

**SOUTHEASTERN WATER ASSOCIATION, INC.**

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**Audited Financial Statements  
for the years ended December 31, 2015 and 2014**

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors  
Southeastern Water Association, Inc.  
Somerset, KY 42503

I have audited the accompanying financial statements of Southeastern Water Association, Inc. (a non-profit organization), which comprise the statements of net assets as of December 31, 2015, and the related statements of activities, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation 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 an opinion on these financial statements based on my audits. I conducted my audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audits 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, 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.

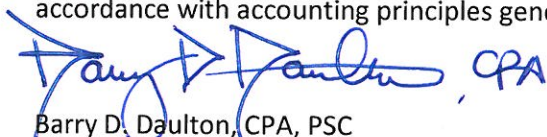
I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

**Prior Period Financial Statements Audited by a Predecessor Auditor**

The financial statements of Southeastern Water Association, Inc. as of December 31, 2014, and for the year then ended were audited by other auditors. Those auditors expressed an unmodified opinion on those financial statements in their report dated December 16, 2015.

**Opinion**

In my 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, 2015, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.



Barry D. Daulton, CPA, PSC

Somerset, Kentucky  
August 19, 2016

**Southeastern Water Association, Inc.**  
**Statements of Net Assets**  
**December 31, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 3,189,791	\$ 2,701,879
Short-term cash investments	963,890	961,478
Accounts receivable	291,082	289,472
Inventory	127,565	92,222
Prepaid expenses	42,348	42,488
	<u>4,614,676</u>	<u>4,087,539</u>
<b>Property, Plant and Equipment</b>		
Property, plant and equipment	34,970,843	34,620,938
Accumulated depreciation	(12,039,384)	(11,172,458)
	<u>22,931,459</u>	<u>23,448,480</u>
<b>Other Assets</b>		
Restricted cash accounts	891,607	661,173
	<u>891,607</u>	<u>661,173</u>
<b>Total Assets</b>	<u>\$ 28,437,742</u>	<u>\$ 28,197,192</u>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 267,566	\$ 369,041
Accrued interest payable	64,226	36,453
Advance tap-on fees	2,595	2,595
Current portion of long-term debt	254,896	254,896
	<u>589,283</u>	<u>662,985</u>
<b>Long-term Liabilities</b>		
Long-term debt	11,428,219	11,531,312
Net of current portion	(254,896)	(254,896)
	<u>11,173,323</u>	<u>11,276,416</u>
<b>Total Liabilities</b>	<u>11,762,606</u>	<u>11,939,401</u>
<b>Net Assets</b>		
Reserved by contract	891,607	661,173
Reserved by board	120,000	120,000
Membership fees	126,111	121,221
Tap-on fees	3,002,973	2,965,378
Other	12,534,445	12,390,019
	<u>16,675,136</u>	<u>16,257,791</u>
<b>Total Liabilities and Net Assets</b>	<u>\$ 28,437,742</u>	<u>\$ 28,197,192</u>

See independent auditor's report and notes to financial statements.

**Southeastern Water Association, Inc.**  
**Statements of Activities**  
**For the years ended December 31, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
<b>Operating revenues</b>		
Sales	\$ 4,085,799	\$ 4,084,758
Cost of Water Sold	<u>1,445,734</u>	<u>1,388,893</u>
	2,640,065	2,695,865
<b>General and administrative</b>		
Depreciation	868,983	851,742
Wages	344,818	319,258
Maintenance	113,133	169,625
Insurance	190,866	180,294
Other general and administrative	90,711	126,542
Customer billing	101,317	101,189
Directors' fees	37,000	36,500
Office expense	66,664	73,079
Bad debt	30,087	40,217
Professional services	69,572	57,219
Tax and license	<u>45,804</u>	<u>55,557</u>
Total cost of general and administrative	<u>1,958,955</u>	<u>2,011,222</u>
Net income (loss) from operations	681,110	684,643
<b>Non-operating revenues (expenses)</b>		
Capital contributions - federal grants	74,142	192,724
Capital contributions - other grants	6,953	42,928
Membership fees collected	4,890	4,965
Tap-on fees collected, net of amounts refunded	37,595	65,115
Interest income	16,962	13,635
Interest expense	<u>(404,307)</u>	<u>(451,208)</u>
Total non-operating revenues (expenses)	<u>(263,765)</u>	<u>(131,841)</u>
Change in unrestricted net assets	417,345	552,802
Unrestricted net assets beginning of year	<u>16,257,791</u>	<u>15,704,989</u>
Unrestricted net assets end of year	<u><u>\$ 16,675,136</u></u>	<u><u>\$ 16,257,791</u></u>

See independent auditor's report and notes to financial statements.

Southeastern Water Association, Inc.  
Statements of Changes in Net Assets  
For the years ended December 31, 2015 and 2014

	Unrestricted: Reserved by Contract	Unrestricted: Reserved by board	Unrestricted: Membership Fees	Unrestricted: Tap-on Fees	Unrestricted: Other	Total
<b>Balances, January 1, 2014</b>	\$ 602,452	\$ 120,000	\$ 116,256	\$ 2,900,263	\$ 11,966,018	\$ 15,704,989
2014 change in net assets			4,965	65,115	482,722	552,802
Transfers	58,721				(58,721)	-
<b>Balances, December 31, 2014</b>	<u>\$ 661,173</u>	<u>\$ 120,000</u>	<u>\$ 121,221</u>	<u>\$ 2,965,378</u>	<u>\$ 12,390,019</u>	<u>\$ 16,257,791</u>
2015 change in net assets			4,890	37,595	374,860	417,345
Transfers	230,434				(230,434)	-
<b>Balances, December 31, 2015</b>	<u>\$ 891,607</u>	<u>\$ 120,000</u>	<u>\$ 126,111</u>	<u>\$ 3,002,973</u>	<u>\$ 12,534,445</u>	<u>\$ 16,675,136</u>

See independent auditor's report and notes to financial statements.

**Southeastern Water Association, Inc.**  
**Statements of Cash Flows**  
**For the years ended December 31, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
<b>Cash flows from operating activities</b>		
Operating income/loss	\$ 681,110	\$ 684,643
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	868,983	851,742
Bad debts	30,087	40,217
(Increase) decrease in operating assets		
Inventory	(35,343)	(25,064)
Accounts receivable	(1,610)	(15,579)
Prepaid expenses	140	(4,940)
Increase (decrease) in operating liabilities		
Accounts payable	(101,475)	195,534
Advance tap-on fees	-	(30,095)
Net cash provided by operating activities	1,441,892	1,696,458
<b>Cash flows from investing activities</b>		
Interest income	16,962	13,635
Redemption of (investment in) certificates of deposits/money market account	(6,783)	(3,179)
Cash payments for the purchase and construction of fixed assets	(349,905)	(466,304)
Net cash used by investing activities	(339,726)	(455,848)
<b>Cash flows from financing activities</b>		
Cash paid for interest expense	(404,307)	(452,027)
Proceeds from federal grants	74,142	192,724
Proceeds from other grants	6,953	42,928
Proceeds from tap-on and membership fees	42,485	70,080
Principal payment on long-term debt	(103,093)	(245,917)
Net cash provided by financing activities	(383,820)	(392,212)
Net increase (decrease) in cash and cash equivalents	718,346	848,398
Cash and cash equivalents beginning of year	3,363,052	2,514,654
Cash and cash equivalents end of year	<u>\$ 4,081,398</u>	<u>\$ 3,363,052</u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the year for interest	376,534	452,027

See independent auditor's report and notes to financial statements.

Southeastern Water Association, Inc.  
Notes to Financial Statements  
For the Years Ended December 31, 2015 and 2014

**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 Associations 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, 2015 and 2014 is stated net of the allowance balance of \$21,909 and \$20,680, respectively.

Southeastern Water Association, Inc.  
Notes to Financial Statements  
For the Years Ended December 31, 2015 and 2014

**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 Associations' 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 require management to make estimates and assumptions that affect reported amount 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.

Southeastern Water Association, Inc.  
Notes to Financial Statements  
For the Years Ended December 31, 2015 and 2014

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

**Comparability**

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

**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 December 31, 2015. The Association has not been audited by the Internal Revenue Service (IRS).

**Management's Review of Subsequent Events**

The Association had evaluated and considered the need to recognize or disclose subsequent events through August 19, 2016, 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, 2015, have not been evaluated by the Association.

**2. Concentration of Credit Risk**

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 \$4,606,314 and \$3,917,308 at December 31, 2015 and 2014 respectively. At December 31, 2015 \$3,467,624 of the excess amount is collateralized with securities held in the name of the financial institution and pledged to the Association. The remaining \$ 1,138,690 bears risk 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, 2015 and 2014 is as follows:

	December 31, 2015	December 31, 2014
Transmission and distribution system	\$ 33,822,570	\$ 33,663,258
Construction work in process	443,715	370,447
Equipment	653,656	536,331
Land and land rights (nondepreciable)	<u>50,902</u>	<u>50,902</u>
Property and equipment	34,970,843	34,620,938
Less accumulated depreciation	<u>(12,039,384)</u>	<u>(11,172,458)</u>
Property and equipment, net	<u>\$ 22,931,459</u>	<u>\$ 23,448,480</u>

Southeastern Water Association, Inc.  
Notes to Financial Statements  
For the Years Ended December 31, 2015 and 2014

**4. Long-Term Liabilities**

**Loans Payable Rural Development**

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

The balances on the RD loans are as follows:

	December 31, <u>2015</u>	December 31, <u>2014</u>
Interest variable loan dated March 8, 2015, payable in annual installments, including interest through November 8, 2046.	\$ 2,980,000	\$ --
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.	3,801,671	3,871,284
4.375% loan dated November 8, 2006, payable in annual installments of \$149,956, including interest through November 8, 2046.	2,506,301	2,545,679
4.5% loan dated September 17, 2004, payable in annual installments of \$101,567, including interest, through September 17, 2044.	1,608,350	1,637,009
4.875% loan dated July 10, 2001, payable in annual installments of \$86,241, including interest, through July 10, 2041.	--	1,229,658
4.5% loan dated February 12, 1997, payable in annual installments of \$13,853, including interest, through February 12, 2039.	172,112	76,886

Southeastern Water Association, Inc.  
Notes to Financial Statements  
For the Years Ended December 31, 2015 and 2014

**4. Long-Term Liabilities, continued**

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
4.5% loan dated February 12, 1997, payable in annual installments of \$9,562, including interest, through February 12, 2037.	\$ 109,791	\$ 112,875
5.0% loan dated February 12, 1997, payable in annual installments of \$63,306, including interest, through January 1, 2033.	--	677,426
5% loan dated February 12, 1997, payable in annual installments of \$46,499, including interest, through January 1, 2032.	--	450,523
4.5% loan dated September 14, 1995, payable in annual installments of \$7,536, including interest, through September 9, 2035.	85,869	88,539
4.5% loan dated September 14, 1995, payable in annual installments of \$13,133, including interest, through September 9, 2035.	164,125	169,274
5% loan dated September 14, 1995, payable in annual installments of \$34,426, including interest, through January 1, 2029.	--	328,128
5% loan dated October 17, 1991, payable in annual installments of \$22,294, including interest, through October 31, 2031.	\$ --	\$ 244,031
	\$ 11,428,219	\$ 11,531,312
Less current portion	<u>(254,896)</u>	<u>(254,896)</u>
	<u>\$ 11,173,323</u>	<u>\$ 11,276,416</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, 2015 and 2014

**4. Long-Term Liabilities, continued**

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

2016	\$ 137,964
2017	\$ 143,435
2018	\$ 148,926
2019	\$ 154,436
2020	\$ 155,996
Later Years	<u>\$10,687,462</u>
	<u>\$11,428,219</u>

Interest incurred on all debt during the years ended December 31, 2015 and 2014 totaled \$404,307 and \$451,208, respectively.

**5. Special Funds and Restrictions**

The debt agreements with Rural Development require the following accounts by 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, 2015 and 2014 was \$524,488 and \$582,821, 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, 2015 and 2014 was \$82,509 and \$58,259, respectively.

Short lived assets reserve account – Monthly deposits are required to commence in January 2014 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.

Southeastern Water Association, Inc.  
Notes to Financial Statements  
For the Years Ended December 31, 2015 and 2014

**5. Special Funds and Restrictions, continued**

Total funds required in the reserve accounts per RD for December 31, 2015 and 2014 was \$642,230 and \$596,580, respectively. Total amount of restricted cash related to RD commitments for December 31, 2015 and 2014 was \$606,996 and \$641,080, respectively. All special funds and restrictions are adequately funded per covenants.

**6. Related-Party Transactions**

In addition to director's fees paid, the Association paid board members and certain members of their immediate families a total of \$36,500 and \$62,238 in 2015 and 2014, respectively, for expenses relating to repairs and maintenance of the Association assets. The Association purchases insurance from a company. One of the board member's brother own stock in the insurance company.

**7. Retirement Plan**

The Association adopted a simplified employee pension plan(SEP) in 1999. This discretionary plan covers substantially all employees. The Association contributes 3% of gross wages for qualifying employees. During 2015 and 2014 the Association made plan contributions of \$13,828 and \$7,269, respectively.