

SOUTHERN WATER AND SEWER DISTRICT
REPORT OF AUDIT OF FINANCIAL STATEMENTS
AND SUPPORTING DATA
YEAR ENDED DECEMBER 31, 2013

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RICHARD F. PAULMANN, CPA, LLC
6005 PARK WOODS ROAD
CRESTWOOD, KY 40014
Ph: (502) 550-1568
e-mail: Richardpaulmann@twc.com

INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Southern Water and Sewer District
McDowell, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of Southern Water and Sewer District, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Southern Water and Sewer District's basic financial statement listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express opinions on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statement are free from material misstatement.

An audit involves performing procedure to obtain audit evidence about the amounts and disclosures in the financial statements. The procedure selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentations 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, I 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.

I believe that the evidence I obtained is sufficient and appropriate to provide a basis for my audit opinions.

Opinions

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Southern Water and Sewer District, as of December 31, 2013, and the respective changes in financial position and where applicable, cash flows thereof for the year ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and budgetary comparison information on pages 3-7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide assurance.

Other Information

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Southern Water and Sewer District's basic financial statements. The 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 also not a required part of the basic financial statements.

The schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 my opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relations to the basic financial statements as a whole.

Other Reporting Required by Governmental Auditing Standards

In accordance with Governmental Auditing Standards, I have also issued my report dated August 20, 2014, on my consideration of Southern Water and Sewer District's internal control over financial reporting and on 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 my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Governmental Auditing Standards in considering Southern Water and Sewer District's internal control over financial reporting and compliance.

The financial statements for the year ended December 31, 2012 are being presented for comparison purposes only. They were audited by William Hollister, PSC dated July 17, 2013 in which an Unmodified Opinion was expressed.

Richard F. Paulmann CPA, LLC

Richard F. Paulmann, CPA-MBA

Crestwood, KY
August 4, 2014

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2013 and 2012

This discussion and analysis of the Southern Water and Sewer District's financial performance provides an overview of the District's financial activities for the years ended December 31, 2013 and December 31, 2012. This information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The District assets exceeded its liabilities at the end of the year by \$18,604,377. This was an increase of \$1,797,820 from the year ended December 31, 2012.
- At December 31, 2013, the District had \$26,423,548 in assets and \$7,819,171 in liabilities. The investment in capital assets, net of related debt, balance at this date was \$17,604,992. The restricted for capital projects balance was \$46,457. The restricted for maintenance balance was \$100,453. The restricted for debt service balance was \$283,254. The restricted for deposits was \$153,021. The unrestricted balance was \$416,200.
- The District had a net income of \$1,797,820 for the year ended December 31, 2013. For the year ended December 31, 2012 the net income was \$618,117.
- The District's water sales were \$3,905,530 for the year ended December 31, 2013. For the year ended December 31, 2012 the water sales were \$3,391,095. This represented an increase of 15.1% which was a result of factors affecting revenue such as increased water usage and increased customers. Also an increase in rates during the year.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise two components: 1) financial statements, and 2) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Financial statements. The financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private – sector business.

The balance sheets present information on all of the District's assets and liabilities, in a comparative format showing the balances as of December 31, 2013 and December 31, 2012. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The statements of revenues, expenses and changes in retained earnings present information showing the District's net income or (loss) for the years then ended.

The statements of cash flows shows the increase or decrease in the cash and cash equivalents for the years ended by the different types of activities.

The financial statements can be found on pages 9 through 13 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 14 through 22 of this report.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2013 and 2012

FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceeded liabilities by \$18,604,377 at the close of the most recent year.

Southern Water and Sewer District's Net Assets

	<u>2013</u>
Current assets	\$ 1,303,142
Restricted assets	430,245
Fixed assets	24,621,274
Other assets	<u>68,887</u>
 Total assets	 <u>26,423,548</u>
 Current liabilities	 1,647,626
Long-term liabilities	<u>6,171,545</u>
 Total liabilities	 <u>7,819,171</u>
 Net assets:	
Investment in	
Capital Assets	17,604,992
Restricted	583,185
Unrestricted	<u>416,200</u>
 Total net assets	 \$ <u>18,604,377</u>

By far the largest portion of the District's net assets reflects its investment in fixed assets (e.g., land, water lines, tanks), less any related debt used to acquire those assets still outstanding.

Grant income was \$1,957,531 during the year. Grant monies and customer contributions accounted for this increase. These monies were used for sewer line expansions.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2013 and 2012

Southern Water and Sewer District's Statements of Revenues, Expenses, and Changes in Retained Earnings

	2013
Revenues:	
Water sales	\$ 3,905,530
Solid waste revenue	975,173
Penalties and service charges	95,682
Other	0
Total revenues	4,976,385
Expenses:	
Water treatment supplies	378,609
Depreciation and amortization	867,669
Purchased water	483,139
Solid Waste payments	945,917
Power for pumping	313,426
Outside services	36,677
Miscellaneous	32,441
Insurance	89,516
Distribution supplies and expense	328,318
Taxes and other	85,328
Customer accounts expense	153,715
Wages	799,090
Sewer supplies and expense	2,647
Employee benefits	335,886
Transportation expense	1,311
Pumping supplies and expense	3,528
Total operating expenses	4,857,217
Net operating income	119,168
Non-operating income (expense)	
Grants income	1,957,531
Capital contribution	1,846
Floyd County Court Settlement	0
Interest income	713
Interest expense	(262,677)
Interest and penalty	(964)
Insurance Recovery	11,999
Settlement income	0
Provision for bad debts	(29,796)
Total non-operating (expense)	1,678,652
Net income (loss) before contributions and transfers	1,797,820
Total net assets, beginning	16,806,557
Total net assets, ending	18,604,377

Operations.

The District showed a net income (loss) of \$1,797,820.

Key elements of this income are as follows:

- Depreciation for the year was \$867,669.
- Grant income of \$1,957,531 was received during the year.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2013 and 2012

Southern Water and Sewer District Budget Comparison

	Actual Amounts	Original Budget Amounts	Variance Positive (Negative) 2013
	2013	2013	
Revenues:			
Water sales	\$ 3,905,530	\$ 3,712,272	\$ 193,258
Solid waste revenue	975,173	1,006,930	(31,757)
Penalties and service charges	95,682	175,234	(79,552)
Other	0	0	0
Total revenues	<u>4,976,385</u>	<u>4,894,436</u>	<u>81,949</u>
Expenses:			
Water treatment supplies	378,609	187,641	(190,968)
Depreciation and amortization	867,669	1,293,018	425,349
Purchased water	483,139	584,074	100,935
Solid Waste payments	945,917	986,298	40,381
Power for pumping	313,426	334,476	21,050
Outside services	36,677	72,842	36,165
Miscellaneous	32,441	26,726	(5,715)
Insurance	89,516	92,298	2,782
Distribution supplies expense	328,318	301,507	(26,811)
Taxes and other	85,328	79,337	(5,991)
Customer accounts expense	153,715	78,807	(74,908)
Wages	799,090	876,203	77,113
Sewer supplies and expense	2,647	0	(2,647)
Employee benefits	335,886	275,228	(60,658)
Transportation expense	1,311	82,551	81,240
Pumping supplies expense	3,528	0	(3,528)
Total operating expenses	<u>4,857,217</u>	<u>5,271,006</u>	<u>413,789</u>
Net operating income	119,168	(376,570)	495,738
Non-operating income (expense)			
Grant income	1,957,531	1,456,762	500,769
Capital contribution	1,846	0	1,846
Floyd County Court Settlement	0	0	0
Interest income	713	7,063	(6,350)
Interest expense	(262,677)	(337,304)	74,627
Interest and penalty	(964)	0	(964)
Insurance Recovery	11,999	0	11,999
Settlement income	0	0	0
Provision for Bad Debts	(29,796)	(35,810)	6,014
Total non-operating income	<u>1,678,652</u>	<u>1,090,711</u>	<u>587,941</u>
Net income (loss)	1,797,820	714,141	1,083,679
	16,806,557		
Total net assets, beginning			
Total net assets, ending	<u>\$ 18,604,377</u>	<u>\$</u>	<u>\$</u>

Budget Comparisons

- Revenues were \$81,949 more than budgeted as a result of water sales being up and new rates in effect and various other differences. Operating expenses were \$413,789 less than budgeted as a result of decreased costs and various other expenses.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2013 and 2012

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

The District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The accrual basis of accounting is utilized by the District. Under this method, revenues are recorded when earned and expenses are recorded at the time the liabilities are incurred.

Capital Assets

The District's investment in utility plant as of December 31, 2013 amounts to \$24,621,274 (net of accumulated depreciation). The investment in utility plant includes the expansion of the water system. The increase in the District's investment in utility plant (net of accumulated depreciation) for the current year was 8.67% percent, before current depreciation.

Additional information on the District's utility plant can be found in Note (5) of the financial statements.

Debt Administration

At the end of the current fiscal year, the District had total debt outstanding of \$6,696,419. Additional information on the District's long-term debt can be found in Note (14) of the financial statements.

Contacting the District's Financial Management

This financial report is designed to provide our customers, creditors, and other users with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Manager, at the Southern Water and Sewer District, P.O. Box 610, McDowell, KY 41647, telephone number (606) 377-9296.

SOUTHER WATER AND SEWER DISTRICT
STATEMENT OF NET ASSETS
31-Dec-13
(with prior year data for comparison purposes only)

	2013	2012
Assets		
Current Assets:		
Cash and Cash Equivalents	\$ 18,520	\$ 30,632
Accounts Receivable (Net of Allowance for Delinquencies of \$244,050 in 2013 and \$214,254 in 2012)	1,176,965	1,188,033
Inventory	56,381	60,018
Prepaid Expenses	51,276	50,849
Total Current Assets	1,303,142	1,329,532
Noncurrent Assets		
Restricted Cash	430,245	356,963
Capital Assets:		
Land	204,829	195,149
Plumbing and Distribution System	42,004,213	37,690,433
Transportation Equipment	397,303	336,433
Furniture, Fixtures and Equipment	151,182	144,996
Construction in Progress	482,708	2,069,787
Total Capital Assets	43,240,235	40,436,798
Less: Accumulated Depreciation	(18,618,961)	(17,779,477)
Net Capital Assets	24,621,274	22,657,321
Other Assets		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	(29,523)	(27,063)
Total Other Assets	68,887	71,347
Total Noncurrent Assets	25,120,406	23,085,631
Total Assets	\$ 26,423,548	\$ 24,415,163

SOUTHER WATER AND SEWER DISTRICT
STATEMENT OF NET ASSETS
31-Dec-13
(with prior year data for comparison purposes only)

	<u>2013</u>	<u>2012</u>
Liabilities		
Current Liabilities		
Accounts Payable	\$ 158,718	\$ 303,193
Accounts Payable Solid Waste	482,070	465,866
Customer Deposits	153,021	132,884
Unearned Tap Fee	-	92,295
Note Payable Line of Credit	241,000	241,000
Note Payable Current	463,339	439,578
Bonds Payable Current	61,535	58,605
Accounts Payable Construction in Progress	9,080	163,232
Accrued Interest	78,863	80,389
Total Current Liabilities	<u>1,647,626</u>	<u>1,977,042</u>
Noncurrent Liabilities		
Notes Payable-Net of Current Portion	2,747,074	2,145,558
Bonds Payable-Net of Current Portion	3,424,471	3,486,006
Total Long Term Liabilities	<u>6,171,545</u>	<u>5,631,564</u>
Total Liabilities	<u>7,819,171</u>	<u>7,608,606</u>
Net Assets:		
Invested in Capital Assets, Net of Related Debt	17,604,992	16,206,185
Restricted for Capital Projects	46,457	26,439
Restricted for Maintenance	100,453	60,767
Restricted for Debt Service	283,254	136,874
Restricted for Deposits	153,021	132,884
Unrestricted	416,200	243,408
Total Net Assets	<u>\$ 18,604,377</u>	<u>\$ 16,806,557</u>

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
 STATEMENT OF REVENUE EXPENDITURE AND CHANGES IN NET ASSETS
 For the Year Ended December 31, 2013
 (with prior data for comparison purposes only)

	For the Year Ended December 31	
	2013	2012
Operating Revenue:		
Water Sales	\$ 3,905,530	\$ 3,391,095
Solid Waste Revenue	975,173	985,060
Penalties and Service Charges	95,682	99,527
Other		6,443
Total Operating Revenue	4,976,385	4,482,125
Operating Expenses:		
Water Treatment Supplies	378,609	240,334
Depreciation and Amortization	867,669	1,437,660
Purchased Water	483,139	471,644
Solid Waste Payments	945,917	955,508
Power for Pumping	313,426	279,208
Outside Services	36,677	47,288
Miscellaneous and Commissioners	32,441	29,031
Insurance	89,516	58,752
Distribution Supplies	328,318	323,025
Payroll and Other Taxes	85,328	75,133
Customer Accounts	153,715	122,057
Wages	799,090	683,509
Transportation	1,311	1,579
Sewer Supplies	2,647	8,107
Employee Benefits	335,886	329,012
Pumping Supplies	3,528	13,103
Total Operating Expense	4,857,217	5,074,950
Operating Income (Loss)	119,168	(592,825)
Non-Operating Revenue (Expense)		
Interest Income	713	777
Interest Expense	(262,677)	(251,423)
Interest and Penalty	(964)	(150)
Floyd County Court Settlement		(133,588)
Provisions for Bad Debts	(29,796)	(23,484)
Insurance Recovery	11,999	95,796
Gain (Loss) on Sale of Assets		
Total Non-Operating Revenue (Expenses)	(280,725)	(312,072)
Income (Loss) Before Capital Contributions	(161,557)	(904,897)
Capital Contributions		
Grant Income	1,957,531	1,518,903
Capital Contributions	1,846	4,111
Total Capital Contributions	1,959,377	1,523,014
Change in Net Assets	1,797,820	618,117
Total Net Assets, Beginning	16,806,557	16,188,440
Total Net Assets, Ending	18,604,377	16,806,557

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Year Ended December 31, 2013
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2013	2012
Cash flows from operating activity		
Cash received from customers	\$ 4,988,404	\$ 4,333,365
Cash payments to suppliers for goods and services	(4,117,086)	(3,756,190)
Cash received for deposits	(72,158)	80,703
Net cash provided by operating activities	799,160	657,878
Cash flows from noncapital financing activities		
Subsidy From Federal and State Grant	2,111,596	1,370,795
Net Cash Provided (Used) By Noncapital Financing Activities	2,111,596	1,370,795
Cash flows from capital and related financing activities		
(Increase) decrease in Restricted Assets Accounts	(73,282)	4,388
Loan Proceeds	830,223	
Bond Proceeds		
Interest Paid	(264,203)	(252,964)
Principle Payment on Notes	(203,946)	(297,965)
Principle Payment on Bonds	(58,605)	(56,632)
Purchase of Utility Plant in Service	(3,098,096)	(167,778)
Decrease (Increase) in Construction in progress	(67,671)	(1,338,615)
Proceeds from insurance recovery	11,999	95,796
Proceeds on Sale of Assets	-	-
Net cash provided by (used for) capital and related financing activities	(2,923,581)	(2,013,770)
Cash flows from investing activities		
Proceeds from earnings on investments	713	777
Net cash provided by (used for) investing activities	713	777
Total increase (decrease) in cash and cash equivalents	(12,112)	15,680
Cash and cash equivalents at beginning of year	30,632	14,952
Cash and cash equivalents at end of year (Note 2)	\$ 18,520	\$ 30,632

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Year Ended December 31, 2013
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2013	2012
Reconciliation of Income from operations to net cash provided by operated activities:		
Income from operations	\$ 119,168	\$ (592,825)
Provisions for Bad Debt	(29,796)	(133,588)
Adjustment to reconcile income from operations to net cash provided by operating activities:		
Operating Activities:		
Depreciation and amortization	867,669	1,437,660
Changes in assets and liabilities:		
Decrease (increase) in utility accounts receivable	40,864	(148,760)
Decrease (increase) in prepaid expense	(427)	(5,901)
Decrease (increase) in material and supplies inventory	3,637	9,718
Increase (decrease) in accounts payable and other payable	(128,271)	12,409
Increase (decrease) in customer deposits	20,137	28,368
Increase (decrease) in un-earned tap fees	(92,295)	52,335
Increase (decrease) in accrued interest	(1,526)	(1,538)
Net cash provided by operating activities	\$ <u>799,160</u>	\$ <u>657,878</u>
 Non-cash operating activities		
Acquisition of Property and Equipment Included in accounts payable	\$ <u>9,081</u>	\$ <u>163,232</u>

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

Note 1 – Summary of Significant Accounting Policies

The significant policies of the district are as follows:

Organization and Business Activities – The district is a governmental organization with its primary activities consisting of sales of water and sewer services to residents in Floyd County Kentucky, pursuant to Chapter 74 of the Kentucky Revised Statutes to operate a water distribution system.

Basis of Accounting – The accounting and reporting policies of the Southern Water and Sewer District relating to the funds included in the accompanying basic financial statements conform to accounting principles generally accepted in the United States of America applicable for local governments. Generally accepted accounting principles for local Governments includes those principles presented by the Governmental Accounting Standards Board (GASB), the American Institute of Certified Public Accountants in the publications entitled Audits of State and Local Governments and by the Financial Accounting Standards Board (when applicable). As allowed in section PBO of GASB's Codification of Governmental Accounting and Financial Reporting Standards the District has elected not to apply Financial Accounting Board Statements and Interpretations, Accounting Research Bulletins of the Committee of Accounting Principle Board Opinions, and Accounting Research Bulletins of the Committee of Accounting and Procedures issued after November 30, 1969. The District first applies restricted resources when an expense is incurred for restricted and unrestricted purposes. The more significant polices of the district are described below.

Basis of Presentation

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, the district uses Proprietary Fund financial statement reporting including a Statement of Net Assets, Statements of Revenues, Expenditures and Changes in Net Assets, and a Statement of Cash Flows.

The Statement of Net Assets includes the District's assets and liabilities and provides Information about the nature and amounts of investments in resources (assets) and the obligations to the District's creditors (liabilities). The difference between the assets and liabilities is shown as net assets. The statement also provides the basis of evaluating the capital structure of the district and assessing its liquidity and financial flexibility.

The statement of Revenue, Expenditure and Changes in Net Assets accounts for the current year's revenue and expense. This statement measures the success of the district's operations over the past year and determines whether the district has recovered its cost through user fees and other charges.

The final required financial statement is the Statement of Cash Flows. This statement reports cash receipts, cash disbursements, and changes in cash resulting from operations and investments during the reporting period.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

Note 1 – Summary of Significant Accounting Policies (Continued)

The Notes to the basic financial statements provide a description of the accounting policies used to prepare the financial statements and present disclosures required by generally accepted accounting principles that are not otherwise present in the financial statements.

The District's basic financial statements include the accounts of all district operations. The District's criteria for including organizations as component units with the District's reporting entity, as set forth in Section 2100 of GASB's Codification of Governmental Accounting and Financial Standards includes whether:

- The Organization is legally separate (can sue and be sued in their own name).
- The District holds the corporate powers of the organization.
- The District appoints voting majority of the organization.
- The Organization has the potential to impose a financial benefit/burden on the Association.
- There is fiscal dependency by the organization on the District.

Component Unit Presentation – Based on the aforementioned criteria the district has no component units.

Cash - For the purpose of the statement of cash flows, the District considers cash to include cash on hand and unrestricted cash in bank.

Inventory – Inventory consist primarily of pipes and supplies to be used for future expansion and repairs of existing of existing lines. Inventory is valued at the lower of cost or market under first – in, first- out (FIFO) method.

Allowance for Doubtful Accounts – The District utilizes the allowance method for accounting for bad debts. This method is based on historical experience and evaluation of outstanding accounts at year end. The Allowance for Doubtful as of December 31, 2013 and 2012 is \$244,050 and \$214,254.

Operating and Non – Operating Revenue – Only water and solid waste revenue and related service charges and penalties are considered as operating revenue.

Applying Resources – Restricted resources are applied first for expenses incurred for which both restricted and unrestricted net assets are available.

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 differ from those estimates.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

Note 2 – Restricted Cash Accounts

The District had the following restricted cash accounts as of December 31, 2013 and 2012.

	<u>2013</u>	<u>2012</u>
KIA Project	\$ 18,558	\$ 39
Repair and Maintenance reserve	100,453	60,737
Construction reserve	7,047	4,685
Bond Depreciation Reserve	96,318	43,125
Road Construction Account	42,939	111,893
Deposit Refunds	153,021	132,884
Insurance Reserve	<u>11,909</u>	<u>3,600</u>
Totals	<u>\$ 430,245</u>	<u>\$ 356,963</u>

The amounts held were above the required minimum for 2013 and below the required minimum for 2012 for all restricted requirements.

Note 3 – Prepaid Items

Prepaid items include prepayment of service contracts, software rights and insurance. These amounts represent payments made in the current year for which services will be provided in the subsequent fiscal year.

Note 4 – Deferred Income from Tap Fees

Unearned tap fees represents payments from customers for taping into the Pride on the River Sewer Line. Southern Water started accepting pre – payments to tap into this line during 2011. Customers were able to tap into the new line during the Month of May 2013 and all previously held amounts were recognized as income during 2013. Unearned tap fees being held was \$0 for 2013 and \$92,295 for 2012.

Note 5 – Deposits with Financial Institutions

As of December 31, 2013, the company had amounts of \$448,765 on deposit with financial institutions with \$250,000 insured by FDIC and \$198,765 was insured by pledged US Treasury Bills.

As of December 31, 2012, the company had amounts of \$387,595 on deposit with financial institutions with \$250,000 insured by FDIC and \$137,595 was insured by pledged US Treasury Bills.

Note 6 – Subsequent Events

In preparing these financial statements, the District has evaluated events and transactions for the potential recognition or disclosure through August 20, 2014, the date the financial statements were available to be issued.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

Note 7 – Capital and Net Assets

Changes in contributed capital and net assets during the years ended December 31, 2013 and December 31, 2012.

	<u>Contributed Capital</u>	<u>Reserves</u>	<u>Net Assets (Deficit)</u>	<u>Total</u>
Balance, December 31, 2011	<u>\$29,054,816</u>	<u>\$ 24,409</u>	<u>\$(12,890,783)</u>	<u>\$16,188,440</u>
Local Contribution - Floyd County Fiscal				
Grant in aid-State Grant Funds	1,518,903			1,518,903
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer		(4,388)	4,388	
Net Income (Loss)			<u>(900,788)</u>	<u>(900,788)</u>
Balance December 31, 2012	<u>\$30,573,719</u>	<u>\$ 20,021</u>	<u>\$(13,787,183)</u>	<u>\$16,806,557</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	1,794,143			1,794,143
Grant in aid-State Grant Funds	163,388			163,388
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer		73,282	(73,282)	
Net Income (Loss)			<u>(159,711)</u>	<u>(159,711)</u>
Balance December 31, 2013	<u>\$32,531,250</u>	<u>\$ 93,303</u>	<u>\$(14,020,176)</u>	<u>\$18,604,377</u>

Note 8 Retirement Plan

The District maintains a defined contribution retirement plan under the provisions of section 401 (K) of the Internal Revenue Code. The plan is a deferred compensation plan which is available to all employees. The maximum salary deferral is limited to amounts allowed per the Internal Revenue Code, which for 2013 and 2012 was \$17,500 and \$17,000 respectively. Normally the District contributes 5% of the employee's basic pay but board approved none for 2012. All contributions are immediately vested. Expenses charged to operations for the retirement plan were \$7,585 and \$0 respectively.

Note 9 – Risk Management

Significant losses covered by commercial insurance with premiums (based on industry information adjusted for any District Claims) for general liability, vehicles, personal and real property. Settlement amounts have not exceeded insurance coverage for the current year or the prior years.

SOUTHERN WATER AND SEWER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2013 AND 2012

Note 10 – Concentrations of Credit Risk

Concentrations of credit risk are limited due to the large number of customers comprising the district's customer base.

Note 11 - Property and Equipment

Capital asset, which include property , plant, equipment and vehicles, are reported in the applicable governmental column in the government – wide financial statements. All capital assets are valued at their historical cost or estimated historical cost is actual historical is not available. Donated assets are valued at their market value on the date donated. Repairs and maintenance are recorded as expenses. Renewals and betterments are capitalized.

Depreciation has been calculated on each class of depreciable property using the straight – line method. Estimated useful lives are as follows. Changes requested Public Service Commission with the last rate increase were made during 2013.

Depreciation has been calculated on each class of depreciable property using the straight – line method. Estimated useful lives are as follows:

Buildings	20 – 50 Years
Improvements	20 – 50 Years
Vehicles	5 – 10 Years
Equipment	7 – 20 Years

The following summarizes the changes to capital assets for 2013:

	Balance <u>01/01/13</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>12/31/13</u>
Land	\$ 195,149	\$ 9,680	\$ -0-	\$ 204,829
Water and Distribution System	37,690,433	4,313,780	-0-	42,004,213
Automotive Equipment	336,433	86,595	25,725	397,303
Furniture, fixtures and Equipment:	144,996	6,186	-0-	151,182
Construction in Progress	<u>2,069,787</u>	<u>67,671</u>	<u>1,654,475</u>	<u>482,708</u>
TOTAL ASSETS	\$ 40,436,798	\$ 4,483,912	\$1,680,475	\$ 43,240,235
Less				
Accumulated Depreciation				
Water Distribution System	17,448,568	832,314	-0-	18,280,882
Automotive Equipment	228,448	32,152	25,725	234,875
Furniture, fixtures and Equipment:	<u>102,461</u>	<u>743</u>	<u>-0-</u>	<u>103,204</u>
Total Accumulated	17,779,477	865,209	25,725	18,618,961
Balance – December 31	<u>\$ 22,657,321</u>			<u>\$ 24,621,274</u>

SOUTHERN WATER AND SEWER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2013 AND 2012

Note 11 - Property and Equipment (Continued)

The following summarizes the changes to capital assets for 2012:

	Balance 01/01/12	Additions	Disposals	Balance 12/31/12
Land	\$ 195,149	\$ -0-	\$ -0-	\$ 195,149
Water and Distribution System	37,522,655	167,778	-0-	37,690,433
Automotive Equipment	336,433	-0-	-0-	336,433
Furniture, fixtures and Equipment:	144,996	-0-	-0-	144,996
Construction in Progress	<u>627,708</u>	<u>1,442,079</u>	-0-	<u>2,069,797</u>
TOTAL ASSETS	\$ 38,826,941	\$ 1,609,857	\$ -0-	\$ 40,436,798
Less				
Accumulated Depreciation				
Water Distribution System	16,047,641	1,400,927	-0-	17,448,568
Automotive Equipment	201,153	27,295	-0-	228,448
Furniture, fixtures and Equipment:	<u>95,483</u>	<u>6,978</u>	-0-	<u>103,204</u>
Total Accumulated	17,779,477	1,435,200	-0-	17,779,477
Balance – December 31	<u>\$ 16,344,277</u>			<u>\$ 22,657,321</u>

Note 12 – Contingencies

The District is involved with multiple car accident actions which are being defended and will be covered by the District’s Insurance Coverage.

Note 13 – Commitments

The District is involved with funding and planning additional phases for the Harold Sewer Project.

Note 14 – Notes and Bonds Payable

All notes and bonds are secured by the Water Distributions system and related assets unless stated as non – secured:

	<u>2013</u>	<u>2012</u>
Summary of Short term line of Credit		
6.25% line of credit First Guaranty National Bank interest due monthly. With principal due upon demand	\$ 241,000	\$ 241,000

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

Note 14 – Notes and Bonds Payable (Continued)

	<u>2013</u>	<u>2012</u>
Summary of Notes Payable		
a) Kentucky Infrastructure Authority 3% installment note, 60 semi - annual payments of \$34,607 including interest due 06/01 and 12/1. Final payment 2024	\$ 644,428	\$ 693,211
b) Kentucky Infrastructure Authority 1% installment note, 40 semi – annual payments of \$1,863 including interest due 06/01 and 12/1. Final payment 2025	40,374	44,109
c) First Guaranty Bank 6.25% installment note monthly payments of \$9,709 including interest final payment 2013.	-0-	22,737
d) Kentucky Infrastructure Authority 3% installment note, 60 semi – annual payments of \$71,898 including interest due 06/01 and 12/1. Final payment 2027	1,634,000	1,726,686
e) First Guaranty Bank, 5.5% installment note monthly payments of \$1,830 including interest final payment 2017	67,319	85,038
f) First Guarantee Bank 6.25 installment note monthly payments of \$2,265 including interest final payment during 2013	-0-	13,355
g) First Guarantee Bank 7.99 installment note monthly payments of \$1,977 including interest final payment during 2016	58,392	-0-
h) Kentucky Infrastructure Authority 1% installment note, 40 semi - annual payments of \$21,174 including interest due 06/01 and 12/1. Final payment 2034	<u>765,900</u>	<u>-0-</u>
Total long – term Notes Payable	<u>\$ 3,210,413</u>	<u>\$ 2,585,136</u>
Less Current maturities	<u>463,339</u>	<u>439,578</u>
Notes Payable less current portion	<u>\$ 2,747,074</u>	<u>\$ 2,145,558</u>

SOUTHERN WATER AND SEWER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2013 AND 2012

Note 14 – Notes and Bonds Payable (Continued)

	<u>2013</u>	<u>2012</u>
Summary of Bonds Payable		
a) Rural Development Revenue Bonds 4.5% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2042.	\$ 2,232,000	\$ 2,269,000
b) Rural Development Revenue Bonds 4.75% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2040.	535,006	545,111
c) Rural Development Revenue Bonds 4.25% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2044.	205,500	208,500
d) Rural Development Revenue Bonds 2.25% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2049.	<u>513,500</u>	<u>522,500</u>
Total Long – Term Bonds Payable	<u>\$ 3,486,006</u>	<u>\$ 3,544,611</u>
Less Current maturities	<u>61,535</u>	<u>58,605</u>
Notes Payable less current portion	<u>\$ 3,424,471</u>	<u>\$ 3,486,006</u>

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

Note 14 – Notes and Bonds Payable (Continued)

Note

Following are maturities of long – term debt as of December 31, 2013:

	<u>Principal</u>	<u>Interest</u>
2014	\$ 283,874	\$ 228,426
2015	294,802	218,386
2016	298,643	207,876
2017	278,440	198,426
2018	276,192	190,164
2019-2023	1,517,225	818,139
2024-2028	1,317,733	583,666
2029-2033	795,603	415,840
2034-2038	826,848	261,633
2039-2043	675,559	86,800
2044-2048	113,000	8,487
2049-2053	<u>19,000</u>	<u>214</u>
Total	<u>\$ 6,696,419</u>	<u>\$ 3,218,067</u>

SOUTHERN WATER AND SEWER DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2013

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
Environmental Protection Agency Capitalization Grants for Clean Water State Revolving Funds	66.458	\$ <u>1,794,143</u>
<u>Total</u>		\$ <u>1,794,143</u>

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2013

NOTE A - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Southern Water and Sewer District, and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, **Audits of States, Local Governments, and Non-Profit Organizations**. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

SOUTHERN WATER AND SEWER DISTRICT
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2013

Environmental Protection Agency Capitalization Grants for Clean Water

There were no prior audit findings noted.

RICHARD F. PAULMANN, LLC
CERTIFIED PUBLIC ACCOUNTANT
6005 PARK WOODS ROAD
CRESTWOOD, KY 40014
(502) 550-1568

**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**

August 20, 2014

To the Board of Commissioners
Southern Water and Sewer District
McDowell, KY

I 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 business-type activities, each major fund of Southern Water and Sewer District, a Kentucky Special District as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise Southern Water and Sewer District's basic financial statements and have issued my report thereon dated August 20, 2014.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered Southern Water and Sewer District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Southern Water and Sewer District's internal control. Accordingly, I do not express an opinion on the effectiveness of Southern Water and Sewer's internal control.

A deficiency 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. A significant deficiency is a deficiency, or 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.

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that I have not identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southern Water and Sewer District's financial statements are free of material misstatement, I 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 my audit, and, accordingly, I do not express such an opinion. The results of my 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 my testing on 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 purposes.

Richard F. Paulmann CPA-MBA

Richard F. Paulmann, LLC

August 20, 2014

RICHARD F. PAULMANN, LLC
CERTIFIED PUBLIC ACCOUNTANT
6005 PARK WOODS ROAD
CRESTWOOD, KY 40014
(502) 550-1568

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE REQUIRED BY OMB CIRCULAR A-133**

August 20, 2014

To the Board of Commissioners
Southern Water and Sewer District
McDowell, KY

Report on Compliance for Major Federal Programs

I have audited Southern Water and Sewer District, 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 Southern Water and Sewer District's major federal programs for the year ended December 31, 2013. Southern Water and Sewer District'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 laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

My responsibility is to express an opinion on compliance for each of Southern Water and Sewer District's major federal programs based on my audit of the types of compliance requirements referred to above. I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Governmental 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 I plan and perform my audit to obtain reasonable assurance about whether noncompliance with the types of material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Southern Water and Sewer District's compliance with those requirements and performing such other procedures as I consider necessary in the circumstances.

I believe that my audit provides a reasonable basis for my opinion on compliance for each major federal program. However, my audit does not provide a legal determination of the Southern Water and Sewer District's compliance.

Opinion on Each Major Federal Program

In my opinion, Southern Water and Sewer District, 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, 2013

Report on Internal Control Over Compliance

Management of Southern Water and Sewer District's is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing my audit of compliance, I considered Southern Water and Sewer District'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, I do not express an opinion on the effectiveness of Southern Water and Sewer District's internal control over compliance.

A deficiency in internal control over compliance exist 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.

My 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 weakness or significant deficiencies. I did not identify any deficiencies in internal control over compliance that I 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 my testing of internal control over compliance and the results of that testing based on the requirements of OMB A-133. Accordingly, this report is not suitable for any other purposes.

Richard F. Paulmann CPA, MBA

Richard F. Paulmann, LLC
August 20, 2014

SOUTHERN WATER AND SEWER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2013

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Southern Water and Sewer District.
2. No material weaknesses were identified during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of Southern Water and Sewer District were disclosed during the audit.
4. No material weaknesses were identified during the audit of the major federal award programs.
5. The auditor's report on compliance for the major federal award programs for Southern Water and Sewer District expresses an unqualified opinion.
6. Audit findings, if any, relative to the major federal award programs for Southern Water and Sewer District are reported on Part C of this Schedule.
7. The programs tested as major programs included:
 - a. 66.458 Environmental Protection Agency Capitalization Grant for Clean Water State Revolving Funds.
8. The threshold for distinguishing Types A and B programs was \$300,000.
9. Southern Water and Sewer District was determined to be a high-risk auditee.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

NONE

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

NONE

SOUTHERN WATER AND SEWER DISTRICT

CORRECTIVE ACTION PLAN

Southern Water and Sewer District respectively submits the following corrective action plan for the Year Ended December 31, 2013 to Richard F. Paulmann, LLC.

SECTION I - INTERNAL CONTROL STRUCTURE REVIEW

A. Comments on Findings and Recommendations

There were no findings noted in the current year's audit report.

B. Actions Taken or Planned

There were no findings noted in the current year's audit report.

C. Status of Corrective Actions on Prior Findings

There were no findings noted in the prior year's audit report.

SECTION II - PROGRAM REVIEW

Big Sandy Area Development assisted with maintaining the compliance on the project and was responsible for disbursing the draw downs on the project. All Environmental agency and State reviews were conducted as required.

A. Comments on Findings and Recommendations

All findings have been addressed and cleared.

B. Action Taken or Planned

All findings have been addressed as recommended by reviewer.

C. Status of Corrective Actions on Prior Findings

There were no findings noted in prior year's audit report.