SOUTHERN WATER AND SEWER DISTRICT

REPORT OF AUDIT OF FINANCIAL STATEMENTS

AND SUPPORTING DATA

YEAR ENDED DECEMBER 31, 2025

\- CONTENTS –

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Southern Water District
McDowell, Kentucky

Report on the Audit of the Financial Statements

Opinions

We have audited the accompanying financial statements of the business-type activities, of the Southern Water District as of and for the year ended December 31, 2025, and the related notes to the financial statements, which collectively comprise the Southern Water District's basic financial statements as listed in the table of contents.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Southern Water District, as of December 31, 2025 and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We conducted our audit 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. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Southern Water's District and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Southern Water District's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Southern Water District's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Southern Water District's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3-7 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We 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 the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide u with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated July 9, 2026, on our consideration of the Southern Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Southern Water District's 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 Southern Water District's internal control over financial reporting and compliance.

The financial statements for the year ended December 31, 2024 are being presented for comparison purposes only.

Sincerely,

Richard F Paulmann

Richard F. Paulmann, CPA, LLC

July 9, 2026

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2025 and 2024

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, 2025 and December 31, 2024. 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 $16,426,314. This was a decrease of $352,445 from the year ended December 31, 2024.

- At December 31, 2025, the District had $20,845,031 in assets and $4,418,717 in liabilities. The investment in capital assets, net of related debt, balance at this date was $15,270,840. The restricted for capital projects balance was $108,703. The restricted for maintenance balance was $209,763. The restricted for debt service balance was $308,744. The restricted for deposits was $1,511. The unrestricted balance was $526,753.

- The District had a net loss of $352,455 for the year ended December 31, 2025. For the year ended December 31, 2024 the net loss was $14,406.

- The District's water sales were $3,866,685 for the year ended December 31, 2025. For the year ended December 31, 2024 the water sales were $3,658,451. This represented an increase of 1%.

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, 2025 and December 31, 2024. 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 19 of this report.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2025 and 2024

FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceeded liabilities $16,426,314 at the close of the most recent year.

Southern Water and Sewer District's Net Assets

	2025	**2024**
Current assets	$ 682,223	$ 578,154
Restricted assets	951,231	1,541,529
Fixed assets	19,172,213	19,410,463
Other assets	39,364	41,824
Total assets	20,845,031	21,571,970
Current liabilities	797,058	891,764
Long-term liabilities	3,651,659	3,901,447
Total liabilities	4,418,717	4,793,211
Net assets:		
Investment in Capital Assets	15,270,840	15,114,463
Restricted	628.721	496,963
Unrestricted	526,753	1,167,333
Total net assets	16,426,314	16,778,759

By far the largest portion of the District's net assets reflects its investment in fixed assets (e.g., land, water lines, tanks), less any related debt used to acquire those assets still outstanding.

Grant income was $237,552 during the year. Grant monies and customer contributions accounted for this increase. These monies were used for water line expansions.

Southern Water and Sewer District's Statements of Revenues, Expenses, and Changes in Retained Earnings

	2025	2024
Water sales	3,886,685	3,658,451
Solid waste revenue	848,423	850,454
Penalties and service charges	87,542	86,127
Other	162,733	332,470
Total revenues	4,985,383	4,927,502
Expenses:		
Water treatment supplies	360,864	271,301
Depreciation and amortization	865,190	904,640
Purchased water	345,036	368,571
Solid Waste payments	823,289	824,941
Power for pumping	480,926	465,681
Outside services	145,234	170,400
Miscellaneous	60,088	47,892
Insurance	89,167	77,012
Distribution supplies and expense	402,228	364,646
Taxes and other	73,107	65,915
Customer accounts expense	98,729	141,950
Wages	910,382	785,165
PCUC Sewer Payments	100,721	99,585
Management Fee	184,425	197,493
Employee benefits	327,137	256,196
Pumping supplies and expense	-0-	4,272
Total operating expenses	5,266,523	5,045,660
Net operating income	(281,140)	(118,158)
Non-operating income (expense)		
Grants income	237,552	261,687
Loan Service Fees	(344)	(1,080)
Interest income	7,937	26,394
Interest expense	(87,097)	(97,859)
Provision for bad debts	(229,353)	(85,390)
Total non-operating (expense)	(71,305)	103,752
Net income (loss) before	(352,445)	(14,406)
Total net assets, beginning	16,778,759	16,739,165
Total net assets, ending	16,426,314	16,778,759

Operations.
The District showed a net income (loss) of ($352,445).
Key elements of this income are as follows:

- Depreciation and Amortization for the year was $865,190.
- Grant income of $237,552 was received during the year.

Southern Water and Sewer District Budget Comparison

	Actual Amounts 2025	Original Budget Amounts 2025	Variance Positive (Negative) 2025
Revenues:			
Water sales	$ 3,886,685	$ 3,823,600	$ (63,085)
Solid waste revenue	848,423	850,900	2,477
Penalties and service charges	87,542	90,200	2,658
Other	162,733	364,640	201,907
Total revenues	4,985,383	5,129,340	143,957
Expenses:			
Water treatment supplies	360,864	260,990	(99,874)
Depreciation and amortization	865,190	857,086	(8,104)
Purchased water	345,036	380,900	35,864
Solid Waste payments	823,289	825,373	2,084
Power for pumping	480,926	470,320	(10,606)
Outside services	145,234	127,130	(18,104)
Miscellaneous	60,088	60,885	797
Insurance	89,167	75,290	(13,877)
Distribution supplies expense	402,228	334,160	(68,068)
Taxes and other	73,107	72,950	(157)
Customer accounts expense	98,729	27,600	(71,129)
Wages	910,382	843,470	(66,912)
PCUC Sewer Payments	100,721	99,850	(871)
Management Fee	184,425	235,990	51,565
Employee benefits	327,137	258,460	(68,677)
Pumping supplies expense		0	0
Total operating expenses	5,266,523	4,930,454	(336,069)
Net operating income	(281,140)	198,886	196,075
Non-operating income (expense)			
Grant Income	237,552	1,416,643	(1,179,091)
Loan Service Fees	(344)	0	(344)
Interest income	7,937	8,510	(573)
Interest expense	(87,097)	(95,147)	8050
Provision for Bad Debts	(229,353)	(105,000)	(124,353)
Total non-operating income	(71,305)	1,225,006	(1,296,311)
Net income (loss)	(352,445)	1,423,892	(1,757,520)
Total net assets, beginning	16,778,759		
Total net assets, ending	$ 16,426,314	$	$

Budget Comparisons

- Revenues were $462,389 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 $114,605 more than budgeted as a result of decreased costs and various other expenses.

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, 2025 amounts to $15,270,840 (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 1.0% 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 $3,651,659. 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.

SOUTHERN WATER AND SEWER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2025 AND 2024
(with prior year data for comparison purposes only)

	2025	2024
Assets		
Current Assets:		
Cash and Cash Equivalents	$ 17,864	$ 53,613
Accounts Receivable (Net of Allowance for Delinquencies of $363,981 in 2025 and $264,960 in 2024)	492,493	378,400
Prepaid Expense	-	-
Inventory	171,866	146,141
Total Current Assets	682,223	578,154
Noncurrent Assets		
Restricted Cash	951,231	1,541,529
Capital Assets:		
Land	215,495	215,495
Plumbing and Distribution System	45,658,973	45,115,038
Transportation Equipment	592,603	592,603
Furniture, Fixtures and Equipment	274,887	274,887
Construction in Progress	245,145	165,598
Total Capital Assets	46,987,103	46,363,621
Less: Accumulated Depreciation	(27,814,890)	(26,953,158)
Net Capital Assets	19,172,213	19,410,463
Other Assets		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	(59,046)	(56,586)
Total Other Assets	39,364	41,824
Total Noncurrent Assets	20,162,808	20,993,816
Total Assets	$ 20,845,031	$ 21,571,970

SOUTHERN WATER AND SEWER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2025 AND 2024
(with prior year data for comparison purposes only)

	2025	2024
Liabilities		
Current Liabilities		
Accounts Paybable	$ 237,139	$ 254,013
Accounts Payable Solid Waste	76,206	39,282
Accounts Payable PCUC Sewer	8,616	15,010
Accrued Sick and Vacation pay	67,929	72,505
Customer Deposits	122,334	110,821
Note Payable Current	249,714	383,053
Bonds Payable Current	500	11,500
Accrued Interest	5,120	5,580
Total Current Liabilities	767,558	891,764
Noncurrent Liabilities		
Notes Payable-Net of Current Portion	3,258,159	3,496,447
Bonds Payable-Net of Current Portion	393,000	405,000
Total Long Term Liabilites	3,651,159	3,901,447
Total Liabilities	4,418,717	4,793,211
Net Position:		
Invested in Capital Assets, Net of Related Debt	15,270,840	15,114,463
Restricted for Capital Projects	108,703	15,665
Restricted for Maintenance	209,763	209,763
Restricted for Debt Service	308,744	259,999
Restricted for Deposits	1,511	11,536
Unrestricted	526,753	1,167,333
Total Net Position	$ 16,426,314	$ 16,778,759

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
STATEMENT OF REVENUE EXPENDITURE AND CHANGES IN NET POSITION
For the Years Ended December 31, 2025 and 2024
(with prior data for comparison purposes only)

	For the Year Ended December 31	
	2025	2024
Operating Revenue:		
Water Sales	$ 3,886,685	$ 3,658,451
Solid Waste Revenue	848,423	850,454
Penalties and Service Charges	87,542	86,127
Other	162,733	332,470
Total Operating Revenue	4,985,383	4,927,502
Operating Expenses:		
Water Treatment Supplies	360,864	271,301
Depreciation and Amortization	865,190	904,640
Purchased Water	345,036	368,571
Solid Waste Payments	823,289	824,941
Power for Pumping	480,926	465,681
Outside Services	145,234	170,400
Miscellaneous and Commissioners	60,088	47,892
Insurance	89,167	77,012
Distribution Supplies	402,228	364,646
Payroll and Other Taxes	73,107	65,915
Customer Accounts	98,729	141,950
Wages	910,382	785,165
PCUC Sewer Payments	100,721	99,585
Management Fee	184,425	197,493
Transportation	-	-
Employee Benefits	327,137	256,196
Pumping Supplies	-	4,272
Total Operating Expense	5,266,523	5,045,660
Operating Income (Loss)	(281,140)	(118,158)
Non-Operating Revenue (Expense)		
Interest Income	7,937	26,394
Interest Expense	(87,097)	(97,859)
Interest and Penalty	-	
Loan Service Fees	(344)	(1,080)
Provisions for Bad Debts	(229,353)	(85,390)
Insurance Recovery	-	-
Gain (Loss) on Sale of Assets	-	
Total Non-Operating Revenue (Expenses)	(308,857)	(157,935)
Income (Loss) Before Capital Contributions	(589,997)	(276,093)
Capital Contributions		
Grant Income	237,552	261,687
Capital Contributions	-	-
Total Capital Contributions	237,552	261,687
Change in Net Position	(352,445)	(14,406)
Total Net Position, Beginning	16,778,759	16,793,165
Total Position Assets, Ending	16,426,314	16,778,759

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Years Ended December 31, 2025 and 2024
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2025	2024
Cash flows from operating activities		
Cash received from customers	$ 4,871,290	$ 4,979,621
Cash payments to suppliers for goods and services	(4,625,308)	(4,448,899)
Cash received from deposits		6,771
Net cash provided by operating activites	245,982	537,493
Cash flows from noncapital financing activities		
Subsidy From Federal and State Grant	237,552	261,687
Net Cash Provided (Used) By Noncapital **Financing Activities**	237,552	261,687
Cash flows from capital and related financing activites		
Loan Proceeds	1,500,000	-
Interest Paid	(87,557)	(97,859)
Principle Payment on Notes	(1,277,432)	(672,912)
Principle Payment on Bonds		
Purchase of Utility Plant in Service	(543,935)	(1,850,148)
Purchase of Automotive Equipment		(41,555)
Decrease (Increase) in Consturction in progress	(79,547)	1,269,918
Proceeds from insurance recovery	-	-
Proceeds on Sale of Assets	-	-
Net cash provided by (used for) capital and related financing activities	(488,471)	(1,392,556)
Cash flows from investing activities		
Proceeds from earnings on investments	7,937	26,394
Net cash provided by (used for) investing activities	7,937	26,394
Total increase (decrease) in cash and cash equivalents	3,000	(566,982)
Cash and cash equivalents at beginning of year	1,595,142	2,162,124
Cash and cash equivalents at end of year (Note 2)	$ 1,598,142	$ 1,595,142
Reconcilation of Cash		
Cash	$ 56,613	$ 53,613
Restricted Cash	1,541,529	1,541,529
Cash at year end	$ 1,598,142	$ 1,595,142

See accompaning notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Years Ended December 31, 2025 and 2024
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2025	2024
Reconcilation of Income from operations to net cash provided by operated activities:		
Income from operations	$ (281,140)	$ (118,158)
Provisions for Bad Debt	(229,353)	(85,390)
Adjustment to reconcile income from operations to net cash provided by operating activities:		
Operating Activities:		
Depreciation and amortization	865,190	904,640
Changes in assets and liabilities:		
Decrease (increase) in utiltiy accounts receivable	(114,093)	51,857
Decrease (increase) in prepaid expense	-	-
Decrease (increase) in material and supplies inventory	(25,725)	(96,750)
Increase (decrease) in accounts payable and other payable	20,050	(124,862)
Increase (decrease) in customer deposits	11,513	6,771
Increase (decrease) in un-earned tap fees	-	-
Increase (decrease) in accrued interest	(460)	(615)
Net cash provided by operating activites	$ 245,982	$ 537,493
Non-cash operating activiites		
Acquistion of Property and Equipment Included in accounts payable	$ -	$ -

See accompanying notes to the basicfinancial statements

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 Statues 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 polices 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.

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, 2025 and 2024 is $343,981 and $264,960.

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, 2025 AND 2024

Note 2 – Restricted Cash Accounts

The District had the following restricted cash accounts as of December 31, 2025 and 2024.

	2025	2024
KIA Project	$ 17,104	$ 17,653
Repair and Maintenance reserve	209,764	209,763
Construction reserve	127,341	805,882
Debt Service	363,645	313,218
Deposit Refunds	123,845	122,357
Insurance Reserve	109,532	72,656
Totals	$ 951,231	$ 1,541,529

The amounts held were above the required minimum for 2025 and 2024 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 – Deposits with Financial Institutions

As of December 31, 2025, the company had amounts of $969,095 on deposit with financial institutions with $250,000 insured by FDIC and $719,095 insured by pledged US Treasury Bills.

As of December 31, 2024, the company had amounts of $1,598,142 on deposit with financial institutions with $250,000 insured by FDIC and $958,879 insured by pledged US Treasury Bills.

Note 6 – Subsequent Events

In preparing these financial statements, the District has evaluated events and transactions for the potential recognition or disclosure through July 9, 2026, 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, 2025 and December 31, 2024.

	Contributed Capital	Reserves	Net Assets (Deficit)	Total
Balance December 31, 2023	$38,213,092	$ 2,152,855	$(23,572,782)	$16,793,165
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	261,687		(261,687)	
Department of transportation				
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer		(611,326)	611,326	
Net Income (Loss)			(14,406)	(14,406)
Balance December 31, 2024	$38,474,779	$1,541,529	$(23,237,549)	$16,778,759
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	237,552		(237,552)	
Department of transportation				
Grant in aid-State Grant Funds				
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer		(590,298)	590,298	
Net Income (Loss)			(352,445)	(352,445)
Balance December 31, 2025	$38,712,331	$ 951,231	$(23,237,248)	$16,426,314

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 2025 and 2024 was $23,500 and $23,000 respectively. Normally the District contributes 3% of the employee's basic pay. All contributions are immediately vested. Expenses charged to operations for the retirement plan were $16,040 and $8,270 respectively.

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.

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 2025:

	Balance 01/01/25	Additions	Disposals	Balance 12/31/25
Land	$ 215,495	$ -0-	$ -0-	$ 215,495
Water and Distribution System	45,115,038	543,934	-0-	45,658,972
Automotive Equipment	592,603	-0-	-0-	592,603
Furniture, fixtures and Equipment:	274,887	-0-	-0-	274,887
Construction in Progress	165,598	79,547	-0-	245,145
OTAL ASSETS	$ 46,363,621	$623,481	$ -0-	$ 46,987,102
Less				
Accumulated Depreciation				
Water Distribution System	26,287,388	837,335	-0-	27,124,723
Automotive Equipment	501,122	22,784	-0-	523,906
Furniture, fixtures and Equipment:	164,649	1,611	-0-	166,260
Total Accumulated	26,953,159	861,730	-0-	27,814,889
Balance – December 31	$ 19,410,463			$ 19,172,213

Note 10 - Property and Equipment (Continued)

The following summarizes the changes to capital assets for 2024:

	Balance 01/01/24	Additions	Disposals	Balance 12/31/24
Land	$ 213,867	$ 1,628	$ -0-	$ 215,495
Water and Distribution System	43,270,892	1,844,146	-0-	45,115,038
Automotive Equipment	551,048	41,555	-0-	592,603
Furniture, fixtures and Equipment:	270,512	4,375	-0-	274,887
Construction in Progress	1,435,516	-0-	1,269,918	165,598
TOTAL ASSETS	$ 45,741,835	$1,891,704	$ 1,269,918	$ 46,363,621
Less				
Accumulated Depreciation				
Water Distribution System	25,403,622	883,766	-0-	26,287,388
Automotive Equipment	484,371	16,751	-0-	501,122
Furniture, fixtures and Equipment:	162,986	1,663	-0-	164,649
Total Accumulated	26,050,979	902,180	-0-	26,953,159
Balance – December 31	$ 19,690,856	989,524	1,269,918	$ 19,410,462

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 – Notes and Bonds Payable

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

Summary of Short term line of Credit	2025	2024
6.25% line of credit First Guaranty National Bank interest due monthly. With principal due upon demand	$ -0-	$ -0-

Note 13 – Notes and Bonds Payable (Continued)

Summary of Notes Payable	2025	2024
Kentucky Infrastructure Authority 3% installment note, 60 semi - annual payments of $34,607 including interest due 06/01 and 12/1. Final payment 2024	$ -0-	$ 19,888
Note Payable EKSAFE State Funding for emergencies. $1,500,000 has been received as of Dec 31, 2023	1,500,000	1,500,000
Kentucky Infrastructure Authority 3% installment note, 60 semi – annual payments of $71,898 including interest due 06/01 and 12/1. Final payment 2027	277,122	409,615
Peoples Bank 5% installment note with monthly payments Of $637 including interest maturing May 2022, secured by A Truck	-0-	-0-
Cobank 2.25% installment note with monthly payments Of $24,745 including interest with final payment in May 2025	-0-	122,866
Cobank 2.25% installment note with monthly payments Of $11,842 including interest with final payment in May 2025	1,713,888	1,797,867
Cobank 2.25% installment note with monthly payments Of $4,002 including interest with final payment in May 2025	-0-	-0-
Community Trust Bank, 4.571% installment note with monthly payments of $2,090 including interest final payment 2026. Secured by a truck, 17,226	16,864	40,763
Total long – term Notes Payable	$ 3,507,874	$ 3,890,999
Less Current maturities	249,715	394,553
Notes Payable less current portion	$ 3,258,159	$ 3,496,446

Summary of Bonds Payable

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.	$ 393,500	$ 405,000
Total Long – Term Bonds Payable	$ 393,500	$ 405,000
Less Current maturities	500	500
Notes Payable less current portion	$ 393,000	$ 405,000

Note

Following are maturities of long – term debt as of December 31, 2024:

	Principal	Interest
2025	$ 394,551	$ 66,952
2026	1,749,714	55,765
2027	244,826	48,306
2028	105,051	42,765
2029	108,788	40,395
2030-2034	598,598	214,459
2035-2039	703,762	237,188
2040-2044	288,708	83,382
2045-2049	101,927	5,718
Total	$ 4,295,999	$ 794,931

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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

July 9, 2026

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, 2025, 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 July 9, 2026.

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.

<u>Compliance and Other Matters</u>

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*.

<u>Purpose of this Report</u>

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
July 9, 2026