

SOUTHERN WATER AND SEWER DISTRICT  
REPORT OF AUDIT OF FINANCIAL STATEMENTS  
AND SUPPORTING DATA  
YEAR ENDED DECEMBER 31, 2016

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Commissioners  
Southern Water and Sewer District  
McDowell, Kentucky

**Report on the Financial Statements**

I have audited the accompanying financial statements of the business-type activities of Southern Water and Sewer District, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Southern Water and Sewer District's basic financial statement listed in the table of contents.

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

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

My responsibility is to express opinions on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statement are free from material misstatement.

An audit involves performing procedure to obtain audit evidence about the amounts and disclosures in the financial statements. The procedure 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 presentations 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 evidence I obtained is sufficient and appropriate to provide a basis for my audit opinions.

### **Opinions**

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Southern Water and Sewer District, as of December 31, 2016, and the respective changes in financial position and where applicable, cash flows thereof for the year ended in accordance with accounting principles generally accepted in the United States of America.

### **Other Matters**

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and budgetary comparison information on pages 3-7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America; which consisted of inquiries of management about methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide assurance.

### **Other Reporting Required by Governmental Auditing Standards**

In accordance with Governmental Auditing Standards, I have also issued my report dated October 20, 2017, on my consideration of Southern Water and Sewer District's internal control over financial reporting and on tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Governmental Auditing Standards in considering Southern Water and Sewer District's internal control over financial reporting and compliance.



Richard F. Paulmann CPA, LLC  
Pewee Valley, KY  
October 20, 2017

SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2016 and 2015

This discussion and analysis of the Southern Water and Sewer District's financial performance provides an overview of the District's financial activities for the years ended December 31, 2016 and December 31, 2015. This information is presented in conjunction with the audited financial statements that follow this section.

**FINANCIAL HIGHLIGHTS**

- The District assets exceeded its liabilities at the end of the year by \$18,324,416. This was a decrease of \$9,056 from the year ended December 31, 2015.
- At December 31, 2016, the District had \$27,206,021 in assets and \$8,881,605 in liabilities. The investment in capital assets, net of related debt, balance at this date was \$17,377,693. The restricted for capital projects balance was \$51,229. The restricted for maintenance balance was \$156,566. The restricted for debt service balance was \$155,811. The restricted for deposits was \$249,424. The unrestricted balance was \$333,693.
- The District had a net loss of \$9,056 for the year ended December 31, 2016. For the year ended December 31, 2015 the net loss was \$356,312.
- The District's water sales were \$3,782,844 for the year ended December 31, 2016. For the year ended December 31, 2015 the water sales were \$3,672,330. This represented an increase of 0.03% which was a result of factors affecting revenue such as increased water usage and increased customers.

**OVERVIEW OF FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise two components: 1) financial statements, and 2) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Financial statements. The financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private – sector business.

The balance sheets present information on all of the District's assets and liabilities, in a comparative format showing the balances as of December 31, 2016 and December 31, 2015. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The statements of revenues, expenses and changes in retained earnings present information showing the District's net income or (loss) for the years then ended.

The statements of cash flows shows the increase or decrease in the cash and cash equivalents for the years ended by the different types of activities.

The financial statements can be found on pages 8 through 12 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 13 through 21 of this report.

SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2016 and 2015

**Southern Water and Sewer District Budget Comparison**

	Actual Amounts	Original Budget Amounts	Variance Positive (Negative) 2016
	2016	2016	
<b>Revenues:</b>			
Water sales	\$ 3,782,844	\$ 3,648,279	\$ 134,565
Solid waste revenue	934,418	940,175	(5,757)
Penalties and service charges	78,611	162,388	(83,777)
Other	115,000	0	115,000
Total revenues	<u>4,910,873</u>	<u>4,750,842</u>	<u>160,031</u>
<b>Expenses:</b>			
Water treatment supplies	144,861	158,609	13,748
Depreciation and amortization	1,055,505	867,670	(187,835)
Purchased water	450,826	465,387	14,561
Solid Waste payments	906,385	909,805	3,420
Power for pumping	429,349	359,369	(69,980)
Outside services	110,072	70,749	(39,323)
Miscellaneous	51,845	64,035	12,190
Insurance	162,989	207,303	44,314
Distribution supplies expense	398,143	416,939	18,796
Taxes and other	106,018	88,820	(17,198)
Customer accounts expense	129,597	34,963	(94,634)
Wages	914,661	866,656	(48,005)
Sewer supplies and expense	30,823	0	(30,823)
Employee benefits	387,805	280,150	(107,655)
Transportation expense	83	125,363	125,280
Pumping supplies expense	45,144	0	(45,144)
Total operating expenses	<u>5,324,106</u>	<u>4,915,818</u>	<u>(408,288)</u>
Net operating income	(413,233)	(164,976)	(248,257)
<b>Non-operating income (expense)</b>			
Grant income	747,807	911,319	(163,512)
Capital contribution	1,787	0	1,787
Interest income	645	3,985	(3,340)
Interest expense	(200,291)	(246,379)	46,088
Interest and penalty	(354)	0	(354)
Insurance Recovery	0	25,000	(25,000)
Provision for Bad Debts	(145,417)	(13,180)	(132,237)
Total non-operating income	<u>404,177</u>	<u>680,745</u>	<u>(276,568)</u>
Net income (loss)	(9,056)	515,769	(524,825)
Total net assets, beginning	18,333,472		
Total net assets, ending	<u>\$ 18,324,416</u>	<u>\$</u>	<u>\$</u>

**Budget Comparisons**

- Revenues were \$192,203 less than budgeted as a result of water sales being down, a decrease in the number of customers and various other differences. Operating expenses were \$26,087 less than budgeted as a result of decreased costs and various other expenses.



SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2016 and 2015

**FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS**

The District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The accrual basis of accounting is utilized by the District. Under this method, revenues are recorded when earned and expenses are recorded at the time the liabilities are incurred.

**Capital Assets**

The District's investment in utility plant as of December 31, 2016 amounts to \$25,302,267 (net of accumulated depreciation). The investment in utility plant includes the expansion of the water system. The increase in the District's investment in utility plant (net of accumulated depreciation) for the current year was 3% percent, before current depreciation.

Additional information on the District's utility plant can be found in Note (5) of the financial statements.

**Debt Administration**

At the end of the current fiscal year, the District had total debt outstanding of \$8,881,605. Additional information on the District's long-term debt can be found in Note (14) of the financial statements.

**Contacting the District's Financial Management**

This financial report is designed to provide our customers, creditors, and other users with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Manager, at the Southern Water and Sewer District, P.O. Box 610, McDowell, KY 41647, telephone number (606) 377-9296.

SOUTHER WATER AND SEWER DISTRICT  
STATEMENT OF NET POSITION  
12/31/2016  
(with prior year data for comparison purposes only)

	<u>2016</u>	<u>2015</u>
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents	\$ 48,727	\$ 51,392
Accounts Receivable (Net of Allowance for Delinquencies of \$230,164 in 2016 and \$235,325 in 2015)	1,106,878	1,137,313
Prepaid Expense	5,048	-
Inventory	<u>68,565</u>	<u>70,536</u>
<b>Total Current Assets</b>	<b>1,229,218</b>	<b>1,259,241</b>
<b>Noncurrent Assets</b>		
Restricted Cash	613,030	1,005,686
<b>Capital Assets:</b>		
Land	204,829	204,829
Plumbing and Distribution System	43,906,055	43,508,591
Transportation Equipment	555,602	444,277
Furniture, Fixtures and Equipment	151,182	151,182
Construction in Progress	<u>2,193,909</u>	<u>1,149,554</u>
<b>Total Capital Assets</b>	<b>47,011,577</b>	<b>45,458,433</b>
Less: Accumulated Depreciation	<u>(21,709,310)</u>	<u>(20,653,805)</u>
<b>Net Capital Assets</b>	<b>25,302,267</b>	<b>24,804,628</b>
<b>Other Assets</b>		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	<u>(36,904)</u>	<u>(34,443)</u>
<b>Total Other Assets</b>	<b>61,506</b>	<b>63,967</b>
<b>Total Noncurrent Assets</b>	<b>25,976,803</b>	<b>25,874,281</b>
<b>Total Assets</b>	<b>\$ <u>27,206,021</u></b>	<b>\$ <u>27,133,522</u></b>

See accompanying notes to the basic financial statements



SOUTHER WATER AND SEWER DISTRICT  
STATEMENT OF NET POSITION  
12/31/2016  
(with prior year data for comparison purposes only)

	<u>2016</u>	<u>2015</u>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Accounts Payable	\$ 327,874	\$ 167,206
Accounts Payable Solid Waste	430,168	439,156
Customer Deposits	189,909	189,308
Note Payable Line of Credit	217,000	229,000
Note Payable Current	244,132	246,594
Bonds Payable Current	92,884	66,981
Accounts Payable Construction in Progress	9,080	9,080
Accrued Interest	74,132	75,966
<b>Total Current Liabilities</b>	<u>1,585,179</u>	<u>1,423,291</u>
 <b>Noncurrent Liabilities</b>		
Notes Payable-Net of Current Portion	4,096,801	4,084,249
Bonds Payable-Net of Current Portion	3,199,625	3,292,509
<b>Total Long Term Liabilities</b>	<u>7,296,426</u>	<u>7,376,758</u>
 <b>Total Liabilities</b>	<u>8,881,605</u>	<u>8,800,049</u>
 <b>Net Position:</b>		
Invested in Capital Assets, Net of Related Debt	17,377,693	16,809,329
Restricted for Capital Projects	51,229	450,245
Restricted for Maintenance	156,566	139,849
Restricted for Debt Service	155,811	176,482
Restricted for Deposits	249,424	239,110
Unrestricted	333,693	518,458
<b>Total Net Position</b>	<u>\$ 18,324,416</u>	<u>\$ 18,333,473</u>

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT  
STATEMENT OF REVENUE EXPENDITURE AND CHANGES IN NET POSITION  
For the Year Ended December 31, 2016  
(with prior data for comparison purposes only)

	For the Year Ended December 31	
	<u>2016</u>	<u>2015</u>
<b>Operating Revenue:</b>		
Water Sales	\$ 3,782,844	\$ 3,672,330
Solid Waste Revenue	934,418	938,456
Penalties and Service Charges	78,611	92,209
Other	<u>115,000</u>	<u>37,781</u>
<b>Total Operating Revenue</b>	<u>4,910,873</u>	<u>4,740,776</u>
<b>Operating Expenses:</b>		
Water Treatment Supplies	144,861	157,738
Depreciation and Amortization	1,055,505	1,030,534
Purchased Water	450,826	438,084
Solid Waste Payments	906,385	903,316
Power for Pumping	429,349	329,585
Outside Services	110,072	73,894
Miscellaneous and Commissioners	51,845	51,273
Insurance	162,989	137,865
Distribution Supplies	398,143	295,695
Payroll and Other Taxes	106,018	92,345
Customer Accounts	129,597	132,944
Wages	914,661	830,460
Transportation	83	1,140
Sewer Supplies	30,823	11,714
Employee Benefits	387,805	361,977
Pumping Supplies	<u>45,144</u>	<u>69,855</u>
<b>Total Operating Expense</b>	<u>5,324,106</u>	<u>4,918,419</u>
<b>Operating Income (Loss)</b>	<u>(413,233)</u>	<u>(177,643)</u>
<b>Non-Operating Revenue (Expense)</b>		
Interest Income	645	484
Interest Expense	(200,291)	(235,144)
Interest and Penalty	(354)	(120)
Loan Service Fees	-	(5,709)
Provisions for Bad Debts	(145,417)	(200,187)
Insurance Recovery	-	46,400
Gain (Loss) on Sale of Assets		
<b>Total Non-Operating Revenue (Expenses)</b>	<u>(345,417)</u>	<u>(394,276)</u>
<b>Income (Loss) Before Capital Contributions</b>	<u>(758,650)</u>	<u>(571,919)</u>
<b>Capital Contributions</b>		
Grant Income	747,807	177,197
Capital Contributions	<u>1,787</u>	<u>38,411</u>
<b>Total Capital Contributions</b>	<u>749,594</u>	<u>215,608</u>
<b>Change in Net Position</b>	(9,056)	(356,311)
<b>Total Net Position, Beginning</b>	<u>18,333,473</u>	<u>18,689,784</u>
<b>Total Position Assets, Ending</b>	<u>18,324,417</u>	<u>18,333,473</u>

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT  
Statement of Cash Flows  
For the Year Ended December 31, 2016  
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2016	2015
<b>Cash flows from operating activity</b>		
Cash received from customers	\$ 4,941,909	\$ 4,643,471
Cash payments to suppliers for goods and services	(4,265,389)	(3,954,931)
Cash received from deposits	601	(1,436)
<b>Net cash provided by operating activities</b>	677,121	687,104
<b>Cash flows from noncapital financing activities</b>		
Subsidy From Federal and State Grant	749,594	215,608
Net Cash Provided (Used) By Noncapital <b>Financing Activities</b>	749,594	215,608
<b>Cash flows from capital and related financing activities</b>		
(Increase ) decrease in Restricted Assets Accounts	392,656	(535,587)
Loan Proceeds	246,517	1,556,820
Interest Paid	(202,479)	(235,144)
Principle Payment on Notes	(246,594)	(256,089)
Principle Payment on Bonds	(66,981)	(64,981)
Purchase of Utility Plant in Service	(397,464)	(1,092,948)
Purchase of Automotive Equipment	(111,325)	(11,956)
Decrease (Increase) in Consturction in progress	(1,044,355)	(265,312)
Proceeds from insurance recovery	-	46,400
Proceeds on Sale of Assets	-	-
Net cash provided by (used for) capital and related financing activities	(1,430,025)	(858,797)
<b>Cash flows from investing activities</b>		
Proceeds from earnings on investments	645	484
Net cash provided by (used for) investing activities	645	484
<b>Total increase (decrease) in cash and cash equivalents</b>	(2,665)	44,399
<b>Cash and cash equivalents at beginning of year</b>	51,392	6,993
<b>Cash and cash equivalents at end of year (Note 2)</b>	\$ 48,727	\$ 51,392

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT  
Statement of Cash Flows  
For the Year Ended December 31, 2016  
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2016	2015
<b>Reconciliation of Income from operations to net cash provided by operated activities:</b>		
Income from operations	\$ (413,233)	\$ (177,644)
Provisions for Bad Debt	(145,417)	(200,187)
Adjustment to reconcile income from operations to net cash provided by operating activities:		
Operating Activities:		
Depreciation and amortization	1,057,966	1,030,534
Changes in assets and liabilities:		
Decrease (increase) in utility accounts receivable	30,435	102,882
Decrease (increase) in prepaid expense	(5,048)	-
Decrease (increase) in material and supplies inventory	1,971	(18,783)
Increase (decrease) in accounts payable and other payable	151,680	(46,481)
Increase (decrease) in customer deposits	601	(12,000)
Increase (decrease) in un-earned tap fees	-	10,564
Increase (decrease) in accrued interest	(1,834)	(1,781)
<b>Net cash provided by operating activities</b>	<b>\$ <u>677,121</u></b>	<b>\$ <u>687,104</u></b>
 <b>Non-cash operating activities</b>		
Acquisition of Property and Equipment Included in accounts payable	\$ <u>15,973</u>	\$ <u>14,080</u>

SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 AND 2015

Note 1 – Summary of Significant Accounting Policies

The significant policies of the district are as follows:

**Organization and Business Activities** – The district is a governmental organization with its primary activities consisting of sale of water and sewer services to residents in Floyd County Kentucky, pursuant to Chapter 74 of the Kentucky Revised Statutes to operate a water distribution system.

**Basis of Accounting** – The accounting and reporting policies of the Southern Water and Sewer District relating to the funds included in the accompanying basic financial statements conform to accounting principles generally accepted in the United States of America applicable for local governments. Generally accepted accounting principles for local Governments includes those principles presented by the Governmental Accounting Standards Board (GASB), the American Institute of Certified Public Accountants in the publications entitled Audits of State and Local Governments and by the Financial Accounting Standards Board (when applicable). As allowed in section PBO of GASB's Codification of Governmental Accounting and Financial Reporting Standards the District has elected not to apply Financial Accounting Board Statements and Interpretations, Accounting Research Bulletins of the Committee of Accounting Principle Board Opinions, and Accounting Research Bulletins of the Committee of Accounting and Procedures issued after November 30, 1969. The District first applies restricted resources when an expense is incurred for restricted and unrestricted purposes. The more significant policies of the district are described below.

**Basis of Presentation**

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, the district uses Proprietary Fund financial statement reporting including a Statement of Net Assets, Statements of Revenues, Expenditures and Changes in Net Assets, and a Statement of Cash Flows.

The Statement of Net Assets includes the District's assets and liabilities and provides Information about the nature and amounts of investments in resources (assets) and the obligations to the District's creditors (liabilities). The difference between the assets and liabilities is shown as net assets. The statement also provides the basis of evaluating the capital structure of the district and assessing its liquidity and financial flexibility.

The statement of Revenue, Expenditure and Changes in Net Assets accounts for the current year's revenue and expense. This statement measures the success of the district's operations over the past year and determines whether the district has recovered its cost through user fees and other charges.

The final required financial statement is the Statement of Cash Flows. This statement reports cash receipts, cash disbursements, and changes in cash resulting from operations and investments during the reporting period.



SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 AND 2015

Note 1 – Summary of Significant Accounting Policies (Continued)

The Notes to the basic financial statements provide a description of the accounting policies used to prepare the financial statements and present disclosures required by generally accepted accounting principles that are not otherwise present in the financial statements.

The District's basic financial statements include the accounts of all district operations. The District's criteria for including organizations as component units with the District's reporting entity, as set forth in Section 2100 of GASB's Codification of Governmental Accounting and Financial Standards includes whether:

- The Organization is legally separate (can sue and be sued in their own name).
- The District holds the corporate powers of the organization.
- The District appoints voting majority of the organization.
- The Organization has the potential to impose a financial benefit/burden on the Association.
- There is fiscal dependency by the organization on the District.

**Component Unit Presentation** – Based on the aforementioned criteria the district has no component units.

**Cash** - For the purpose of the statement of cash flows, the District considers cash to include cash on hand and unrestricted cash in bank.

**Inventory** – Inventory consists primarily of pipes and supplies to be used for future expansion and repairs of existing lines. Inventory is valued at the lower of cost or market under first-in, first-out (FIFO) method.

**Allowance for Doubtful Accounts** – The District utilizes the allowance method for accounting for bad debts. This method is based on historical experience and evaluation of outstanding accounts at year end. The Allowance for Doubtful as of December 31, 2016 and 20145 is \$230,164 and \$235,325.

**Operating and Non – Operating Revenue** – Only water and solid waste revenue and related service charges and penalties are considered as operating revenue.

**Applying Resources** – Restricted resources are applied first for expenses incurred for which both restricted and unrestricted net assets are available.

**Use of Estimates** – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results can differ from those estimates.

SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 AND 2015

**Note 2 – Restricted Cash Accounts**

The District had the following restricted cash accounts as of December 31, 2016 and 2015.

	<u>2016</u>	<u>2015</u>
KIA Project	\$ 28,135	\$ 22,503
Repair and Maintenance reserve	156,566	139,849
Construction reserve	20,033	427,742
Bond Depreciation Reserve	104,988	129,056
Road Construction Account	21,355	21,334
Deposit Refunds	249,424	239,110
Insurance Reserve	<u>32,529</u>	<u>26,092</u>
Totals	<u>\$ 613,030</u>	<u>\$ 1,005,686</u>

The amounts held were below the required minimum for 2016 and 2015 for all restricted requirements.

**Note 3 – Prepaid Items**

Prepaid items include prepayment of service contracts, software rights and insurance. These amounts represent payments made in the current year for which services will be provided in the subsequent fiscal year.

**Note 4 – Deferred Income from Tap Fees**

Unearned tap fees represent payments from customers for tapping into the Pride on the River Sewer Line. Southern Water started accepting pre – payments to tap into this line during 2011. Customers were able to tap into the new line during the Month of May 2013 and all previously held amounts were recognized as income during 2013. Unearned tap fees being held were \$0 for 2015 and 2016.

**Note 5 – Deposits with Financial Institutions**

As of December 31, 2016, the company had amounts of \$661,757 on deposit with financial institutions with \$250,000 insured by FDIC and \$999,027 insured by pledged US Treasury Bills.

As of December 31, 2015, the company had amounts of \$1,057,078 on deposit with financial institutions with \$250,000 insured by FDIC and \$998,911 insured by pledged US Treasury Bills.

**Note 6 – Subsequent Events**

Southern Water and Sewer District and the Prestonsburg City's Utilities Commission entered into an agreement for Prestonsburg City's Utilities Commission to purchase the sewer operations and assets from the District. Prestonsburg City's Utilities Commission took over the operations on July 1, 2017. The details of the transaction are still being negotiated. Once completed, an estimated \$7,865,636 in assets and \$1,792,705 in liabilities will be removed from Southern Water and Sewer District's financial

SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 AND 2015

**Note 6 – Subsequent Events (Continued)**

statements. This will cause an estimated reduction in Southern Water and Sewer District’s revenue of just under \$500,000 yearly.

In preparing these financial statements, the District has evaluated events and transactions for the potential recognition or disclosure through October 20, 2017, the date the financial statements were available to be issued.

**Note 7 – Capital and Net Assets**

Changes in contributed capital and net assets during the years ended December 31, 2016 and December 31, 2015.

	Contributed Capital	Reserves	Net Assets (Deficit)	Total
Balance December 31, 2015	<u>\$33,336,352</u>	<u>\$ 133,157</u>	<u>\$(14,779,725)</u>	<u>\$18,689,784</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans				
Department of transportation	177,197			177,197
State Contribution DOT				
Grant in Aid – Fema	36,591			36,591
Other				
Transfer		535,587	(535,587)	
Net Income (Loss)			<u>(570,100)</u>	<u>(570,100)</u>
Balance December 31, 2015	<u>\$33,550,140</u>	<u>\$ 668,744</u>	<u>\$(15,885,412)</u>	<u>\$18,333,472</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	320,170			320,170
Department of transportation	427,637			427,637
Grant in aid-State Grant Funds				
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer		(392,656)	392,656	
Net Income (Loss)			<u>(757,863)</u>	<u>(757,863)</u>
Balance December 31, 2016	<u>\$34,297,947</u>	<u>\$276,088</u>	<u>\$(16,281,446)</u>	<u>\$18,324,416</u>

**Note 8 Retirement Plan**

The District maintains a defined contribution retirement plan under the provisions of section 401 (K) of the Internal Revenue Code. The plan is a deferred compensation plan which is available to all employees. The maximum salary deferral is limited to amounts allowed per the Internal Revenue Code, which for 2016 and 2015 was \$18,000 and \$18,000 respectively. Normally the District contributes 5% of the employee’s basic pay. All contributions are immediately vested. Expenses charged to operations for the retirement plan were \$21,398 and \$18,792 respectively. PAGE 16



SOUTHERN WATER AND SEWER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 DECEMBER 31, 2016 AND 2015

**Note 9 – Risk Management**

Significant losses covered by commercial insurance with premiums (based on industry information adjusted for any District Claims) for general liability, vehicles, personal and real property. Settlement amounts have not exceeded insurance coverage for the current year or the prior years.

**Note 10 - Property and Equipment**

Capital assets, which include property, plant, equipment and vehicles, are reported in the applicable governmental column in the government – wide financial statements. All capital assets are valued at their historical cost or estimated historical cost if actual historical is not available. Donated assets are valued at their market value on the date donated. Repairs and maintenance are recorded as expenses. Renewals and betterments are capitalized.

Depreciation has been calculated on each class of depreciable property using the straight – line method. Estimated useful lives are as follows. Changes requested by Public Service Commission with the last rate increase were made during 2013.

Depreciation has been calculated on each class of depreciable property using the straight – line method. Estimated useful lives are as follows:

Buildings	20 – 50 Years
Improvements	20 – 50 Years
Vehicles	5 – 10 Years
Equipment	7 – 20 Years

The following summarizes the changes to capital assets for 2015:

	Balance <u>01/01/15</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>12/31/16</u>
Land	\$ 204,829	\$ 0	\$ -0-	\$ 204,829
Water and Distribution System	42,508,591	397,464	-0-	43,906,055
Automotive Equipment	444,277	111,325	-0-	555,602
Furniture, fixtures and Equipment:	151,182	-0-	-0-	151,182
Construction in Progress	<u>1,149,554</u>	<u>1,044,355</u>	-0-	<u>2,193,909</u>
<b>TOTAL ASSETS</b>	<b>\$ 44,458,433</b>	<b>\$ 1,553,144</b>	<b>\$ -0-</b>	<b>\$ 47,011,577</b>
Less				
Accumulated Depreciation				
Water Distribution System	20,247,318	1,011,523	-0-	21,258,841
Automotive Equipment	300,048	42,037	-0-	342,085
Furniture, fixtures and Equipment:	<u>106,439</u>	<u>1,945</u>	-0-	<u>108,384</u>
Total Accumulated	20,653,805	1,055,505	-0-	21,709,310
<b>Balance – December 31</b>	<b><u>\$ 24,804,628</u></b>			<b><u>\$ 25,302,267</u></b>

SOUTHERN WATER AND SEWER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 DECEMBER 31, 2016 AND 2015

**Note 10 - Property and Equipment (Continued)**

The following summarizes the changes to capital assets for 2015:

	Balance <u>01/01/15</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>12/31/15</u>
Land	\$ 204,829	\$ -0-	\$ -0-	\$ 204,829
Water and Distribution System	42,415,643	1,092,948	-0-	42,508,591
Automotive Equipment	432,321	11,956	-0-	444,277
Furniture, fixtures and Equipment:	151,182	-0-	-0-	151,182
Construction in Progress	<u>884,242</u>	<u>265,312</u>	<u>-0-</u>	<u>1,149,554</u>
<b>TOTAL ASSETS</b>	<b>\$ 44,088,217</b>	<b>\$ 1,370,216</b>	<b>\$ -0-</b>	<b>\$ 45,458,433</b>
Less				
Accumulated Depreciation				
Water Distribution System	19,251,539	995,800	-0-	20,247,318
Automotive Equipment	269,606	30,442	-0-	300,048
Furniture, fixtures and Equipment:	<u>104,583</u>	<u>1,835</u>	<u>-0-</u>	<u>106,439</u>
Total Accumulated	19,625,728	1,028,077	-0-	20,653,805
<b>Balance – December 31</b>	<b><u>\$ 24,462,489</u></b>			<b><u>\$ 24,804,628</u></b>

**Note 11 – Concentrations of Credit Risk**

Concentrations of credit risk are limited due to the large number of customers comprising the district's customer base.

**Note 12 – Contingencies**

The District is involved with multiple car accident actions which are being defended and will be covered by the District's Insurance Coverage.

**Note 13 – Notes and Bonds Payable**

All notes and bonds are secured by the Water Distributions system and related assets unless stated as non – secured:

	<u>2016</u>	<u>2015</u>
<b>Summary of Short term line of Credit</b>		
6.25% line of credit First Guaranty National Bank interest due monthly. With principal due upon demand	\$ 217,000	\$ 229,000



SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 AND 2015

**Note 13 – Notes and Bonds Payable (Continued)**

	<u>2016</u>	<u>2015</u>
<b>Summary of Notes Payable</b>		
a) Kentucky Infrastructure Authority 3% installment note, 60 semi - annual payments of \$34,607 including interest due 06/01 and 12/1. Final payment 2024	\$ 489,054	\$ 542,395
b) Kentucky Infrastructure Authority 1% installment note, 40 semi – annual payments of \$1,863 including interest due 06/01 and 12/1. Final payment 2025	30,284	34,019
c) Kentucky Infrastructure Authority 3% installment note, 60 semi – annual payments of \$71,898 including interest due 06/01 and 12/1. Final payment 2027	1,338,796	1,440,149
d) First Guaranty Bank, 5.5% installment note monthly payments of \$1,830 including interest final payment 2017	7,931	28,822
e) A purchase agreement, original balance of \$25,018 At 5.9% interest, secured by vehicle; payments are \$483 for 60 months maturing September 2019	14,666	19,434
f) First Guaranty Bank 7.99 installment note monthly payments of \$1,977 including interest final payment during 2016	-0-	17,212
g) Kentucky Infrastructure Authority 1% installment note, 40 semi - annual payments of \$21,174 including interest due 06/01 and 12/1. Final payment 2034	660,526	696,002
h) First Guaranty Bank, 4.316% installment note monthly payments of \$940 including interest final payment 2019	26,676	36,567

SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 AND 2015

**Note 13 – Notes and Bonds Payable (Continued)**

	<u>2016</u>	<u>2015</u>
i) Regions Bank, 2.6% to convert to RD installment Note \$45,188 principal Jan 1 plus interest and interest only payment each July 1. Maturity January 2056.	1,773,000	1,516,243
<b>Total long – term Notes Payable</b>	<u>\$ 4,340,933</u>	<u>\$ 4,330,843</u>
Less Current maturities	<u>244,132</u>	<u>246,594</u>
Notes Payable less current portion	<u>\$ 4,096,801</u>	<u>\$ 4,084,249</u>
 <b>Summary of Bonds Payable</b>		
a) Rural Development Revenue Bonds 4.5% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2042.	\$ 2,109,000	\$ 2,152,000
b) Rural Development Revenue Bonds 4.75% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2040.	501,509	512,990
c) Rural Development Revenue Bonds 4.25% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2044.	195,000	198,500
d) Rural Development Revenue Bonds 2.25% installments, with set principal and interest payment due on the first of each year and an interest payment due each July 1. Final payment 2049.	<u>487,000</u>	<u>496,000</u>
<b>Total Long – Term Bonds Payable</b>	<u>\$ 3,292,509</u>	<u>\$ 3,359,490</u>
Less Current maturities	<u>92,884</u>	<u>66,981</u>
Notes Payable less current portion	<u>\$ 3,199,625</u>	<u>\$ 3,292,509</u>

SOUTHERN WATER AND SEWER DISTRICT  
 NOTES TO FINANCIAL STATEMENTS  
 DECEMBER 31, 2016 AND 2015

**Note 13 – Notes and Bonds Payable (Continued)**

**Note**

Following are maturities of long – term debt as of December 31, 2016:

	<b><u>Principal</u></b>	<b><u>Interest</u></b>
2017	\$ 337,016	\$ 245,858
2018	337,528	236,100
2019	340,519	226,001
2020	339,773	216,060
2021	348,204	205,783
2022-2026	1,740,536	867,191
2027-2031	1,147,340	635,444
2032-2036	1,029,940	458,266
2037-2041	1,047,785	252,360
2042-2046	485,940	88,267
2047-2051	287,440	46,091
2052-2056	<u>191,421</u>	<u>14,685</u>
<b>Total</b>	<b><u>\$ 7,633,442</u></b>	<b><u>\$ 3,492,106</u></b>



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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

October 20, 2017

To the Board of Commissioners  
Southern Water and Sewer District  
McDowell, KY

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 the business-type activities, each major fund, and the aggregate remaining fund information of Southern Water and Sewer District, (a Kentucky Special District) as of and for the year ended December 31, 2016, and the related notes to the financial statements; which collectively comprise Southern Water and Sewer District's basic financial statements and have issued my report thereon dated October 20, 2017.

**Internal Control Over Financial Reporting**

In planning and performing my audit of the financial statements, I considered Southern Water and Sewer District'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 Southern Water and Sewer District's internal control. Accordingly, I do not express an opinion on the effectiveness of Southern Water and Sewer District'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, or a combination of deficiencies in internal control is a deficiency, or 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.

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 Southern Water and Sewer District'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 my testing on 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 purposes.

*Richard F. Paulmann*

Richard F. Paulmann, LLC

October 20, 2017