

SOUTHERN WATER AND SEWER DISTRICT
REPORT OF AUDIT OF FINANCIAL STATEMENTS
AND SUPPORTING DATA
YEAR ENDED DECEMBER 31, 2015

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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, 2015, 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. My audit is presented 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 audit 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 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, 2015, 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.

Other Matters

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, 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. 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 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 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 Information

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Southern Water and Sewer District's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*; and is also not a required part of the basic financial statements.

The schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements; or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*' I have also issued my report dated September 7, 2016, on my consideration of Southern Water and Sewer District's internal control over financial reporting and on my 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 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 and Sewer District's internal control over financial reporting and compliance.



Richard F. Paulmann CPA, LLC
Pewee Valley, KY
September 27, 2016

**SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2015 and 2014**

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, 2015 and December 31, 2014. 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 \$18,333,473. This was a decrease of \$356,312 from the year ended December 31, 2014.
- At December 31, 2015, the District had \$27,133,522 in assets and \$8,800,049 in liabilities. The investment in capital assets, net of related debt, balance at this date was \$16,809,329. The restricted for capital projects balance was \$450,245. The restricted for maintenance balance was \$139,849. The restricted for debt service balance was \$176,482. The restricted for deposits was \$239,110. The unrestricted balance was \$518,458.
- The District had a net loss of \$356,312 for the year ended December 31, 2015. For the year ended December 31, 2014 the net income was \$85,407.
- The District's water sales were \$3,672,330 for the year ended December 31, 2015. For the year ended December 31, 2014 the water sales were \$3,669,094. This represented an increase of 0.09% 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, 2015 and December 31, 2014. 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, 2015 and 2014

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 by \$18,333,473 at the close of the most recent year.

Southern Water and Sewer District's Net Assets

		2015
Current assets	\$	1,259,241
Restricted assets		1,005,686
Fixed assets		24,804,628
Other assets		63,967
 Total assets		 27,133,522
 Current liabilities		 1,423,291
Long-term liabilities		7,376,758
 Total liabilities		 8,800,049
 Net assets:		
Investment in		
Capital Assets		16,809,329
Restricted		1,005,686
Unrestricted		518,458
 Total net assets	 \$	 18,333,473

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 \$177,197 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
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2015 and 2014

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

	2015
Revenues:	
Water sales	\$ 3,672,330
Solid waste revenue	938,456
Penalties and service charges	92,209
Other	37,781
Total revenues	4,740,776
 Expenses:	
Water treatment supplies	157,738
Depreciation and amortization	1,030,534
Purchased water	438,084
Solid Waste payments	903,316
Power for pumping	329,585
Outside services	73,894
Miscellaneous	51,273
Insurance	137,865
Distribution supplies and expense	295,695
Taxes and other	92,345
Customer accounts expense	132,944
Wages	830,461
Sewer supplies and expense	11,714
Employee benefits	361,977
Transportation expense	1,140
Pumping supplies and expense	69,855
Total operating expenses	4,918,420
Net operating income	(177,644)
 Non-operating income (expense)	
Grants income	177,197
Capital contribution	38,411
Floyd County Court Settlement	0
Interest income	484
Interest expense	(235,144)
Interest and penalty	(120)
Insurance Recovery	46,400
Loan service fees	(5,709)
Provision for bad debts	(200,187)
Total non-operating (expense)	(178,668)
Net income (loss) before contributions and transfers	(356,312)
Total net assets, beginning	18,689,784
Total net assets, ending	18,333,472

Operations.

The District showed a net income (loss) of (\$356,312).

Key elements of this income are as follows:

- Depreciation for the year was \$1,030,534.
- Grant income of \$177,197 was received during the year.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2015 and 2014

Southern Water and Sewer District Budget Comparison

	Actual Amounts	Original Budget Amounts	Variance Positive (Negative) 2015
	2015	2015	
Revenues:			
Water sales	\$ 3,672,330	\$ 3,851,256	\$ (178,926)
Solid waste revenue	938,456	940,901	(2,445)
Penalties and service charges	92,209	140,822	(48,613)
Other	37,781	0	37,781
Total revenues	<u>4,740,776</u>	<u>4,932,979</u>	<u>(192,203)</u>
Expenses:			
Water treatment supplies	157,738	153,390	(4,348)
Depreciation and amortization	1,030,534	867,670	(162,864)
Purchased water	438,084	544,315	106,231
Solid Waste payments	903,316	912,674	9,358
Power for pumping	329,585	369,515	39,930
Outside services	73,894	71,470	(2,424)
Miscellaneous	51,273	44,585	(6,688)
Insurance	137,865	102,254	(35,611)
Distribution supplies expense	295,695	275,878	(19,817)
Taxes and other	92,345	95,243	2,898
Customer accounts expense	132,944	37,441	(95,503)
Wages	830,461	949,403	118,942
Sewer supplies and expense	11,714	3,200	(8,514)
Employee benefits	361,977	259,176	(102,801)
Transportation expense	1,140	258,293	257,153
Pumping supplies expense	69,855	0	(69,855)
Total operating expenses	<u>4,918,420</u>	<u>4,944,507</u>	<u>26,087</u>
Net operating income	(177,644)	(11,528)	(166,116)
Non-operating income (expense)			
Grant income	177,197	720,799	(543,602)
Capital contribution	38,411	0	38,411
Floyd County Court Settlement	0	0	0
Interest income	484	4,097	(3,613)
Interest expense	(235,144)	(306,264)	71,120
Interest and penalty	(120)	0	(120)
Insurance Recovery	46,400	10,000	36,400
Loan service fees	(5,709)	0	(5,709)
Provision for Bad Debts	(200,187)	(29,796)	(170,391)
Total non-operating income	<u>(178,668)</u>	<u>398,836</u>	<u>(577,504)</u>
Net income (loss)	(356,312)	387,308	(743,620)
Total net assets, beginning	18,689,784		
Total net assets, ending	<u>\$ 18,333,472</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, 2015 and 2014

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, 2015 amounts to \$24,804,628 (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 1.40% 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 \$8,800,049. 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
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2015 and 2014

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

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SOUTHER WATER AND SEWER DISTRICT
STATEMENT OF NET POSITION
12/31/2015
(with prior year data for comparison purposes only)

	2015	2014
Assets		
Current Assets:		
Cash and Cash Equivalents	\$ 51,392	\$ 6,993
Accounts Receivable (Net of Allowance for Delinquencies of \$235,325 in 2015 and \$257,216 in 2014)	1,137,313	1,240,195
Inventory	70,536	51,753
Total Current Assets	1,259,241	1,298,941
Noncurrent Assets		
Restricted Cash	1,005,686	470,099
Capital Assets:		
Land	204,829	204,829
Plumbing and Distribution System	43,508,591	42,415,643
Transportation Equipment	444,277	432,321
Furniture, Fixtures and Equipment	151,182	151,182
Construction in Progress	1,149,554	884,242
Total Capital Assets	45,458,433	44,088,217
Less: Accumulated Depreciation	(20,653,805)	(19,625,731)
Net Capital Assets	24,804,628	24,462,486
Other Assets		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	(34,443)	(31,983)
Total Other Assets	63,967	66,427
Total Noncurrent Assets	25,874,281	24,999,012
Total Assets	\$ 27,133,522	\$ 26,297,953

See accompanying notes to the basic financial statements

SOUTHER WATER AND SEWER DISTRICT
STATEMENT OF NET POSITION
12/31/2015
(with prior year data for comparison purposes only)

	<u>2015</u>	<u>2014</u>
Liabilities		
Current Liabilities		
Accounts Payable	\$ 167,206	\$ 207,987
Accounts Payable Solid Waste	439,156	414,452
Customer Deposits	189,308	175,344
Note Payable Line of Credit	229,000	241,000
Note Payable Current	246,594	236,030
Bonds Payable Current	66,981	64,981
Accounts Payable Construction in Progress	9,080	53,448
Accrued Interest	75,966	77,747
Total Current Liabilities	<u>1,423,291</u>	<u>1,470,989</u>
Noncurrent Liabilities		
Notes Payable-Net of Current Portion	4,084,249	2,777,690
Bonds Payable-Net of Current Portion	3,292,509	3,359,490
Total Long Term Liabilites	<u>7,376,758</u>	<u>6,137,180</u>
Total Liabilities	<u>8,800,049</u>	<u>7,608,169</u>
Net Assets:		
Invested in Capital Assets, Net of Related Debt	16,809,329	17,705,548
Restricted for Capital Projects	450,245	30,110
Restricted for Maintenance	139,849	120,145
Restricted for Debt Service	176,482	144,655
Restricted for Deposits	239,110	175,189
Unrestricted	518,458	514,137
Total Net Assets	<u>\$ 18,333,473</u>	<u>\$ 18,689,784</u>

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
 STATEMENT OF REVENUE EXPENDITURE AND CHANGES IN NET ASSETS
 For the Year Ended December 31, 2015
 (with prior data for comparison purposes only)

	For the Year Ended December 31	
	2015	2014
Operating Revenue:		
Water Sales	\$ 3,672,330	\$ 3,669,094
Solid Waste Revenue	938,456	954,559
Penalties and Service Charges	92,209	95,265
Other	37,781	-
Total Operating Revenue	4,740,776	4,718,918
Operating Expenses:		
Water Treatment Supplies	157,738	346,653
Depreciation and Amortization	1,030,534	1,009,229
Purchased Water	438,084	515,356
Solid Waste Payments	903,316	925,922
Power for Pumping	329,585	362,959
Outside Services	73,894	62,050
Miscellaneous and Commissioners	51,273	42,979
Insurance	137,865	76,342
Distribution Supplies	295,695	335,011
Payroll and Other Taxes	92,345	96,152
Customer Accounts	132,944	72,990
Wages	830,461	906,791
Transportation	1,140	3,836
Sewer Supplies	11,714	13,546
Employee Benefits	361,977	386,526
Pumping Supplies	69,855	32,624
Total Operating Expense	4,918,420	5,188,966
Operating Income (Loss)	(177,644)	(470,048)
Non-Operating Revenue (Expense)		
Interest Income	484	449
Interest Expense	(235,144)	(246,415)
Interest and Penalty	(120)	
Loan Service Fees	(5,709)	(6,079)
Provisions for Bad Debts	(200,187)	(13,167)
Insurance Recovery	46,400	10,000
Gain (Loss) on Sale of Assets		
Total Non-Operating Revenue (Expenses)	(394,276)	(255,212)
Income (Loss) Before Capital Contributions	(571,920)	(725,260)
Capital Contributions		
Grant Income	177,197	805,102
Capital Contributions	38,411	5,565
Total Capital Contributions	215,608	810,667
Change in Net Assets	(356,312)	85,407
Total Net Assets, Beginning	18,689,784	18,604,377
Total Net Assets, Ending	18,333,472	18,689,784

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Year Ended December 31, 2015
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2015	2014
Cash flows from operating activity		
Cash received from customers	\$ 4,643,471	\$ 4,668,855
Cash payments to suppliers for goods and services	(3,954,931)	(4,130,375)
Cash received from deposits	(1,436)	22,323
Net cash provided by operating activities	687,104	560,803
Cash flows from noncapital financing activities		
Subsidy From Federal and State Grant	215,608	810,667
Net Cash Provided (Used) By Noncapital Financing Activities	215,608	810,667
Cash flows from capital and related financing activities		
(Increase) decrease in Restricted Assets Accounts	(535,587)	(39,854)
Loan Proceeds	1,556,820	25,018
Bond Proceeds		
Interest Paid	(235,144)	(246,415)
Principle Payment on Notes	(256,089)	(191,827)
Principle Payment on Bonds	(64,981)	(64,981)
Purchase of Utility Plant in Service	(1,092,948)	(438,835)
Purchase of Automotive Equipment	(11,956)	(35,018)
Decrease (Increase) in Consturction in progress	(265,312)	(401,534)
Proceeds from insurance recovery	46,400	10,000
Proceeds on Sale of Assets	-	-
Net cash provided by (used for) capital and related financing activities	(858,797)	(1,383,446)
Cash flows from investing activities		
Proceeds from earnings on investments	484	449
Net cash provided by (used for) investing activities	484	449
Total increase (decrease) in cash and cash equivalents	44,399	(11,527)
Cash and cash equivalents at beginning of year	6,993	18,520
Cash and cash equivalents at end of year (Note 2)	\$ 51,392	\$ 6,993

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Year Ended December 31, 2015
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2015	2014
Reconciliation of income from operations to net cash provided by operated activities:		
Income from operations	\$ (177,644)	\$ (470,048)
Provisions for Bad Debt	(200,187)	(13,167)
Adjustment to reconcile income from operations to net cash provided by operating activities:		
Operating Activities:		
Depreciation and amortization	1,030,534	1,009,229
Changes in assets and liabilities:		
Decrease (increase) in utility accounts receivable	102,882	(63,230)
Decrease (Increase) in prepaid expense	-	51,276
Decrease (Increase) in material and supplies inventory	(18,783)	4,628
Increase (decrease) in accounts payable and other payable	(46,481)	17,927
Increase (decrease) in customer deposits	(12,000)	22,323
Increase (decrease) in un-earned tap fees	10,564	-
Increase (decrease) in accrued interest	(1,781)	1,865
Net cash provided by operating activities	<u>\$ 687,104</u>	<u>\$ 560,803</u>
Non-cash operating activities		
Acquisition of Property and Equipment Included in accounts payable	<u>\$ 14,080</u>	<u>\$ 53,448</u>

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

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 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.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

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, 2015 and 2014 is \$235,325 and \$257,216.

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, 2015 AND 2014

Note 2 – Restricted Cash Accounts

The District had the following restricted cash accounts as of December 31, 2015 and 2014.

	<u>2015</u>	<u>2014</u>
KIA Project	\$ 22,503	\$ 3,240
Repair and Maintenance reserve	139,849	120,145
Construction reserve	427,742	61,355
Bond Depreciation Reserve	129,056	49,294
Road Construction Account	21,334	29,205
Deposit Refunds	239,110	175,189
Insurance Reserve	<u>26,092</u>	<u>31,671</u>
Totals	<u>\$1,005,686</u>	<u>\$ 470,099</u>

The amounts held were below the required minimum for 2015 and 2014 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 taping 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 2014 and 2015.

Note 5 – Deposits with Financial Institutions

As of December 31, 2014, 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.

As of December 31, 2014, the company had amounts of \$477,092 on deposit with financial institutions with \$250,000 insured by FDIC and \$227,092 insured by pledged US Treasury Bills.

Note 6 – Subsequent Events

During the year 2016 Southern Water Sewer District will complete the Allen to Martin project with the receipt of federal Grant of \$1,417,000. The project will service 3000 customers, 11 storage tanks and 14 pumping stations. Total estimated project cost of \$3,190,000 with \$1,489,149 expended during 2015 financed through RD loan

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 6 – Subsequent Events (Continued)

In preparing these financial statements, the District has evaluated events and transactions for the potential recognition or disclosure through September 27, 2016, 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, 2015 and December 31, 2014.

	Contributed <u>Capital</u>	<u>Reserves</u>	Net Assets <u>(Deficit)</u>	<u>Total</u>
Balance December 31, 2013	<u>\$32,531,250</u>	<u>\$ 93,303</u>	<u>\$(14,020,176)</u>	<u>\$18,604,377</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans				
Department of transportation	805,102			805,102
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer		39,854	(39,854)	
Net Income (Loss)			<u>(719,695)</u>	<u>(719,695)</u>
Balance December 31, 2014	<u>\$33,336,352</u>	<u>\$ 133,157</u>	<u>\$(14,779,725)</u>	<u>\$18,689,784</u>
Local Contribution - Floyd County Fiscal				
Department of transportation	177,197			177,197
Grant in aid-State Grant Funds				
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>

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 2015 and 2014 was \$18,000 and \$17,500 respectively. Normally the District contributes 5% of the employee's basic pay but board approved none for 2012. All contributions are immediately vested. Expenses charged to operations for the retirement plan were \$18,792 and \$19,847 respectively.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

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 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>	Additions	Disposals	Balance <u>12/31/15</u>
Land	\$ 204,829	\$ 0	\$ -0-	\$ 204,829
Water and Distribution System	42,415,643	1,092,948	-0-	43,508,591
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>	-0-	<u>1,149,554</u>
TOTAL ASSETS	\$ 44,088,217	\$ 1,370,216	\$ -0-	\$ 45,458,433
Less				
Accumulated Depreciation				
Water Distribution System	19,251,539	995,779	-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>	-0-	<u>106,439</u>
Total Accumulated	19,625,731	1,028,074	-0-	20,653,805
Balance – December 31	<u>\$ 24,462,486</u>			<u>\$ 24,804,628</u>

SOUTHERN WATER AND SEWER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2015 AND 2014

Note 10 - Property and Equipment (Continued)

The following summarizes the changes to capital assets for 2014:

	Balance <u>01/01/14</u>	Additions	Disposals	Balance <u>12/31/14</u>
Land	\$ 204,829	\$ -0-	\$ -0-	\$ 204,829
Water and Distribution System	42,004,213	411,430	-0-	42,415,643
Automotive Equipment	397,303	35,018	-0-	432,321
Furniture, fixtures and Equipment:	151,182	-0-	-0-	151,182
Construction in Progress	<u>482,708</u>	<u>793,085</u>	<u>391,551</u>	<u>884,242</u>
TOTAL ASSETS	\$ 43,240,235	\$ 1,239,533	\$ 391,551	\$ 44,088,217
Less				
Accumulated Depreciation				
Water Distribution System	18,280,882	970,657	-0-	19,251,539
Automotive Equipment	234,875	34,731	-0-	269,606
Furniture, fixtures and Equipment:	<u>103,204</u>	<u>1,382</u>	<u>-0-</u>	<u>104,586</u>
Total Accumulated	18,618,961	865,209	-0-	19,625,731
Balance – December 31	<u>\$ 24,621,274</u>			<u>\$ 24,462,486</u>

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 – Commitments

The District is involved with funding and planning additional phases for the Harold Sewer Project.

Note 14 – Notes and Bonds Payable

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

	<u>2015</u>	<u>2014</u>
Summary of Short term line of Credit		
6.25% line of credit First Guaranty National Bank interest due monthly. With principal due upon demand	\$ 229,000	\$ 241,000

SOUTHERN WATER AND SEWER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2014 AND 2013

Note 14 – Notes and Bonds Payable (Continued)

	<u>2015</u>	<u>2014</u>
Summary of Notes Payable		
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	\$ 542,395	\$ 594,171
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	34,019	37,044
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	1,440,149	1,538,514
d) First Guaranty Bank, 5.5% installment note monthly payments of \$1,830 including interest final payment 2017	28,822	48,598
A purchase agreement, original balance of \$25,018 At 5.9% interest, secured by vehicle; payments are \$483 for 60 months maturing September 2019	19,434	23,933
e) First Guaranty Bank 7.99 installment note monthly payments of \$1,977 including interest final payment during 2016	17,212	40,334
f) Kentucky Infrastructure Authority 1% installment note, 40 semi - annual payments of \$21,174 including interest due 06/01 and 12/1. Final payment 2034	696,002	731,126
g) First Guaranty Bank, 4.316% installment note monthly payments of \$940 including interest final payment 2019	36,567	-0-

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 14 – Notes and Bonds Payable (Continued)

	<u>2015</u>	<u>2014</u>
h) 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.	1,516,243	-0-
Total long – term Notes Payable	<u>\$ 4,330,843</u>	<u>\$ 3,013,720</u>
Less Current maturities	<u>246,594</u>	<u>236,030</u>
Notes Payable less current portion	<u>\$ 4,084,249</u>	<u>\$ 2,777,690</u>

Summary of Bonds Payable

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.	\$ 2,152,000	\$ 2,193,000
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.	512,990	524,471
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.	198,500	202,000
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>496,000</u>	<u>505,000</u>
Total Long – Term Bonds Payable	<u>\$ 3,359,490</u>	<u>\$ 3,424,471</u>
Less Current maturities	<u>66,981</u>	<u>64,981</u>
Notes Payable less current portion	<u>\$ 3,292,509</u>	<u>\$ 3,359,490</u>

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 14 – Notes and Bonds Payable (Continued)

Note

Following are maturities of long – term debt as of December 31, 2015:

	<u>Principal</u>	<u>Interest</u>
2016	\$ 313,575	\$ 233,188
2017	337,017	246,206
2018	337,528	235,995
2019	340,517	226,587
2020	339,629	215,733
2021-2025	1,766,007	919,800
2026-2030	1,259,089	674,386
2031-2035	1,038,507	494,892
2036-2040	1,048,730	307,089
2041-2045	621,441	116,037
2046-2050	<u>288,293</u>	<u>53,578</u>
Total	<u>\$ 7,690,333</u>	<u>\$ 3,723,491</u>

SOUTHERN WATER AND SEWER DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2015

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Agriculture Water and Waste Disposal for Rural Communities		
Guarantee Loans for Waste Water Disposal Systems		
Beginning value zero	,10.760	\$ 1,489,145
<u>Total</u>		\$ 1,489,145

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2015

Note A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal Guaranteed Loan activity of Southern Water and Sewer District year end outstanding balance \$1,489,145, and is presented on the accrual basis of accounting. Amount was expended during 2015 with no prior balance. The information in this schedule is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements by title 2 U.S. Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, **Audits of States, Local Governments, and Non-Profit Organizations**. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, basic financial statements. Southern Water and Sewer District did not elect to use the 10% de minimis indirect cost rate.

**SOUTHERN WATER AND SEWER DISTRICT
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2015**

Department of Agriculture Water and Waste Disposal for Rural Communities

There were no prior audit finds noted.

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CERTIFIED PUBLIC ACCOUNTANT
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(502) 550-1568

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

September 27, 2016

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, 2015, 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 September 27, 2016.

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

September 27, 2016

RICHARD F. PAULMANN, CPA, LLC
301 MOUNT MERCY ROAD
PEWEE VALLEY, KY 40056
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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

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

Report on Compliance for Each Major Federal Program

I have audited Southern Water and Sewer District's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Southern Water and Sewer District's major federal programs for the year ended December 31, 2015. Major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

My responsibility is to express an opinion on compliance for each of Southern Water and Sewer District's major federal programs based on my audit of the types of compliance requirements referred to above. I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that I plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Southern Water and Sewer District's compliance with those requirements and performing such an audit provides a reasonable basis for my opinion on compliance for each major federal program. However, my audit does not provide a legal determination of the Southern Water and Sewer District's compliance.

Opinion on Each Major Federal Program

In my opinion, Southern Water and Sewer District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2015..

Report on Internal Control over Compliance

Management of Southern Water and Sewer District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing my audit of compliance, I considered Southern Water and Sewer District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances; for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance; but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of the Southern Water and Sewer District's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A

significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

My consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. I did not identify any deficiencies in internal control over compliance that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of my testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Richard F. Paulmann CPA, LLC
Pewee Valley, KY
September 27, 2016

SOUTHERN WATER AND SEWER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COST
FOR THE YEAR ENDED DECEMBER 31, 2015

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Southern Water and Sewer District.
2. No material weakness were identified during the audit of financial statements.
3. No instances of noncompliance material to the financial statements of Southern Water and Sewer were disclosed during the audit.
4. No material weaknesses were identified during the audit of major federal awards program.
5. The auditor's report on compliance for the major federal awards program for Southern Water and Sewer District expresses an unmodified opinion.
6. Audit findings, if any, relative to the major federal program for Southern Water and Sewer District are reported on Part C of this schedule.
7. The programs tested as major programs included:
 - a. 10.760 Department of Agriculture Water and Waste Disposal for Rural Communities.
8. The threshold for distinguishing Type A and B programs was \$750,000.
9. Southern Water and Sewer District was determined to be a high-risk auditee.

B. FINDING – FINANCIAL STATEMENT AUDIT

NONE

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARDS PROGRAM AUDIT

NONE

**SOUTHERN WATER AND SEWER DISTRICT
CORRECTIVE ACTION PLAN
FOR THE YEAR ENDED DECEMBER 31, 2015**

Southern Water and Sewer District respectively submits the following corrective action plan for the Year Ended December 31, 2015 to Richard F. Paulmann CPA, LLC.

SECTION I – INTERNAL CONTROL STRUCTURE REVIEW

A. Comments on Findings and Recommendations

There were no findings noted in the current year's audit report.

B. Actions Taken or Planned

There were no findings noted in the current year's audit report.

C. Status of Corrective Actions on Prior Findings

There were no findings noted in the prior year's audit report

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

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 by \$18,333,473 at the close of the most recent year.

Southern Water and Sewer District's Net Assets

	<u>2016</u>
Current assets	\$ 1,229,218
Restricted assets	613,030
Fixed assets	25,302,267
Other assets	<u>61,506</u>
 Total assets	 <u>27,206,021</u>
 Current liabilities	 1,585,179
Long-term liabilities	<u>7,296,426</u>
 Total liabilities	 <u>8,881,605</u>
 Net assets:	
Investment in	
Capital Assets	17,377,693
Restricted	613,030
Unrestricted	<u>333,693</u>
 Total net assets	 \$ <u>18,324,416</u>

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 \$747,807 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
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2016 and 2015

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

	2016
Revenues:	
Water sales	\$ 3,782,844
Solid waste revenue	934,418
Penalties and service charges	78,611
Other	115,000
Total revenues	4,910,873
Expenses:	
Water treatment supplies	144,861
Depreciation and amortization	1,055,505
Purchased water	450,826
Solid Waste payments	906,385
Power for pumping	429,349
Outside services	110,072
Miscellaneous	51,845
Insurance	162,989
Distribution supplies and expense	398,143
Taxes and other	106,018
Customer accounts expense	129,597
Wages	914,661
Sewer supplies and expense	30,823
Employee benefits	387,805
Transportation expense	83
Pumping supplies and expense	45,144
Total operating expenses	5,324,106
Net operating income	(413,233)
Non-operating income (expense)	
Grants income	747,807
Capital contribution	1,787
Interest income	645
Interest expense	(200,291)
Interest and penalty	(354)
Provision for bad debts	(145,417)
Total non-operating (expense)	404,177
Net income (loss) before contributions and transfers	(9,056)
Total net assets, beginning	18,333,472
Total net assets, ending	18,324,416

Operations.

The District showed a net income (loss) of (\$9,056).

Key elements of this income are as follows:

- Depreciation for the year was \$1,055,505.
- Grant income of \$747,807 was received during the year.

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	
Revenues:			
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>
Expenses:			
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)
Non-operating income (expense)			
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>
Assets		
Current Assets:		
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>
Total Current Assets	1,229,218	1,259,241
Noncurrent Assets		
Restricted Cash	613,030	1,005,686
Capital Assets:		
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>
Total Capital Assets	47,011,577	45,458,433
Less: Accumulated Depreciation	<u>(21,709,310)</u>	<u>(20,653,805)</u>
Net Capital Assets	25,302,267	24,804,628
Other Assets		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	<u>(36,904)</u>	<u>(34,443)</u>
Total Other Assets	61,506	63,967
Total Noncurrent Assets	25,976,803	25,874,281
Total Assets	\$ <u>27,206,021</u>	\$ <u>27,133,522</u>

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>
Liabilities		
Current Liabilities		
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
Total Current Liabilities	<u>1,585,179</u>	<u>1,423,291</u>
Noncurrent Liabilities		
Notes Payable-Net of Current Portion	4,096,801	4,084,249
Bonds Payable-Net of Current Portion	3,199,625	3,292,509
Total Long Term Liabilities	<u>7,296,426</u>	<u>7,376,758</u>
Total Liabilities	<u>8,881,605</u>	<u>8,800,049</u>
Net Position:		
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
Total Net Position	<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	
	2016	2015
Operating Revenue:		
Water Sales	\$ 3,782,844	\$ 3,672,330
Solid Waste Revenue	934,418	938,456
Penalties and Service Charges	78,611	92,209
Other	115,000	37,781
Total Operating Revenue	4,910,873	4,740,776
Operating Expenses:		
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	45,144	69,855
Total Operating Expense	5,324,106	4,918,419
Operating Income (Loss)	(413,233)	(177,643)
Non-Operating Revenue (Expense)		
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		
Total Non-Operating Revenue (Expenses)	(345,417)	(394,276)
Income (Loss) Before Capital Contributions	(758,650)	(571,919)
Capital Contributions		
Grant Income	747,807	177,197
Capital Contributions	1,787	38,411
Total Capital Contributions	749,594	215,608
Change in Net Position	(9,056)	(356,311)
Total Net Position, Beginning	18,333,473	18,689,784
Total Position Assets, Ending	18,324,417	18,333,473

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
Cash flows from operating activity		
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)
Net cash provided by operating activities	677,121	687,104
Cash flows from noncapital financing activities		
Subsidy From Federal and State Grant	749,594	215,608
Net Cash Provided (Used) By Noncapital Financing Activities	749,594	215,608
Cash flows from capital and related financing activities		
(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)
Cash flows from investing activities		
Proceeds from earnings on investments	645	484
Net cash provided by (used for) investing activities	645	484
Total increase (decrease) in cash and cash equivalents	(2,665)	44,399
Cash and cash equivalents at beginning of year	51,392	6,993
Cash and cash equivalents at end of year (Note 2)	\$ 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
Reconciliation of Income from operations to net cash provided by operated activities:		
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)
Net cash provided by operating activities	\$ <u>677,121</u>	\$ <u>687,104</u>
 Non-cash operating activities		
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 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.

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 taping 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.

	<u>Contributed Capital</u>	<u>Reserves</u>	<u>Net Assets (Deficit)</u>	<u>Total</u>
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			Balance
	<u>01/01/15</u>	<u>Additions</u>	<u>Disposals</u>	<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>
TOTAL ASSETS	\$ 44,458,433	\$ 1,553,144	\$ -0-	\$ 47,011,577
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
Balance – December 31	<u>\$ 24,804,628</u>			<u>\$ 25,302,267</u>

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>
TOTAL ASSETS	\$ 44,088,217	\$ 1,370,216	\$ -0-	\$ 45,458,433
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
Balance – December 31	<u>\$ 24,462,489</u>			<u>\$ 24,804,628</u>

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>
Summary of Short term line of Credit		
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>
Summary of Notes Payable		
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
Total long – term Notes Payable	<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>

Summary of Bonds Payable

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>
Total Long – Term Bonds Payable	<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:

	<u>Principal</u>	<u>Interest</u>
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>
Total	<u>\$ 7,633,442</u>	<u>\$ 3,492,106</u>

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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.

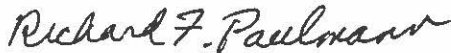
My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during my audit I did not identify 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, LLC

October 20, 2017

SOUTHERN WATER AND SEWER DISTRICT
REPORT OF AUDIT OF FINANCIAL STATEMENTS
AND SUPPORTING DATA
YEAR ENDED DECEMBER 31, 2017

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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 years ended December 31, 2017 and 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, 2017 and 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.

Emphasis of Matter

Southern Water and Sewer is involved with transfer of the Harold Sewer Plant to the City Of Prestonsburg, Kentucky. This will be contingent upon appraisal to be completed in the next few months. See note 5 page 15 for details.

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 19, 2018, 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

Richard F. Paulmann CPA, LLC
Pewee Valley, KY
October 19, 2018

**SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2017 and 2016**

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, 2017 and December 31, 2016. 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 \$18,178,400. This was a decrease of \$146,017 from the year ended December 31, 2016.
- At December 31, 2017, the District had \$27,423,245 in assets and \$9,244,845 in liabilities. The investment in capital assets, net of related debt, balance at this date was \$17,451,480. The restricted for capital projects balance was \$48,992. The restricted for maintenance balance was \$180,277. The restricted for debt service balance was \$147,400. The restricted for deposits was \$231,253. The unrestricted balance was \$119,068.
- The District had a net loss of \$146,017 for the year ended December 31, 2017. For the year ended December 31, 2016 the net loss was \$9,056.
- The District's water sales were \$3,462,963 for the year ended December 31, 2017. For the year ended December 31, 2016 the water sales were \$3,782,844. This represented a decrease of 8.5% which was a result of July 1 transfer of customers relating to the Harold Sewer plant.

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, 2017 and December 31, 2016. 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, 2017 and 2016

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 by \$18,178,400 at the close of the most recent year.

Southern Water and Sewer District's Net Assets

		2017
Current assets	\$	1,221,278
Restricted assets		607,852
Fixed assets		25,535,069
Other assets		59,046
Total assets		27,423,245
Current liabilities		3,188,272
Long-term liabilities		6,056,573
Total liabilities		9,244,845
Net assets:		
Investment in		
Capital Assets		17,451,480
Restricted		607,852
Unrestricted		119,068
Total net assets	\$	18,178,400

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 \$953,173 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
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2017 and 2016

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

	2017
Revenues:	
Water sales	\$ 3,462,963
Solid waste revenue	961,451
Penalties and service charges	61,851
Other	0
Total revenues	4,486,265
Expenses:	
Water treatment supplies	140,059
Depreciation and amortization	1,079,218
Purchased water	385,632
Solid Waste payments	929,650
Power for pumping	389,993
Outside services	72,438
Miscellaneous	67,961
Insurance	110,249
Distribution supplies and expense	405,317
Taxes and other	84,115
Customer accounts expense	140,999
Wages	942,443
Sewer supplies and expense	4,058
Employee benefits	431,165
Transportation expense	1,554
Pumping supplies and expense	39,951
Total operating expenses	5,224,802
Net operating income	(738,537)
Non-operating income (expense)	
Grants income	953,173
Loan Service Fees	(1,583)
Gain/(Loss) on Sale of Assets	12,813
Interest income	4,066
Interest expense	(242,065)
Interest and penalty	(217)
Provision for bad debts	(133,667)
Total non-operating (expense)	592,520
Net income (loss) before contributions and transfers	(146,017)
Total net assets, beginning	18,324,417
Total net assets, ending	18,178,400

Operations.

The District showed a net income (loss) of (\$146,017).

Key elements of this income are as follows:

- Depreciation for the year was \$1,079,218.
- Grant income of \$953,173 was received during the year.

SOUTHERN WATER AND SEWER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2017 and 2016

Southern Water and Sewer District Budget Comparison

	Actual Amounts	Original Budget Amounts	Variance Positive (Negative)
	2017	2017	2017
Revenues:			
Water sales	\$ 3,462,963	\$ 3,769,200	\$ (306,237)
Solid waste revenue	961,451	933,119	28,332
Penalties and service charges	61,851	166,664	(104,813)
Other	0	0	0
Total revenues	<u>4,486,265</u>	<u>4,868,983</u>	<u>(382,718)</u>
Expenses:			
Water treatment supplies	140,059	156,605	16,546
Depreciation and amortization	1,079,218	865,006	(214,212)
Purchased water	385,632	530,905	145,273
Solid Waste payments	929,650	905,125	(24,525)
Power for pumping	389,993	474,359	84,366
Outside services	72,438	154,754	82,316
Miscellaneous	67,961	75,561	7,600
Insurance	110,249	192,507	82,258
Distribution supplies expense	405,317	283,876	(121,441)
Taxes and other	84,115	104,185	20,070
Customer accounts expense	140,999	33,989	(107,010)
Wages	942,443	1,005,960	63,517
Sewer supplies and expense	4,058	0	(4,058)
Employee benefits	431,165	360,041	(71,124)
Transportation expense	1,554	123,548	121,994
Pumping supplies expense	39,951	0	(39,951)
Total operating expenses	<u>5,224,802</u>	<u>5,266,421</u>	<u>41,619</u>
Net operating income	(738,537)	(397,438)	(341,099)
Non-operating income (expense)			
Grant income	953,173	674,460	278,713
Loan Service Fees	(1,583)	0	(1,583)
Gain/(Loss) on Sale of Assets	12,813		12,813
Interest income	4,066	3,000	1,066
Interest expense	(242,065)	(241,321)	(744)
Interest and penalty	(217)	0	(217)
Provision for Bad Debts	(133,667)	(35,000)	(98,667)
Total non-operating income	<u>592,520</u>	<u>401,139</u>	<u>191,381</u>
Net income (loss)	(146,017)	3,701	(149,718)
Total net assets, beginning	18,324,417		
Total net assets, ending	<u>\$ 18,178,400</u>	<u>\$</u>	<u>\$</u>

Budget Comparisons

- Revenues were \$382,718 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 \$41,619 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, 2017 and 2016

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, 2017 amounts to \$25,535,069 (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% 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 \$9,244,845. 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
DECEMBER 31, 2017 AND 2016
(with prior year data for comparison purposes only)

	<u>2017</u>	<u>2016</u>
Assets		
Current Assets:		
Cash and Cash Equivalents	\$ 29,494	\$ 48,727
Accounts Receivable (Net of Allowance for Delinquencies of \$241,732 in 2017 and \$230,164 in 2016)	1,155,651	1,106,878
Prepaid Expense	-	5,048
Inventory	<u>36,133</u>	<u>68,565</u>
Total Current Assets	1,221,278	1,229,218
Noncurrent Assets		
Restricted Cash	607,852	613,030
Capital Assets:		
Land	206,256	204,829
Plumbing and Distribution System	43,989,850	43,906,055
Transportation Equipment	600,847	555,602
Furniture, Fixtures and Equipment	198,616	151,182
Construction in Progress	<u>3,232,339</u>	<u>2,193,909</u>
Total Capital Assets	48,227,908	47,011,577
Less: Accumulated Depreciation	<u>(22,692,839)</u>	<u>(21,709,310)</u>
Net Capital Assets	25,535,069	25,302,267
Other Assets		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	<u>(39,364)</u>	<u>(36,904)</u>
Total Other Assets	59,046	61,506
Total Noncurrent Assets	26,201,967	25,976,803
Total Assets	\$ <u>27,423,245</u>	\$ <u>27,206,021</u>

See accompanying notes to the basic financial statements

SOUTHER WATER AND SEWER DISTRICT
STATEMENT OF NET POSITION
DECEMBER 31, 2017 AND 2016
(with prior year data for comparison purposes only)

	<u>2017</u>	<u>2016</u>
Liabilities		
Current Liabilities		
Accounts Payable	\$ 379,073	\$ 224,327
Accounts Payable Solid Waste	426,652	430,168
Accrued Sick and Vacation pay	144,758	103,547
Customer Deposits	201,693	189,909
Deposit Harold Sewer	1,462,695	-
Note Payable Line of Credit	237,883	217,000
Note Payable Current	163,195	244,132
Bonds Payable Current	83,500	92,884
Accounts Payable Construction in Progress	9,080	9,080
Accrued Interest	79,743	74,132
Total Current Liabilities	<u>3,188,272</u>	<u>1,585,179</u>
Noncurrent Liabilities		
Notes Payable-Net of Current Portion	3,406,573	4,096,801
Bonds Payable-Net of Current Portion	2,650,000	3,199,625
Total Long Term Liabilities	<u>6,056,573</u>	<u>7,296,426</u>
Total Liabilities	<u>9,244,845</u>	<u>8,881,605</u>
Net Position:		
Invested in Capital Assets, Net of Related Debt	17,451,480	17,377,693
Restricted for Capital Projects	48,922	51,229
Restricted for Maintenance	180,277	156,566
Restricted for Debt Service	147,400	155,811
Restricted for Deposits	231,253	249,425
Unrestricted	119,068	333,693
Total Net Position	<u>\$ 18,178,400</u>	<u>\$ 18,324,417</u>

SOUTHERN WATER AND SEWER DISTRICT
 STATEMENT OF REVENUE EXPENDITURE AND CHANGES IN NET POSITION
 For the Years Ended December 31, 2017 and 2016
 (with prior data for comparison purposes only)

	For the Year Ended December 31	
	<u>2017</u>	<u>2016</u>
Operating Revenue:		
Water Sales	\$ 3,462,963	\$ 3,782,844
Solid Waste Revenue	961,451	934,418
Penalties and Service Charges	61,851	78,611
Other	-	115,000
Total Operating Revenue	<u>4,486,265</u>	<u>4,910,873</u>
Operating Expenses:		
Water Treatment Supplies	140,059	144,861
Depreciation and Amortization	1,079,218	1,055,505
Purchased Water	385,632	450,826
Solid Waste Payments	929,650	906,385
Power for Pumping	389,993	429,349
Outside Services	72,438	110,072
Miscellaneous and Commissioners	67,961	51,845
Insurance	110,249	162,989
Distribution Supplies	405,317	398,143
Payroll and Other Taxes	84,115	106,018
Customer Accounts	140,999	129,597
Wages	942,443	914,661
Transportation	1,554	83
Sewer Supplies	4,058	30,823
Employee Benefits	431,165	387,805
Pumping Supplies	39,951	45,144
Total Operating Expense	<u>5,224,802</u>	<u>5,324,106</u>
Operating Income (Loss)	<u>(738,537)</u>	<u>(413,233)</u>
Non-Operating Revenue (Expense)		
Interest Income	4,066	645
Interest Expense	(242,065)	(200,291)
Interest and Penalty	(217)	(354)
Loan Service Fees	(1,583)	-
Provisions for Bad Debts	(133,667)	(145,417)
Insurance Recovery	-	-
Gain (Loss) on Sale of Assets	12,813	-
Total Non-Operating Revenue (Expenses)	<u>(360,653)</u>	<u>(345,417)</u>
Income (Loss) Before Capital Contributions	<u>(1,099,190)</u>	<u>(758,650)</u>
Capital Contributions		
Grant Income	953,173	747,807
Capital Contributions	-	1,787
Total Capital Contributions	<u>953,173</u>	<u>749,594</u>
Change in Net Position	(146,017)	(9,056)
Total Net Position, Beginning	<u>18,324,417</u>	<u>18,333,473</u>
Total Position Assets, Ending	<u>18,178,400</u>	<u>18,324,417</u>

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Years Ended December 31, 2017 and 2016
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2017	2016
Cash flows from operating activity		
Cash received from customers	\$ 4,437,492	\$ 4,941,909
Cash payments to suppliers for goods and services	(4,043,719)	(4,265,389)
Cash received from deposits	11,784	601
Net cash provided by operating activities	405,557	677,121
Cash flows from noncapital financing activities		
Subsidy From Federal and State Grant	953,173	749,594
Net Cash Provided (Used) By Noncapital Financing Activities	953,173	749,594
Cash flows from capital and related financing activities		
(Increase) decrease in Restricted Assets Accounts	5,178	392,656
Loan Proceeds	146,867	246,517
Deposits from Prestonsburg for the Harold Sewer Plant	1,462,695	
Interest Paid	(236,671)	(202,479)
Principle Payment on Notes	(897,149)	(246,594)
Principle Payment on Bonds	(559,009)	(66,981)
Purchase of Utility Plant in Service	(152,339)	(397,464)
Purchase of Automotive Equipment	(125,985)	(111,325)
Decrease (increase) in Consturction in progress	(1,038,429)	(1,044,355)
Proceeds from insurance recovery	-	-
Proceeds on Sale of Assets	12,813	-
Net cash provided by (used for) capital and related financing activities	(1,382,029)	(1,430,025)
Cash flows from investing activities		
Proceeds from earnings on investments	4,066	645
Net cash provided by (used for) investing activities	4,066	645
Total increase (decrease) in cash and cash equivalents	(19,233)	(2,665)
Cash and cash equivalents at beginning of year	48,727	51,392
Cash and cash equivalents at end of year (Note 2)	\$ 29,494	\$ 48,727

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
Statement of Cash Flows
For the Years Ended December 31, 2017 and 2016
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2017	2016
Reconciliation of income from operations to net cash provided by operated activities:		
Income from operations	\$ (738,537)	\$ (413,233)
Provisions for Bad Debt	(133,667)	(145,417)
Adjustment to reconcile income from operations to net cash provided by operating activities:		
Operating Activities:		
Depreciation and amortization	1,079,218	1,057,966
Changes in assets and liabilities:		
Decrease (increase) in utility accounts receivable	(48,773)	30,465
Decrease (increase) in prepaid expense	5,048	(5,048)
Decrease (increase) in material and supplies inventory	32,432	1,971
Increase (decrease) in accounts payable and other payable	192,441	151,680
Increase (decrease) in customer deposits	11,784	601
Increase (decrease) in un-earned tap fees	-	-
Increase (decrease) in accrued interest	5,611	(1,834)
Net cash provided by operating activities	\$ <u>405,557</u>	\$ <u>677,151</u>
 Non-cash operating activities		
Acquisition of Property and Equipment Included in accounts payable	\$ <u>10,425</u>	\$ <u>15,973</u>

See accompanying notes to the basic financial statements

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

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 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.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

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, 2017 and 2016 is \$241,732 and \$230,165.

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, 2017 AND 2016

Note 2 – Restricted Cash Accounts

The District had the following restricted cash accounts as of December 31, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
KIA Project	\$ 26,331	\$ 28,135
Repair and Maintenance reserve	180,457	156,566
Construction reserve	43,944	20,033
Bond Depreciation Reserve	64,028	104,988
Road Construction Account	21,358	21,355
Deposit Refunds	231,254	249,424
Insurance Reserve	<u>40,480</u>	<u>32,529</u>
Totals	<u>\$ 607,852</u>	<u>\$ 613,030</u>

The amounts held were below the required minimum for 2017 and 2016 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, 2017, the company had amounts of \$637,346 on deposit with financial institutions with \$250,000 insured by FDIC and \$813,463 insured by pledged US Treasury Bills.

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.

Note 5 – Contingency

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 \$6,053,143 in assets at Southern Waters Sewers cost basis will be removed from Southern Water and Sewer District's financial statements. This will cause an estimated reduction in Southern Water and Sewer District's revenue of just under \$500,000 yearly. The final dollar amounts that will be transferred are contingent upon appraisal currently being completed. During the year, loans of \$1,142,352 were paid off, computer equipment for \$47,343 was purchased; and cash was transferred of \$255,000.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

Note 6 – Subsequent Events

In preparing these financial statements, the District has evaluated events and transactions for the potential recognition or disclosure through October 19, 2018, 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, 2017 and December 31, 2016.

	<u>Contributed Capital</u>	<u>Reserves</u>	<u>Net Assets (Deficit)</u>	<u>Total</u>
Balance December 31, 2015	<u>\$33,550,140</u>	<u>\$ 668,744</u>	<u>\$(15,884,411)</u>	<u>\$18,334,473</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	320,170			320,170
Department of transportation	427,637			427,637
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>\$(16,249,618)</u>	<u>\$18,324,417</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	643,853			643,853
Department of transportation	251,192			251,192
Grant in aid-State Grant Funds				
State Contribution DOT				
Grant in Aid – Fema	58,128			58,128
Other				
Transfer		(5,178)	5,178	
Net Income (Loss)			<u>(1,099,190)</u>	<u>(1,099,190)</u>
Balance December 31, 2017	<u>\$35,251,120</u>	<u>\$270,910</u>	<u>\$(17,343,630)</u>	<u>\$18,178,400</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 2017 and 2016 was \$18,000 and \$18,000 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 \$17,093 and \$21,398 respectively.

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

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 2017:

	Balance <u>01/01/16</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>12/31/17</u>
Land	\$ 204,829	\$ 1,427	\$ -0-	\$ 206,256
Water and Distribution System	43,906,055	96,283	12,488	43,989,850
Automotive Equipment	555,602	125,985	80,740	600,847
Furniture, fixtures and Equipment:	151,182	47,434	-0-	198,616
Construction in Progress	<u>2,193,909</u>	<u>1,038,429</u>	<u>-0-</u>	<u>3,232,338</u>
TOTAL ASSETS	\$ 47,011,577	1,309,429	\$ 93,228	\$ 48,227,907
Less				
Accumulated Depreciation				
Water Distribution System	21,258,841	1,016,524	12,488	22,262,877
Automotive Equipment	342,085	51,525	80,740	312,870
Furniture, fixtures and Equipment:	<u>108,384</u>	<u>8,709</u>	<u>-0-</u>	<u>117,093</u>
Total Accumulated	21,709,310	1,076,758	93,228	22,692,840
Balance – December 31	<u>\$ 25,302,267</u>			<u>\$ 23,535,067</u>

SOUTHERN WATER AND SEWER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2017 AND 2016

Note 10 - Property and Equipment (Continued)

The following summarizes the changes to capital assets for 2016:

	Balance <u>01/01/16</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>1,149,355</u>	-0-	<u>2,193,909</u>
TOTAL ASSETS	\$ 44,458,433	\$1,553,144	\$ -0-	\$ 47,011,577
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
Balance – December 31	<u>\$ 24,804,628</u>			<u>\$ 25,302,267</u>

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:

	<u>2017</u>	<u>2016</u>
Summary of Short term line of Credit		
6.25% line of credit First Guaranty National Bank interest due monthly. With principal due upon demand	\$ 237,883	\$ 217,000

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

Note 13 – Notes and Bonds Payable (Continued)

	<u>2017</u>	<u>2016</u>
Summary of Notes Payable		
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	\$ 434,101	\$ 489,054
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	-0-	30,284
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	1,234,387	1,338,796
d) First Guaranty Bank, 5.5% installment note monthly payments of \$1,830 including interest final payment 2017	-0-	7,931
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	9,606	14,666
f) First Guaranty Bank 4.25 installment note monthly payments of \$1990 including interest final Balloon payment during November 2019 Secured by 5 trucks	124,448	-0-
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	-0-	660,526
h) First Guaranty Bank, 4.316% installment note monthly payments of \$940 including interest final payment 2019	17,226	26,676

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

Note 13 – Notes and Bonds Payable (Continued)

	<u>2017</u>	<u>2016</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.	1,750,000	1,773,000
Total long – term Notes Payable	<u>\$ 3,569,768</u>	<u>\$ 4,340,933</u>
Less Current maturities	163,195	244,132
Notes Payable less current portion	<u>\$ 3,406,573</u>	<u>\$ 4,096,801</u>
 Summary of Bonds Payable		
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.	\$ 2,065,000	\$ 2,109,000
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.	-0-	501,509
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.	191,000	195,000
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>477,500</u>	<u>487,000</u>
Total Long – Term Bonds Payable	<u>\$ 2,733,500</u>	<u>\$ 3,292,509</u>
Less Current maturities	83,500	92,884
Notes Payable less current portion	<u>\$ 2,650,000</u>	<u>\$ 3,199,625</u>

SOUTHERN WATER AND SEWER DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

Note 13 – Notes and Bonds Payable (Continued)

Note

Following are maturities of long – term debt as of December 31, 2017:

	<u>Principal</u>	<u>Interest</u>
2018	\$ 286,558	\$ 206,896
2019	410,918	202,022
2020	284,941	188,453
2021	292,708	179,259
2022	300,134	169,555
2023-2027	1,294,264	705,202
2028-2032	875,065	523,878
2033-2037	837,940	381,992
2038-2042	976,440	200,036
2043-2047	349,940	78,788
2048-2052	225,940	39,069
2053-2057	<u>168,420</u>	<u>9,598</u>
Total	<u>\$ 6,303,268</u>	<u>\$ 2,884,715</u>

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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 19, 2018

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, 2017, 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 19, 2018.

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, LLC
October 19, 2018