Report

of

Muhlenberg County Water District #3
Bremen, Kentucky

For The Years Ended December 31, 2016 and 2015

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Alexander, Toney & Knight PLLC

CERTIFIED PUBLIC ACCOUNTANTS
28 Court Street
Madisonville, Kentucky 42431
(270) 821-4824
FAX: (270) 825-4554
Email: atk@atkcpas.com

Larry R. Alexander, CPA
Harold R. Toney, Jr., CPA
Anthony Knight, CPA

Members
American Institute of Certified Public Accountants
Kentucky Society of Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Commissioners
Muhlenberg County Water District Number 3
Bremen, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Muhlenberg County Water District Number 3 as of and for the years ended December 31, 2016 and 2015, and the related notes to the 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.

Auditor's Responsibility

Our responsibility is to express opinions 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Muhlenberg County Water District Number 3 as of December 31, 2016 and 2015, and the 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.

Emphasis of Matter

Change in Accounting Principle

As discussed in Note K to the financial statements, in 2015, the District adopted new accounting guidance, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27 (GASB 68)*. 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 management's discussion and analysis on pages 3-7 and pension schedules on pages 23-24 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2017, on our consideration of Muhlenberg County Water District Number 3'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 the 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 Muhlenberg County Water District Number 3's internal control over financial reporting and compliance.

Alexander, Toney & Knight PLLC

Madisonville, Kentucky
March 20, 2017

MUHLENBERG COUNTY WATER DISTRICT NUMBER 3
Management's Discussion and Analysis
December 31, 2016 and 2015

The discussion and analysis of the Muhlenberg County Water District Number 3's financial performance provides an overview and analysis of the District's financial activities for the years ended December 31, 2016 and 2015. It should be read in conjunction with the accompanying basic financial statements.

Financial Highlights for the Year 2016

* The District's net position decreased $7.5 thousand from $2.793 million to $2.785 million.

Overview Of The Financial Statements

This report consists of this management's discussion and analysis, basic financial statements, and notes to the financial statements. The basic financial statements are reported using the full accrual basis of accounting.

Basic financial statements:

The Statements of Net Position include information on the District's assets, deferred outflows of resources, liabilities, and deferred inflows of resources and provide information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). In simple terms, this statement presents a snap-shot view of the assets the District owns, the liabilities it owes and the net difference. The net difference is further separated into amounts restricted for specific purposes and unrestricted amounts.

The Statements of Revenues, Expenses, and Changes in Fund Net Position include the District's revenues and expenses for the years ended December 31, 2016 and 2015. This statement provides information on the District's operations and can be used to determine whether the District has recovered all of its actual and projected costs through user fees and other charges.

The Statements of Cash Flows include information on the District's cash receipts and payments and the changes in cash balances resulting from operating activities, investing activities, and financing activities.

The notes to the financial statements provide additional disclosures required by governmental accounting standards and provide information to assist the reader in understanding the District's financial condition.

District Financial Analysis

A summary of the District's Statements of Net Position is presented below.

Table 1
Condensed Statements of Net Position
(in thousands)

	2016	2015	dollar change	percent change	2014	dollar change	percent change
Current assets	$ 976.7	$1,033.8	($ 57.1)	(5.5%)	$1,096.8	($ 63.0)	(5.7%)
Capital assets	2,087.5	1,995.9	91.6	4.6%	1,974.5	21.4	1.1%
Other noncurrent assets	198.5	199.9	(1.4)	(0.7%)	98.7	101.2	102.5%
Total assets	3,262.7	3,229.6	33.1	1.0%	3,170.0	59.6	1.9%
Total deferred outflows of resources	108.4	* 65.9	42.5	64.5%	0.0	65.9	100.0%
Current liabilities	79.2	84.8	(5.6)	(6.6%)	99.6	(14.8)	(14.9%)
Long-term liabilities	506.9	* 418.2	88.7	21.2%	22.6	395.6	1,750.4%
Total liabilities	586.1	503.0	83.1	16.5%	122.2	380.8	311.6%
Total deferred inflows of resources	0.0	* 0.0	0.0	0.0%	0.0	0.0	0.0%
Net assets invested in capital assets, net of related debt	2,087.5	1,986.8	100.7	5.1%	1,944.6	42.2	2.2%
Unrestricted net position	697.5	805.7	(108.2)	(13.4%)	1,103.2	(297.5)	(27.0%)
Total net position	$2,785.0	*$2,792.5	($ 7.5)	(0.3%)	$3,047.8	($ 255.3)	(8.4%)

*as restated, see note K

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by $2.785 million at the close of the current year.

2015 to 2016

As shown in table 1, the District's total assets increased by $33,100 from $3,229,600 to $3,262,700. Current assets decreased $57,100. This was due to decreases in cash and cash equivalents which decreased $56,600. The District used cash reserves to fund purchases of capital assets. Water sales also fell during the year although water purchases remained similar. Capital assets increased $91,600 as capital asset acquisitions out paced depreciation expense.

Deferred outflows of resources-pensions increased $42,500 due to changes in the District's proportional share of the County Employee Retirement System (CERS) valuation measurements.

The District's long-term liabilities increased $88,700. Net pension liability increased $88,000, also due to the District's proportional share of CERS valuation measurements.

2014 to 2015

As shown in table 1, the District's total assets increased by $59,600 from $3,170,000 to $3,229,600. Current assets decreased $63,000. This was due in part to decreases in cash and cash equivalents which decreased $26,000. The District had an overall increase in cash of $75,000 and also reclassified previously unrestricted cash to restricted cash, thus moving those cash amounts from current assets to other noncurrent assets. Accounts receivable decreased $15,000 as the District had lower water sales at year end when compared to the prior year. Inventory decreased $21,000 as the District has decided to keep less on hand considering their close proximity to suppliers. Capital assets increased $21,400 as capital asset acquisitions out paced depreciation expense. Other noncurrent assets, which includes restricted cash, increased $101,200 as the District moved cash into the construction fund.

The District's long-term liabilities increased $395,600 as the District implemented GASB 68 during the year resulting in a net pension liability of $404,505.

The District's total net position decreased $255,300 due to the net effect of the increase in total assets and increase in total liabilities referred to above.

A summary of the District's Statements of Revenues, Expenses and Changes in Net Position is presented below.

Table 2
Condensed Statements of Revenues, Expenses and Changes in Net Position
(in thousands)

	2016	2015	dollar change	percent change	2014	dollar change	percent change
Operating revenues	$1,348.5	$1,411.2	($ 62.7)	(4.4%)	$1,450.9	($ 39.7)	(2.7%)
Nonoperating revenues	4.2	7.5	(3.3)	(44.0%)	5.0	2.5	50.0%
Total revenues	1,352.7	1,418.7	(66.0)	(4.7%)	1,455.9	(37.2)	(2.6%)
Operating expenses	1,376.0	*1,342.7	33.3	2.5%	1,378.1	(35.4)	(2.6%)
Nonoperating expenses	0.1	0.3	(0.2)	(66.7%)	0.5	(0.2)	(40.0%)
Total expenses	1,376.1	1,343.0	33.1	2.5%	1,378.6	(35.6)	(2.6%)
Income (loss) before capital contributions	(23.4)	75.7	(99.1)	(130.9%)	77.3	(1.6)	(2.1%)
Capital contributions	15.9	3.3	12.6	381.8%	65.9	(62.6)	(95.0%)
Changes in net position	(7.5)	79.0	(86.5)	(109.5%)	143.2	(64.2)	(44.8%)
Beginning net position	2,792.5	*2,713.6	78.9	2.9%	2,904.6	(191.0)	(6.6%)
Ending net position	$2,785.0	$2,792.6	($ 7.6)	(0.3%)	$3,047.8	($ 255.2)	(8.4%)

* as restated, see note K.

2015 to 2016
As shown in table 2, the District's total revenues decreased $62,700. Residential water sales decreased $13,400, commercial water sales decreased $30,500, and resale water sales decreased $12,700.

The District's total expenses increased $33,100 from the prior year. Purchased water remained similar to the prior year while water sales decreased indicating an increase in water loss. Employee benefits increased $41,270, the effect of increasing proportional share of CERS pension expense.

Capital contributions increased $12,600 due to an increase in customer funding of small construction projects.

Changes in net position decreased $7,600 due to the net effect of the above changes.

2014 to 2015
As shown in table 2, the District's total revenues decreased $37,200. Resale water sales decreased $33,600 during the year.

The District's total expenses decreased $35,600 from the prior year. Purchased water decreased $33,800 which is in part to less water sold as well as less water loss during the year.

Capital contributions decreased $62,600 due to not receiving any state grant monies during the current year. The District had received grant monies in the prior year in connection with construction projects.

Changes in net position increased $79,000 due to the net effect of the above changes.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2016 the District had $2,087,447 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net increase (additions, retirements, depreciation) of $91,504 from the prior year.

Significant expenditures during the year included expenditures on meters for $89,340, SCADA radio system for $15,800, and completion of the Clark Street line replacement project of which $108,732 was capitalized.

At December 31, 2015 the District had $1,995,943 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net increase (additions, retirements, depreciation) of $21,352 from the prior year.

Significant expenditures during the year included expenditures on meters for $15,891 and the purchases of two trucks for $38,858.

A comparison of the District's capital assets over the past three years is presented in Note E of the financial statements.

Long-Term Debt

At December 31, 2016, the District had $19,495, net reductions of $8,655, in long-term liabilities which included customer deposits and a capital lease. There were no new borrowings.

At December 31, 2015, the District had $28,150, net reductions of $34,559, in long-term liabilities which included customer deposits and a capital lease. There were no new borrowings.

Additional information on the District's long-term debt can be found in Note F of the financial statements.

Currently Known Facts, Decisions, or Conditions

There are no currently known facts, decisions, or conditions that District management expects to have a significant effect on financial position or results of operations.

Requests For Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Muhlenberg County Water District Number 3, 4789 Main Street, Bremen, Kentucky 42325.

Muhlenberg County Water District Number 3
Statement of Net Position
December 31, 2016 and 2015

	2016	2015
Assets		
Current assets		
Cash and cash equivalents	$ 783,608	$ 840,230
Accounts receivable	156,826	158,804
Material and parts inventory	25,769	24,330
Prepaid expenses	10,505	10,421
Total current assets	976,708	1,033,785
Noncurrent assets		
Restricted cash and cash equivalents	198,538	199,945
Capital assets:		
Nondepreciable	125,336	153,026
Depreciable, net of accumulated depreciation	1,962,116	1,842,917
Total noncurrent assets	2,285,990	2,195,888
Total assets	3,262,698	3,229,673
Deferred outflows of resources		
Deferred outflows of resources-pensions (2015 restated, see note K)	108,355	65,853
Total deferred outflows of resources	108,355	65,853
Liabilities		
Current liabilities payable from current assets		
Accounts payable	64,359	61,767
Accrued taxes and other payables	2,059	2,220
Accrued interest payable	6	11
Capital lease-due within one year	0	9,180
Accumulated compensated absences	7,607	6,360
	74,031	79,538
Current liabilities payable from restricted assets		
Customer deposits	5,134	5,239
	5,134	5,239
Total current liabilities	79,165	84,777
Long-term liabilities		
Net pension liability (2015 restated, see note K)	492,576	404,505
Customer deposits	14,361	13,731
Total noncurrent liabilities	506,937	418,236
Total liabilities	586,102	503,013
Deferred inflows of resources		
Deferred inflows of resources-pensions (2015 restated, see note K)	0	0
Total deferred inflows of resources	0	0
Net Position		
Invested in capital assets, net of related debt	2,087,452	1,986,763
Unrestricted	697,499	805,750
Total net position	$2,784,951	$2,792,513

The accompanying notes are an integral part of these statements.

Muhlenberg County Water District Number 3
Statement of Revenues, Expenses and Changes in Fund Net Position
Years Ended December 31, 2016 and 2015

	2016	2015
Operating revenues		
Water sales	$1,306,851	$1,363,462
Other operating revenues	41,634	47,763
Total operating revenues	1,348,485	1,411,225
Operating expenses		
Purchased water	701,170	704,048
Salaries and wages	254,047	255,996
Depreciation	96,929	98,200
Employee benefits (2015 restated, see note K)	127,044	85,774
Transportation	11,325	15,332
Contract services	27,718	27,925
Taxes	19,439	21,389
Purchased power	29,643	31,058
Materials and supplies	46,046	46,133
Insurance	20,634	18,996
Miscellaneous	35,911	32,296
Regulatory commission expense	2,739	2,758
Uncollectible accounts	3,437	2,784
Total operating expenses	1,376,082	1,342,689
Operating income (loss)	(27,597)	68,536
Nonoperating revenues (expenses)		
Interest income	4,146	4,597
Interest expense	(60)	(384)
Gains (losses) on disposition of capital assets	0	2,952
Total nonoperating revenues (expenses)	4,086	7,165
Income (loss) before contributions	(23,511)	75,701
Capital contributions-tap fees	6,500	3,250
Capital contributions-customers	9,449	0
Change in net position	(7,562)	78,951
Net position beginning of year, as restated, see note K	2,792,513	2,713,562
Net position end of year	$2,784,951	$2,792,513

The accompanying notes are an integral part of these statements.

Muhlenberg County Water District Number 3
Statement of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Cash received from customers	$1,305,392	$1,378,267
Cash payments to suppliers for goods and services	(973,420)	(964,404)
Cash payments to employees for services	(254,047)	(255,996)
Other operating revenues	41,634	47,763
Net cash provided (used) by operating activities	119,559	205,630
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(188,437)	(119,712)
Interest paid on customer deposits	(21)	(26)
Interest paid on capital lease	(45)	(358)
Principal paid on capital lease	(9,180)	(20,840)
Capital contributions received from customers	15,949	3,250
Proceeds received on disposition of capital assets	0	2,952
Net cash provided (used) for capital and related financing activities	(181,734)	(134,734)
Cash flows from investing activities		
Interest earned on bank deposits	4,146	4,597
Net cash provided (used) for investing activities	4,146	4,597
Net increase (decrease) in cash and cash equivalents	(58,029)	75,493
Cash and cash equivalents at beginning of year	1,040,175	964,682
Cash and cash equivalents at end of year	$ 982,146	$1,040,175

Reconciliation of operating income to net cash provided (used) by operating activities

	2016	2015
Operating income (loss)	($ 27,597)	$ 68,536
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	96,929	98,200
(Gain) loss on asset dispositions	0	160
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	1,978	14,805
(Increase) decrease in inventory	(1,439)	21,156
(Increase) decrease in prepaid expenses	(84)	1,250
(Increase) decrease in deferred outflows-pensions	(42,502)	0
Increase (decrease) in accounts payable	2,592	(2,667)
Increase (decrease) in accrued expenses	(161)	(84)
Increase (decrease in pension liability	88,071	4,371
Increase (decrease) in customer deposits	525	383
Increase (decrease) in accumulated compensated absences	1,247	(480)
Total adjustments	147,156	137,094
Net cash provided by operating activities	$ 119,559	$ 205,630

The accompanying notes are an integral part of these statements.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Muhlenberg County Water District Number 3 (the "District") conform to Generally Accepted Accounting Principles (GAAP) as applicable to governments. The District's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. The following is a summary of the more significant policies:

The Financial Reporting Entity

Muhlenberg County Water District Number 3 was created on April 24, 1967, under the provisions of Chapter 74 of the Kentucky Revised Statutes of the Commonwealth of Kentucky. The principal office of the District is located at Bremen, Kentucky. The District is composed of three commissioners who are appointed by the Muhlenberg County Judge Executive and provides water to its members in and around Muhlenberg County, Kentucky.

In evaluating how to define the government, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GASB Statements No. 14 and 61. The District has no component units.

Basis of Presentation, Measurement Focus, and Basis of Accounting

The accounts of the District are organized in accordance with the uniform system of accounts adopted by the Public Service Commission of Kentucky. Those accounts are organized on the basis of a proprietary fund type, specifically an enterprise fund. Enterprise Funds account for activities 1) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or 2) that are required by laws or regulations that the activities costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or 3) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net position. Net position is required to be displayed in three components: 1) invested in capital assets, net of related debt, 2) restricted, and 3) unrestricted. Invested in capital assets, net of related debt is capital assets net of accumulated depreciation and reduced by outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Restricted net position are those with constraints placed on their use by either: 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation. Net position not otherwise classified as restricted, are shown as unrestricted. The statements of revenue, expenses, and changes in net position present increases (revenues) and decreases (expenses) in net position.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The accounts of the District are maintained on the accrual basis of accounting. Its revenues are recognized when they are earned, and its expenses are recognized when they are incurred.

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues and expenses of the District's enterprise fund are charges to customers for sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Unbilled water receivables for utility services provided through December 31 are included in the financial statements.

When both restricted and unrestricted resources are available for use, the District generally first uses restricted resources, then unrestricted resources as they are needed.

Cash and Cash Equivalents
All cash except for a small amount kept "on hand" is deposited in financial institutions. Deposits are interest bearing checking accounts and certificates of deposit. Unrestricted cash is available to be expended for normal operating expenses. Restricted cash is limited to payments of bond principal and interest, emergency capital improvements, and other designated purposes. Cash and cash equivalents are defined as being all monies on deposit in banks and investments with a maturity of 90 days or less. The District does not have a formal deposit and investment policy for credit risk, custodial credit risk, or limitations on deposits and investments.

Inventory
Inventory consists primarily of replacement parts and supplies. Inventory is stated at the lower of cost or market. Cost is determined primarily by the first-in, first-out method.

Capital Assets
Capital assets, which include property, plant, and equipment, are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. No interest was capitalized during the years ended December 31, 2016 and 2015.

Capital assets of the District are depreciated using a straight-line method over the following estimated useful lives:

Structures, improvements and water system	10 to 65 years
Furniture, machinery and equipment	2 to 10 years
Vehicles	5 years

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Restricted Net Position
Restricted net position is cash set aside for the repayment of debt in compliance with bond covenants and cash restricted for future operations in compliance with escrow reserve agreements. The District currently doesn't have any restricted net position.

Long-Term Liabilities
Long-term debt is reported as liabilities in the statement of net position. Long-term debt is reported at face value.

Deferred Outflows/Inflows of Resources
In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

Pensions
For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources, and pension expense, information about the fiduciary net position of the County Employees Retirement System Non-Hazardous (CERS) and additions to/deductions from CERS's fiduciary net postion have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Uncollectible Accounts
All accounts receivable are considered by management to be collectible, therefore no provision for uncollectible accounts has been established. Uncollectible accounts are expensed using the direct write-off method.

Use of Estimates
The preparation of financial statements in accordance with accounting principals generally accepted in the United States requires management to make estimates that affect amounts reported in the financial statements during the reporting period. Actual results could differ from those estimates.

NOTE B - DEPOSITS

The District maintains deposits with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to law, the depository institution should pledge sufficient securities as collateral which, together with FDIC insurance, equals or exceeds the amount 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 of securities should be evidenced by an agreement that is (1) in writing, (2) 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 (3) an official record of the depository institution. This agreement, signed by both parties, must be sufficient to create an enforceable and perfected security interest in the collateral under Kentucky law.

Also by Kentucky law, the District is allowed to invest as specified in KRS 66.480 which includes U. S. Treasury and its Obligations, certain federal investments, repurchase agreements, commercial banks' certificates of deposit, and savings and loan deposits.

Deposits are categorized to give an indication of risk assumed by the District at the end of the year. Category 1 includes deposits that are insured, Category 2 includes collateralized deposits held by the pledging institution's trust department or agent in the District's name, and Category 3 includes uncollateralized and uninsured deposits.

On December 31, 2016, the reconciled balance of the District's deposits totaled $981,646 and the bank balances were $992,704. Of the bank balances $533,483 was covered by federal depository insurance (category 1). Also of the bank balances, $459,221 was collateralized by additional securities held by the pledging depository institution's trust department or agent in the District's name (category 2).

On December 31, 2015, the reconciled balance of the District's deposits totaled $1,040,175 and the bank balances were $1,049,307. Of the bank balances $613,849 was covered by federal depository insurance (category 1). Also of the bank balances, $435,458 was collateralized by additional securities held by the pledging depository institution's trust department or agent in the District's name (category 2).

NOTE C - PREPAID EXPENSES

Prepaid expenses include prepaid insurance, which represents the amount of unexpired insurance, which the District had previously paid for at the balance sheet date.

At December 31, 2016, the District's prepaid expenses consisted of $10,505 of insurance. At December 31, 2015, the District's prepaid expenses consisted of $10,421 of insurance.

Muhlenberg County Water District Number 3
Notes to Financial Statements
December 31, 2016 and 2015

NOTE D - RESTRICTED CASH AND CASH EQUIVALENTS

The District has cash set aside for the repayment of debt (which has been fully paid), cash restricted for future operations, cash set aside for future capital assets, and cash set aside for repayment of customer deposits.

Restricted balances as of December 31 are as follows:

	2016	2015
Customer meter deposit fund	$ 23,783	$ 23,128
Construction fund	174,755	176,817
Totals	$ 198,538	$ 199,945

NOTE E - CAPITAL ASSETS

Capital asset activities for the years ended December 31, 2016 and 2015, were as follows:

	Balances 12/31/14	Transfers/ Additions	Transfers/ Retirements	Balances 12/31/15	Transfers/ Additions	Transfers/ Retirements	Balances 12/31/16
Business-type activities:							
Capital assets not being depreciated							
Land & land rights	$ 22,950	$ 0	$ 0	$ 22,950	$ 0	$ 0	$ 22,950
Construction in progress	73,896	56,180	0	130,076	81,042	108,732	102,386
Total	96,846	56,180	0	153,026	81,042	108,732	125,336
Capital assets being depreciated							
Structures, improvements, & water system	3,252,653	21,170	1,350	3,272,473	199,524	23,445	3,448,552
Office furniture & equipment	54,215	2,165	0	56,380	0	0	56,380
Vehicles & equipment	107,136	39,287	26,105	120,318	0	0	120,318
Machinery & equipment	453,958	910	0	454,868	16,599	1,516	469,951
Total	3,867,962	63,532	27,455	3,904,039	216,123	24,961	4,095,201
Total capital assets	3,964,808	119,712	27,455	4,057,065	297,165	133,693	4,220,537
Less accumulated depreciation for:							
Structures, improvements, & water system	1,680,381	59,690	1,189	1,738,882	60,237	23,445	1,775,674
Office furniture & equipment	35,094	3,679	0	38,773	3,347	0	42,120
Vehicles & equipment	82,990	8,596	26,106	65,480	11,130	0	76,610
Machinery & equipment	191,752	26,235	0	217,987	22,215	1,516	238,686
Total accumulated depreciation	1,990,217	98,200	27,295	2,061,122	96,929	24,961	2,133,090
Total business-type activities capital assets, net	$1,974,591	$ 21,512	$ 160	$1,995,943	$ 200,236	$ 108,732	$2,087,447

NOTE F – LONG-TERM LIABILITIES

During 2014, the District entered into an agreement with a financial institution to finance the leasing of equipment. The lease agreement qualifies as a capital lease for accounting purposes. The equipment had an original cost of $42,527. Monthly payments of $1,772, including interest at a rate of 2.1038% began in June 2014 and continued through May 2016. The debt service requirements to maturity were met during 2016.

Amortization expense associated with capital leases is presented with depreciation expense. The gross amount of equipment leased under capital leases is $42,527 with accumulated depreciation of $10,632 as of December 31, 2016 and of $6,379 as of December 31, 2015.

Long-term liability activity

Long-term liability activity for the years ended December 31, 2016 and 2015, were as follows:

	Balances 12/31/14	Additions	Reductions	Balances 12/31/15	Additions	Reductions	Balances 12/31/16	Amounts Due Within One Year
Capital Lease	$ 30,020	$ 0	$ 20,840	$ 9,180	$ 0	$ 9,180	$ 0	$ 0
Customer Deposits	18,585	5,251	4,866	18,970	5,671	5,146	19,495	5,134
Business-type *Activities Long-*Term Liabilities	$ 48,605	$ 5,251	$ 25,706	$ 28,150	$ 5,671	$ 14,326	$ 19,495	$ 5,134

NOTE G - ACCUMULATED COMPENSATED ABSENCES

Effective March 2011 employees are no longer permitted to accumulate earned but unused vacation days beyond one year. The employees must use or cash out their yearly allotment of vacation time earned by the annual anniversary date of their employment.

NOTE H - EMPLOYEES' PENSION PLAN

General Information about the Pension Plan

Plan Description. The District and covered employees contribute to the County Employers Retirement System (CERS), a cost-sharing, multiple-employer defined benefit plan administered by the Board of Trustees of the Kentucky Retirement Systems (KRS). Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of the Kentucky Retirement Systems. The CERS financial statements and other supplementary information are contained in the publicly available annual financial report of the Kentucky Retirement Systems. Copies of the report are sent to each participating employer as well as distributed to legislative personnel, state libraries and other interested parties. Copies may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West 1260 Louisville Road, Frankfort, Kentucky 40601 or by calling 1-502-564-4646.

NOTE H - EMPLOYEES' PENSION PLAN continued

Benefits provided. Kentucky Revised Statue Section 61.645 establishes the benefit terms and can be amended only by the Kentucky General Assembly. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living adjustments are provided at the discretion of the State legislature. There are currently three benefit tiers. Tier 1 members are those participating in the plan before 9/1/2008, Tier 2 members are those that began participation 9/1/2008 through 12/31/2013, and Tier 3 are those members that began participation on or after 1/1/2014.

Benefits provided-non hazardous. Tier 1 non-hazardous members are eligible to retire with an unreduced benefit at age 65 with four years of service credit or after 27 years of service credit regardless of age. Benefits are determined by a formula using the member's highest five consecutive year average compensation, which must contain at least 48 months. Reduced benefits for early retirement are available at age 55 and vested or 25 years of service credit. Members vest with five years of service credit. Service related disability benefits are provided after five years of service. Tier 2 non-hazardous members are eligible to retire based on the rule of 87: the member must be at least age 57 and age + earned service must equal 87 years at retirement or at age 65 with five years of service credit. Benefits are determined by a formula using the member's highest five consecutive year average compensation, which must be 60 months. Reduced benefits for early retirement are available at age 60 with 10 years of service. Tier 3 non-hazardous members are also eligible to retire based on the rule of 87. Benefits are determined by a life annuity calculated in accordance with actuarial assumptions and methods adopted by the board based on a member's accumulated account balance. Tier 3 members are not eligible for reduced retirement benefits.

Contributions. Per Kentucky Revised Statute 61.565, normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems on the basis of an annual valuation last preceding 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 bases adopted by the Board. For the year ended December 31, 2016, plan members were required to contribute 5% of their annual creditable compensation. Plan members hired subsequent to September 1, 2008 were required to contribute 6% of their annual creditable compensation. The District is required to contribute at an actuarial determined rate. The District was required to contribute 18.68%, 13.95% for pensions and 4.73% for insurance, of each employee's creditable compensation for the last six months of the year ended December 31, 2016. The District was required to contribute 17.06%, 12.42% for pensions and 4.64% for insurance, of each employee's creditable compensation for the first six months of the year ended December 31, 2016 and for the final six months of the year ended December 31, 2015. The District was required to contribute 17.67%, 12.75% for pensions and 4.92% for insurance, of each employee's creditable compensation for the first six months of the year ended December 31, 2015 and for the final six months of the year ended December 31, 2014. The District was required to contribute 18.89%, 13.74% for pensions and 5.15% for insurance, of each employee's creditable compensation for the first six months of the year ended December 31, 2014. The District's contributions to CERS for the years ended December 31, 2016, 2015 and 2014 were $40,952, $42,341, and $37,814, respectively. The District's payable to the plan at December 31, 2016 and 2015 was $0 and $0, respectively, which consisted of employees' withholdings and legally required contributions for the month of December.

NOTE H - EMPLOYEES' PENSION PLAN continued

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At December 31, 2016, the District reported a liability of $492,576 for its proportionate share of the net pension liability. The District's net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate net pension liability was determined by an actuarial valuation as of that date. At December 31, 2015, the District reported a liability of $404,505 for its proportionate share of the net pension liability. The District's net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate net pension liability was determined by an actuarial valuation as of that date.

For the year ended December 31, 2016, the District recognized pension expense of $74,731. For the year ended December 31, 2015, the District recognized pension expense of $46,498. At December 31, 2016 and 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	12/31/2016		12/31/2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on pension plan investments	$ 46,307	$ -	$ 3,626	$ -
Net difference between expected and actual experience	2,150	-	3,362	-
Changes in proportional and differences between employer contributions and proportional share of contributions	17,469	-	2,480	-
Change of assumptions	26,094	-	40,790	-
District contributions subsequent to the measurement date	16,335	-	15,595	-
Total	$ 108,355	$ -	$ 65,853	$ -

$16,335 reported as deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	
2017	$ 34,181
2018	22,868
2019	22,273
2020	12,698

Actuarial assumptions.

The total pension liability in the June 30, 2016 and 2015 actuarial valuations using standard roll-forward techniques, 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 pension plan investment expense, including inflation

NOTE H - EMPLOYEES' PENSION PLAN continued

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 assumption 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 KRS. 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.

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

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
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	(0.25)
Total	100%	

Discount rate. For CERS, the discount rate used to measure the total pension liability was 7.50%. 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 discount rate does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through 2117.

NOTE H - EMPLOYEES' PENSION 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%, 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%) or 1-percentage-point higher (8.50%) than the current rate.

	1% Decrease (6.50%)	Discount Rate (7.50%)	1% Increase (8.50%)
District's 2016 proportionate share of the net pension liability	$ 613,563	$ 492,576	$ 388,469
District's 2015 proportionate share of the net pension liability	$ 516,503	$ 404,505	$ 308,737

2015

Change in assumptions. Since the prior measurement date, the demographic and economic assumptions that affect the measurement of the total pension liability have been updated. The changes are noted below:

- 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.

Pension plan fiduciary net position. Detailed information about the pension plan's fiduciary net position is available in the separately issued financial report of CERS.

NOTE I - RISK MANAGEMENT

The District is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. The District purchases commercial insurance for all risks of losses. Settlements resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE J - CONSTRUCTION IN PROGRESS AND CONSTRUCTION PROJECTS PAYABLE

During 2016, the District incurred $1,151 in materials cost related to the Clark Street Line Replacement project. These costs are considered construction in progress until the line replacement is complete and in service. The project was completed in 2016 and $108,732 related costs of the project were capitalized. Also, during 2016, the District purchased a large volume of meters of which $77,824 cost is awaiting to be placed in service at year end.

During 2015, the District incurred $35,284 in labor, excavating, legal, and materials cost related to the Clark Street Line Replacement project. These costs are considered construction in progress until the line replacement is complete and in service. Also, during 2015, the District incurred $20,895 in land, legal, and materials cost related to the the new office building project.

NOTE K – PRIOR PERIOD ADJUSTMENT AND RESTATEMENT OF COMPARATIVE STATEMENTS

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement no. 68, "Accounting and Financial Reporting for Pensions" (GASB 68). GASB 68 replaced the requirements of GASB 27, "Accounting for Pensions by State and Local Governmental Employers" and GASB 50, "Pension Disclosures", as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. GASB 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pensions benefits as a liability to more comprehensively and comparably measure the annual costs of pension benefits. Cost-sharing governmental employers, such as the District, are required to report a net pension liability, pension expense and pension-related deferred outflows and inflows of resources based on their proportionate share of the collective amounts for all governments in the plan. The standard required a restatement of Beginning Net Position in the year of adoption.

The provisions of GASB 68 were effective for fiscal periods beginning after June 15, 2014. The District adopted GASB 68 for the year ended December 31, 2015 which was the first year of implementation for the District.

As originally reported, the adoption of the standard impacted the District's financial position and resulted in a restatement to reduce beginning net position in the amount of $312,000.

As restated for December 31, 2015, Deferred Outflows of Resources-Pensions incorrectly included the insurance portion of current District contributions subsequent to the measurement date of June 30, 2015. Also, a measurement date of June 30, 2014 was incorrectly used. The measurement date of June 30, 2015, included with a valuation report which was not available at the time should have been used. Deferred Outflows of Resources-Pensions was understated $23,726 and the correct amount of $65,853 has been restated on the comparative 2015 Statement of Net Position. Net Pension Liability was understated $102,505 and the correct amount of $404,505 has been restated on the comparative 2015 Statement of Net Position. Deferred Inflows of Resources-Pensions was overstated $34,000 and the correct amount of $0 has been restated on the comparative 2015 Statement of Net Position. Employee Benefits was understated $22,498 and the correct amount of $85,774 has been restated on the comparative 2015 Statement of Revenues, Expenses and Changes in Fund Net Position. The net effect was a $44,779 net reduction of Beginning Total Net Position.

Required Supplementary Information

Muhlenberg County Water District District Number 3
Schedule of Proportionate Share of the Net Pension Liability
December 31, 2016 and 2015

	2016	2015
Total net pension liability for County Employees' Retirement System	$ 6,639,559,678	$ 5,834,631,445
District's proportion of the net pension liability (asset)	0.01000%	0.00941%
District's proprtionate share of the net pension liability (asset)	$ 492,576	$ 404,505
District's covered-employer payroll	$ 237,399	$ 219,505
District's proportionate share of the net pension liability (asset) as a percentage of its covered-employer payroll	207.49%	184.28%
Total pension plan's fiduciary net position	$ 8,151,568,466	$ 8,519,001,523
Total pension plan's pension liability	$14,791,128,144	$14,353,632,968
Total Pension Plan's fiduciary net position as a percentage of the total pension liability	55.11%	59.35%

Note: This schedule is intended to present a 10-year trend per GASB 68. Additional years will be reported as incurred

Muhlenberg County Water District Number 3
Schedule of District Contributions
December 31, 2016 and 2015

	2016	2015
Actuarially determined contribution	$ 40,500	$ 38,786
Contributions in relation to the actuarially determined contribution	40,500	38,786
Contribution deficiency (excess)	$ 0	$ 0
District's covered-employee payroll	$ 237,399	$ 219,505
Contributions as a percentage of covered-employee payroll	17.06%	17.67%

Note: This schedule is intended to present a 10-year trend per GASB 68. Additional years will be reported as incurred

Alexander, Toney & Knight PLLC

CERTIFIED PUBLIC ACCOUNTANTS
28 Court Street
Madisonville, Kentucky 42431
(270) 821-4824
FAX: (270) 825-4554
Email: atk@atkcpas.com

Larry R. Alexander, CPA
Harold R. Toney, Jr., CPA
Tony Knight, CPA

Members
American Institute of Certified Public Accountants
Kentucky Society of Certified Public Accountants

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 Commissioners
Muhlenberg County Water District Number 3
Bremen, Kentucky

We have audited, 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, the financial statements of Muhlenberg County Water District Number 3 as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, and have issued our report thereon dated March 20, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Muhlenberg County Water District Number 3'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Muhlenberg County Water District Number 3's internal control. Accordingly, we do not express an opinion on the effectiveness of Muhlenberg County Water District Number 3'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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, as discussed below, that we consider to be significant deficiencies.

2016-1 Segregation of Duties

Condition: The internal control relating to receipts and disbursements is inadequate due to a lack of segregation of duties.
Criteria: Adequate segregation of duties is essential to an adequate internal control over financial reporting by allocating various duties among employees.
Effect: The lack of proper segregation of duties may permit errors or irregularities to go undetected.
Cause: There is a small number of accounting personnel. The cost versus benefit relationship prevents the District from hiring enough accounting personnel to properly segregate key accounting functions.
Recommendation: While the small number of employees that exist will never provide proper segregation of duties, the District should continually review job responsibilities for better accounting controls.
Response: The District concurs with the recommendation and will continually review job responsibilities to improve accounting controls when possible.

2016-2 Lack of Financial Reporting Expertise

Condition: The District lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures. 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.
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.
Effect: The absence of such controls may allow errors to go undetected.
Cause: There is a lack of personnel who possess the required knowledge.
Recommendation: We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements or review the financial statements as prepared by the auditor for compliance with generally accepted accounting principles.
Response: Management has determined that it is more cost effective to continue to engage the auditor to draft the financial statements and related notes.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Muhlenberg County Water District Number 3's financial statements are free of 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*.

Muhlenberg County Water District Number 3's Response to Findings

Muhlenberg County Water District Number 3's response to the findings identified in our audit is described above. Muhlenberg County Water District Number 3's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purposes.

Alexander, Toney & Knight PLLC

Madisonville, Kentucky
March 20, 2017