

Southeastern Water Association, Inc.

**Audited Financial Statements
and Supplemental Information**

for the years ended December 31, 2013 and 2012

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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Southeastern Water Association, Inc. (a nonprofit corporation) which comprise the statements of financial position as of December 31, 2013 and 2012, and the related statements of activities and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements, which comprise the Association'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 of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

To the Board of Directors
Southeastern Water Association, Inc.
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effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the 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 Southeastern Water Association, Inc. as of December 31, 2013 and 2012, and the changes in its net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required

In accordance with *Government Auditing Standards*, we have issued our report on September 16, 2014 on our consideration of the Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. Also, in accordance with RUS Part 1773, we have issued our report on September 16, 2014 on our consideration of the Association's compliance with aspects of contractual agreements and regulatory requirements for loan and grant recipients. The purpose of these reports are to describe the scope of our testing of internal control over financial reporting or on compliance with aspects of contractual agreements and the results of that testing, not to provide an opinion on internal control over financial reporting or on compliance with aspects of contractual agreements and regulatory requirements of loan and grant recipients. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and RUS Part 1773 in considering the Association's internal control over financial reporting and compliance with aspects of contractual agreements and regulatory requirements for loan and grant recipients.

Somerset, Kentucky
September 16, 2014

Southeastern Water Association, Inc.
Statements of Financial Position
December 31, 2013 and 2012

	2013	2012
Assets		
Current assets		
Cash	\$ 930,678	\$ 515,909
Certificates of deposit, savings and money market	1,939,823	1,739,552
Accounts receivable, net	314,110	321,208
Inventory	67,158	65,350
Prepaid expenses	<u>37,548</u>	<u>39,082</u>
Total current assets	<u>3,289,317</u>	<u>2,681,101</u>
Restricted cash	602,452	630,459
Property and equipment, net	<u>23,833,918</u>	<u>24,189,248</u>
Total assets	<u>\$ 27,725,687</u>	<u>\$ 27,500,808</u>
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued liabilities	\$ 173,507	\$ 469,426
Accrued interest	37,272	122,936
Advance tap-on fees	32,690	32,690
Current portion of long-term debt	<u>244,677</u>	<u>182,591</u>
Total current liabilities	<u>488,146</u>	<u>807,643</u>
Non-current liabilities		
Loans payable to Rural Development	11,532,552	11,832,982
Loans payable to Capmark	<u>-</u>	<u>184,431</u>
Total non-current liabilities	<u>11,532,552</u>	<u>12,017,413</u>
Total liabilities	<u>12,020,698</u>	<u>12,825,056</u>
Net Assets		
Unrestricted		
Reserved by contract	602,452	630,459
Reserved by board	120,000	120,000
Membership fees	116,256	110,866
Tap-on fees	2,900,263	2,844,423
Other	<u>11,966,018</u>	<u>10,970,004</u>
Total net assets	<u>15,704,989</u>	<u>14,675,752</u>
Total liabilities and net assets	<u>\$ 27,725,687</u>	<u>\$ 27,500,808</u>

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

Southeastern Water Association, Inc.
Statements of Activities
For the Years Ended December 31, 2013 and 2012

	2013	2012
Operating revenues		
Sales	\$ 3,967,897	\$ 3,858,128
Cost of water sold	<u>(1,394,676)</u>	<u>(1,362,603)</u>
Net revenues from water	<u>2,573,221</u>	<u>2,495,525</u>
 General and administrative		
Depreciation	746,250	729,675
Wages	303,899	302,453
Maintenance	113,048	91,954
Insurance expense	145,547	119,023
Other general and administrative	105,487	100,778
Customer billing	99,403	98,447
Directors' fees	34,400	36,650
Office expense	58,695	54,952
Bad debts	38,649	40,657
Professional fees	57,432	49,681
Tax and license	38,177	37,014
Total general and administrative	<u>1,740,987</u>	<u>1,661,284</u>
 Net income (loss) from operations	 <u>832,234</u>	 <u>834,241</u>
 Non-operating revenues (expenses)		
Capital contributions - federal grants	471,526	916,608
Capital contributions - other grants	-	76,621
Membership fees collected	5,390	5,050
Tap-on fees collected, net of amounts refunded	55,840	31,825
Interest income	7,877	7,340
Gain (loss) on disposal of equipment	-	1,500
Interest expense	<u>(343,630)</u>	<u>(427,782)</u>
Total non-operating revenues (expenses)	<u>197,003</u>	<u>611,162</u>
 Change in net assets	 1,029,237	 1,445,403
 Net assets - beginning	 <u>14,675,752</u>	 <u>13,230,349</u>
 Net Assets - Ending	 <u>\$ 15,704,989</u>	 <u>\$ 14,675,752</u>

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

Southeastern Water Association, Inc.
Statements of Changes in Net Assets
For the Years Ended December 31, 2013 and 2012

	<u>Unrestricted: Reserved by contract</u>	<u>Unrestricted: Reserved by board</u>	<u>Unrestricted: Membership Fees</u>	<u>Unrestricted: Tap-on Fees</u>	<u>Unrestricted: Other</u>	<u>Total</u>
Balances, January 1, 2012	\$ 584,715	\$ 120,000	\$ 105,816	\$ 2,812,598	\$ 9,607,220	\$ 13,230,349
2012 net change in unrestricted net assets					415,299	415,299
Transfers	45,744				(45,744)	-
Grants					993,229	993,229
Membership fees			5,050			5,050
Tap-on fees transferred from Advance tap-on fees				31,825		31,825
Balances, December 31, 2012	630,459	120,000	110,866	2,844,423	10,970,004	14,675,752
2013 net change in unrestricted net assets					496,481	496,481
Transfers	(28,007)				28,007	-
Grants					471,526	471,526
Membership fees			5,390			5,390
Tap-on fees				55,840		55,840
Balances, December 31, 2013	<u>\$ 602,452</u>	<u>\$ 120,000</u>	<u>\$ 116,256</u>	<u>\$ 2,900,263</u>	<u>\$ 11,966,018</u>	<u>\$ 15,704,989</u>

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

Southeastern Water Association, Inc.
Statements of Cash Flows
For the Years Ended December 31, 2013 and 2012

	2013	2012
Cash flows from operating activities		
Net income from operations	\$ 832,234	\$ 834,241
Adjustments to reconcile net income from operations to net cash provided by operating activities		
Depreciation	746,250	729,675
Bad Debts	38,649	40,657
(Increase) decrease in		
Inventory	(1,808)	(15,145)
Accounts receivable	13,321	(59,539)
Prepaid expenses	1,534	(530)
Increase (decrease) in		
Accounts payable and accrued liabilities	(295,919)	(59,051)
Advance tap-on fees	<u>-</u>	<u>(525)</u>
Net cash provided by operating activities	<u>1,334,261</u>	<u>1,469,783</u>
Cash flows from investing activities		
Interest income	7,877	7,340
Redemption of (investment in) certificates of deposit/money market account	(200,271)	(641,749)
Proceeds from sale of property	-	1,500
Cash payments for the purchase and construction of fixed assets	(315,405)	(1,140,945)
Interest expense capitalized into construction work in process	<u>(120,387)</u>	<u>(53,372)</u>
Net cash used by investing activities	<u>(628,186)</u>	<u>(1,827,226)</u>
Cash flows from financing activities		
Cash paid for interest expense	(429,294)	(387,533)
Proceeds from federal grants	471,526	916,608
Proceeds from other grants	-	76,621
Proceeds from tap on and membership fees	61,230	36,875
Proceeds from long-term debt	-	197,848
Principal payments on long-term debt	<u>(422,775)</u>	<u>(174,527)</u>
Net cash (used) provided by financing activities	<u>(319,313)</u>	<u>665,892</u>
Net increase (decrease) in cash and cash equivalents	386,762	308,449
Cash and cash equivalents, beginning of year	<u>1,146,368</u>	<u>837,919</u>
Cash and cash equivalents, end of year	<u>\$ 1,533,130</u>	<u>\$ 1,146,368</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	<u>\$ 549,681</u>	<u>\$ 440,905</u>

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

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

1. Nature of Activities and Summary of Significant Accounting Policies

Southeastern Water Association, Inc. (the Association) was formed as a result of an order by the Public Service Commission of Kentucky which required the merger of Nelson Valley Water Association, Inc., Tateville Water Association, Inc., Elihu-Rush Branch Water Association, Inc. and Barnesburg Water Association, Inc. The Association purchases water from the City of Somerset Water Service and distributes the water to residents of the Nelson Valley, Tateville, Elihu-Rush Branch and Barnesburg areas of Pulaski County, Kentucky. The accompanying financial statements are presented on the accrual basis of accounting.

The Association falls under the oversight and regulations of the Kentucky Public Service Commission and accordingly follows their prescribed Uniform System of Accounts.

Basis of Presentation

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

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Association considers cash in the bank and certificates of deposit with an original maturity of one year or less, both restricted and unrestricted, to be cash and cash equivalents.

Accounts Receivable

The Association extends credit to substantially all of its customers. Accounts receivable are stated at the face amount of the water bills, which approximates fair market value. Specific accounts deemed uncollectible are charged to bad debt upon evaluation by management. Evaluation factors include familiarity with the customer, credit history and the age of the unpaid bill.

Allowance for Doubtful Accounts

The Association maintains an allowance for doubtful accounts based on percentages applied to the various aging periods of accounts receivable. The accounts receivable balance at December 31, 2013 and 2012 is stated net of the allowance balance of \$24,515 and \$30,738, respectively.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

1. Nature of Activities and Summary of Significant Accounting Policies, continued

Inventory

Inventory of the Association consists of supplies and materials for Association use. This inventory is valued at first-in, first-out cost, which approximates market.

Property and Equipment

Property and equipment with useful lives of more than one year are stated at historical cost. The costs of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized. Depreciation is computed using straight line over estimated useful lives ranging from 5 to 40 years.

Advance Tap-On Fees

The Association allows potential customers to pay tap-on fees in advance of construction of lines. Amounts paid in advance remain payable back to the customer until the customer receives water service. Upon receipt of water service the tap-on fee is reclassified to Unrestricted Net Assets - Tap-On-Fees.

Membership Fees

The Association requires all customers to be members of the Association. This is provided by the customer paying a one time nonrefundable fee of \$10.

Grants

Grants received by the Association that are used to offset the acquisition, improvement or construction costs of the Association's property, facilities or equipment used to provide utility services to the public are recorded as non-operating revenue. Grant revenues are transferred at year end to the equity account Unrestricted Net Assets - Other.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, net position and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Advertising Costs

Advertising costs are expensed when incurred. Advertising costs for the years ending December 31, 2013 and 2012 were \$1,299 and \$1,613, respectively.

Comparability

Certain prior year amounts have been restated to conform to current year presentation.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

1. Nature of Activities and Summary of Significant Accounting Policies, continued

Income Tax Status

The Association is a nonprofit organization, exempt under Internal Revenue Section 501(c)(12). No income tax is applicable due to the Association's tax exempt status. The Association is not aware of any uncertain income tax positions as of September 16, 2014. The Association has not been audited by the Internal Revenue Service (IRS). However, the tax years of 2010 forward could be subject to examination by the IRS or other applicable tax jurisdiction.

Management's Review of Subsequent Events

The Association has evaluated and considered the need to recognize or disclose subsequent events through September 16, 2014, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the year ended December 31, 2013, have not been evaluated by the Association.

2. Collateralization

The Association held deposits at one bank. Accounts at an institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Cash at this institution exceeded FDIC insured limits. The amounts in excess of the FDIC limit totaled \$3,224,645 and \$2,648,145 at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, the entire excess amount is collateralized with securities held in the name of the financial institution and pledged to the Association. Securities cannot be moved or redeemed without prior approval of the Association.

3. Property and Equipment

The cost of property and equipment at December 31, 2013 and 2012 is as follows:

	December 31, 2013	December 31, 2012
Transmission and distribution system	\$ 33,616,080	\$ 28,082,013
Construction work in process	-	5,165,894
Equipment	487,652	483,155
Land and land rights (nondepreciable)	50,902	40,902
Property and equipment	34,154,634	33,771,964
Less accumulated depreciation	(10,320,716)	(9,582,716)
Property and equipment, net	\$ 23,833,918	\$ 24,189,248

During the years ended December 31, 2013 and 2012, interest, on debt, of \$120,387 and \$53,372, respectively, was capitalized into construction work in process and construction completed.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

4. Long-Term Liabilities

Loans Payable to Rural Development

Loans from Rural Development (RD) financed installation of distribution mains and water lines. Real estate and revenues sufficient to fund the annual debt service secure the loans.

The balances on the RD loans are as follows:

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
2.375% loan dated February 2, 2011, payable in annual installments of \$160,799, including interest, through February 2, 2054, with interest only payable on February 2, 2012 and February 2, 2013.	\$ 3,939,264	\$ 3,995,000
4.375% loan dated November 8, 2006, payable in annual installments of \$149,956, including interest, through November 8, 2046.	2,583,374	2,619,460
4.5% loan dated September 17, 2004, payable in annual installments of \$101,567, including interest, through September 17, 2044.	1,664,410	1,690,607
4.875% loan dated July 10, 2001, payable in annual installments of \$86,241, including interest, through July 10, 2041.	1,259,322	1,287,577
4.5% loan dated February 12, 1997, payable in annual installments of \$13,853, including interest, through February 12, 2039.	181,451	185,815
4.5% loan dated February 12, 1997, payable in annual installments of \$9,562, including interest, through February 12, 2037.	115,824	118,643
5.0% loan dated February 12, 1997, payable in annual installments of \$63,306, including interest, through January 1, 2033.	701,870	725,124

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

4. Long-Term Liabilities, continued

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
5% loan dated February 12, 1997, payable in annual installments of \$46,499, including interest, through January 1, 2032.	\$ 467,109	\$ 482,888
4.5% loan dated September 14, 1995, payable in annual installments of \$7,536, including interest, through September 9, 2035.	91,093	93,534
4.5% loan dated September 14, 1995, payable in annual installments of \$13,133, including interest, through September 9, 2035.	174,196	178,902
5% loan dated September 14, 1995, payable in annual installments of \$34,426, including interest, through January 1, 2029.	345,461	361,951
5% loan dated October 17, 1991, payable in annual installments of \$22,294, including interest, through October 31, 2031.	<u>253,855</u>	<u>263,202</u>
	11,777,229	12,002,703
Less current portion	<u>(244,677)</u>	<u>(169,720)</u>
	<u>\$ 11,532,552</u>	<u>\$ 11,832,982</u>

The Association has a *Supplementary Payment Agreement* with RD in place in which loan payments are made in monthly installments. The monthly installments are adequate to cover the annual requirements of all outstanding RD loans.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

4. Long-Term Liabilities, continued

Loans Payable to Capmark

Loans from Capmark, formerly GMAC Commercial Mortgage, financed installation of distribution mains and water lines to customers. Assets and revenues sufficient to fund the annual debt service secured the loans. In March of 2013 the board voted to pay off these loans early due to the high interest rates.

The balances on the Capmark loans are as follows:

	December 31, 2013	December 31, 2012
5.0% loan dated June 1983, payable in annual installments of \$14,693, including interest, through June 2023.	-	\$ 121,857
7.375% loan dated June 1983, payable in annual installments of \$10,225, including interest, through June 2023.	-	75,445
	-	197,302
Less current portion	-	(12,871)
	\$ -	\$ 184,431

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

2014	\$ 244,677
2015	254,896
2016	268,317
2017	276,718
Later years	10,732,620
	\$ 11,777,229

Interest incurred on all debt during the years ended December 31, 2013 and 2012 totaled \$464,017 and \$481,154, respectively. During the years ended December 31, 2013 and 2012 interest of \$120,387 and \$53,372 was capitalized into construction work in process and construction completed.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2013 and 2012

5. Special Funds and Restrictions

The debt agreements with Rural Development require the following accounts be maintained by the utility as long as any outstanding debt remains;

General account - All operating funds received shall be deposited in this account. Funds will be used for operating and maintenance expenses and will be transferred to other accounts as needed.

Funded depreciation reserve account - The Association is required to make monthly deposits into this account as provided by the letter of conditions from RD. Ten percent of each loan is required to be deposited into this account over a period of ten years. These funds may be used for debt service or for unusual repairs or improvements if proper approvals are obtained and no funds are available in the general account. The balance as of December 31, 2013 and 2012 was \$531,502 and \$480,040 respectively.

Debt service reserve account - Monthly deposits are required to be made into this account. Funds are to be used to make payments on Rural Development loans. The account was established per Rural Development loan requirements. The balance as of December 31, 2013 and 2012 was \$58,201 and \$115,600 respectively.

Short lived assets reserve account - Monthly deposits are required to commence in January 2013 into this account as provided by the letter of conditions for loan 26. These funds may be used to replace short lived assets used in the normal course of business at the discretion of the Association.

Total funds required in the reserve accounts per RD for December 31, 2013 and 2012 was \$545,820 and \$477,060, respectively. Total amount of restricted cash related to RD commitments for December 31, 2013 and 2012 was \$589,703 and \$595,640, respectively. The reserve account for short lived assets was not opened until 2014, however, because the Association's total reserved funds were more than required for 2013, RD waived the requirement for 2013.

6. Related-Party Transactions

In addition to directors' fees paid, the Association paid board members and certain members of their immediate families a total of \$5,166 and \$0 in 2013 and 2012, respectively, for expenses relating to repairs and maintenance of the Association's assets.

7. Retirement Plan

The Association adopted a simplified employee pension plan (SEP) in 1999. This discretionary plan covers substantially all employees. In September 2013, the Board elected to increase the contributions from 2% of gross wages for qualifying employees to 3% of gross wages for qualifying employees, effective September 1, 2013. The Board also elected to contribute an additional amount on 2012 gross wages for qualifying employees of 1.5%. This was funded in July 2013. During 2013 and 2012 the Association made plan contributions of \$9,752 and \$5,721, respectively.

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Southeastern Water Association, Inc. (a nonprofit organization) which comprise the statements of financial position as of December 31, 2013 and 2012, and the related statements of activities and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated September 16, 2014.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given those limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

We noted certain matters that we have reported to management of Southeastern Water Association, Inc. in a separate letter dated September 16, 2014.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southeastern Water Association, Inc.'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. In accordance with the provisions of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33, we have included our report on compliance with aspects of contractual agreements and regulator requirements for loan and grant recipients.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Somerset, Kentucky
September 16, 2014

**Independent Auditor's Report on Compliance with
Aspects of Contractual Agreements and Regulatory
Requirements for Waste Water Borrowers**

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

We have audited, 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, the financial statements of Southeastern Water Association, Inc. (the Association), which comprise the statements of financial position as of December 31, 2013 and 2012 and the related statements of activities and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements and have issued our report thereon dated September 16, 2014. In accordance with *Government Auditing Standards*, we have also issued our report on September 16, 2014, on our consideration of the Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Association failed to comply with the terms, covenants, provisions or conditions of their loan, grant and security instruments as set forth in 7CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Association's noncompliance with the above-referenced terms, covenants, provisions or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Association's accounting and records to indicate that the Association did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material and overhead costs, and the distribution of these costs to construction, retirement and maintenance or other expenses accounts;

Reconcile continuing property records to the controlling general ledger plant accounts;

Clear construction accounts and accrue depreciation on completed construction;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material or scrap;

Maintain adequate control over materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain written RUS approval to enter into any contract for the management, operation or maintenance of the borrower's system if the contract covers all or substantially all of the waste water system;

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Record depreciation in accordance with RUS requirements ;

Comply with the requirements for the detailed schedule of deferred debits and deferred credits;
and

Comply with the requirements for the detailed schedule of investments.

This report is intended solely for the information and use of the board of directors, management and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.