

MORGAN COUNTY WATER DISTRICT

AUDIT OF FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

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Independent Auditors' Report

To the Board of Directors
Morgan County Water District
West Liberty, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Morgan County Water District, as of and for the years ended December 31, 2016 and 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 auditors consider 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.

To the Board of Directors
Morgan County Water District
West Liberty, Kentucky

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Morgan County Water District, as of December 31, 2016 and 2015, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As described in Note K to the financial statements, in 2015, Morgan County Water District adopted the new accounting guidance, GASB Statement 68, Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule of the District's Proportionate Share of the Net Pension Liability and the Schedule of the Districts' Contributions listed in the table of contents 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 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's 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.

To the Board of Directors
Morgan County Water District
West Liberty, Kentucky

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 26, 2017, 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.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

April 26, 2017

MORGAN COUNTY WATER DISTRICT
STATEMENTS OF NET POSITION
December 31, 2016 and 2015

| | 2016 | 2015 |
|---|----------------|----------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash - Unrestricted | \$ 5,495 | \$ 22,267 |
| Cash - Restricted | 105,771 | 169,136 |
| Accounts Receivable | 109,430 | 87,951 |
| Unbilled Receivables | 49,569 | 49,569 |
| Allowance for Doubtful Accts. | (13,595) | (8,011) |
| Prepaid Insurance | 7,412 | 7,412 |
| Total Current Assets | 264,082 | 328,324 |
| NONCURRENT ASSETS | | |
| Prepaid Capital Lease (Net of Accumulated Amortization of \$21,382 and \$17,104) | 401,982 | 406,259 |
| Cash - Restricted | 40,948 | 50,567 |
| Total Noncurrent Assets | 442,930 | 456,826 |
| PROPERTY AND EQUIPMENT | | |
| Construction in Progress | 54,950 | |
| Water Lines | 21,795,865 | 21,795,865 |
| Accum. Depr. Water Lines | (4,851,523) | (4,415,126) |
| Office Equipment | 1,099 | 1,099 |
| Accum. Depr. Office Equipment | (1,099) | (1,099) |
| Equipment and Vehicles | 457,603 | 457,603 |
| Accum. Depr. Equipment and Vehicles | (360,633) | (333,595) |
| Land | 66,176 | 66,176 |
| Total Property and Equipment | 17,162,438 | 17,570,923 |
| TOTAL ASSETS | 17,869,450 | 18,356,073 |
| DEFERRED OUTFLOWS OF RESOURCES | | |
| Pension Liabilities | 91,723 | 28,251 |

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF NET POSITION
December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|----------------------|----------------------|
| LIABILITIES AND NET POSITION | | |
| CURRENT LIABILITIES | | |
| Bank Overdraft | 9,093 | |
| Accrued Interest | 50,025 | 92,524 |
| Accrued Expenses | 75,089 | 73,971 |
| Accrued Salaries | 3,000 | 3,000 |
| Accounts Payable-Water Purchases (Restated) | 28,242 | 37,840 |
| Accounts Payable-Construction | | 14,939 |
| Accounts Payable-Retirement | 2,842 | 2,842 |
| Bonds Payable | 43,860 | 76,850 |
| Total Current Liabilities | 212,151 | 301,966 |
| LONG-TERM LIABILITIES | | |
| Compensated Absences | 10,953 | 10,953 |
| Net Pension Liability | 305,472 | 218,000 |
| Bonds Payable | 3,756,230 | 3,763,870 |
| | 4,072,655 | 3,992,823 |
| OTHER LIABILITIES | | |
| Customer Deposits | 16,420 | 17,149 |
| TOTAL LIABILITIES | 4,301,226 | 4,311,938 |
| DEFERRED INFLOWS OF RESOURCES | | |
| Net Difference Between Projected and Actual | | |
| Investment Earnings on Pension Plan Investments | 0 | 24,000 |
| Refunding Bond Premium | | |
| (Net of Accumulated Amortization of \$2,084) | 50,017 | 0 |
| NET POSITION: | | |
| Invested in Capital Assets, Net of Related Debt | 13,714,313 | 14,136,462 |
| Restricted for Debt Service | 105,771 | 169,136 |
| Restricted for Depreciation Reserve | 20,197 | 29,228 |
| Restricted for Construction | 877 | 752 |
| Unrestricted | (231,228) | (287,192) |
| TOTAL NET POSITION | \$ 13,609,930 | \$ 14,048,386 |

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

MORGAN COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION
For The Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|----------------------------------|---------------|---------------|
| OPERATING REVENUES | | |
| Water Collection | \$ 1,247,511 | \$ 1,222,203 |
| Sales Tax | (2,122) | (1,689) |
| Utility And Local Tax | (32,763) | (34,031) |
| State Reimb. Relocation Projects | 74,907 | 228,396 |
| Tap-On Fees | 39,785 | 32,589 |
| Miscellaneous | 22,628 | 19,567 |
| Net Operating Revenues | 1,349,946 | 1,467,035 |
| OPERATING EXPENSES | | |
| Advertising | 1,198 | 50 |
| Bank Charges | 1,170 | 382 |
| Depreciation | 463,435 | 441,786 |
| Fuel | 10,052 | 10,608 |
| Insurance | 58,847 | 55,680 |
| Miscellaneous | 5,072 | 5,082 |
| Office Supplies | 5,401 | 5,027 |
| Outside Services | 41,999 | 47,074 |
| Payroll Taxes | 11,958 | 11,827 |
| Postage | 12,433 | 12,586 |
| Relocation Project Expenses | 71,049 | 231,038 |
| Repairs & Maintenance | 10,649 | 5,053 |
| Retirement | 29,589 | 17,000 |
| Salaries | 169,427 | 161,037 |
| Supplies & Testing | 68,965 | 43,425 |
| Travel | 625 | 774 |
| Uniforms | 1,669 | 1,392 |
| Unemployment Insurance | 317 | 326 |
| Utilities and Telephone | 40,419 | 39,290 |
| Water Purchased (Restated) | 630,517 | 717,287 |
| Worker's Compensation | 4,664 | 4,724 |
| Total Operating Expenses | 1,639,455 | 1,811,448 |
| NET OPERATING INCOME | (289,509) | (344,413) |

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION
For The Years Ended December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|---------------|---------------|
| NON OPERATING REVENUES (EXPENSES) | | |
| Interest and Amortization Expense | (155,680) | (162,257) |
| Interest Income | 83 | 153 |
| Cost of Issuance | (48,425) | |
| Gain on Sale of Land | | 15,826 |
| Grant Proceeds | 55,075 | 175,936 |
| | (148,947) | 29,658 |
| Total Non Operating Revenues (Expenses) | | |
| Change in Net Position | (438,456) | (314,755) |
| Total Net Position - Beginning (Restated) | 14,048,386 | 14,363,141 |
| Total Net Position - Ending | \$ 13,609,930 | \$ 14,048,386 |

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|--------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Payments from Customers | \$ 1,292,448 | \$ 1,272,250 |
| State Reimb. Relocation Projects | 74,907 | 228,396 |
| Miscellaneous Income | 1,581 | 2,109 |
| Payments to Vendors | (977,283) | (1,101,772) |
| Payments for Payroll and Related Expenses | (257,041) | (245,190) |
| Net Cash Provided/(Used) by Operating Activities: | 134,612 | 155,793 |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES: | | |
| Net (Deposits)/Withdrawals Customer Deposit Account | 716 | 2,505 |
| Net Cash Provided/(Used) by Noncapital Financing Activities | 716 | 2,505 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | |
| Interest and Amortization | (193,903) | (163,443) |
| Net (Deposits)/Withdrawals into or from Bond Sinking Fund | 63,365 | (3,532) |
| Net (Deposits)/Withdrawals into or from Dep. Reserve Fund | 9,030 | 54,963 |
| Net (Deposits)/Withdrawals into or from Cash - Construction | (126) | (105) |
| Net Customer Deposits (Returned)/Collected | (729) | (2,496) |
| Grant Proceeds | 55,075 | 175,936 |
| Constructed Fixed Assets | (54,950) | (175,836) |
| Sale of Assets | | 24,850 |
| Bond Proceeds | 1,330,000 | |
| Reduction in Bonds Payable | (1,370,630) | (71,440) |
| Bond Premium | 50,017 | |
| Cost of Issuance | (48,425) | |
| Net Cash Provided/(Used) by Capital and Related Financing Activities | (161,276) | (161,103) |

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

**MORGAN COUNTY WATER DISTRICT
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|------------|-----------|
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Cash Received from Interest | 83 | 153 |
| Net Cash Provided/(Used) by Investing Activities | 83 | 153 |
| INCREASE/(DECREASE) IN CASH | (25,865) | (2,652) |
| CASH AT BEGINNING OF YEAR | 22,267 | 24,919 |
| CASH AT END OF YEAR | \$ (3,598) | \$ 22,267 |

Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:

| | | |
|--|-------------------|-------------------|
| Net Operating Income | \$ (289,509) | \$ (306,573) |
| Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities: | | |
| Depreciation | 463,435 | 441,786 |
| Accounts Receivable | (21,479) | |
| Accounts Payable Water Line Relcoation Projects | (14,939) | 14,939 |
| Accrued Pension Liability | | (11,251) |
| Accrued Expenses | (1,467) | 16,892 |
| Allawance for Doubtful Accounts | 5,584 | |
| Accounts Payable - Water Purchases | (9,598) | |
| Payroll Tax Liability | 2,585 | |
| Net Cash Provided/Used by Operating Activities | \$ 134,612 | \$ 155,793 |

Supplementary Information

| | 2016 | 2015 |
|--|-------------------|-------------------|
| Interest Paid | \$ 195,987 | \$ 163,443 |
| Accrued Interest | (42,499) | (5,462) |
| Amortization of Bond Premium | (2,084) | |
| Total Interest Charged to Expense | \$ 151,404 | \$ 157,981 |

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

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Morgan County Water District (the District) is presented to assist in understanding the District's financial statements. The financial statements and notes are representations of the District's management, who are responsible for their integrity and objectivity. These accounting policies, as applied to the aforementioned financial statements, conform to generally accepted accounting principles applicable to governmental units.

Organization & Activity

The Morgan County Water District was created in accordance with Chapter 74 of the Kentucky Revised Statutes in February 1992. The purpose of the District is to provide water service to residents of Morgan County.

Financial Reporting Entity

The District complies with GASB Statements No. 14, "The Financial Reporting Entity" and No. 39, "Determining Whether Certain Organizations Are Component Units." These Statements establish standards for defining and reporting on the financial reporting entity. They define component units as legally separate organizations for which the officials of the primary government are financially accountable and other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The District is not considered a component unit of any other governmental unit for financial reporting purposes.

The District considered all potential component units in determining what organizations should be included in its financial statements. Based on an evaluation of the established criteria, management determined that there were no component units to include in the District's financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The basic financial statements provide information about the District's business-type activities. The financial statements for the business-type activities are also often referred to as enterprise fund financial statements.

"Measurement Focus" is an accounting term used to describe which transaction and types of balances are recorded within the various financial statements. The expression, "Basis of Accounting," refers to when transactions or events are recorded regardless of measurement focus applied.

Because of the "businesslike" characteristics of the District's operations, the accompanying financial statements report the economic resources measurement focus and the accrual basis of accounting. The accounting objective of the "economic resources" measurement focus is the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net position.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Under full accrual accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred or economic asset used, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The District utilizes an enterprise fund to record its financial operating activities. In governmental accounting, the enterprise fund is used to account for operations that are financed and operated in a manner similar to private business or where the Board has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management accountability.

As the means for delivering services to its customers, the District utilizes an office building, infrastructure, office equipment, equipment and vehicles. To provide the resources that are necessary to pay for water services and the related support functions, the District charges its customers monthly user fees, which are based on the specific level of services that they are receiving. Because the operations of the District closely mirror those of a typical, commercial company, its accounting records reflect a similar approach for measuring its business activity.

The District's various bond resolutions or ordinances require the establishment of certain accounts, which are referred to as "funds." These required accounts are maintained as part of accounting records of the Water Fund. They include the Sinking Fund (Debt Service), Revenue Fund and Depreciation Reserve Fund (Repairs and Maintenance). These are not "funds" as the term is used in generally accepted accounting principles, but are separate "accounts" used to delineate the accounting and reporting for bond related money and repayment security requirements. The balances and activity that occur in these various accounts represent specific segments of the Water Utility enterprise fund as reported in the District's financial statements.

The enterprise fund used by the District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the District's ongoing operations. The principal operating revenues are charges to customers for sales and services that are provided to them. The District also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water system. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Budgeting

The District prepares annual operating budgets for the managerial control of expenditures and for the monitoring of cash flows during the fiscal year. Project-length budgets, which generally encompass more than one fiscal year, are also prepared for major construction projects. Both the operating and project-length expenditure plans are prepared on the cash basis of accounting, which significantly differs from the accrual basis of accounting that the District uses in the preparation of its financial statements.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Budgeting (Continued)

These managerial budgets that are prepared for operations each year or at the inception of a major construction project are not adopted by the Board as legally imposed restrictions on expenditures. Basically, the operating budgets provide management with a tool for estimating and monitoring cash flows in each fiscal period. Accordingly, budgetary comparisons are not presented in the accompanying financial statements.

Allowance for Doubtful Accounts

An allowance for doubtful accounts has been established for utility accounts receivables that are 30+ days delinquent at year-end. Bills are due by the tenth of each month. It is the policy of the District to shut off water service thirty days from the billing date. Customer deposits held are applied to outstanding bills.

Accounts and Unbilled Receivables

Accounts receivable are stated at face amount. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed December 23 is for customer usage from approximately November 16 through December 15. The entire amount is considered accounts receivable as of December 31. The billing mailed on January 26 of the subsequent year is for usage from approximately December 16 through January 15. Fifty percent of this billing is considered unbilled receivables at December 31.

Deposits and Investments

KRS 66.480 authorizes the District to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Property, Plant and Equipment

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., water distribution systems, sewer collection systems and similar items) are reported as a component of noncurrent assets in the basic financial statement. Capital assets are generally defined by the District as being those assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

The reported value excludes the costs of normal maintenance and repairs that are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, Plant and Equipment (Continued)

Depreciation is charged as an expense against operations. Capital assets of the District are depreciated using the straight-line method over their estimated useful lives in years as set forth as follows.

| <u>Category</u> | <u>Life in years</u> |
|------------------------|--------------------------|
| Buildings | 10-75 |
| Equipment and Vehicles | 3-25 |
| Water Lines | 10-50 |
| Office Equipment | 3-25 |

The depreciation expense provided on proprietary fund assets during the years ended December 31, 2016 and 2015 are \$463,435 and \$441,786, respectively.

Capitalized Interest On Indebtedness

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is reflected in the capitalized value of the asset constructed. The total interest expense incurred by the District during the current fiscal year was \$153,488. Of this year's amount, \$0 was considered to be capitalized interest.

Cash and Cash Equivalents

For the purpose of these financial statements, cash and cash equivalents consist of unrestricted cash on hand, demand and savings deposits, certificates of deposit, and bank overdrafts.

Inventory and Prepaid Items

The District does not maintain an inventory of supplies. Supplies are purchased as needed.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. An example of a prepaid item for the District is property and liability insurance premiums.

Restricted Net Position

Some of the District's assets have certain constraints that have been placed on how they can be used. By definition, restricted assets are cash or other assets, whose use in whole or in part are restricted for specific purposes bound by virtue of contractual agreements, legal requirements or enabling legislation.

Certain proceeds of the District's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because their use is limited by applicable bond covenants. The "debt service" accounts are used to segregate resources accumulated for debt service payments over the next twelve months. The "depreciation reserve" account is used to report resources set aside to meet unexpected contingencies or to fund asset renewals, replacements and extensions.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Federal Income Tax

The District is exempt from federal income tax.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B - CASH AND INVESTMENTS

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the District and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. As of December 31, 2016, these requirements were met.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the District's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240(4). As of December 31, 2016, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

NOTE C - RESTRICTIONS ON CASH

Bond Sinking Funds

Deposits into Bond Sinking Funds are required to be made monthly in order to accumulate funds for payment of bond principle and interest. At December 31, 2016, \$93,950 was required to be on deposit to meet payments of interest and principal due on bonds at January 1, 2016. The balance in this account at December 31, 2016 was \$105,771.

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various bond documents. The District was required to deposit \$2,500 per month into the account. The District had \$20,197 on deposit in this account for the purpose of maintaining the water system at December 31, 2016.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE C - RESTRICTIONS ON CASH (Continued)

Restricted Cash Accounts

The District is required to maintain special deposit accounts for customer deposits, construction projects, and long-term debt obligations. The following is a listing of restricted cash accounts of the District at December 31, 2016:

| | 2016 | 2015 |
|--------------------------------|------------|------------|
| Customer Deposit Accounts | \$ 19,873 | \$ 20,587 |
| Bond and Interest Sinking Fund | 105,771 | 169,136 |
| Depreciation Reserve Fund | 20,197 | 29,228 |
| Construction Account | 878 | 752 |
| Total Restricted Cash Accounts | \$ 146,719 | \$ 219,703 |

NOTE D – CAPITAL LEASES

The District has entered into two lease agreements as lessee with the Morgan County Fiscal Court for the use of 2,500 square feet of office space at 1009 Hwy 172, West Liberty, Kentucky 41472 and 2,500 square feet of office and storage space at 150 County Garage Road, West Liberty, Kentucky 41472. The lease agreements qualify as capital leases for accounting purposes (the terms of the leases are equal to seventy-five percent or more of the estimated economic life of the leased properties). The terms of the leases are ninety-nine years. In 2012, the District prepaid \$423,364 in full payment of all future lease payments. Amortization expense for each of the fiscal years ended December 31, 2016 and 2015 was \$4,276.

NOTE E – BOND PREMIUM

On November 30, 2016, the District entered into an assistance agreement with Kentucky Rural Water Association to refund six Rural Development bonds. (See Note H). The bond premium of \$52,101, a result of the refunding, will be amortized over the 25-year term of the bond at \$2,084 per year. At December 31, 2016, the bond premium, net of accumulated amortization of \$2,084, is \$50,017 and is classified as a deferred inflow.

NOTE F – FAIR VALUE MEASUREMENT

GASB Statement No. 72, Fair Value Measurement and Application, became effective in fiscal year 2016 which requires the measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques.

The carrying amount of the following financial instruments approximate fair value because of the short maturity of the instruments: cash equivalents and accounts receivable.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE G - PROPERTY, PLANT AND EQUIPMENT

The District's property, plant and equipment consist of the following:

| | December 31, 2015 | | | December 31, 2016 |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | Beginning | | | Ending |
| | Balance | Increases | Decreases | Balance |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Primary Government: | | | | |
| <u>Business-Type Activities:</u> | | | | |
| Capital Assets Not Being Depreciated: | | | | |
| Land | \$ 66,176 | \$ | \$ | \$ 66,176 |
| Construction In Progress | | 54,950 | | 54,950 |
| Total Capital Assets Not Being Depreciated | <u>66,176</u> | <u>54,950</u> | | <u>121,126</u> |
| Capital Assets, Being Depreciated: | | | | |
| Office Equipment | 1,099 | | | 1,099 |
| Vehicles and Equipment | 457,603 | | | 457,603 |
| Waterlines | 21,795,865 | | | 21,795,865 |
| Total Capital Assets Being Depreciated | <u>22,254,567</u> | | | <u>22,254,567</u> |
| Less Accumulated Depreciation for: | | | | |
| Office Equipment | (1,099) | | | (1,099) |
| Vehicles and Equipment | (333,595) | (27,038) | | (360,633) |
| Waterlines | (4,415,126) | (436,397) | | (4,851,523) |
| Total Accumulated Depreciation | <u>(4,749,820)</u> | <u>(463,435)</u> | | <u>(5,213,255)</u> |
| Total Capital Assets, Being Depreciated, Net | <u>17,504,747</u> | <u>(463,435)</u> | | <u>17,041,312</u> |
| Business-Type Activities Capital Assets, Net | <u>\$ 17,570,923</u> | <u>\$ (408,485)</u> | <u>\$ 0</u> | <u>\$ 17,162,438</u> |

NOTE H - BONDS PAYABLE

The following is a summary of the long-term debt transactions of the Morgan County Water District for the years ended December 31, 2016 and 2015:

| <u>Water Utility Fund Revenue Bonds</u> | <u>2016</u> | <u>2015</u> |
|---|---------------------|---------------------|
| Bonds Payable - Beginning | \$ 3,840,720 | \$ 3,912,160 |
| Bonds Retired | (1,370,630) | (71,440) |
| Bonds Added | 1,330,000 | |
| Bonds Payable - Ending | <u>\$ 3,800,090</u> | <u>\$ 3,840,720</u> |

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE H - BONDS PAYABLE (CONTINUED)

Bonds payable at December 31, 2016 consists of the following issues:

| | | |
|--|----|---------------------|
| \$300,000 Water revenue bonds, Series A 1993 maturing through January 1, 2033, with interest at 5.0 percent | \$ | 0 |
| \$17,000 Water revenue bonds, Series B 1993, maturing through January 1, 2033, with interest at 5.0 percent | | 0 |
| \$375,000 Water revenue bonds, Series 1995, maturing through January 1, 2035, with interest at 4.5 percent | | 0 |
| \$75,000 Water revenue bonds, Series 1999, maturing through January 1, 2039, with interest at 4.5 percent | | 0 |
| \$332,000 Water revenue bonds, Series 2001, maturing through January 1, 2040, with interest at 3.25 percent | | 253,000 |
| \$300,000 Water revenue bonds, Series 2002, maturing through January 1, 2042, with interest at 4.50 percent | | 0 |
| \$600,000 Water revenue bonds, Series 2003, maturing through January 1, 2043, with interest at 4.375 percent | | 0 |
| \$1,000,000 Water revenue bonds, Series 2006, maturing through January 1, 2045, with interest at 4.125 percent | | 880,000 |
| \$1,446,000 Water revenue bonds, Series 2008, maturing through January 1, 2048, with interest at 4.125 percent | | 1,337,090 |
| \$1,330,000 KRWFC revenue bonds, Series 2016 D, maturing through January 1, 2042 with interest varied from 3.5% - 5% | | <u>1,330,000</u> |
| Total | | <u>\$ 3,800,090</u> |

Bond Collateralization Requirements

According to Bond documents, the Bonds shall be payable solely out of the gross revenues of the System. In addition to the revenue pledge securing the Bonds, a lien is created and granted in favor of the Bond owners on all contracts and on all other rights of the District pertaining to the System.

Compliance with Bond Ordinances

The bond ordinances contain significant limitations and restrictions on annual debt service requirements, maintenance of and flow of monies through various restricted accounts, minimum amounts to be maintained in various sinking funds and minimum revenue bond coverages. Funds held in the various reserves at December 31, 2016, required by the revenue bond ordinances are reported in the accompanying financial statements as restricted cash.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE H - BONDS PAYABLE (CONTINUED)

Bond Refunding

On November 30, 2016, the District entered an assistance agreement with Kentucky Rural Water Finance Corporation in the amount of \$1,330,000 for the purpose of refinancing and currently refunding certain obligations of the District in order to affect substantial debt service savings. The following bond series were refunded: Series A 1993, Series B 1993, Series 1995, Series 1999, Series 2002, and Series 2003. A bond premium of \$52,101 will be amortized over the 25-year term of the bond at \$2,084 per year. (See Note E.)

Sinking Fund Requirements

Sinking fund requirements are equal to the debt service requirements. The annual requirements to amortize all bonds as of December 31, 2016, according to the bond documents, including interest payments are as follows:

WATER REVENUE BOND – SERIES 2001

| YEAR | PRINCIPAL | INTEREST | TOTAL |
|------|------------|------------|------------|
| 2017 | \$ 7,000 | \$ 8,223 | \$ 15,223 |
| 2018 | 7,500 | 7,995 | 15,495 |
| 2019 | 7,500 | 7,751 | 15,251 |
| 2020 | 8,000 | 7,508 | 15,508 |
| 2021 | 8,000 | 7,248 | 15,248 |
| 2022 | 8,500 | 6,988 | 15,488 |
| 2023 | 8,500 | 6,711 | 15,211 |
| 2024 | 9,000 | 6,435 | 15,435 |
| 2025 | 9,000 | 6,143 | 15,143 |
| 2026 | 9,500 | 5,850 | 15,350 |
| 2027 | 10,000 | 5,541 | 15,541 |
| 2028 | 10,000 | 5,216 | 15,216 |
| 2029 | 10,500 | 4,891 | 15,391 |
| 2030 | 11,000 | 4,550 | 15,550 |
| 2031 | 11,000 | 4,193 | 15,193 |
| 2032 | 11,500 | 3,835 | 15,335 |
| 2033 | 12,000 | 3,461 | 15,461 |
| 2034 | 12,000 | 3,071 | 15,071 |
| 2035 | 13,000 | 2,681 | 15,681 |
| 2036 | 13,000 | 2,259 | 15,259 |
| 2037 | 13,500 | 1,836 | 15,336 |
| 2038 | 14,000 | 1,398 | 15,398 |
| 2039 | 14,500 | 943 | 15,443 |
| 2040 | 14,500 | 471 | 14,971 |
| | \$ 253,000 | \$ 115,198 | \$ 368,198 |

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE H - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND – SERIES 2006

| YEAR | PRINCIPAL | INTEREST | TOTAL |
|------|-------------------|-------------------|---------------------|
| 2017 | \$ 16,000 | \$ 36,300 | \$ 52,300 |
| 2018 | 17,000 | 35,640 | 52,640 |
| 2019 | 18,000 | 34,939 | 52,939 |
| 2020 | 18,000 | 34,196 | 52,196 |
| 2021 | 19,000 | 33,454 | 52,454 |
| 2022 | 20,000 | 32,670 | 52,670 |
| 2023 | 21,000 | 31,845 | 52,845 |
| 2024 | 22,000 | 30,979 | 52,979 |
| 2025 | 22,000 | 30,071 | 52,071 |
| 2026 | 23,000 | 29,164 | 52,164 |
| 2027 | 24,000 | 28,215 | 52,215 |
| 2028 | 25,000 | 27,225 | 52,225 |
| 2029 | 26,000 | 26,194 | 52,194 |
| 2030 | 27,000 | 25,121 | 52,121 |
| 2031 | 29,000 | 24,008 | 53,008 |
| 2032 | 30,000 | 22,811 | 52,811 |
| 2033 | 31,000 | 21,574 | 52,574 |
| 2034 | 32,000 | 20,295 | 52,295 |
| 2035 | 34,000 | 18,975 | 52,975 |
| 2036 | 35,000 | 17,573 | 52,573 |
| 2037 | 36,000 | 16,129 | 52,129 |
| 2038 | 38,000 | 14,644 | 52,644 |
| 2039 | 39,000 | 13,076 | 52,076 |
| 2040 | 41,000 | 11,468 | 52,468 |
| 2041 | 43,000 | 9,776 | 52,776 |
| 2042 | 45,000 | 8,003 | 53,003 |
| 2043 | 46,000 | 6,146 | 52,146 |
| 2044 | 48,000 | 4,249 | 52,249 |
| 2045 | 55,000 | 2,269 | 57,269 |
| | <u>\$ 880,000</u> | <u>\$ 647,009</u> | <u>\$ 1,527,009</u> |

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE H - BONDS PAYABLE (CONTINUED)

WATER REVENUE BOND – SERIES 2008

| YEAR | PRINCIPAL | INTEREST | TOTAL |
|------|---------------------|---------------------|---------------------|
| 2017 | \$ 20,860 | \$ 55,155 | \$ 76,015 |
| 2018 | 21,720 | 54,294 | 76,014 |
| 2019 | 22,620 | 53,399 | 76,019 |
| 2020 | 23,550 | 52,465 | 76,015 |
| 2021 | 24,520 | 51,494 | 76,014 |
| 2022 | 25,530 | 50,483 | 76,013 |
| 2023 | 26,590 | 49,429 | 76,019 |
| 2024 | 27,680 | 48,333 | 76,013 |
| 2025 | 28,820 | 47,191 | 76,011 |
| 2026 | 30,010 | 46,002 | 76,012 |
| 2027 | 31,250 | 44,764 | 76,014 |
| 2028 | 32,540 | 43,475 | 76,015 |
| 2029 | 33,880 | 42,133 | 76,013 |
| 2030 | 35,280 | 40,735 | 76,015 |
| 2031 | 36,740 | 39,280 | 76,020 |
| 2032 | 38,250 | 37,764 | 76,014 |
| 2033 | 39,830 | 36,187 | 76,017 |
| 2034 | 41,470 | 34,544 | 76,014 |
| 2035 | 43,180 | 32,833 | 76,013 |
| 2036 | 44,960 | 31,052 | 76,012 |
| 2037 | 46,820 | 29,197 | 76,017 |
| 2038 | 48,750 | 27,266 | 76,016 |
| 2039 | 50,760 | 25,255 | 76,015 |
| 2040 | 52,850 | 23,161 | 76,011 |
| 2041 | 55,030 | 20,981 | 76,011 |
| 2042 | 57,300 | 18,711 | 76,011 |
| 2043 | 59,670 | 16,347 | 76,017 |
| 2044 | 62,130 | 13,886 | 76,016 |
| 2045 | 64,690 | 11,323 | 76,013 |
| 2046 | 67,360 | 8,655 | 76,015 |
| 2047 | 70,140 | 5,876 | 76,016 |
| 2048 | 72,310 | 2,983 | 75,293 |
| | <u>\$ 1,337,090</u> | <u>\$ 1,094,653</u> | <u>\$ 2,431,743</u> |

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE H - BONDS PAYABLE (CONTINUED)

KRWFC REFUNDING BOND – SERIES 2016 D

| YEAR | PRINCIPAL | FEES & INTEREST | TOTAL |
|------|---------------------|--------------------|---------------------|
| 2017 | \$ | \$ 35,705 | \$ 35,705 |
| 2018 | 35,000 | 52,413 | 87,413 |
| 2019 | 45,000 | 50,812 | 95,812 |
| 2020 | 50,000 | 48,912 | 98,912 |
| 2021 | 50,000 | 46,912 | 96,912 |
| 2022 | 50,000 | 44,913 | 94,913 |
| 2023 | 55,000 | 42,537 | 97,537 |
| 2024 | 55,000 | 40,062 | 95,062 |
| 2025 | 60,000 | 37,762 | 97,762 |
| 2026 | 60,000 | 35,062 | 95,062 |
| 2027 | 65,000 | 32,262 | 97,262 |
| 2028 | 65,000 | 29,662 | 94,662 |
| 2029 | 65,000 | 27,062 | 92,062 |
| 2030 | 70,000 | 24,537 | 94,537 |
| 2031 | 70,000 | 22,087 | 92,087 |
| 2032 | 75,000 | 19,550 | 94,550 |
| 2033 | 55,000 | 17,207 | 72,207 |
| 2034 | 60,000 | 15,051 | 75,051 |
| 2035 | 40,000 | 13,176 | 53,176 |
| 2036 | 45,000 | 11,582 | 56,582 |
| 2037 | 45,000 | 9,894 | 54,894 |
| 2038 | 45,000 | 8,150 | 53,150 |
| 2039 | 45,000 | 6,350 | 51,350 |
| 2040 | 45,000 | 4,550 | 49,550 |
| 2041 | 50,000 | 2,650 | 52,650 |
| 2042 | 30,000 | 600 | 30,600 |
| | <u>\$ 1,330,000</u> | <u>\$ 679,460</u> | <u>\$ 2,009,460</u> |

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE H - BONDS PAYABLE (CONTINUED)

BONDS PAYABLE IN THE AGGREGATE

| Year Ended December 31 | Scheduled Principal | Scheduled Interest |
|---------------------------|------------------------|-----------------------|
| 2017 | \$ 43,860 | \$ 135,383 |
| 2018 | 81,220 | 150,342 |
| 2019 | 93,120 | 146,901 |
| 2020 | 99,550 | 143,081 |
| 2021 | 101,520 | 139,108 |
| 2022-2026 | 571,130 | 628,630 |
| 2027-2031 | 688,190 | 501,151 |
| 2032-2036 | 706,190 | 365,481 |
| 2037-2041 | 737,710 | 227,195 |
| 2042-2046 | 535,150 | 90,189 |
| 2047-2051 | 142,450 | 8,859 |
| Totals | <u>\$ 3,800,090</u> | <u>\$ 2,536,320</u> |

NOTE I - RETIREMENT

General Information about the Pension Plan

The District has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement System. This is a cost sharing multiple employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Retirement benefits may be extended to beneficiaries of the plan members under certain circumstances. Benefit contributions and provisions are established by statute.

Nonhazardous covered employees are required to contribute five (5) percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008 are required to contribute six (6) percent of their salary to be allocated as follows: 5% will go to the member's account and 1% will go to the KRS insurance fund. The District's contribution rate for nonhazardous employees was 17.06 percent for the first six months of 2016 and 18.68 percent for the last six months of 2016.

In accordance with Senate Bill 2, signed by the Governor on April 4, 2013, 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. Members contribute 5% (nonhazardous) of their annual creditable compensation and 1% to the health insurance fund which is not credited to the member's account and is not refundable.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE I - RETIREMENT (CONTINUED)

General Information about the Pension Plan (Continued)

The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of the member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. A member's account is credited with a 4% (nonhazardous) employer pay credit. The employer pay credit represents a portion of the employer contribution.

The District's contribution for calendar year 2014 was \$31,008, calendar year 2015 was \$28,251, and calendar year 2016 was \$29,589.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

CERS also provides post-retirement health care coverage as follows:

For member participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

| <u>Years of Service</u> | <u>% Paid by Insurance Fund</u> | <u>% Paid by Member through Payroll Deduction</u> |
|-------------------------|---------------------------------|---|
| 20 or more | 100% | 0% |
| 15-19 | 75% | 25% |
| 10-14 | 50% | 50% |
| 4-9 | 25% | 75% |
| Less than 4 | 0% | 100% |

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment, which is updated annually due to changes in the Consumer Price Index.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE I - RETIREMENT (CONTINUED)

Pension Liabilities

At December 31, 2016, the District has a liability of \$305,472 for its proportionate share of the net pension liability for non-hazardous retirement. The net pension liability was measured as of June 30, 2015, the most recent audited information, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date by the Kentucky Retirement Systems. 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 June 30, 2015, the District's proportion was .007105%.

At December 31, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| NON-HAZARDOUS | Deferred Outflows of Resources | Deferred Inflows of Resources |
|--|-----------------------------------|----------------------------------|
| Differences Between Expected and Actual Experience | \$ 2,539 | \$ |
| Changes in Assumptions | 30,804 | |
| Net Difference Between Projected and Actual Earnings Earnings on Pension Plan Investments | 2,738 | |
| Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions | 10,130 | |
| District Contributions and Cash Balance Subsequent to the Measurement Date | 45,512 | |
| Total | \$ 91,723 | \$ 0 |

The collective amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| | Non-Hazardous |
|------------|---------------|
| Year 1 | \$ 12,361 |
| Year 2 | \$ 12,361 |
| Year 3 | \$ 5,851 |
| Year 4 | \$ 5,509 |
| Year 5 | \$ 0 |
| Thereafter | \$ 0 |

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE I - RETIREMENT (CONTINUED)

Pension Liabilities (Continued)

Actuarial Methods and Assumptions

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

| | |
|---------------------------|--|
| Inflation | 3.25% |
| Salary Increases | 4.0%, average, including inflation |
| Investment Rate of Return | 7.50%, net of pension plan investment expense, including inflation |

The mortality table used for active members is 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. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.

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 for Kentucky Retirement Systems. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term rate of return assumption 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 timeframe. 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.

**MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE I - RETIREMENT (CONTINUED)

Pension Liabilities (Continued)

Actuarial Methods and Assumptions (Continued)

Projected future benefit payments for all current plan members were projected through 2117.

| <u>Asset Class</u> | <u>Target Allocation</u> | <u>Long-Term Expected Real Rate of Return</u> |
|--|--------------------------|---|
| Combined Equity | 44% | 5.40% |
| Combined Fixed Income | 19% | 1.50% |
| Real Return (Diversified Inflation Strategies) | 10% | 3.50% |
| Real Estate | 5% | 4.50% |
| Absolute Return (Diversified Hedge Funds) | 10% | 4.25% |
| Private Equity | 10% | 8.50% |
| Cash Equivalent | 2% | (.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 27 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 following presents the net pension liability of the District, calculated using the discount rate of percent, as well as what the District's net pension liability would be if it were calculated using a discount rate that is one-percentage-point lower (6.50 percent) or one-percentage-point higher (8.50 percent) than the current rate for non-hazardous:

| NON-HAZARDOUS | <u>1% Decrease (6.50%)</u> | <u>Current Discount Rate (7.50%)</u> | <u>1% Increase (8.50%)</u> |
|----------------------------------|----------------------------|--------------------------------------|----------------------------|
| District's Net Pension Liability | \$ 389,985 | \$ 305,481 | \$ 233,112 |

MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE I - RETIREMENT (CONTINUED)

Pension Liabilities (Continued)

Deferred Inflows and Outflows

The Schedule of Deferred Inflows and Outflows, and Pension Expense include only certain categories of deferred outflows of resources and deferred inflows of resources. These include differences between expected and actual experience, changes of assumptions and differences between projected and actual earnings on plan investments. The Schedule does not include deferred outflows/inflows of resources for changes in the employer's proportionate share of contributions or employer contributions made subsequent to the measurement date. The net pension liability as of December 31, 2016, is based on the June 30, 2015 actuarial valuation. Deferred outflows and inflows related to differences between projected and actual earnings on plan investments are netted and amortized over a closed five year period.

401K

In January 2001, the district began a non-matching 401K deferred compensation plan. The employees may contribute twenty-five percent (25%) of their compensation, not to exceed \$10,500 annually. Participation is optional. Benefits are available upon separation of service or attainment of age fifty-nine and one-half (59.5) years. Benefits must commence by the later of: April 1 of the calendar year in which employment ends, or the calendar year in which the employee reaches age seventy and one-half (70.5) years of age.

NOTE J - INSURANCE COVERAGE

For the fiscal years ended December 31, 2016 and 2015, the District was a member of the Kentucky Association of Counties All Lines Insurance Fund (KALF). KALF is a self- insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses. There have been no settlements that have exceeded insurance coverage for each of the past three fiscal years.

NOTE K – COMPENSATED ABSENCES

Upon termination of employment from the District, an employee who has been an employee of the District for a total of twelve months shall be compensated for a maximum of fifteen days of accrued annual leave. Employees accumulate 3.69 hours of annual leave per pay period. Employees employed less than six months upon termination will not be compensated for accrued annual leave, unless approved by the Water District Manager. Annual leave accrued as of December 31, 2016 and 2015 is \$10,953 and \$10,953, respectively.

NOTE L – SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 26, 2017, which is the date the financial statements were available to be issued.

MORGAN COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE M – PRIOR PERIOD ADJUSTMENT

Accounts Payable – Water Purchases, Water Purchases, and Total Net Position were restated to account for unrecorded water purchase billings outstanding at December 31, 2015 in the amount of \$37,480.

Beginning Net Position for the year ended December 31, 2015 was decreased by \$225,000 to accommodate the implementation of GASB 68, Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27.

NOTE N – CONSTRUCTION IN PROGRESS

Construction in progress totaled \$54,950 as of December 31, 2016. The construction in progress is a systems improvement project funded by an Abandoned Mine Lands grant in the amount of \$730,000.

**MORGAN COUNTY WATER DISTRICT
SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE
NET PENSION LIABILITY
For the Year Ended December 31, 2016 and 2015**

| <i>(Actuarial Valuation Report Year)</i> | Non-Hazardous | |
|---|----------------------|-------------|
| | <u>2014</u> | <u>2015</u> |
| District's Proportion of the Net Pension Liability (Asset) | 0.006712% | 0.007105% |
| District's Proportionate Share of the Net Pension Liability (Asset) | \$ 218,000 | \$ 305,472 |
| District's Covered-Employee Payroll | \$ 181,675 | \$ 175,555 |
| District's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Its Covered-Employee Payroll | 119.99% | 174.00% |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 66.80% | 57.52% |

Note:

This schedule will eventually cover the ten (10) most recent fiscal years; however, this is the information available as of the implementation of GASB 68.

**MORGAN COUNTY WATER DISTRICT
SCHEDULE OF THE DISTRICTS' PENSION CONTRIBUTIONS
Fiscal Year Ended December 31, 2016 and 2015**

| <i>(Actuarial Valuation Report Year)</i> | Non-Hazardous | |
|---|----------------------|---------------|
| | <u>2014</u> | <u>2015</u> |
| Contractually Required Pension Contribution | \$ 29,088 | \$ 21,212 |
| Pension Contributions in Relation to the Contractually Required Pension Contribution | <u>29,088</u> | <u>21,212</u> |
| Pension Contribution Deficiency (Excess) | <u>\$ 0</u> | <u>\$ 0</u> |
| District's Covered-Employee Payroll | \$ 181,675 | \$ 175,555 |
| Pension Contributions as a Percentage of Covered-Employee Payroll | 16.01% | 12.08% |

Note:

This schedule will eventually cover the ten (10) most recent fiscal years; however, this is the information available as of the implementation of GASB 68.

**MORGAN COUNTY WATER DISTRICT
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
December 31, 2016**

Note 1. Changes in Benefit Terms

The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30, 2015 listed below:

2009: A new benefit tier for members who first participate on or after September 1, 2008 was introduced which included the following changes:

1. Tiered Structure for benefit accrual rates
2. New retirement eligibility requirements
3. Different rules for the computation of final average compensation

2014: As cash balance plan was introduced for members whose participation date is on or after January 1, 2014

Note 2. Changes of Assumption

The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2015:

- The assumed investment rate of return was decreased from 7.75% to 7.50%.
- The assumed rate of inflation was reduced from 3.50% to 3.25%.
- The assumed rate of wage inflation was reduced from 1.00% to 0.75%.
- Payroll growth assumption was reduced from 4.50% to 4.00%.
- The mortality table used for active members is 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. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.
- The assumed rates of Retirement, Withdrawal, and Disability were updated to more accurately reflect experience.

Note 3. Method and Assumptions Used in Calculations of Actuarially Determined Contributions

The actuarially determined contribution rates are determined on an annual basis beginning with the fiscal years ended 2018, determined as of July 1, 2016. The amortization period of the unfunded liability has been reset as of July 1, 2013 to a closed 30-year period. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

MORGAN COUNTY WATER DISTRICT
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
December 31, 2016

Note 3. Method and Assumptions Used in Calculations of Actuarially Determined Contributions (Continued)

| | |
|-------------------------------|---|
| Actuarial cost method | Entry age |
| Amortization method | Level percentage of payroll, closed |
| Remaining amortization period | 27 years |
| Asset valuation method | 5-year smoothed market |
| Inflation | 3.25 percent |
| Salary increase | 4.00, average, including inflation |
| Investment rate of return | 7.50 percent, net of pension plan investment expense, including inflation |

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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*

Board of Directors
Morgan County Water District
West Liberty, 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 business-type activities of Morgan County Water District (the District) as of and for the years ended December 31, 2016 and 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 April 26, 2017.

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.

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. 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Morgan 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.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

April 26, 2017