

SOUTHEASTERN WATER ASSOCIATION, INC.

**Audited Financial Statements
for the years ended December 31, 2016 and 2015**

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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, 2016 and 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.

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, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Barry D. Daulton, CPA, PSC

Somerset, Kentucky
September 29, 2017

Southeastern Water Association, Inc.
Statements of Net Assets
December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 3,111,107	\$ 3,189,791
Short-term cash investments	966,305	963,890
Accounts receivable (see note 1)	336,068	291,082
Inventory	87,095	127,565
Prepaid expenses	42,373	42,348
Total current assets	4,542,948	4,614,676
Property, Plant and Equipment		
Property, plant and equipment	35,842,840	34,970,843
Accumulated depreciation	(12,938,342)	(12,039,384)
Net property, plant and equipment (see note 3)	22,904,498	22,931,459
Other Assets		
Restricted cash accounts (see note 5)	918,201	891,607
Total other assets	918,201	891,607
Total Assets	<u>\$ 28,365,647</u>	<u>\$ 28,437,742</u>
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	\$ 320,894	\$ 267,566
Accrued interest payable	62,340	64,226
Retainage payable	30,360	-
Advance tap-on fees	2,595	2,595
Current portion of long-term debt	170,381	254,896
Total current liabilities	586,570	589,283
Long-term Liabilities		
Long-term debt	11,144,427	11,428,219
Net of current portion	(170,381)	(254,896)
Total long-term liabilities (see note 4)	10,974,046	11,173,323
Total Liabilities	11,560,616	11,762,606
Net Assets		
Reserved by contract	918,201	891,607
Reserved by board	120,000	120,000
Membership fees	130,821	126,111
Tap-on fees	3,038,508	3,002,973
Other	12,597,501	12,534,445
Total net assets	16,805,031	16,675,136
Total Liabilities and Net Assets	<u>\$ 28,365,647</u>	<u>\$ 28,437,742</u>

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

Southeastern Water Association, Inc.
Statements of Activities
For the years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues		
Sales	\$ 4,023,160	\$ 4,085,799
Cost of Water Sold	<u>(1,411,337)</u>	<u>(1,445,734)</u>
	2,611,823	2,640,065
General and administrative		
Depreciation	943,430	868,983
Wages	384,200	344,818
Maintenance	179,233	113,133
Insurance	188,696	190,866
Other general and administrative	108,116	90,711
Customer billing	102,529	101,317
Directors' fees	39,500	37,000
Office expense	78,291	66,664
Bad debt	13,882	30,087
Professional services	78,792	69,572
Tax and license	34,312	45,804
Total cost of general and administrative	<u>2,150,981</u>	<u>1,958,955</u>
Net income (loss) from operations	460,842	681,110
Non-operating revenues (expenses)		
Capital contributions - federal grants	-	74,142
Capital contributions - other grants	-	6,953
Gain(Loss) on sale	825	-
Membership fees collected	4,710	4,890
Tap-on fees collected, net of amounts refunded	35,535	37,595
Interest income	17,092	16,962
Interest expense	<u>(389,109)</u>	<u>(404,307)</u>
Total non-operating revenues (expenses)	<u>(330,947)</u>	<u>(263,765)</u>
Change in unrestricted net assets	129,895	417,345
Unrestricted net assets beginning of year	<u>16,675,136</u>	<u>16,257,791</u>
Unrestricted net assets end of year	<u><u>\$ 16,805,031</u></u>	<u><u>\$ 16,675,136</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, 2016 and 2015

	Unrestricted: Reserved by Contract	Unrestricted: Reserved by board	Unrestricted: Membership Fees	Unrestricted: Tap-on Fees	Unrestricted: Other	Total
Balances, January 1, 2015	\$ 661,173	\$ 120,000	\$ 121,221	\$ 2,965,378	\$ 12,390,019	\$ 16,257,791
2015 change in net assets	-	-	4,890	37,595	374,860	417,345
Transfers	230,434	-	-	-	(230,434)	-
Balances, December 31, 2015	<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>
2016 change in net assets	-	-	4,710	35,535	89,650	129,895
Transfers	26,594	-	-	-	(26,594)	-
Balances, December 31, 2016	<u>\$ 918,201</u>	<u>\$ 120,000</u>	<u>\$ 130,821</u>	<u>\$ 3,038,508</u>	<u>\$ 12,597,501</u>	<u>\$ 16,805,031</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, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Operating income/loss	\$ 460,842	\$ 681,110
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	943,430	868,983
Bad debts	13,882	30,087
(Increase) decrease in operating assets		
Inventory	40,470	(35,343)
Accounts receivable	(44,986)	(1,610)
Prepaid expenses	(25)	140
Increase (decrease) in operating liabilities		
Accounts payable	21,033	(101,475)
Net cash provided by operating activities	1,434,646	1,441,892
Cash flows from investing activities		
Interest income	17,092	16,962
Redemption of (investment in) certificates of deposits/money market account	-	(6,783)
Cash payments for the purchase and construction of fixed assets	(871,997)	(349,905)
Net cash used by investing activities	(854,905)	(339,726)
Cash flows from financing activities		
Cash paid for interest expense	(389,109)	(404,307)
Proceeds from federal grants	-	74,142
Proceeds from other grants	-	6,953
Proceeds from sale of asset	825	-
Proceeds from tap-on and membership fees	40,245	42,485
Principal payment on long-term debt	(283,792)	(103,093)
Net cash provided by financing activities	(631,831)	(383,820)
Net increase (decrease) in cash and cash equivalents	(52,090)	718,346
Cash and cash equivalents beginning of year	4,081,398	3,363,052
Cash and cash equivalents end of year	<u>\$ 4,029,308</u>	<u>\$ 4,081,398</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 390,995	\$ 376,534

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

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2016 and 2015

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, 2016 and 2015 is stated net of the allowance balance of \$25,295 and \$21,909, respectively.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2016 and 2015

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, 2016 and 2015

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, 2016. 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 September 27, 2017, 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, 2016, 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 \$4,553,393 and \$4,606,314 at December 31, 2016 and 2015 respectively. At December 31, 2015 \$3,981,473 of the excess amount is collateralized with securities held in the name of the financial institution and pledged to the Association. The remaining \$ 571,920 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, 2016 and 2015 is as follows:

	December 31, <u>2016</u>	December 31, <u>2015</u>
Transmission and distribution system	\$ 34,753,232	\$ 33,822,570
Construction work in process	-	443,715
Equipment	1,038,706	653,656
Land and land rights (nondepreciable)	<u>50,902</u>	<u>50,902</u>
Property and equipment	35,842,840	34,970,843
Less accumulated depreciation	<u>(12,938,342)</u>	<u>(12,039,384)</u>
Property and equipment, net	<u>\$ 22,904,498</u>	<u>\$ 22,931,459</u>

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2016 and 2015

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>2016</u>	December 31, <u>2015</u>
Interest variable loan dated March 8, 2015, payable in annual installments, including interest through November 8, 2046.	\$ 2,855,000	\$ 2,980,000
2.375% loan dated February 2, 2011 payable in annual installments of \$160,799, including interest, through February 2, 2051, with interest only payable on February 2, 2012 and February 2, 2013.	3,730,387	3,801,671
4.375% loan dated November 8, 2006, payable in annual installments of \$149,956, including interest through November 8, 2046.	2,465,166	2,506,301
4.5% loan dated September 17, 2004, payable in annual installments of \$101,567, including interest, through September 17, 2044.	1,578,373	1,608,350
4.5% loan dated February 12, 1997, payable in annual installments of \$12,636, including interest, through February 12, 2039.	167,118	172,112
4.5% loan dated February 12, 1997, payable in annual installments of \$8,100, including interest, through February 12, 2037.	106,565	109,791
4.5% loan dated September 14, 1995, payable in annual installments of \$6,600, including interest, through September 9, 2035.	83,076	85,869

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2016 and 2015

4. Long-Term Liabilities, continued

	December 31, <u>2015</u>	December 31, <u>2014</u>
4.5% loan dated September 14, 1995, payable in annual installments of \$12,660, including interest, through September 9, 2035.	\$ 158,741	\$ 164,125
	\$ 11,144,427	\$ 11,428,219
Less current portion	<u>(170,381)</u>	<u>(254,896)</u>
	<u>\$ 10,974,046</u>	<u>\$ 11,173,323</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.

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

2017	\$ 170,381
2018	\$ 148,926
2019	\$ 154,436
2020	\$ 155,996
2021	\$ 157,556
Later Years	<u>\$10,357,132</u>
	<u>\$11,144,427</u>

Interest incurred on all debt during the years ended December 31, 2016 and 2015 totaled \$389,189 and \$404,307, 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.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2016 and 2015

5. Special Funds and Restrictions, continued

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, 2016 and 2015 was \$555,519 and \$524,488, 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, 2016 and 2015 was \$64,953 and \$82,509, 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.

Total funds required in the reserve accounts per RD for December 31, 2016 and 2015 was \$687,880 and \$642,230, respectively. Total amount of restricted cash related to RD commitments for December 31, 2016 and 2015 was \$620,472 and \$606,996, 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 \$39,500 and \$36,500 in 2016 and 2015, respectively, for expenses relating to repairs and maintenance of the Association assets. The Association purchases insurance from a company. A 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 2016 and 2015 the Association made plan contributions of \$23,293 and \$13,828, respectively.