

**EAST PENDLETON COUNTY
WATER DISTRICT
Falmouth, Kentucky**

**FINANCIAL STATEMENTS
December 31, 2015**

CONTENTS

Independent Auditors' Report.....	1-2
Financial Statements	
Statement of Net Position	3
Statement of Revenues, Expenses and Changes in Net Position	4
Statement of Cash Flows	5
Notes to Financial Statements	6-14
Required Supplementary Information	
Schedule of Proportionate Share of the Net Pension Liability	15
Schedule of Contributions	16
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with <i>Government Auditing Standards</i>	17-19



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
East Pendleton County Water District
Falmouth, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the East Pendleton County Water District (the District) as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we 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 auditors' 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, we 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.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the East Pendleton County Water District, as of December 31, 2015, and the changes in financial position, and 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 pension schedules on pages 15-16 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. We and other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the Management Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 27, 2016, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 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 District's internal control over financial reporting and compliance.

RFH

RFH, PLLC
June 27, 2016

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2015

ASSETS

Current assets	
Cash	\$ 251,550
Customer accounts receivable, net	82,596
Inventory	<u>16,827</u>
Total current assets	<u>350,973</u>
Restricted assets	
Cash	222,914
Cash - construction	44,848
Certificates of deposit	<u>254,620</u>
Total restricted assets	<u>522,382</u>
Capital assets	
Property, plant and equipment- Water	7,184,181
Less: accumulated depreciation- Water	(3,301,700)
Property, plant and equipment- Sewer	34,952
Less: accumulated depreciation- Sewer	<u>(27,361)</u>
Total capital assets	<u>3,890,072</u>
Total assets	<u>4,763,427</u>
DEFERRED OUTFLOWS OF RESOURCES	
Deferred outflows - pension	<u>77,185</u>
Total assets and deferred outflows of resources	<u>\$ 4,840,612</u>

LIABILITIES

Current liabilities	
Accounts payable	\$ 27,727
Taxes payable	4,266
Customer deposits	38,630
Accrued interest payable	1,456
Current portion of debt	<u>91,138</u>
Total current liabilities	<u>163,217</u>
Noncurrent liabilities	
Net pension liability	524,772
KIA notes payable	148,702
Bonds payable, net	<u>1,021,100</u>
Total noncurrent liabilities	<u>1,694,574</u>
Total liabilities	<u>1,857,791</u>

DEFERRED INFLOWS OF RESOURCES

Defeasance on refunding	16,822
Deferred inflows - pension	<u>19,031</u>
Total deferred inflows of resources	<u>35,853</u>

NET POSITION

Net investment in capital assets	2,629,132
Restricted for debt service	248,890
Restricted for depreciation	228,644
Unrestricted	<u>(159,698)</u>
Total net position	<u>2,946,968</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 4,840,612</u>

The accompanying notes are an integral part of the financial statements.

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
for the year ended December 31, 2015

OPERATING INCOME	
Water sales	\$ 1,062,411
Sewer sales	20,124
Other revenue	<u>28,768</u>
Total operating income	<u>1,111,303</u>
OPERATING EXPENSES	
Water purchases	216,873
Pumping	26,692
Operation	216,977
Maintenance	7,758
General and administrative	325,090
Sewer expenses	<u>14,021</u>
Total operating expense	<u>807,411</u>
Operating income before depreciation	303,892
Depreciation expense	<u>(108,370)</u>
OPERATING INCOME	195,522
Non-operating income (expense)	
Interest income	2,170
Interest expense related to debt	<u>(81,499)</u>
Total non-operating income (expense)	<u>(79,329)</u>
INCOME BEFORE CAPITAL CONTRIBUTIONS	116,193
Capital contributions	
Tap fees	<u>14,223</u>
Change in net position	130,416
Net position, beginning of year, as restated	<u>2,816,552</u>
NET POSITION, END OF YEAR	<u>\$ 2,946,968</u>

The accompanying notes are an integral
part of the financial statements.

EAST PENDLETON COUNTY WATER DISTRICT
STATEMENT OF CASH FLOWS
for the year ended December 31, 2015

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers	\$ 1,106,459
Payments to suppliers	(360,115)
Payments for employee services and benefits	<u>(408,033)</u>
Net cash provided by operating activities	<u>338,311</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Retirement of debt principal	(1,083,764)
Interest paid	(98,444)
Proceeds from issuance of bond	895,000
Purchase of fixed assets	(121,488)
Tap fees	<u>14,223</u>
Net cash (used in) capital and related financing activities	<u>(394,473)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Investment in certificates of deposit	(1,451)
Interest income	<u>2,170</u>
Net cash provided by investing activities	<u>719</u>
NET (DECREASE) IN CASH	(55,443)
Cash, beginning of year	<u>574,755</u>
CASH, END OF YEAR	<u><u>\$ 519,312</u></u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 195,522
Noncash items included in operating income	
Depreciation	108,370
Defeasance on refunding	17,403
Changes in assets and liabilities	
(Increase) decrease in accounts receivables	(4,844)
(Increase) decrease in inventory	1,873
Increase (decrease) in accounts payable	(2,682)
Increase (decrease) in other payables	135
Increase (decrease) in customer deposits	3,265
Increase (decrease) in net pension liability	<u>19,269</u>
Net cash provided by operating activities	<u><u>\$ 338,311</u></u>
Supplemental disclosure of cash flow information	
Non-cash capital and related financing information:	
Fixed asset additions accrued as accounts payable	<u>\$ 541</u>
Defeasance on debt refunding	<u>\$ 17,403</u>
Amortization of defeasance on refunding	<u><u>\$ 581</u></u>
Components of cash on the Statement of Net Position	
Cash	\$ 251,550
Restricted cash	222,914
Construction	<u>44,848</u>
	<u><u>\$ 519,312</u></u>

The accompanying notes are an integral part of the financial statements.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015

1. ORGANIZATION AND ACCOUNTING POLICIES

The East Pendleton County Water District (the District) was created and organized as a public body incorporated in Pendleton County, Kentucky, pursuant to Chapter 74 of the Kentucky Revised Statutes, by the Pendleton County Fiscal Court to operate a water distribution system.

Reporting Entity

The East Pendleton County Water District's financial statements include the operations of all entities for which the District exercises oversight responsibility. Oversight responsibility includes, but is not limited to, financial interdependency, selection of the governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters.

There are no other entities that are subject to the District's oversight responsibility as indicated above.

Basis of Accounting

The net position of the District is classified into three categories; net investment in capital assets, restricted and unrestricted. The restricted net assets consist of reserves for bond retirement and depreciation costs relating to the construction, replacement, extension, additions and/or improvements to the system in addition to customer deposits. These reserves are discussed in Note 5.

When both restricted and unrestricted resources are available for use, the District's Board of Commissioners makes a determination as to which resource should be used first.

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

The District reports all revenues and expenses as operating, except interest income, interest expense, amortization, gains and losses on disposal of assets, and capital contributions.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the District defines cash as cash on hand, cash in bank, money market funds in both unrestricted and restricted accounts, and certificates of deposit with an initial maturity of less than 90 days.

Accounts Receivable

The District's accounts receivable reserve represents its estimate of all uncollectible accounts. The reserve at December 31, 2015 totaled \$3,500.

Inventory

The District's inventory is composed of chemicals, equipment and supply-type items used for routine maintenance, repairs and new water lines. The inventory is stated at the lower of cost (first-in, first-out method) or market.

EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015

1. ORGANIZATION AND ACCOUNTING POLICIES (CONTINUED)

Property and Equipment

Fixed assets are recorded at cost. Depreciation has been provided using the straight-line method over the estimated useful life of the asset, which ranges from 7 - 62.5 years. Land and land rights are not subject to depreciation. Interest costs during construction of fixed assets are capitalized as a part of the cost.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Management's Review of Subsequent Events

The District has evaluated and considered the need to recognize or disclose subsequent events through June 27, 2016, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the year ended December 31, 2015, have not been evaluated by the District.

2. CASH AND INVESTMENTS

Under Kentucky Revised Statute 66.480 the District is allowed to invest in obligations of the U.S. Treasury and U.S. agencies, obligations of the Commonwealth of Kentucky and its agencies, insured savings and loans, or interest bearing deposits of insured national or state banks.

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. In order to anticipate market changes and provide a level of security for all funds, the collateralization level shall be one hundred percent of the market value of the principal, plus accrued interest.

The District's deposits and investments at December 31, 2015 were entirely covered by Federal Depository Insurance or by collateral held by the custodial banks in the District's name.

The table presented below is designed to disclose the level of custody credit risk assumed by the District, based upon how its deposits were insured or secured with collateral at December 31, 2015. The categories of credit risk are defined as follows:

- (1) Insured or collateralized with securities held by the government or by its agent in the government's name.
- (2) Collateralized with securities held by the pledging financial institution's trust department or agent in the government's name.
- (3) Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the government's name.

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

2. CASH AND INVESTMENTS (CONTINUED)

Type of Deposit	Category			Total Bank Amount	Total Carrying Amount
	1	2	3		
Cash	\$ 519,150	\$ -	\$ -	\$ 519,150	\$ 519,312
Certificates of deposit	<u>254,620</u>	<u>-</u>	<u>-</u>	<u>254,620</u>	<u>254,620</u>
	<u>\$ 773,770</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 773,770</u>	<u>\$ 773,932</u>

3. CAPITAL ASSETS

The following is a summary of capital asset activity during the year:

	Balance 12/31/2014	Additions	Disposals	Balance 12/31/2015
Capital assets not depreciated:				
Organizational costs	\$ 7,200	\$ -	\$ -	\$ 7,200
Water land	16,157	-	-	16,157
Sewer land	<u>1,168</u>	<u>-</u>	<u>-</u>	<u>1,168</u>
Totals	<u>24,525</u>	<u>-</u>	<u>-</u>	<u>24,525</u>
Capital assets being depreciated:				
Water property and equipment	7,038,795	122,029	-	7,160,824
Sewer property and equipment	<u>33,784</u>	<u>-</u>	<u>-</u>	<u>33,784</u>
Totals	7,072,579	122,029	-	7,194,608
Less: accumulated depreciation	<u>3,220,691</u>	<u>108,370</u>	<u>-</u>	<u>3,329,061</u>
Net depreciable assets	<u>3,851,888</u>	<u>13,659</u>	<u>-</u>	<u>3,865,547</u>
Total capital assets, net	<u>\$ 3,876,413</u>	<u>\$ 13,659</u>	<u>\$ -</u>	<u>\$ 3,890,072</u>

Depreciation expense totaled \$108,370 for the year ended December 31, 2015.

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

4. LONG-TERM DEBT

The following is a summary of the bonds and notes outstanding for the District for the year ended December 31, 2015:

Bonds and Notes

Kentucky Infrastructure Authority Loan - \$244,590 and restructured to \$155,000, dated 4/28/98 and restructured 08/01/04 with payments through 2017, bearing interest at rates from 3.1% - 5.25%.	\$ 22,500
USDA, Rural Development Bond – \$195,000, dated 2/22/07 with payments through 2042, bearing interest at a rate of 4.125%.	172,300
USDA, Rural Development Bond – \$100,000, dated 2/22/07 with payments through 2044, bearing interest at a rate of 4.125%.	88,500
Kentucky Infrastructure Authority Loan - \$160,000 Dated 2/22/07 with payments through 2044, bearing interest at a rate of 4.125%.	147,640
Kentucky Rural Water Finance Corporation Bond - \$895,000, dated 2/19/2015 with payments through 2041, bearing interest at 2.25 – 3.625%.	<u>830,000</u>
	1,260,940
Less: current portion of debt	<u>(91,138)</u>
Long-term debt	<u>\$ 1,169,802</u>

The annual requirements to amortize all bonds and notes outstanding as of December 31, 2015 are as follows:

Year Ending December 31,	Principle	Interest	Payment
2016	\$ 91,138	\$ 39,164	\$ 130,302
2017	83,917	36,729	120,646
2018	76,900	35,513	112,413
2019	82,288	33,548	115,836
2020	82,781	31,561	114,342
2021-2025	375,301	119,474	494,775
2026-2030	133,409	77,429	210,838
2031-2035	142,706	53,601	196,307
2036-2040	134,000	28,371	162,371
2041-2044	<u>58,500</u>	<u>6,475</u>	<u>64,975</u>
	<u>\$ 1,260,940</u>	<u>\$ 461,865</u>	<u>\$ 1,722,805</u>

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

4. LONG-TERM DEBT (CONTINUED)

The following is a summary of changes in long-term debt and net pension liability:

	December 31, 2014	Additions	Retirements	December 31, 2015	Due Within One Year
Net pension liability \$	420,000	\$ 104,772	\$ -	\$ 524,772	\$ -
Long-term debt	<u>1,449,704</u>	<u>895,000</u>	<u>(1,083,764)</u>	<u>1,260,940</u>	<u>91,138</u>
	<u>\$ 1,869,704</u>	<u>\$ 999,772</u>	<u>\$ (1,083,764)</u>	<u>\$ 1,785,712</u>	<u>\$ 91,138</u>

5. COMPLIANCE WITH BOND RESOLUTIONS

The bond resolution requires the District to maintain certain reserves as follows:

Reserve Fund – This reserve is to receive a monthly transfer of \$483 until a balance of \$58,000 is accumulated for all bond issues. In addition, this reserve is to receive all proceeds collected from potential customers to aid construction of extensions and any insurance proceeds from property damage. Funds may be used only for the purpose of paying the cost of unusual or extraordinary maintenance and repairs not included in the budget and cost of constructing extensions or improvements to the system. The Reserve Fund balance totaled \$227,844 at December 31, 2015.

Bond and Interest Sinking Fund – This reserve is to receive a monthly transfer of 1/12 of the next interest due and 1/12 of the next principal due. In addition, this reserve is to receive any excess revenues at the close of each year after provision of anticipated operating expenses for a two-month period. This reserve can only be used to pay debt service on the bond issues. The Bond and Interest Sinking Fund balances totaled \$248,890 at December 31, 2015.

Maintenance and Replacement Reserve – This reserve is to receive an amount equal to ten percent of the amount of loan payments until the amount on deposit is equal to five percent of the original principal amount of the loan. Funds may be used for extraordinary maintenance expenses related to the water tank painting project or for the costs of replacing worn or obsolete portions of the project. At December 31, 2015 the required balance in this reserve was \$800, and the Maintenance and Replacement Reserve totaled \$800.

6. LEASE COMMITMENTS

The District leases office equipment under a non-cancellable operating lease agreement. Rental expense for the years ended December 31, 2015 was \$1,665. Future minimum lease payments including applicable taxes and fees for operating leases at December 31, 2015 are as follows:

December 31,	
2016	\$ 1,546
2017	<u>258</u>
Total lease payments	<u>\$ 1,804</u>

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

7. RETIREMENT PLAN

The East Pendleton County Water District is a participating employer of the County Employees' Retirement System (CERS). Under the provisions of Kentucky Revised Statute 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS. The plan issues publicly available financial statements which may be downloaded from the Kentucky Retirement Systems website.

Plan Description – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of state legislature.

Contributions – For the year ended December 31, 2015, plan members were required to contribute 5.00% of wages for non-hazardous job classifications. Employees hired after September 2008 were required to contribute an additional 1% to cover the cost of medical insurance that is provided through CERS. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.5455(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended December 31, 2015, participating employers contributed 17.67% through June 30 and 17.06% thereafter, of each non-hazardous employee's wages, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

Plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own account. Plan members contribute 5.00% of wages to their own account and 1% to the health insurance fund. The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of each member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. For non-hazardous members, their account is credited with a 4% employer pay credit. The employer pay credit represents a portion of the employer contribution.

The District contributed \$41,578 for the year ended December 31, 2015, or 100% of the required contribution. The contribution was allocated \$30,001 to the CERS pension fund and \$11,577 to the CERS insurance fund.

Benefits – CERS provides retirement, health insurance, death and disability benefits to Plan employees and beneficiaries. Employees are vested in the plan after five years' service. For retirement purposes, employees are grouped into three tiers based on hire date:

Tier 1	Participation date Unreduced retirement Reduced retirement At least	Before September 1, 2008 27 years service or 65 years old At least 5 years service and 55 years old 25 years service and any age
Tier 2	Participation date Unreduced retirement Reduced retirement	September 1, 2008 - December 31, 2013 At least 5 years service and 65 years old or age 57+ and sum of service years plus age equal 87 At least 10 years service and 60 years old
Tier 3	Participation date Unreduced retirement Reduced retirement	After December 31, 2013 At least 5 years service and 65 years old or age 57+ and sum of service years plus age equal 87 Not available

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

7. RETIREMENT PLAN (CONTINUED)

Cost of living adjustments are provided at the discretion of the General Assembly. Retirement is based on a factor of the number of years' service and hire date multiplied by the average of the highest five years' earnings. Reduced benefits are based on factors of both of these components. Participating employees become eligible to receive the health insurance benefit after at least 180 months of service. Death benefits are provided for both death after retirement and death prior to retirement. Death benefits after retirement are \$5,000 in lump sum. Five years' service is required for death benefits prior to retirement and the employee must have suffered a duty-related death. The decedent's beneficiary will receive the higher of the normal death benefit and \$10,000 plus 25% of the decedent's monthly final rate of pay and any dependent child will receive 10% of the decedent's monthly final rate of pay up to 40% for all dependent children. Five years' service is required for nonservice-related disability benefits.

Pension Liabilities, Expense, Deferred Outflows of Resources and Deferred Inflows of Resources – At December 31, 2015, the District reported a liability of \$524,772 or its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At December 31, 2015, the District's proportion was .012205 percent, which was equal to its proportion measured as of June 30, 2015. At June 30, 2015, the District's proportion was .012205 percent, which was a decrease of .000738% from its proportion measured as of June 30, 2014.

For the year ended December 31, 2015, the District recognized pension expense of \$51,459. At December 31, 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual results	\$ 4,361	\$ -
Changes of assumptions	52,917	-
Net difference between projected and actual earnings on Plan investments	4,704	-
Changes in proportion and differences between Company contributions and proportionate share of contributions	-	19,031
Company contributions subsequent to the measurement date	15,202	-
Total	\$ 77,185	\$ 19,031

The \$15,202 of deferred outflows of resources resulting from the District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year ending December 31,			
2017	\$	13,477	
2018		13,477	
2019		6,010	
2020		9,987	

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

7. RETIREMENT PLAN (CONTINUED)

Actuarial Assumptions – The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	4.00%, average, including inflation
Investment rate of return	7.50%, net of Plan investment expense, including inflation

Mortality rates were based on the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP- 2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years. Several factors are considered in evaluating the long-term rate of return assumptions including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer time frame. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

The target allocation and best estimates of nominal real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-term Nominal Real Rate of Return
Combined Equity	44%	5.4%
Combined Fixed Income	19%	1.5%
Real Return (Diversified Inflation Strategies)	10%	3.5%
Real Estate	5%	4.5%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.5%
Cash Equivalent	<u>2%</u>	-.25%
Total	<u>100%</u>	

Discount Rate – The discount rate used to measure the total pension liability was 7.50 percent. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 28 year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period. The discount rate does not use a municipal bond rate.

**EAST PENDLETON COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2015**

7. RETIREMENT PLAN (CONTINUED)

Sensitivity of the District's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate
– The following presents the District's proportionate share of the net pension liability calculated using the discount rate of 7.50 percent, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.50 percent) or 1-percentage-point higher (8.50 percent) than the current rate:

	Discount rate		District's proportionate share of net pension liability
1% decrease	6.50%	\$	669,937
Current discount rate	7.50%	\$	524,772
1% increase	8.50%	\$	400,452

Payable to the Pension Plan – At December 31, 2015, the District reported a payable of \$5,797 for the outstanding amount of contributions to the pension plan required for the year ended December 31, 2015. The payable includes both the pension and insurance contribution allocation.

8. RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the District also carries commercial insurance for all other risks of loss such as worker's compensation and employee health and accident coverage. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

9. RESTATEMENT OF NET POSITION

Implementation of new accounting standard GASB Statement No. 68

During 2015 the District implemented GASB Statement No. 68, Accounting and Financial Reporting for Pensions, which addresses financial reporting for state and local government employers whose employees are provided with pensions through pension plans that are covered under Statement No. 67, Financial Reporting for Pension Plans.

The guidance contained in Statement 68 changed how governments calculate and report the costs and obligations associated with pensions. Under the new standards GASB requires that cost-sharing governments report a net pension liability, pension expense, and pension related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan. In addition, GASB requires Statement 68 to be applied retroactively, which has resulted in a restatement of beginning net position as follows:

Net position, at beginning of year		\$ 3,263,901
Beginning net pension liability		<u>(447,349)</u>
Net position, at beginning of year, as restated		<u>\$ 2,816,552</u>

REQUIRED SUPPLEMENTARY INFORMATION

**EAST PENDLETON COUNTY WATER DISTRICT
REQUIRED SUPPLEMENTARY SCHEDULE OF
PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
Last Two Fiscal Years***

	2015	2014
District's proportion of the net pension liability	0.012205%	0.012943%
District's proportionate share of the net pension liability (asset)	\$ 524,772	\$ 420,000
District's covered employee payroll	\$ 239,531	\$ 301,368
District's share of the net pension liability (asset) as a percentage of its covered employee payroll	219.08%	139.36%
Plan fiduciary net position as a percentage of the total pension liability	59.97%	66.80%

Notes:

There were no changes in benefit terms. However, the following changes in assumptions were modified as of the June 30, 2015 valuation:

The assumed investment rate of return was decreased from 7.75% to 7.5%.

The assumed rate of inflation was reduced from 3.5% to 3.25%.

**EAST PENDLETON COUNTY WATER DISTRICT
REQUIRED SUPPLEMENTARY SCHEDULE OF
CONTRIBUTIONS
Last Three Fiscal Years***

	2015	2014	2013
Contractually required employer contribution	\$ 30,001	\$ 40,040	\$ 36,629
Contributions relative to contractually required employer contribution	<u>\$ 30,001</u>	<u>\$ 40,040</u>	<u>\$ 36,629</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
District's covered employee payroll	\$ 239,531	\$ 301,368	\$ 295,298
Employer contributions as a percentage of covered-employee payroll	12.52%	13.29%	12.40%

Notes:

There were no changes in benefit terms. However, the following changes in assumptions were modified as of the June 30, 2015 valuation:

The assumed investment rate of return was decreased from 7.75% to 7.5%.

The assumed rate of inflation was reduced from 3.5% to 3.25%.

The assumed rate of wage inflation was reduced from 1% to .75%.

Payroll growth assumption was reduced from 4.5% to 4%.

Mortality rates were based on the RP-2000 Combined Mortality Table projected with

Scale BB to 2013 (multiplied by 50% for males and 30% for females).

For healthy retired members and beneficiaries, the mortality table used is the RP-2000

Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females).

For disabled members, the RP- 2000 Combined Disabled Mortality Table projected with

Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement.

The assumed rates of retirement, withdrawal, and disability were updated to more accurately reflect experience.

Contractually required employer contributions exclude the portion of contributions paid to CERS but allocated to the insurance fund of the CERS. The above contributions only include those contributions allocated directly to the CERS pension fund.



**INDEPENDENT AUDITORS' 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 Commissioners
East Pendleton County Water District
Falmouth, Kentucky

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 the East Pendleton County Water District (the District), as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated June 27, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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. However, as described in the accompanying schedule of findings and responses, we identified a certain deficiency in internal control that we consider to be a material weakness.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness (2015-001).

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 to those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the East Pendleton County Water District'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 determination of financial statement amounts. 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*.

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 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 purpose.

RFH

RFH, PLLC
June 27, 2016

**EAST PENDLETON COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
December 31, 2015**

FINDING 2015-001 (recurring)

CRITERIA:

The District is required to have internal controls in place that enable it to prepare complete financial statements, including note disclosures, in compliance with generally accepted accounting principles.

CONDITION:

The District lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures.

CAUSE:

Management engaged the auditor to prepare draft financial statements, including the related notes to the financial statements. Management reviewed, approved and accepted responsibility for the financial statements prior to their issuance.

RECOMMENDATION:

We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements and ensure compliance with generally accepted accounting principles.

RESPONSE:

This is an ongoing finding. Management has determined that it is more cost effective to continue to engage the auditor to draft the financial statements and related notes.