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SOUTHERN WATER AND SEWER DISTRICT  
REPORT OF AUDIT OF FINANCIAL STATEMENTS  
AND SUPPORTING DATA  
YEAR ENDED DECEMBER 31, 2014

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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, 2014, 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 and the standards applicable to financial statement 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 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, 2014, 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 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 Reporting Required by Governmental Auditing Standards**

In accordance with Governmental Auditing Standards, I have also issued my report dated August 20, 2014, 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

*Richard F. Paulmann*

Pewee Valley, KY  
August 20, 2015



SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2014 and 2013

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, 2014 and December 31, 2013. 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 \$18,689,784. This was an increase of \$85,407 from the year ended December 31, 2013.
- At December 31, 2014, the District had \$26,297,953 in assets and \$7,608,169 in liabilities. The investment in capital assets, net of related debt, balance at this date was \$17,705,548. The restricted for capital projects balance was \$30,110. The restricted for maintenance balance was \$120,145. The restricted for debt service balance was \$144,655. The restricted for deposits was \$175,189. The unrestricted balance was \$514,137.
- The District had a net income of \$85,407 for the year ended December 31, 2014. For the year ended December 31, 2013 the net income was \$1,797,820.
- The District's water sales were \$3,669,094 for the year ended December 31, 2014. For the year ended December 31, 2013 the water sales were \$3,905,530. This represented a decrease of 6% which was a result of factors affecting revenue such as decreased 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, 2014 and December 31, 2013. 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 9 through 13 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 14 through 22 of this report.

SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2014 and 2013

**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 \$18,689,784 at the close of the most recent year.

**Southern Water and Sewer District's Net Assets**

	<u>2014</u>
Current assets	\$ 1,298,941
Restricted assets	470,099
Fixed assets	24,462,486
Other assets	<u>66,427</u>
Total assets	<u>26,297,953</u>
Current liabilities	1,470,989
Long-term liabilities	<u>6,137,180</u>
Total liabilities	<u>7,608,169</u>
Net assets:	
Investment in Capital Assets	17,705,548
Restricted	470,099
Unrestricted	<u>514,137</u>
Total net assets	<u>\$ 18,689,784</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 \$805,102 during the year. Grant monies and customer contributions accounted for this increase. These monies were used for sewer line expansions.

SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2014 and 2013

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

	2014
Revenues:	
Water sales	\$ 3,669,094
Solid waste revenue	954,559
Penalties and service charges	95,265
Other	0
Total revenues	4,718,918
Expenses:	
Water treatment supplies	346,653
Depreciation and amortization	1,009,229
Purchased water	515,356
Solid Waste payments	925,922
Power for pumping	362,959
Outside services	62,050
Miscellaneous	42,979
Insurance	76,342
Distribution supplies and expense	335,011
Taxes and other	96,152
Customer accounts expense	72,990
Wages	906,791
Sewer supplies and expense	13,546
Employee benefits	386,526
Transportation expense	3,836
Pumping supplies and expense	32,624
Total operating expenses	5,188,966
Net operating income	(470,048)
Non-operating income (expense)	
Grants income	805,102
Capital contribution	5,565
Floyd County Court Settlement	0
Interest income	449
Interest expense	(246,415)
Interest and penalty	0
Insurance Recovery	10,000
Settlement income	(6,079)
Provision for bad debts	(13,167)
Total non-operating (expense)	555,455
Net income (loss) before contributions and transfers	85,407
Total net assets, beginning	18,604,377
Total net assets, ending	18,689,784

**Operations.**

The District showed a net income (loss) of \$85,407.

Key elements of this income are as follows:

- Depreciation for the year was \$1,009,229.
- Grant income of \$805,102 was received during the year.

SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2014 and 2013

**Southern Water and Sewer District Budget Comparison**

	Actual Amounts	Original Budget Amounts	Variance Positive (Negative)
	2014	2014	2014
<b>Revenues:</b>			
Water sales	\$ 3,669,094	\$ 3,778,006	\$ (108,912)
Solid waste revenue	954,559	983,437	(28,878)
Penalties and service charges	95,265	149,058	(53,793)
Other	0	0	0
<b>Total revenues</b>	<u>4,718,918</u>	<u>4,910,501</u>	<u>(191,583)</u>
<b>Expenses:</b>			
Water treatment supplies	346,653	178,353	(168,300)
Depreciation and amortization	1,009,229	865,007	(144,222)
Purchased water	515,356	514,635	(721)
Solid Waste payments	925,922	953,934	28,012
Power for pumping	362,959	413,880	50,921
Outside services	62,050	53,995	(8,055)
Miscellaneous	42,979	36,849	(6,130)
Insurance	76,342	92,198	15,856
Distribution supplies expense	335,011	318,905	(16,106)
Taxes and other	96,152	91,919	(4,233)
Customer accounts expense	72,990	66,703	(6,287)
Wages	906,791	795,435	(111,356)
Sewer supplies and expense	13,546	3,158	(10,388)
Employee benefits	386,526	248,549	(137,977)
Transportation expense	3,836	153,886	150,050
Pumping supplies expense	32,624	0	(32,624)
<b>Total operating expenses</b>	<u>5,188,966</u>	<u>4,787,406</u>	<u>(401,560)</u>
<b>Net operating income</b>	(470,048)	123,095	(593,143)
<b>Non-operating income (expense)</b>			
Grant income	805,102	1,345,445	(540,343)
Capital contribution	5,565	0	5,565
Floyd County Court Settlement	0	0	0
Interest income	449	5,208	(4,759)
Interest expense	(246,415)	(246,726)	311
Interest and penalty	0	0	0
Insurance Recovery	10,000	11,999	(1,999)
Loan service fees	(6,079)	0	(6,079)
Provision for Bad Debts	(13,167)	(24,189)	11,022
<b>Total non-operating income</b>	<u>555,455</u>	<u>1,091,737</u>	<u>(536,282)</u>
<b>Net income (loss)</b>	<u>85,407</u>	<u>1,214,832</u>	<u>(1,129,425)</u>
<b>Total net assets, beginning</b>	<u>18,604,377</u>		
<b>Total net assets, ending</b>	<u>\$ 18,689,784</u>	<u>\$</u>	<u>\$</u>

**Budget Comparisons**

- Revenues were \$191,583 more than budgeted as a result of water sales being up and new rates in effect and various other differences. Operating expenses were \$401,560 more than budgeted as a result of overtime costs and various other expenses.



SOUTHERN WATER AND SEWER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Years ended December 31, 2014 and 2013

**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, 2014 amounts to \$24,462,486 (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 .645% 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 \$7,608,169. 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  
12/31/2014  
(with prior year data for comparison purposes only)

	2014	2013
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents	\$ 6,993	\$ 18,520
Accounts Receivable (Net of Allowance for Delinquencies of \$257,216 in 2014 and \$244,050 in 2013)	1,240,195	1,176,965
Inventory	51,753	56,381
Prepaid Expenses	-	51,276
	1,298,941	1,303,142
<b>Noncurrent Assets</b>		
Restricted Cash	470,099	430,245
<b>Capital Assets:</b>		
Land	204,829	204,829
Plumbing and Distribution System	42,415,643	42,004,213
Transportation Equipment	432,321	397,303
Furniture, Fixtures and Equipment	151,182	151,182
Construction in Progress	884,242	482,708
	44,088,217	43,240,235
Less: Accumulated Depreciation	(19,625,731)	(18,618,961)
	24,462,486	24,621,274
<b>Other Assets</b>		
Prepaid Interest	98,410	98,410
Less Accumulated Amortization	(31,983)	(29,523)
	66,427	68,887
<b>Total Noncurrent Assets</b>	24,999,012	25,120,406
<b>Total Assets</b>	\$ 26,297,953	\$ 26,423,548

SOUTHER WATER AND SEWER DISTRICT  
STATEMENT OF NET POSITION  
12/31/2014  
(with prior year data for comparison purposes only)

	2014	2013
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Accounts Payable	\$ 207,987	\$ 158,718
Accounts Payable Solid Waste	414,452	482,070
Customer Deposits	175,344	153,021
Note Payable Line of Credit	241,000	241,000
Note Payable Current	236,030	222,339
Bonds Payable Current	64,981	61,535
Accounts Payable Construction in Progress	53,448	9,080
Accrued Interest	77,747	78,863
<b>Total Current Liabilities</b>	1,470,989	1,406,626
<b>Noncurrent Liabilities</b>		
Notes Payable-Net of Current Portion	2,777,690	2,988,074
Bonds Payable-Net of Current Portion	3,359,490	3,424,471
<b>Total Long Term Liabilities</b>	6,137,180	6,412,545
<b>Total Liabilities</b>	7,608,169	7,819,171
<b>Net Assets:</b>		
Invested in Capital Assets, Net of Related Debt	17,705,548	17,604,992
Restricted for Capital Projects	30,110	46,457
Restricted for Maintenance	120,145	100,453
Restricted for Debt Service	144,655	283,254
Restricted for Deposits	175,189	153,021
Unrestricted	514,137	416,200
<b>Total Net Assets</b>	\$ 18,689,784	\$ 18,604,377

See accompanying notes to the basic financial statements  
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SOUTHERN WATER AND SEWER DISTRICT  
 STATEMENT OF REVENUE EXPENDITURE AND CHANGES IN NET ASSETS  
 For the Year Ended December 31, 2014  
 (with prior data for comparison purposes only)

	For the Year Ended December 31	
	2014	2013
<b>Operating Revenue:</b>		
Water Sales	\$ 3,669,094	\$ 3,905,530
Solid Waste Revenue	954,559	975,173
Penalties and Service Charges	95,265	95,682
Other	-	-
<b>Total Operating Revenue</b>	<u>4,718,918</u>	<u>4,976,385</u>
<b>Operating Expenses:</b>		
Water Treatment Supplies	346,653	378,609
Depreciation and Amortization	1,009,229	867,669
Purchased Water	515,356	483,139
Solid Waste Payments	925,922	945,917
Power for Pumping	362,959	313,426
Outside Services	62,050	36,677
Miscellaneous and Commissioners	42,979	32,441
Insurance	76,342	89,516
Distribution Supplies	335,011	328,318
Payroll and Other Taxes	96,152	85,328
Customer Accounts	72,990	153,715
Wages	906,791	799,090
Transportation	3,836	1,311
Sewer Supplies	13,546	2,647
Employee Benefits	386,526	335,886
Pumping Supplies	32,624	3,528
<b>Total Operating Expense</b>	<u>5,188,966</u>	<u>4,857,217</u>
<b>Operating Income (Loss)</b>	<u>(470,048)</u>	<u>119,168</u>
<b>Non-Operating Revenue (Expense)</b>		
Interest Income	449	715
Interest Expense	(246,415)	(262,677)
Interest and Penalty	-	(964)
Loan Service Fees	(6,079)	-
Provisions for Bad Debts	(13,167)	(29,796)
Insurance Recovery	10,000	11,995
Gain (Loss) on Sale of Assets	-	-
<b>Total Non-Operating Revenue (Expenses)</b>	<u>(255,212)</u>	<u>(280,725)</u>
<b>Income (Loss) Before Capital Contributions</b>	<u>(725,260)</u>	<u>(161,557)</u>
<b>Capital Contributions</b>		
Grant Income	805,102	1,957,531
Capital Contributions	5,565	1,846
<b>Total Capital Contributions</b>	<u>810,667</u>	<u>1,959,377</u>
<b>Change in Net Assets</b>	85,407	1,797,820
<b>Total Net Assets, Beginning</b>	<u>18,604,377</u>	<u>16,806,557</u>
<b>Total Net Assets, Ending</b>	<u>18,689,784</u>	<u>18,604,377</u>

See accompanying notes to the basic financial statements



SOUTHERN WATER AND SEWER DISTRICT  
Statement of Cash Flows  
For the Year Ended December 31, 2014  
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2014	2013
<b>Cash flows from operating activity</b>		
Cash received from customers	\$ 4,668,855	\$ 4,988,404
Cash payments to suppliers for goods and services	(4,130,375)	(4,117,086)
Cash received from deposits	22,323	(72,158)
<b>Net cash provided by operating activities</b>	560,803	799,160
 <b>Cash flows from noncapital financing activities</b>		
Subsidy From Federal and State Grant	810,667	2,111,596
Net Cash Provided (Used) By Noncapital Financing Activities	810,667	2,111,596
 <b>Cash flows from capital and related financing activities</b>		
(Increase ) decrease in Restricted Assets Accounts	(39,854)	(73,282)
Loan Proceeds	25,018	830,223
Bond Proceeds		
Interest Paid	(246,415)	(264,203)
Principle Payment on Notes	(191,827)	(203,946)
Principle Payment on Bonds	(64,981)	(58,605)
Purchase of Utility Plant in Service	(438,835)	(3,098,096)
Purchase of Truck	(35,018)	-
Decrease (Increase) in Consturction in progress	(401,534)	(67,671)
Proceeds from insurance recovery	10,000	11,999
Proceeds on Sale of Assets	-	-
Net cash provided by (used for) capital and related financing activities	(1,383,446)	(2,923,581)
 <b>Cash flows from investing activities</b>		
Proceeds from earnings on investments	449	713
Net cash provided by (used for) investing activities	449	713
 <b>Total increase (decrease) in cash and cash equivalents</b>	(11,527)	(12,112)
 <b>Cash and cash equivalents at beginning of year</b>	18,520	30,632
 <b>Cash and cash equivalents at end of year (Note 2)</b>	\$ 6,993	\$ 18,520

SOUTHERN WATER AND SEWER DISTRICT  
Statement of Cash Flows  
For the Year Ended December 31, 2014  
(with prior year data for comparison purposes only)

	For the Year Ended December 31	
	2014	2013
<b>Reconciliation of Income from operations to net cash provided by operated activities:</b>		
Income from operations	\$ (470,048)	\$ 119,168
Provisions for Bad Debt	(13,167)	(29,796)
<b>Adjustment to reconcile income from operations to net cash provided by operating activities:</b>		
<b>Operating Activities:</b>		
Depreciation and amortization	1,009,229	867,669
<b>Changes in assets and liabilities:</b>		
Decrease (increase) in utility accounts receivable	(63,230)	40,864
Decrease (increase) in prepaid expense	51,276	(427)
Decrease (increase) in material and supplies inventory	4,628	3,637
Increase (decrease) in accounts payable and other payable	17,927	(128,271)
Increase (decrease) in customer deposits	22,323	20,137
Increase (decrease) in un-earned tap fees	-	(92,295)
Increase (decrease) in accrued interest	1,865	(1,526)
<b>Net cash provided by operating activities</b>	<b>\$ 560,803</b>	<b>\$ 799,160</b>
<b>Non-cash operating activities</b>		
Acquisition of Property and Equipment Included in accounts payable	\$ 53,448	\$ 9,081

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

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, 2014 AND 2013

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, 2014 and 2013 is \$257,216 and \$244,050.

**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, 2014 AND 2013

**Note 2 – Restricted Cash Accounts**

The District had the following restricted cash accounts as of December 31, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
KIA Project	\$ 3,240	\$ 18,558
Repair and Maintenance reserve	120,145	100,453
Construction reserve	61,355	7,047
Bond Depreciation Reserve	49,294	96,318
Road Construction Account	29,205	42,939
Deposit Refunds	175,189	153,021
Insurance Reserve	<u>31,671</u>	<u>11,909</u>
Totals	<u>\$ 470,099</u>	<u>\$ 430,245</u>

The amounts held were below the required minimum for 2014 and 2013 for all restricted requirements.

**Note 3 – Prepaid Items**

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

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

Unearned tap fees represent payments from customers for tapping into the Pride on the River Sewer Line. Southern Water started accepting pre – payments to tap into this line during 2011. Customers were able to tap into the new line during the Month of May 2013 and all previously held amounts were recognized as income during 2013. Unearned tap fees being held were \$0 for 2013 and 2014.

**Note 5 – Deposits with Financial Institutions**

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.

As of December 31, 2013, the company had amounts of \$448,765 on deposit with financial institutions with \$250,000 insured by FDIC and \$198,765 insured by pledged US Treasury Bills.

**Note 6 – Subsequent Events**

In preparing these financial statements, the District has evaluated events and transactions for the potential recognition or disclosure through August 17, 2015, the date the financial statements were available to be issued.

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

**Note 7 – Capital and Net Assets**

Changes in contributed capital and net assets during the years ended December 31, 2014 and December 31, 2013.

	Contributed <u>Capital</u>	<u>Reserves</u>	Net Assets <u>(Deficit)</u>	<u>Total</u>
Balance December 31, 2013	<u>\$30,573,719</u>	<u>\$ 20,021</u>	<u>\$(13,787,183)</u>	<u>\$18,806,557</u>
Local Contribution - Floyd County Fiscal				
Federal Grants and Loans	1,794,143			1,794,143
Grant in aid-State Grant Funds	163,388			163,388
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer				
Net Income (Loss)		73,282	(73,282)	
Balance December 31, 2013	<u>\$32,531,250</u>	<u>\$ 93,303</u>	<u>\$(159,711)</u>	<u>(159,711)</u>
Local Contribution - Floyd County Fiscal				
Department of transportation	805,102			805,102
Grant in aid-State Grant Funds				
State Contribution DOT				
Grant in Aid – Fema				
Other				
Transfer				
Net Income (Loss)		39,854	(39,854)	
Balance December 31, 2014	<u>\$33,336,352</u>	<u>\$ 133,157</u>	<u>\$(14,779,725)</u>	<u>\$18,689,784</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 2014 and 2013 was \$17,500 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 \$19,847 and \$7,585 respectively.

**Note 9 – Risk Management**

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

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

**Note 10 – Concentrations of Credit Risk**

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

**Note 11 - 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 2013:

	Balance 01/01/14	Additions	Disposals	Balance 12/31/14
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	482,708	793,085	391,551	884,242
<b>TOTAL ASSETS</b>	<b>\$ 43,240,235</b>	<b>\$ 1,239,533</b>	<b>\$ 391,551</b>	<b>\$ 44,088,217</b>
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:	103,204	1,382	-0-	104,586
Total Accumulated	18,618,961	1,006,770	-0-	19,625,731
<b>Balance – December 31</b>	<b>\$ 24,621,274</b>			<b>\$ 24,462,486</b>

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

**Note 11 - Property and Equipment (Continued)**

The following summarizes the changes to capital assets for 2013:

	Balance <u>01/01/13</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>12/31/13</u>
Land	\$ 195,149	\$ 9,680	\$ -0-	\$ 204,829
Water and Distribution System	37,690,433	4,313,780	-0-	42,004,213
Automotive Equipment	336,433	86,595	25,725	397,303
Furniture, fixtures and Equipment:	144,996	6,186	-0-	151,182
Construction in Progress	<u>2,069,787</u>	<u>67,671</u>	<u>1,654,750</u>	<u>482,708</u>
<b>TOTAL ASSETS</b>	<b>\$ 40,436,798</b>	<b>\$ 4,483,912</b>	<b>\$1,680,475</b>	<b>\$ 43,240,235</b>
Less				
Accumulated Depreciation				
Water Distribution System	17,448,568	832,314	-0-	18,280,882
Automotive Equipment	228,448	32,152	25,725	234,875
Furniture, fixtures and Equipment:	<u>102,461</u>	<u>743</u>	<u>-0-</u>	<u>103,204</u>
Total Accumulated	17,779,477	865,209	25,725	18,618,961
<b>Balance – December 31</b>	<b><u>\$ 22,657,321</u></b>			<b><u>\$ 24,621,274</u></b>

**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>2014</u>	<u>2013</u>
<b>Summary of Short term line of Credit</b>		
6.25% line of credit First Guaranty National Bank interest due monthly. With principal due upon demand	\$ 241,000	\$ 241,000



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

**Note 14 – Notes and Bonds Payable (Continued)**

<b>Summary of Notes Payable</b>	<u>2014</u>	<u>2013</u>
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	\$ 594,171	\$ 644,428
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	37,044	40,374
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	1,538,514	1,634,000
d) First Guaranty Bank, 5.5% installment note monthly payments of \$1,830 including interest final payment 2017	48,598	67,319
A purchase agreement, original balance of \$25,018 At 5.9% interest, secured by vehicle; payments are \$483 for 60 months maturing September 2019	23,933	-0-
e) First Guaranty Bank 7.99 installment note monthly payments of \$1,977 including interest final payment during 2016	40,334	58,392
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	<u>731,126</u>	<u>765,900</u>
<b>Total long – term Notes Payable</b>	<u>\$ 3,013,720</u>	<u>\$ 3,210,413</u>
Less Current maturities	<u>236,030</u>	<u>222,339</u>
Notes Payable less current portion	<u>\$ 2,777,690</u>	<u>\$ 2,988,074</u>

SOUTHERN WATER AND SEWER DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2013 AND 2012

**Note 14 – Notes and Bonds Payable (Continued)**

<b>Summary of Bonds Payable</b>	<u>2014</u>	<u>2013</u>
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.	\$ 2,193,000	\$ 2,232,000
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.	524,471	535,006
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.	202,000	205,500
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>505,000</u>	<u>513,500</u>
<b>Total Long – Term Bonds Payable</b>	<u>\$ 3,424,471</u>	<u>\$ 3,486,006</u>
Less Current maturities	<u>64,981</u>	<u>61,535</u>
Notes Payable less current portion	<u>\$ 3,359,490</u>	<u>\$ 3,424,471</u>

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

**Note 14 – Notes and Bonds Payable (Continued)**

**Note**

Following are maturities of long – term debt as of December 31, 2013:

	<b><u>Principal</u></b>	<b><u>Interest</u></b>
2015	\$ 301,011	\$ 219,386
2016	303,411	208,606
2017	281,501	198,849
2018	281,559	190,238
2019	289,765	182,459
2020-2024	1,564,936	771,251
2025-2029	1,140,513	547,662
2030-2034	825,111	386,759
2035-2039	819,213	227,770
2040-2044	529,171	57,015
2045-2049	<u>102,000</u>	<u>5,118</u>
<b>Total</b>	<b><u>\$ 6,438,191</u></b>	<b><u>\$ 2,995,113</u></b>

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

August 20, 2015

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 of Southern Water and Sewer District, a Kentucky Special District as of and for the year ended December 31, 2014, 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 August 20, 2015.

**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's internal control.

My consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, I identified certain deficiencies in internal control that I consider to be a significant deficiency.

A deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or 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.



I consider the deficiency following to be a significant deficiency.

- 1.) Deposits tested did not come back to the totals shown in the general ledger accounts. Also the miscellaneous revenue report was not appropriately printed.

Views of responsible officials.

Management agrees deposit did not agree to amounts in the general ledger and the miscellaneous revenue report was not appropriately printed and maintained. The report will be printed going forward and cross training and other procedures will be used to ensure this does not happen again.

### **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  
August 20, 2015