SOUTHERN BLACK HILLS WATER SYSTEM, INC.

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT
DECEMBER 31, 2025 AND 2024

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

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KETEL THORSTENSON
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Southern Black Hills Water System, Inc.
Hot Springs, South Dakota

Report on the Financial Statements

Opinion
We have audited the accompanying financial statements of Southern Black Hills Water System, Inc (the System), which comprise the statements of assets, liabilities, and net assets – modified cash basis as of December 31, 2025 and 2024 and the related statements of revenues, expenses, and changes in net assets – modified cash basis, statements of functional expenses – modified cash basis, and statements of cash flows – modified cash basis for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net assets of the System, as of December 31, 2025 and 2024, and its revenues, expenses, and changes in net assets and its cash flows for the years then ended in accordance with the modified cash basis of accounting, as described in Note 1.

Basis for Opinion
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the System and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter Regarding Basis of Accounting
We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements
Management is responsible for the preparation and fair presentation of the financial statements in accordance with the modified cash basis of accounting described in Note 1; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the System's ability to continue as a going concern for a reasonable period of time.

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

Supplementary Information
Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2026 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

Ketel Thorstenson, LLP

KETEL THORSTENSON, LLP
Certified Public Accountants

June 25, 2026

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

STATEMENTS OF ASSETS, LIABILITIES, AND NET ASSETS - MODIFIED CASH BASIS
DECEMBER 31, 2025 AND 2024

ASSETS	2025	2024
Current Assets		
Cash	$ 313,643	$ 18,344
Noncurrent Assets		
Restricted Cash	326,492	311,492
Property and Equipment		
Vehicles and Equipment	233,051	209,498
Water Systems	18,578,836	18,290,119
Less Accumulated Depreciation	4,780,809	4,398,897
	14,031,078	14,100,720
Land	196,630	196,630
Construction in Progress	5,617,711	1,169,780
Net Property and Equipment	19,845,419	15,467,130
TOTAL ASSETS	$ 20,485,554	$ 15,796,966
LIABILITIES AND NET ASSETS		
Current Liabilities		
Current Portion of Long-Term Debt	$ 95,465	$ 79,843
Long-Term Liabilities		
Long-Term Debt, Net of Current Portion	3,950,245	3,045,579
NET ASSETS		
Without Donor Restriction, Board Designated - Debt Service	326,492	311,492
Without Donor Restriction, Unallocated	16,113,352	12,360,052
Total Net Assets	16,439,844	12,671,544
TOTAL LIABILITIES AND NET ASSETS	$ 20,485,554	$ 15,796,966

The accompanying notes are an integral part of these statements.

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS - MODIFIED CASH BASIS
FOR THE YEARS ENDED DECEMBER 31, 2025 AND 2024

	2025	2024
Support and Revenue		
Water Sales	$ 806,545	$ 759,482
Grants	4,037,737	609,802
Legal Settlement	-	150,000
Interest Income	8,471	3,350
Hook Up Fees	73,507	69,667
Total Support and Revenue	4,926,260	1,592,301
Expenses		
Depreciation	381,912	390,224
Payroll and Payroll Taxes	179,266	171,682
Repairs and Maintenance	178,044	113,305
Interest	101,279	101,676
Occupancy	94,608	95,122
Legal	44,120	55,853
Accounting	42,258	40,962
Insurance	41,775	34,551
Transportation and Auto	29,810	17,288
Small Equipment	26,274	31,536
Professional Services	20,504	15,366
Office Expenses	9,677	5,458
Conference and Meeting	8,433	8,080
Total Expenses	1,157,960	1,081,103
Change in Net Assets	3,768,300	511,198
Net Assets -- Beginning of Year	12,671,544	12,160,346
Net Assets -- End of Year	$ 16,439,844	$ 12,671,544

The accompanying notes are an integral part of these statements.

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

STATEMENTS OF FUNCTIONAL EXPENSES - MODIFIED CASH BASIS
FOR THE YEARS ENDED DECEMBER 31, 2025 AND 2024

	Program Services	Management and General	Fundraising	2025 Total
Depreciation	$ 381,912	$ -	$ -	$ 381,912
Payroll and Payroll Taxes	69,932	109,334	-	179,266
Repairs and Maintenance	178,044	-	-	178,044
Interest	101,279	-	-	101,279
Occupancy	79,404	15,204	-	94,608
Legal	-	44,120	-	44,120
Accounting	-	42,258	-	42,258
Insurance	-	41,775	-	41,775
Transportation and Auto	29,810	-	-	29,810
Small Equipment	26,274	-	-	26,274
Professional Services	20,504	-	-	20,504
Office Expenses	-	9,677	-	9,677
Conference and Meeting	-	8,433	-	8,433
TOTAL FUNCTIONAL EXPENSES	$ 887,159	$ 270,801	$ -	$ 1,157,960

	Program Services	Management and General	Fundraising	2024 Total
Depreciation	$ 390,224	$ -	$ -	$ 390,224
Payroll and Payroll Taxes	66,590	105,092	-	171,682
Repairs and Maintenance	113,305	-	-	113,305
Interest	101,676	-	-	101,676
Occupancy	67,701	27,421	-	95,122
Legal	-	55,853	-	55,853
Accounting	-	40,962	-	40,962
Insurance	-	34,551	-	34,551
Transportation and Auto	17,288	-	-	17,288
Small Equipment	31,536	-	-	31,536
Professional Services	15,366	-	-	15,366
Office Expenses	-	5,458	-	5,458
Conference and Meeting	-	8,080	-	8,080
TOTAL FUNCTIONAL EXPENSES	$ 803,686	$ 277,417	$ -	$ 1,081,103

The accompanying notes are an integral part of these statements.

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

STATEMENTS OF CASH FLOWS - MODIFIED CASH BASIS
FOR THE YEARS ENDED DECEMBER 31, 2025 AND 2024

	2025	2024
Cash Flows from Operating Activities		
Change in Net Assets	$ 3,768,300	$ 511,198
Adjustments to Reconcile Change in Net Assets to Net Cash Flows Provided by Operating Activities:		
Depreciation	381,912	390,224
Net Cash Flows Provided by Operating Activities	4,150,212	901,422
Cash Flows Used in Investing Activities		
Purchases of Capital Assets	(4,760,201)	(772,801)
Cash Flows from Financing Activities		
Borrowings on Long-Term Debt	987,685	-
Principal Payments on Long-Term Debt	(67,397)	(77,317)
Net Cash Flows Provided by (Used in) Financing Activities	920,288	(77,317)
Net Increase in Cash and Restricted Cash	310,299	51,304
Cash and Restricted Cash -- Beginning of Year	329,836	278,532
Cash and Restricted Cash -- End of Year	$ 640,135	$ 329,836
Reconciliation of Cash and Restricted Cash:		
Cash	$ 313,643	$ 18,344
Restricted Cash	326,492	311,492
Total Cash and Restricted Cash	$ 640,135	$ 329,836
Supplemental Disclosures of Cash Flow Information		
Cash Paid During the Year for Interest	$ 101,279	$ 101,676

The accompanying notes are an integral part of these statements.

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2025 AND 2024

(1) Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Southern Black Hills Water System, Inc. (the System) is a non-profit organization incorporated in the state of South Dakota. The System's mission is to plan and construct a regional water system with the purpose of providing safe and dependable water to all current and future residents, businesses, and communities of the Southern Black Hills that are in need of water by the most economic and timely means possible.

Basis of Accounting

The financial statements have been prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. The cash basis of accounting involves the measurement of cash and changes in cash resulting from cash receipt and disbursement transactions. Under the cash basis of accounting, transactions are recorded in the accounts when cash is received or disbursed, and assets and liabilities are recognized to the extent that cash has been received or disbursed.

Modifications to the cash basis of accounting implemented by the System in these financial statements are:

1. Recording of property and equipment arising from cash transactions and donations and depreciating those assets where appropriate.
2. Recording of long-term debt arising from cash transactions.
3. Recording of both property and equipment and related long-term debt used to finance the asset acquisition.

As a result of the use of the modified cash basis of accounting, certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid and accrued expenses and liabilities) are not recorded in these financial statements.

Financial Statement Presentation

The System reports information according to two classes of net assets: net assets without donor restriction and net assets with donor restriction.

Net Assets without Donor Restrictions – Net assets of the System not subject to donor-imposed restrictions and are available for general operations. In addition, the Board may designate net assets without donor restrictions for specific purposes.

Net Assets with Donor Restrictions – Net assets of the System subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is when the stipulated time has elapsed, when the purpose for which the resource was restricted has been fulfilled, or both. The System has no net assets with donor restrictions.

Use of Estimates

The preparation of financial statements in conformity with the modified cash basis of accounting requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the related reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2025 AND 2024

(1) Nature of Operations and Summary of Significant Accounting Policies

Summary of Significant Accounting Policies

Cash

The System maintains cash balances that may at times exceed federally insured limits. The System has not experienced any losses in these accounts and does not expect to incur losses in the future.

Property and Equipment

Property and equipment purchases over $5,000 are capitalized at cost. Donated water systems are recorded as contributions and capitalized at the developer's cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

	Years
Vehicles	5
Equipment	5-25
Water Systems	50

Income Taxes

The System is exempt from federal income tax under Section 501(c)(12) of the Internal Revenue Code. At December 31, 2025, the System believes no significant uncertain tax positions or liabilities exist.

Subsequent Events

The System has evaluated subsequent events through June 25, 2026, the date which the financial statements were available for issue.

(2) Long-Term Debt

The following is a summary of the long-term debt:

	2025	2024
USDA Rural Utilities Services Loan 91-01 for Phase I, due in monthly installments of $13,854, interest at 3.25 percent, matures July 2050, secured by a pledge of net water revenue.	$ 2,812,135	$ 2,873,638
USDA Rural Utilities Services Loan 91-03 for Phase II, due in monthly installments of $1,062, interest at 2.75 percent, matures May 2053, secured by a pledge of net water revenue.	245,890	251,784
Drinking Water State Revolving Fund Loan C462432-01, due in quarterly installments of $6,097, interest at 2.125 percent, matures November 2055, secured by a pledge of net water revenue.	540,000	-
Drinking Water State Revolving Fund Loan C462432-02, borrowings up to $1,584,000, matures in 30 years after initial loan amortization, interest at 3.75 interest, due in quarterly installments, secured by a pledge of net water revenue.	447,685	-
	4,045,710	3,125,422
Less Current Portion	95,465	79,843
	$ 3,950,245	$ 3,045,579

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2025 AND 2024

(2) Long-Term Debt

The System has bond reserve and asset management reserve requirements totaling $326,492 at December 31, 2025, in accordance with the debt covenants on both USDA loans. As of December 31, 2025, the System was in compliance with these covenants.

Future principal maturities of long-term debt as of December 31, 2025 are as follows:

2026	$	95,465
2027		98,432
2028		101,493
2029		104,651
2030		107,909
Thereafter		3,537,760
	$	4,045,710

(3) Continuing Operations and Commitments

The ability of the System to continue as a going concern is dependent on State and Federal grants covering future water system costs and water system repairs until sufficient customers are obtained to generate cash flows necessary to meet such obligations. The Board has increased water rates each year and is actively pursuing new revenue sources in order to meet reserve requirements. The System has commitments for future grant and loan funding from state and federal sources totaling approximately $2,188,000 at December 31, 2025 to fund water system expansion. The System has not historically encountered issues in obtaining grant funding when repairs or expansion projects are necessary.

As of December 31, 2025, the System has remaining construction commitments of approximately $2,293,000.

(4) Liquidity and Availability

The System's financial assets available for general expenditure within one year are its cash balance of $313,643 and $18,344 as of December 31, 2025 and 2024, respectively. In the event of unanticipated liquidity issues, the System would adjust water system fees or seek grant or loan funds.

SINGLE AUDIT SECTION

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2025

	Identifying Number	Assistance Listing Number	Amount
U.S. Department of Treasury			
Pass-Through the S.D. Board of Water and Natural Resources:			
Coronavirus State and Local Fiscal Recovery Funds (COVID-19)	2022G-ARP-196	21.027	$ 3,492,630
Total U.S. Department of Treasury			3,492,630
Total Federal Expenditures			$ 3,492,630

Note 1 – Basis of Presentation and Summary of Significant Accounting Policies

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal award activity of the System under programs of the federal government for the year ended December 31, 2025. The information in this Schedule is presented in accordance with the 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). Because the Schedule presents only a selected portion of the operations of the System, it is not intended to and does not present the net assets, changes in net assets, or cash flows of the System.

Expenditures reported on the Schedule are reported on the modified-cash basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Note 2 – Indirect Cost Rate

The System did not elect to use the 15 percent de minimis indirect cost rate as allowed under the Uniform Guidance.

OTHER REPORTS

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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*

To the Board of Directors
Southern Black Hills Water System, Inc.
Hot Springs, South Dakota

We 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 Southern Black Hills Water System, Inc. (the System), which comprise the statements of assets, liabilities, and net assets – modified cash basis as of December 31, 2025, and the related statements of revenues, expenses, and net assets – modified cash basis, functional expenses – modified cash basis, and cash flows – modified cash basis for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated June 25, 2026.

Report on Internal Control over Financial Reporting
In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System'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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified certain deficiencies in internal control, described in the accompanying Schedule of Findings as #2025-001, #2025-002, and #2025-003 that we consider to be material weaknesses.

Report on Compliance and Other Matters
As part of obtaining reasonable assurance about whether the System's financial statements are free from material misstatement, we 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 financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

System's Response to Findings
Government Auditing Standards requires the auditor to perform limited procedures on the System's response to the findings identified in our audit and described in the accompanying Schedule of Findings. The System's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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

Ketel Thorstenson, LLP

KETEL THORSTENSON, LLP
Certified Public Accountants

June 25, 2026

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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 Directors
Southern Black Hills Water System, Inc.
Rapid City, South Dakota

Report on Compliance for Each Major Federal Program

Opinion on Each Major Federal Program

We have audited Southern Black Hills Water System, Inc's (the System) compliance with the types of compliance requirements identified as subject to audit in the OMB *Compliance Supplement* that could have a direct and material effect on each of the System's major federal programs for the year ended December 31, 2025. The System's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings.

In our opinion, the System complied, in all material respects, with the 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, 2025.

Basis for Opinion on Each Major Federal Program

We conducted our 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). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of System and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination of the System's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to System's federal programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on System's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards, *Government Auditing Standards,* and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material, if there is a substantial likelihood that, individually, or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the System's compliance with the requirements of each major federal program as a whole.

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

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the System's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of the System's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances 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 the System's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we did identify certain deficiencies in internal control over compliance that we consider to be a material weakness and a significant deficiency.

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 a 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. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings as #2025-001 to be a material weakness.

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. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings as #2025-004 to be a significant deficiency.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

Government Auditing Standards requires the auditor to perform limited procedures on the System's response to the internal control over compliance findings identified in our compliance audit described in the accompanying Schedule of Findings. The System's response was not subjected to the other auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our 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.

Ketel Thorstenson, LLP

KETEL THORSTENSON, LLP
Certified Public Accountants

June 25, 2026

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

SCHEDULE OF FINDINGS
DECEMBER 31, 2025

A. SUMMARY OF AUDIT RESULTS

1. The Independent Auditor's Report expresses an unmodified opinion on all of the financial statements of the System.

2. Material weaknesses disclosed during the audit of the financial statements are reported in the 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*.

3. No instances of noncompliance material to the financial statements of the System were disclosed during the audit.

4. A material weakness and significant deficiency disclosed during the audit of the major federal award program are reported in the Independent Auditor's Report on Compliance for Each Major Federal Program and on Internal Control over Compliance Required by the Uniform Guidance.

5. The auditor's report on compliance for the major federal award programs for the System expresses unmodified opinions on all major programs, as listed in #7.

6. Audit findings relative to the major federal award program for the System are reported in Part C of this schedule.

7. The program tested as a major program was the Coronavirus State and Local Fiscal Recovery Funds (ALN #21.027).

8. The threshold for distinguishing types A and B programs was $1,000,000.

9. The System was not determined to be a low risk auditee.

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

SCHEDULE OF FINDINGS
DECEMBER 31, 2025

B. FINDINGS – FINANCIAL STATEMENT AUDIT

Material Weaknesses

Finding #2025-001: Financial Statement and Schedule of Expenditures of Federal Awards (SEFA) Preparation

Federal Program Affected: Coronavirus State and Local Fiscal Recovery Funds, ALN #21.027

Compliance Requirement: Reporting

Questioned Costs: None

Condition and Cause: As a matter of practicality and efficiency, we have assisted in drafting the financial statements and SEFA, in both form and content, based on information provided by management during the audit.

Criteria and Effect: Management and those charged with governance are ultimately responsible for preparing and presenting the financial statements and SEFA in accordance with the applicable financial reporting framework. The auditor's responsibility for the financial statements and SEFA is to express an opinion on them based on the audit evidence obtained.

Repeat Finding from Prior Year: Yes, prior year finding #2024-001.

Recommendation: Management and if applicable, governance, should review the financial statements and SEFA for accuracy of account balances and context of note disclosures. Management and governance should inquire of the auditors about any balances or disclosures which management does not understand or cannot reconcile to internal records prior to signing the management representation letter.

Response/Corrective Action Plan: The System agrees with the above Finding. See Corrective Action Plan.

Finding #2025-002: Audit Adjustments

Federal Program Affected: None

Compliance Requirement: Not applicable

Questioned Costs: None

Condition and Cause: During the course of our engagement, we proposed material audit adjustments.

Criteria and Effect: These adjustments were not identified as a result of the System's existing internal controls, and therefore, could have resulted in a material misstatement of the System's financial statements.

Repeat Finding from Prior Year: Yes, prior year finding #2024-002.

Recommendation: We recommend the following:
- Remove accounts payable and payroll accruals to reflect the modified cash basis of accounting.
- Record appropriate principal portion of debt payments against the liability balance and interest expense.
- Depreciation expense should be recorded and agreed to the depreciation schedule each year.
- Reconcile grant funding received against the balance recorded in the general ledger.

Views of Responsible Officials: See System's Corrective Action Plan

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

SCHEDULE OF FINDINGS
DECEMBER 31, 2025

B. FINDINGS – FINANCIAL STATEMENT AUDIT

Material Weaknesses

<u>Finding #2025-003: Lack of Segregation of Duties</u>

Federal Program Affected: None

Compliance Requirement: Not applicable

Questioned Costs: None

Condition and Cause: The System has a general lack of segregation of duties due to the limited number of staff. More specifically:

- Bank reconciliations are prepared monthly but not reviewed in detail. Additionally, bank statements are not reviewed in detail.
- Reconciliations are not performed between monthly billings and cash receipts.
- Customer payments are received by an independent consultant who also handles the billings and can adjust customer accounts.
- Journal entries were not properly reviewed.

Criteria and Effect: This deficiency could result in a material misstatement to the financial statements that would not be prevented or detected by the System's management.

Repeat Finding from Prior Year: Yes, prior year finding #2024-003.

Recommendation: We recommend the following:

- Bank reconciliations should be reviewed each month after preparation to ensure the general ledger balance for cash agrees to the balance used in the reconciliation process. Additionally, bank statements should be reviewed by the Manager to verify the propriety of vendors and any potential electronic transactions.
- Although the System operates on the modified cash basis of accounting, a reconciliation should be performed monthly to ensure the billings agree to cash receipts.
- Customer payments should be received at the System's office and not deposited by the independent consultant who handles the meter reading, billing, and can adjust the customer account balances.
- Journal entries should be reviewed by the Manager when reviewing monthly activity.

Views of Responsible Officials: See System's Corrective Action Plan

SOUTHERN BLACK HILLS WATER SYSTEM, INC.

SCHEDULE OF FINDINGS
DECEMBER 31, 2025

C. FINDINGS AND QUESTIONS COSTS – MAJOR FEDERAL PROGRAMS AUDIT

See Finding 2025-001 above.

Significant Deficiency

Finding #2025-04: Written Uniform Guidance Policies

Federal Program Affected: Coronavirus State and Local Fiscal Recovery Funds, ALN #21.027

Compliance Requirement: Allowable Cost, Activities Allowed/Unallowed, and Procurement

Questioned Costs: None

Condition and Cause: The System does not have written Uniform Guidance policies related to federal grant compliance.

Criteria and Effect: Uniform Guidance specifically requires entities to maintain written policies. Not properly maintaining such policies leads to noncompliance and potential unallowable costs.

Repeat Finding from Prior Year: No

Recommendation: The System should create written Uniform Guidance policies specific to administering federal funds.

Views of Responsible Officials: See System's Corrective Action Plan

MANAGEMENT RESPONSE

SOUTHERN BLACK HILLS WATER SYSTEM

SOUTHERN BLACK HILLS WATER SYSTEM
26858 Highway 385
Hot Springs, South Dakota 57747
Phone 605-745-4669

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
DECEMBER 31, 2025

Southern Black Hills Water System, Inc. respectfully submits the following summary schedule of prior audit findings from the December 31, 2024, Schedule of Findings. The findings are numbered consistently with the numbers assigned in the 2024 Schedule of Findings.

Finding #2024-001: Financial Statement Preparation

Status: It is more cost effective for the System to hire Ketel Thorstenson, LLP, a public accounting firm, to prepare the full disclosure financial statements as a part of the annual audit process. The System will review the draft financial statements and accompanying notes to the financial statements.

Initial Year Report: Ongoing

Reasons for Recurrence and Corrective Action Plan: The System is satisfied that appropriate actions have been taken to allow them to take responsibility for the financial statements prepared by the auditors. The finding will be repeated in 2025, see Corrective Action Plan.

Finding #2024-002: Audit Adjustments

Status: The System processes debt and capital asset activity on a cash basis.

Initial Year Report: Ongoing

Reasons for Recurrence and Corrective Action Plan: The Southern Black Hills Water System reviews, approves and posts all audit adjustments.

Finding #2024-003: Lack of Segregation of Duties

Status: The System has a general lack of segregation of duties due to the continued limited number of staff.

Initial Year Report: Ongoing

Reasons for Recurrence and Corrective Action Plan: It is not cost effective for the Southern Black Hills Water System Board of Directors to hire more staff.

SOUTHERN BLACK HILLS WATER SYSTEM

SOUTHERN BLACK HILLS WATER SYSTEM
26858 Highway 385
Hot Springs, South Dakota 57747
Phone 605-745-4669

CORRECTIVE ACTION PLAN
DECEMBER 31, 2025

Southern Black Hills Water System, Inc. respectfully submits the following corrective action plan regarding findings from the December 31, 2025 Schedule of Findings. The findings are numbered consistently with the numbers assigned in the 2025 Schedule of Findings.

<u>Finding #2025-001: Financial Statement and Schedule of Expenditures of Federal Awards (SEFA) Preparation</u>

Responsible Individuals: Don Peterson, System Manager

Corrective Action Plan: Management of the System has reviewed the financial statements and schedule of expenditures of federal awards (SEFA) prepared by Ketel Thorstenson, LLP. The financial statements and SEFA have been compared and reconciled to the internal records maintained by the System. Management and the Board of Directors has been given adequate opportunity to ask questions regarding the financials statements and note disclosures and have received sufficient responses from the auditors prior to final publication of the audited financial statements and SEFA. Management is satisfied that appropriate actions have been taken to allow them to take responsibility for the financial statements.

Anticipated Completion Date: Ongoing

<u>Finding #2025-002: Audit Adjustments</u>

Responsible Individuals: Don Peterson, System Manager

Corrective Action Plan: The Southern Black Hills Water System staff will work on audit adjustments.

Anticipated Completion Date: Ongoing

<u>Finding #2025-003: Lack of Segregation of Duties</u>

Responsible Individuals: Don Peterson, System Manager

Corrective Action Plan: At this time, the System will accept the degree of risk that is associated with this condition. It is not cost effective for the Southern Black Hills Water System Board of Directors to hire more staff.

Anticipated Completion Date: Ongoing

<u>Finding #2025-004: Written Uniform Guidance Policies</u>

Responsible Individuals: Don Peterson, System Manager

Corrective Action Plan: The System is working on developing written Uniform Guidance policies.

Anticipated Completion Date: Ongoing