balance Dec. 31, 2011	Additions	Payments	Balance Dec. 31, 2012	Due Within One Year
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
4.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through July 2035	1,666,816	-	(26,100)	1,640,716	25,713
2.5% note payable to the United States Department of Agriculture-Rural Development; due in annual installments, including interest, through July 2035	3,598,000	-	-	3,598,000	60,900
	$ 7,598,848	$ -	$ (213,237)	$ 7,385,611	$ 280,691

Note 5 – Long-term Debt (Continued)

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

Year Ended December 31	Principal	Interest	Total
2014	$ 290,177	$ 240,396	$ 530,573
2015	243,077	230,565	473,642
2016	194,249	222,503	416,752
2017	191,788	214,709	406,497
2018	176,877	207,804	384,681
2019-2023	991,828	931,995	1,923,823
2024-2028	1,125,902	732,908	1,858,810
2029-2033	1,045,322	526,541	1,571,863
2034-2038	950,937	354,821	1,305,758
2039-2043	984,023	202,297	1,186,320
2044-2048	634,966	74,384	709,350
2049-2050	269,704	9,298	279,002
	$ 7,098,850	$ 3,948,221	$ 11,047,071

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 2013, 2012, and 2011 were $22,471, $20,562 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 March 28, 2014, the date on which the financial statements were available to be issued.

Christian Sturgeon
& Associates, PSC
Certified Public Accountants

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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, 2013 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 March 28, 2014.

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 responses, 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 responses to be material weaknesses. (See items 2013-1 and 2013-2)

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*.

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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 responses. 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

March 28, 2014

A. Findings – Financial Statement Audit

2013-1

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.

2013-2

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.