

Southeastern Water Association, Inc.

**Audited Financial Statements
for the years ended December 31, 2018 and 2017**

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Phone: 606-451-1550
Fax: 606-451-0194
Email: rdt1869@aol.com

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, 2018 and 2017, 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 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 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.

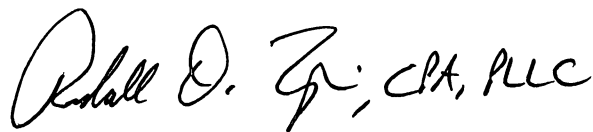
I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

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, 2018 and 2017, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated May 30, 2019, on my consideration of Southeastern Water Association, Inc.'s internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on 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 Southeastern Water Association, Inc.'s internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Rodall D. Zepher, CPA, PLLC". The signature is written in a cursive, flowing style.

May 30, 2019
Somerset, Kentucky

Southeastern Water Association, Inc.
Statements of Net Assets
December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,673,728	\$ 2,223,151
Short-term cash investments	2,903,449	2,175,208
Accounts receivable	361,341	341,952
Inventory	100,904	156,898
Prepaid expenses	57,417	51,828
Total current assets	<u>5,096,839</u>	<u>4,949,037</u>
Property, Plant and Equipment		
Property, plant and equipment	36,280,902	36,066,552
Accumulated depreciation	<u>(14,746,721)</u>	<u>(13,911,585)</u>
Net property, plant and equipment	21,534,181	22,154,967
Other Assets		
Restricted cash accounts	1,088,210	1,020,030
Total other assets	<u>1,088,210</u>	<u>1,020,030</u>
Total Assets	<u><u>\$ 27,719,230</u></u>	<u><u>\$ 28,124,034</u></u>
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	\$ 178,983	\$ 175,821
Accrued liabilities	30,172	13,417
Accrued interest payable	53,369	55,209
Retainage payable	-	-
Customer deposits	108,896	96,999
Advance tap-on fees	2,595	2,595
Current portion of long-term debt	316,900	305,600
Total current liabilities	<u>690,915</u>	<u>649,641</u>
Long-term Liabilities		
Long-term debt	10,544,585	10,849,955
Net of current portion	<u>(316,900)</u>	<u>(305,600)</u>
Total long-term liabilities	<u>10,227,685</u>	<u>10,544,355</u>
Total Liabilities	10,918,600	11,193,996
Net Assets		
Unrealized gain/loss on investments	(1,428)	(950)
Reserved by contract	1,088,210	1,020,030
Reserved by board	1,120,000	120,000
Membership fees	139,936	135,361
Tap-on fees	3,131,723	3,082,798
Other	<u>11,322,189</u>	<u>12,572,799</u>
Total net assets	<u>16,800,630</u>	<u>16,930,038</u>
Total Liabilities and Net Assets	<u><u>\$ 27,719,230</u></u>	<u><u>\$ 28,124,034</u></u>

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

Southeastern Water Association, Inc.
Statements of Activities
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating revenues		
Sales	\$ 4,104,403	\$ 3,974,493
Cost of water sold	<u>(2,062,195)</u>	<u>(1,812,275)</u>
	2,042,208	2,162,218
General and administrative		
Depreciation	980,038	988,985
Wages	216,660	204,454
Maintenance	40,752	20,769
Insurance	252,141	210,034
Other general and administrative	30,366	33,311
Auto and truck	50,049	39,965
Pension plan expense	24,673	19,669
Bank charges	2,191	2,487
PSC fees	9,310	3,963
Utilities	9,317	8,019
Telephone	6,000	5,248
Meter reading	108,170	104,914
Customer billing	29,984	29,022
Directors' fees	36,000	40,000
Office expense	25,742	23,192
Bad debt	8,503	8,651
Professional services	52,151	61,066
Tax and license	21,991	20,954
Total cost of general and administrative	<u>1,904,038</u>	<u>1,824,703</u>
Net income (loss) from operations	138,170	337,515
Non-operating revenues (expenses)		
Gain(Loss) on sale	(22,232)	305
Membership fees collected	4,575	4,540
Tap-on fees collected, net of amounts refunded	48,925	44,290
Interest income	69,440	42,275
Interest expense	<u>(367,808)</u>	<u>(371,965)</u>
Total non-operating revenues (expenses)	<u>(267,100)</u>	<u>(280,555)</u>
Change in unrestricted net assets	<u>\$ (128,930)</u>	<u>\$ 56,960</u>
Other comprehensive income		
Change in net assets	\$ (128,930)	\$ 56,960
Change in unrealized gain/loss on investments	<u>(478)</u>	<u>(950)</u>
Other comprehensive income	<u>\$ (129,408)</u>	<u>\$ 56,010</u>

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

Southeastern Water Association, Inc.
Statements of Changes in Net Assets
For the years ended December 31, 2018 and 2017

	Unrestricted: Reserved by Contract	Unrestricted: Reserved by board	Unrestricted: Membership Fees	Unrestricted: Tap-on Fees	Unrestricted: Other	Total
Balances, January 1, 2017	\$ 918,201	\$ 120,000	\$ 130,821	\$ 3,038,508	\$ 12,666,498	\$ 16,874,028
2017 change in net assets	-	-	4,540	44,290	8,130	56,960
Transfers	101,829	-	-	-	(101,829)	-
Balances, December 31, 2017	<u>\$ 1,020,030</u>	<u>\$ 120,000</u>	<u>\$ 135,361</u>	<u>\$ 3,082,798</u>	<u>\$ 12,572,799</u>	<u>\$ 16,930,988</u>
2018 change in net assets	-	-	4,575	48,925	(182,430)	(128,930)
Transfers	68,180	1,000,000	-	-	(1,068,180)	-
Balances, December 31, 2018	<u>\$ 1,088,210</u>	<u>\$ 1,120,000</u>	<u>\$ 139,936</u>	<u>\$ 3,131,723</u>	<u>\$ 11,322,189</u>	<u>\$ 16,802,058</u>

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

Southeastern Water Association, Inc.
Statements of Cash Flows
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Operating income/loss	\$ 138,170	\$ 337,515
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	980,038	988,985
Bad debts	8,503	8,651
(Increase) decrease in operating assets		
Inventory	55,994	(69,803)
Accounts receivable	(27,892)	(14,535)
Prepaid expenses	(5,589)	(9,455)
Increase (decrease) in operating liabilities		
Accounts payable	3,162	(24,005)
Accrued liabilities	16,739	(5,992)
Accrued interest	(1,840)	(7,131)
Net cash provided by operating activities	1,167,285	1,204,230
Cash flows from investing activities		
Interest income	69,440	42,275
Redemption of (investment in) certificates of deposits/money market account	(728,719)	(1,209,852)
Proceeds from sale of asset	-	305
Cash payments for the purchase and construction of fixed assets	(381,468)	(239,454)
Net cash used by investing activities	(1,040,747)	(1,406,726)
Cash flows from financing activities		
Interest expense	(367,808)	(371,965)
Increase in customer deposits	11,897	33,976
Proceeds from tap-on and membership fees	53,500	48,830
Principal payment on long-term debt	(305,370)	(294,472)
Net cash provided by financing activities	(607,781)	(583,631)
Net increase (decrease) in cash and cash equivalents	(481,243)	(786,127)
Cash and cash equivalents beginning of year	3,243,181	4,029,308
Cash and cash equivalents end of year	<u>\$ 2,761,938</u>	<u>\$ 3,243,181</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	<u>\$ 369,648</u>	<u>\$ 377,956</u>

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

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

1. Summary of Significant Accounting Policies

Organization and Nature of Activities

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 Association falls under the oversight and regulations of the Kentucky Public Service commission and accordingly follows their prescribed uniform System of Accounts.

Method of Accounting

The Association prepares its financial statements on the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when earned, rather than when received and expenses are recognized when incurred rather than when paid.

Basis of Presentation

The Association prepares its financial statements in accordance with FASB ASC 958, *Not for Profit Entities*. Under FASB ASC 958, the Association is required to report information regarding its financial position and activities based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets – 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 – Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Association and/or passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that must be maintained permanently by the Association. Generally, the donors of these assets permit the Association to use all or part of the income earned on any related investments for general or specific purposes.

At December 31, 2018 and 2017, the Association had no temporarily or permanently restricted net assets.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

1. Summary of Significant Accounting Policies, continued

Revenue Recognition

The Association considers revenues earned when substantially all requirements have been met to entitle them to receive the funds, which is when the meters have been read and the bills prepared. Fees collected from new members and for meter sets and tap-on fees are generally recognized as revenue when they are received or when considered non-refundable.

Credit risk

Financial instruments which potentially subject the Association to concentrations of credit risk consist principally of cash, cash equivalents and trade receivables. The Association places its cash deposits with high credit quality financial institutions and generally limits the amount of credit exposure by using multiple institutions and requiring collateral pledges. Concentrations of credit risk with respect to trade receivables are limited due to the Association's large number of customers.

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. Cash and cash equivalents on the statement of cash flows includes amounts classified as cash and cash equivalents and restricted cash on the statement of net assets.

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, 2018 and 2017 is stated net of the allowance balance of \$25,858 and \$25,660, respectively.

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.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

1. Summary of Significant Accounting Policies, continued

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 they receive 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 by 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.

Comparability

Certain prior year amounts have been restated to conform to current year presentation. The restatements had no effect on the change in net assets for either period.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

1. Summary of Significant Accounting Policies, concluded

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, 2018 for any open tax years.

2. Concentration of Credit Risk

The Association held deposits at multiple banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Cash at two institutions exceeded FDIC insured limits. The amounts in excess of the FDIC limit totaled \$2,146,939 and \$3,524,366 at December 31, 2018 and 2017 respectively. At December 31, 2018 and 2017, all of the 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, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Transmission and distribution system	\$ 34,923,020	\$ 34,801,904
Construction work in process	-	-
Equipment	1,151,522	1,060,288
Land and land rights (nondepreciable)	<u>206,360</u>	<u>204,360</u>
Property and equipment	36,280,902	36,066,552
Less accumulated depreciation	<u>(14,746,721)</u>	<u>(13,911,585)</u>
Property and equipment, net	<u>\$ 21,534,181</u>	<u>\$ 22,154,967</u>

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.

During 2015, a group of these loans were refinanced through Kentucky Rural Water Finance Corporation into a 2015 Series Revenue Bonds at an interest savings.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

4. Long-Term Liabilities, continued

The balances on the Association's loans are as follows:

	<u>2018</u>	<u>2017</u>
Interest variable revenue bonds dated March 8, 2015, payable in annual installments, including interest through February, 2041.	\$ 2,590,000	\$ 2,725,000
2.375% loan dated February 2, 2011 payable in annual installments of \$160,799, including interest, through February 2, 2051.	3,582,642	3,657,391
4.375% loan dated November 8, 2006, payable in annual installments of \$149,956, including interest through November 8, 2046.	2,377,304	2,422,194
4.5% loan dated September 17, 2004, payable in annual installments of \$101,567, including interest, through September 17, 2044.	1,514,226	1,547,020
4.5% loan dated February 12, 1997, payable in annual installments of \$13,853, including interest, through February 12, 2039.	156,433	161,895
4.5% loan dated February 12, 1997, payable in annual installments of \$9,159, including interest, through February 12, 2037.	99,663	103,192
4.5% loan dated September 14, 1995, payable in annual installments of \$7,536, including interest, through September 9, 2035.	77,099	80,154
4.5% loan dated September 14, 1995, payable in annual installments of \$13,133, including interest, through September 9, 2035.	\$ 147,218	\$ 153,109
	\$ 10,544,585	\$ 10,849,955
Less current portion	<u>(316,900)</u>	<u>(305,600)</u>
	<u>\$ 10,227,685</u>	<u>\$ 10,544,355</u>

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

4. Long-Term Liabilities, continued

The Association has a supplementary agreement with RD in which payments are made in monthly installments at an amount that is adequate to cover the annual requirements of all outstanding loans.

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

2019	\$ 316,900
2020	323,500
2021	334,700
2022	346,600
2023	358,200
Later years	<u>8,864,685</u>
	<u>\$ 10,544,585</u>

Interest incurred on all debt during the years ended December 31, 2018 and 2017 totaled \$367,808 and \$371,965, respectively.

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, 2018 and 2017 was \$622,542 and \$587,552, respectively, which met all required RD covenants.

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, 2018 and 2017 was \$65,005 and \$64,934, 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. The balance as of December 31, 2018 and 2017 was \$43,559 and \$25,524, respectively, which met all required RD covenants.

Southeastern Water Association, Inc.
Notes to Financial Statements
For the Years Ended December 31, 2018 and 2017

6. Related-Party Transactions

The Association paid \$36,000 and \$40,000 in 2018 and 2017, respectively, for director's fees. The board paid an employee \$3,000 during the year to provide contract cleaning service for their office. The Association purchases insurance from a company. A board member's brother owns stock in the insurance company.

7. Retirement Plan

The Association adopted a simple employee pension plan (SEP) in 1999. This discretionary plan covers substantially all employees. The Association contributes 3% of gross wages for qualifying employees. During 2018 and 2017 the Association made plan contributions of \$24,673 and \$19,669, respectively.

8. Subsequent Events

The Association has evaluated and considered the need to recognize or disclose subsequent events through May 30, 2019, 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, 2018, have not been evaluated by the Association.

SUPPLEMENTAL INFORMATION

Phone: 606-451-1550
Fax: 606-451-0194
Email: rdt1869@aol.com

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, KY 42503

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Southeastern Water Association, Inc. (a non-profit organization), which comprise the statement of net assets as of December 31, 2018, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated May 30, 2019.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I 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 my 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, I do not express an opinion on the effectiveness of the Association'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 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.

To the Board of Directors
Southeastern Water Association, Inc.
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My 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 these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southeastern Water Association, Inc.'s financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Association'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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



May 30, 2019
Somerset, Kentucky