

SOUTHSIDE WATER ASSOCIATION
Beattyville, Kentucky

REPORT ON EXAMINATION OF BASIC FINANCIAL
STATEMENTS AND SUPPLEMENTAL DATA
Period Ended November 7, 2013

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Southside Water Association
Beattyville, Kentucky

Report on Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Southside Water Association as of and for the period January 1, 2013 through November 7, 2013 and the related notes to the financial statements, which collectively comprise the District's basic financial statements as 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

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, of the Southside Water Association as of November 7, 2013, and the respective changes in financial position, and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Transfer of Ownership

As discussed in Note 9 to the financial statements, the City of Beattyville acquired Southside Water on November 7, 2013. The period covered in these financial statements is January 1, 2013 until the date of acquisition, November 7, 2013. Our opinion is not modified with respect to this matter.

Other Matters

Required supplementary information

Management has omitted the management 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 reports required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated June 27, 2014, on our consideration of the Southside 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 Southside Water Association's internal control over financial reporting and compliance.

John T. Lane & Associates, LLC

Mount Sterling, Kentucky

June 27, 2014

This report contains 13 pages.

SOUTHSIDE WATER ASSOCIATION
Statement of Net Position
Proprietary Fund
November 7, 2013

ASSETS

Current Assets	
Cash and cash equivalents - unrestricted	\$ 10,837
Cash and cash equivalents - restricted (note 7)	845
Accounts receivable - net of allowance for doubtful accounts (note 1)	10,541
Prepaid insurance	<u>185</u>
Total Current Assets	<u>22,408</u>
Noncurrent Assets	
Capital assets: (note 1)	
Plant, equipment and lines	1,000,307
Less accumulated depreciation	<u>(346,238)</u>
Total Noncurrent Assets	<u>654,069</u>
Total Assets	<u><u>\$ 676,477</u></u>

LIABILITIES

Current Liabilities	
Accrued expenses	\$ 30,948
Bonds payable	17,350
Payable from restricted assets	<u>37,280</u>
Total Current Liabilities	<u>85,578</u>
Noncurrent Liabilities	
Bonds payable (note 2)	<u>327,436</u>
Total noncurrent Liabilities	<u>327,436</u>
Total Liabilities	<u>413,014</u>

NET POSITION

Net investment in capital assets	309,283
Restricted	(36,435)
Unrestricted	<u>(9,385)</u>
Total Net Position	<u><u>\$ 263,463</u></u>

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

SOUTHSIDE WATER ASSOCIATION
Statement of Revenues, Expenses and Changes in Fund Net Position
Proprietary Fund
For the period ended November 7, 2013

Revenues	
Water revenues	\$ 152,077
Other user fees	80,058
Other income	<u>3,650</u>
Total Revenues	<u>235,785</u>
Expenses	
Utilities	9,412
Salaries	32,328
Taxes	7,731
Supplies	1,931
Office expense	451
Insurance	14,794
Water purchased	81,858
Outside services	8,111
Garbage	80,058
Rent	2,123
Other	8,792
Depreciation	<u>17,101</u>
Total Operating Expenses	<u>264,690</u>
Operating Income (Loss)	<u>(28,905)</u>
Nonoperating Revenues (Expenses)	
Interest expense	(12,517)
Net Nonoperating Revenues (Expenses)	<u>(12,517)</u>
Net Income (Loss)	(41,422)
Total Net Position - beginning	<u>304,885</u>
Total Net Position - ending	<u><u>\$ 263,463</u></u>

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

SOUTHSIDE WATER ASSOCIATION
Statement of Cash Flows
Proprietary Fund Type
November 7, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:	
Operating revenues	\$ 238,218
Cash paid to employees	(32,328)
Cash paid for general and administrative expenses	<u>(191,596)</u>
Net Cash provided by operating activities	<u>14,294</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Customer deposits	<u>1,050</u>
Net Cash provided by investing activities	<u>1,050</u>
CASH FLOWS FROM CAPITAL AND FINANCING ACTIVITIES:	
Interest expense	(430)
Principal payments	<u>(6,451)</u>
Net Cash used in capital and financing activities	(6,881)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	8,463
CASH AND CASH EQUIVALENTS - 1/1/13	<u>3,219</u>
CASH AND CASH EQUIVALENTS - 11/7/13	<u><u>\$ 11,682</u></u>
RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net Operating Income	\$ (28,905)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
Depreciation	17,101
(Increase)/Decrease in accounts receivable	2,432
(Increase)/Decrease in prepaid expenses	6,682
Increase/(Decrease) in accounts payable	<u>16,984</u>
Net cash provided by operating activities	<u><u>\$ 14,294</u></u>

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

SOUTHSIDE WATER ASSOCIATION
Notes to the Financial Statements
November 7, 2013

Note 1 - Summary of Significant Accounting Policies

The accounting policies of the Association conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies.

The Reporting Entity

The Association, for financial purposes, includes all of the funds relevant to the operations of the Association. The financial statements presented herein do not include agencies which have been formed under applicable state laws or separate and distinct units of government apart from the Southside Water Association.

The financial statements of the Association would include those of separately administered organizations that are controlled by or dependent on the Association. Control or dependence is determined on the basis of financial interdependency, selection of governing Association, designation of management, ability to significantly influence operations, accountability of fiscal matters, scope of public service, and financing relations.

Based on the foregoing criteria there are not other organizations included in these financial statements.

Depreciation Reserve Fund - Monthly transfers are required to be made into this fund in the amount of \$155 until the sum of \$18,600 is reached. Only expenditures for capital improvements or extraordinary expenses are permitted to be paid from this fund. No monthly transfers were made to this account during 2013. The required balance at November 7, 2013 is \$5,425. The Association had set aside \$343 into this fund at November 7, 2013.

Debt Service Fund-Transfers in proportion to income availability shall be made from the general account and set aside in an account designated as the debt service account, in sufficient amounts which will accumulate for the next installment on the note. As of November 7, 2013 no debt service account had been established.

Enterprise Funds

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprise where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the Association is determined by its measurement focus. The transactions of the Association are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets (i.e., total assets net of total liabilities) are segmented into invested in capital assets, net of related debt, restricted and unrestricted components. When both restricted and unrestricted resources are available for use, it is the Association's policy to use restricted resources first, and then unrestricted resources as they are needed.

An enterprise fund distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Authority's principal ongoing operations. The principal operating revenues of the Authority are operating grants and tenant rental revenue. Operating expenses of the Authority include the cost of producing the revenue and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Basis of Accounting

The records of the Association are maintained and the budgetary process is based on the cash basis method of accounting. Adjustments have been made to reflect the accrual basis method of accounting.

Cash

At November 7, 2013, the carrying amount of the Association's deposits was \$11,682 and the bank balance was \$12,754. Of the bank balance 100% was covered by federal deposit insurance or collateralized by securities held by the pledging financial institution in the entity's name. The Association considers all investments with a maturity date of three months or less from date of purchase to be cash equivalents. Certificates of deposit that are redeemable immediately with little or no penalty are considered cash equivalents

Fixed Assets

Fixed assets purchased are capitalized at the time of purchase. Such assets are recorded at cost. Donated assets are recorded at fair market value at the date of donation.

The Association's capitalization policy is as follows: expenditures costing more than \$1,000 with an estimated useful life greater than one year are capitalized; all others are expensed.

Depreciation of property and equipment is computed by the straight-line method based upon the estimate useful lives of the assets as follows:

<u>Class</u>	<u>Life</u>
Utility Plant	50 years

Net Position

Net position represents the difference between assets and liabilities. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any borrowing used for the acquisition, construction or improvement of those assets. Net position is recorded as restricted when there are limitations imposed on its use by external restrictions.

Accounts Receivable

The receivable reflected in the statements in the amount of \$10,541 are net of allowance for uncollectibles in the amount of \$6,214.

Use of 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 the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Note 2 - Pension Plan

The Association's employees are not covered by any pension or retirement plan.

Note 3 - Leave Policies

The Association's employees are not covered by any leave policies.

Note 4 - Changes in Fixed Assets

The following is a summary of changes in the fixed assets for the fiscal year:

	<u>balance</u> <u>12/31/12</u>	<u>Transfer/</u> <u>Additions</u>	<u>Deletions</u>	<u>balance</u> <u>11/7/13</u>
Utility plant & equipment	<u>\$1,000,307</u>	\$-	\$-	<u>\$1,000,307</u>
	<u>1,000,307</u>	:	:	<u>1,000,307</u>
Accumulated depreciation	<u>329,137</u>	<u>17,101</u>	:	<u>346,238</u>
Net fixed assets	<u>671,170</u>			<u>654,069</u>

Note 5 – Restricted Cash

Restricted cash is composed of the following:

Depreciation reserve fund	\$343
Customer deposit fund	<u>502</u>
	<u>\$845</u>

Note 6 – Contingencies

The Association is subject to possible examinations made by Federal and State authorities who determine compliance with terms, conditions, laws, and regulations governing other grants given to the Association in the current and prior years. There were no examinations for the period ended November 7, 2013. Areas of noncompliance, if any, as a result of examinations would be included as a part of the "Findings and Questioned Costs" section of this report.

Note 7 – Risk Management

The Association is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Association carries commercial insurance coverage for the risks to the extent deemed prudent by Association management.

Note 8- Bonds/Notes payable

The amount shown in the accompanying financial statements as notes payable represents the Association's obligation to make loan payments. At November 7, 2013, two loans had an outstanding balance. Details of these loan are summarized as follows:

Note A

Lender – Rural Development

Balance of loan - \$342,773

Rate – 4.125%

Interest only payments for 2009 & 2010. Principal and interest payments are due beginning with the 2011 fiscal year.

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time.

Note B

Lender – Farmers State Bank

Balance of loan - \$2,013

Rate – 5.75%

Interest and principal payments of \$671 due monthly

Schedule of Bonds/Notes

Payable

	<u>balance</u> <u>12/31/12</u>	<u>Additions</u>	<u>Payments</u>	<u>balance</u> <u>12/31/13</u>	<u>Current</u> <u>portion</u>
USDA	\$342,773	\$-	\$-	\$342,773	\$15,337
Farmers State Bank	<u>8,464</u>	<u>-</u>	<u>6,451</u>	<u>2,013</u>	<u>2,013</u>
	\$351,237	\$-	\$7,354	\$344,786	\$17,350

Note-9 Transfer of Ownership

At its 2013 annual meeting the membership voted to “merge” with the City of Beattyville. Temporary operations of the Southside Water Association by the City of Beattyville began July 1, 2013. On November 7, 2013 ownership was transferred to the City of Beattyville. Southside transferred all of its personal and real property. The City of Beattyville issued revenue bonds sufficient to retire the USDA promissory note referenced in note 8.

SUPPLEMENTAL DATA

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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

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 business-type activities of the Southside Water Association as of and for the period ended November 7, 2013, and the related notes to the financial statements, which collectively comprise Southside Water Association's basic financial statements and have issued our report thereon dated June 27, 2014.

Internal Control Over Financial Reporting

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

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. We consider the deficiencies described in the accompanying schedule of findings to be material weaknesses. (13-01 & 13-02)

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. We consider the deficiency described in the accompany schedule of findings to be a significant deficiency. (13-03)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Southside Water Association'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 four instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. (13-04, 13-05, 13-06, & 13-07)

Southside Water Association's Response to Findings

The Southside Water Association's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Southside Water Association's responses and, accordingly, we express no opinion on them.

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.

John T. Lane & Associates, LLC

June 27, 2014

SOUTHSIDE WATER ASSOCIATION
Findings and Responses
November 7, 2013

Prior Findings

12-01, 12-02, 12-03, 12-04 and 12-05 repeated as 13-01, 13-02, 13-03, 13-04 and 13-05.

Current Findings

13-01 Lack of Segregation of Duties

Condition: The Association has an inadequate segregation of duties within its internal control process.

Criteria: All governmental entities should design their internal control to provide an adequate segregation of duties.

Cause: The Association does not have sufficient employees to adequately design its internal control.

Recommendation: The Association should continue to design and implement its internal control policies to provide the maximum segregation of duties possible.

Response: We will do as recommended.

13-02 Understanding of GAAP

Condition: The Association lacks controls over the selection and application of accounting principles that are in conformity with GAAP.

Criteria: Accounting personnel should possess the expertise to understand and implement accounting procedures that are in accordance with GAAP.

Cause: The Association lacks the funding to employ a qualified accountant.

Recommendation: The Association's bookkeeper along with the chairman of the board should review and approve the financial statements.

Response: We will do as recommended.

13-03 Budget Review

Condition: The District prepares an annual budget. However, actual performance is not measured against the annual budget.

Criteria: A more frequent review of operating results and budget variations will enable management to more actively run the business by recognizing unusual trends that may indicate fraud, unwise use of resources, operational inefficiencies, poor decision making or missed business opportunities.

Cause: Unknown

Recommendation: We recommend a budget review that includes participation of appropriate employees no less frequent than quarterly.

Response: We will start reviewing our budget quarterly at our monthly board meetings.

13-04 USDA Loan (Sinking Fund)

Condition: The Association is required to establish a separate bank account (sinking fund) and make monthly transfers to it for its principal and interest payments. The Association is also required to make timely principal and interest payments.

Criteria: Setting aside funds to make principal and interest payments will ensure the Association has funds to cover its debt, when due.

Cause: Unknown.

Recommendation: Establish a separate bank account, ensure monthly transfers are made, sufficient to cover the next principal and/or interest payment and make said payment when due.

Response: We will do as recommended.

SOUTHSIDE WATER ASSOCIATION
Findings and Responses (continued)
November 7, 2013

13-05 USDA Loan (Depreciation Reserve)

Condition: The Association is required to make monthly transfers into this account in the amount of \$155.

Criteria: The required monthly transfers were not made during 2013.

Cause: Unknown.

Recommendation: Ensure monthly transfers are made.

Response: We will do as recommended.

13-06 USDA Loan (Principal & Interest)

Condition: The Association has not made the required principal & interest payments on its note with the USDA.

Criteria: Annual principal & interest payments are required to be made on the USDA note.

Cause: Unknown.

Recommendation: Make the required principal and interest payments to bring the note current.

Response: We will do as recommended.

13-07 Federal Tax Deposits & Forms 941

Condition: The Association could not provide copies of three of the four quarterly 941s. It was also determined the Association has not made the required federal tax deposits.

Criteria: The Association is required to complete and submit form 941 quarterly and make federal tax deposits monthly.

Cause: Unknown.

Recommendation: File the required forms 941 and make the required federal tax deposits.

Response: We will do as recommended.