

SANDY HOOK WATER DISTRICT
AUDIT OF FINANCIAL STATEMENTS
For The Year Ended December 31, 2015

TABLE OF CONTENTS

	<u>Page</u>
Independent Auditors' Report	1
Statement of Net Position	4
Statement of Revenues, Expenses and Changes in Fund Net Position	6
Statement of Cash Flows	8
Notes to the Financial Statements	10
Required Supplemental Information:	
Schedule of the District's Proportionate Share of the Net Pension Liability	27
Schedule of the Districts' Contributions	28
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 <i>Government Auditing Standards</i>	29
Comment and Recommendation	31

Morgan-Franklin, LLC

Certified Public Accountants
PO Box 428, 749 Broadway Street
West Liberty, KY 41472

Brenda K. Morgan, CPA
Jody B. Franklin, CPA

Phone: (606) 743-1884
Fax: (606) 743-189
office@morganfranklincpa.com

INDEPENDENT AUDITORS' REPORT

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Sandy Hook Water District, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the 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.

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

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

Opinion

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

Change in Accounting Principle

As described in Note L to the financial statements, in 2015, Sandy Hook 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 Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2016, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

March 23, 2016

**SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2015**

ASSETS

CURRENT ASSETS

Cash - Unrestricted	\$ 83,053
Cash - Restricted	329,785
Accounts Receivable	69,559
Prepaid Expenses	<u>7,145</u>

Total Current Assets 489,542

NONCURRENT ASSETS

Capital Assets - Net of Accumulated Depreciation

Land	146,998
Land Improvements	5,985
Buildings and Building Improvements	713,648
Wells and Springs	279,502
Electric Pumping Equipment	10,035
Transmission and Distribution	5,709,331
Treatment Plant	74,527
Miscellaneous Equipment	13,120
Transportation Equipment	58,071
Furniture and Fixtures	<u>371</u>

Total Noncurrent Assets 7,011,588

TOTAL ASSETS 7,501,130

DEFERRED OUTFLOWS OF RESOURCES

Pension Contributions 35,697

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

**SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2015**

LIABILITIES AND NET POSITION

CURRENT LIABILITIES

Accrued Interest	31,170
Due to City of Sandy Hook	19,034
Accrued Taxes	535
Accrued Salaries	894
Unearned Revenues	2,833
Accounts Payable	31,520
Bonds Payable	40,800
Total Current Liabilities	126,786

LONG-TERM LIABILITIES

Bonds Payable	1,454,500
Compensated Absenses	6,319
Total Long-Term Liabilities	1,460,819

OTHER LIABILITIES

Net Pension Liabilities	219,000
Customer Deposits	26,409
Total Other Liabilities	245,409

TOTAL LIABILITIES 1,833,014

DEFERRED INFLOWS OF RESOURCES

Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	24,000
--	--------

NET POSITION

Invested in Capital Assets, Net of Related Debt	5,516,288
Restricted for:	
Debt Service	163,981
Depreciation Reserve	114,092
Sewer Collections	19,034
Unrestricted	(133,582)

TOTAL NET POSITION 5,679,813

TOTAL LIABILITIES AND NET POSITION \$ 7,536,827

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

SANDY HOOK WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSTION
For The Year Ended December 31, 2015

OPERATING REVENUES

Water Sales	\$ 631,604
Service Revenues	20,242
Miscellaneous Revenues	<u>25,351</u>
 Total Operating Revenues	 677,197

OPERATING EXPENSES

Water Expenses	
Advertising	560
Depreciation	204,093
Dues and Subscriptions	3,301
Legal and Accounting Services	10,650
Miscellaneous	5,403
Office Supplies	3,382
Lease Expense	792
Payroll Taxes	14,358
Postage	6,338
Professional Services	1,393
Insurance	42,190
Workers Comp	5,828
Repairs and Maintenance	104,776
Retirement	18,000
Salaries and Wages	205,627
Supplies and Testing	21,282
Taxes and Licenses	1,311
Telephone and Utilities	58,534
Travel and Automobile	<u>11,037</u>
 Total Operating Expenses	 <u>718,855</u>

NET OPERATING INCOME (LOSS) (41,658)

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

SANDY HOOKWATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For The Year Ended December 31, 2015

NON OPERATING REVENUES (EXPENSES)

Grant Proceeds	97,717
Interest Expense	(68,454)
Interest Income	<u>353</u>
Total Non Operating Revenues (Expenses)	<u>29,616</u>
Net Change in Net Position	(12,042)
Net Position - Beginning (Restated)	<u>5,691,855</u>
Total Net Position - Ending	<u><u>\$ 5,679,813</u></u>

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

**SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2015**

CASH FLOWS FROM OPERATING ACTIVITIES

Payments from Customers	\$ 662,209
Payments for Sewer Collection Fees	9,600
Payments to Vendors	(218,431)
Payments for Payroll and Related Expenses	<u>(298,853)</u>
 Net Cash Provided (Used) by Operating Activities	 154,525

CASH FLOWS FROM CAPITAL AND
RELATED FINANCING ACTIVITIES

Grant Proceeds	97,718
Interest Paid on Debt	(62,311)
Fixed Assets Purchased or Constructed	(165,519)
Payments on Capital Debt	<u>(31,200)</u>
 Net Cash Provided (Used) by Capital and Related Financing Activities	 (161,312)

CASH FLOWS FROM INVESTING ACTIVITIES

Cash Received from Interest	<u>353</u>
 Net Cash Provided (Used) by Investing Activities	 <u>353</u>

INCREASE (DECREASE) IN CASH (6,434)

CASH AT BEGINNING OF YEAR 419,272

CASH AT END OF YEAR \$ 412,838

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

**SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2015**

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

Net Operating Income	\$ (41,658)
Adjustments to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	204,093
Changes in Assets/Liabilities:	
Accounts Receivable	(6,494)
Accounts Payable	18,864
Accrued Taxes	(1,203)
Accrued Pension Liability	(17,697)
Accrued Payroll Taxes	(5,392)
Due to City of Sandy Hook	2,906
Customer Deposits	<u>1,106</u>
Net Cash Provided (Used) by Operating Activities	<u><u>\$ 154,525</u></u>

Supplementary Information

Interest Expensed	\$ 68,454
-------------------	-----------

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

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Sandy Hook 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.

Regulatory Requirements

The District is subject to the regulatory authority of the Kentucky Public Service Commission (“PSC”) pursuant to KRS 278.040.

Organization & Activity

The District was created in accordance with Chapter 74 of the Kentucky Revised Statutes in 1957. The purpose of the District is to provide water services to residents in Sandy Hook, Kentucky and the surrounding area.

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 District’s financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America.

All activities of the District are accounted for within a single proprietary (enterprise reporting) entity. Proprietary entities are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expense, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. 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 associated with the operations are included on the Statement of Net Position. Net Position is segregated into “invested in capital assets, net of related debt;” “restricted;” and “unrestricted” components.

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

In accordance with Kentucky Revised Statute 65.065, the District is required to submit a balanced budget to the Elliott County Fiscal Court prior to December 1. The budget includes proposed expenditures and means of financing them for the upcoming year. Annual budgets are adopted on a basis consistent with generally accepted accounting principles. Expenditures may not legally exceed budgeted appropriations at the fund level. All appropriations lapse at calendar year end.

Allowance for Doubtful Accounts

No allowance for doubtful accounts has been established. The District considers all receivables to be fully collectible based on their strict cut-off policy. If amounts become uncollectible, the amounts due are offset by any customer deposit held and the balance charged to operations when that determination is made.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivables

Accounts receivables are stated at face amount and include billed and unbilled receivables due as of December 31, 2015. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed on December 30, 2015 was for customer usage from approximately November 25 through December 25, 2015. The entire amount is considered accounts receivable as of December 31, 2015. The billing mailed on January 27, 2016 was for usage from approximately December 26, 2015 through January 25, 2016. Approximately five days of this billing is considered unbilled receivables at December 31, 2015.

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, and similar items, are reported as a component of noncurrent assets in the basic financial statements. 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.

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.

The depreciation expense provided on proprietary fund assets during the period ended December 31, 2015 is \$204,093.

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. There was no capitalized interest in 2015.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

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

Inventory and Prepaid Items

The District maintains an inventory of supplies to make minor repairs to the water district systems. It is the policy of the water district to expense the items as they are purchased.

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.

The District collects sewer revenues on behalf of the City of Sandy Hook. The amount owed to the City of Sandy Hook as of December 31, 2015 is reported as a component of restricted net position.

Federal Income Tax

The District is exempt from federal income tax since it is a governmental entity. Accordingly, the financial statements include no provision for income taxes.

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.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE B – RESTRICTIONS ON CASH

Bond Sinking Fund

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, 2015, \$96,210 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, 2015 was \$163,981.

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various bond documents. The District was required to deposit \$2,760 per month into the account. At December 31, 2015, \$102,720 was the required balance of the Depreciation Reserve account. The District had \$114,092 in this account for the purpose of maintaining the water system.

Restricted Cash Accounts

The District is required to maintain special deposit accounts for customer deposits and long-term debt obligations. The following is a listing of restricted cash accounts of the District:

Customer Deposit Fees Account	\$ 29,974
Equipment Replacement Account	2,704
Sewer Revenue Held for the City of Sandy Hook	19,034
Bond and Interest Sinking Fund	163,981
Depreciation Reserve Fund	<u>114,092</u>
Total Restricted Cash Accounts	<u><u>\$ 329,785</u></u>

NOTE C – NET POSITION

Equity is classified as net position and displayed in three components:

- Invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets;
- Restricted net position - resulting from constraints placed on net position by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and
- Unrestricted net position - those assets that do not meet the definition of restricted net position or invested in capital assets.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE D – 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, 2015, 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. As of December 31, 2015, the bank balance was \$444,154.

The bank balances were either insured by FDIC or covered by pledged collateral as of December 31, 2015.

NOTE E – PROPERTY, PLANT, AND EQUIPMENT

The District’s major classes of utility capital assets and accumulated depreciation are shown below:

	Balance 12/31/2014	Additions	Disposals	Balance 12/31/2015
Land	\$ 146,998	\$	\$	\$ 146,998
Construction in Progress	830,707	81,461	912,168	
Land Improvements	16,320			16,320
Buildings and Building Improvements	906,007			906,007
Wells and Springs	78,896	250,000		328,896
Transmission and Distribution	7,283,195	662,168		7,945,363
Treatment Plant	420,514			420,514
Electric Pumping Equipment	30,344			30,344
Miscellaneous Equipment	102,087		5,800	96,287
Furniture and Fixtures	5,876			5,876
Transportation Equipment	55,766	67,749	38,190	85,325
Total	9,876,710	1,061,378	956,158	9,981,930

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE E – PROPERTY, PLANT, AND EQUIPMENT (Continued)

	Balance 12/31/2014	Additions	Disposals	Balance 12/31/2015
Accumulated Depreciation:				
Land Improvements	9,247	1,088		10,335
Buildings and Building Improvements	174,661	17,699		192,360
Wells and Springs	47,472	1,922		49,394
Transmission and Distribution	2,077,022	159,009		2,236,031
Treatment Plant	334,959	11,028		345,987
Electric Pumping Equipment	19,003	1,306		20,309
Miscellaneous Equipment	86,658	2,309	5,800	83,167
Furniture and Fixtures	5,451	53		5,504
Transportation Equipment	55,766	9,679	38,190	27,255
Total	2,810,239	204,093	43,990	2,970,342
Fixed Assets Net of A/D	\$ 7,066,471	\$ 857,285	\$ 912,168	\$ 7,011,588

NOTE G – BONDS PAYABLE

1. Waterworks Revenue Series 1988

On May 25, 1988, the District entered into an agreement with Rural Development to issue \$237,000 in Waterworks Revenue Bonds for the purpose of financing the cost of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 6.25% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2015, the principal balance outstanding was \$153,000. Debt service requirements for year ending December 31, 2015, and thereafter are as follows:

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE G – BONDS PAYABLE (Continued)

1. Waterworks Revenue Series 1988 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2016	\$ 9,562	\$ 8,000
2017	9,062	8,000
2018	8,562	9,000
2019	8,000	9,000
2020	7,438	10,000
2021-2025	26,940	61,000
2026-2028	6,124	48,000
Totals	\$ 75,688	\$ 153,000

2. Waterworks Revenue Bond Series 1991

On July 24, 1991, the District entered into an agreement with Rural Development to issue \$316,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2015, the principal balance outstanding was \$192,000. Debt service requirements for year ending December 31, 2015, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2016	\$ 9,600	\$ 9,000
2017	9,150	9,000
2018	8,700	10,000
2019	8,200	10,000
2020	7,700	11,000
2021-2025	29,800	63,000
2026-2030	12,300	80,000
Totals	\$ 85,450	\$ 192,000

3. Waterworks Revenue Bond Series 1992

On May 27, 1992, the District entered into an agreement with Rural Development to issue \$70,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2015, the principal balance outstanding was \$46,800. Debt service requirements for year ending December 31, 2015, and thereafter are as follows:

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE G – BONDS PAYABLE (Continued)

3. Waterworks Revenue Bond Series 1992 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2016	\$ 2,340	\$ 1,800
2017	2,250	1,900
2018	2,156	2,000
2019	2,056	2,100
2020	1,950	2,200
2021-2025	7,988	12,800
2026-2030	4,448	16,300
2031-2032	582	7,700
Totals	\$ 23,770	\$ 46,800

4. Waterworks Revenue Bonds Series 1995

On April 27, 1995, the District entered into an agreement with Rural Development to issue \$259,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2015, the principal balance outstanding was \$184,000. Debt service requirements for year ending December 31, 2015, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2016	\$ 8,280	\$ 6,000
2017	8,010	6,500
2018	7,718	7,000
2019	7,402	7,000
2020	7,088	7,500
2021-2025	30,016	43,500
2026-2030	19,372	53,000
2031-2034	6,166	53,500
Totals	\$ 94,052	\$ 184,000

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE G – BONDS PAYABLE (CONTINUED)

5. Waterworks Revenue Bonds Series 2001

On June 20, 2001, the District entered into an agreement with Rural Development to issue \$495,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2015, the principal balance outstanding was \$415,500. Debt service requirements for year ending December 31, 2015, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2016	\$ 18,698	\$ 8,500
2017	18,316	9,000
2018	17,910	9,500
2019	17,482	10,000
2020	17,032	10,500
2021-2025	77,628	60,000
2026-2030	62,932	74,000
2031-2035	44,688	92,500
2036-2040	21,938	115,000
2041	1,192	26,500
Totals	\$ 297,816	\$ 415,500

6. Waterworks Revenue Bonds Series 2014

On July 21, 2014, the District entered into an agreement with Rural Development to issue \$504,000 Waterworks Revenue bonds for the purpose of the construction of extensions, additions and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 2.75% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2015, the principal balance outstanding was \$504,000. Debt service requirements for year ending December 31, 2015, and thereafter are as follows:

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE G – BONDS PAYABLE (CONTINUED)

6. Waterworks Revenue Bonds Series 2014 (Continued)

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2016	\$ 13,757	\$ 7,500
2017	13,544	8,000
2018	13,324	8,000
2019	13,097	8,500
2020	12,863	8,500
2021-2025	60,568	47,000
2026-2030	53,693	53,000
2031-2035	45,883	61,000
2036-2040	36,927	69,500
2041-2045	26,676	80,000
2046-2050	14,816	92,500
2051-2053	2,496	60,500
Totals	<u>\$ 307,644</u>	<u>\$ 504,000</u>

7. Long Term Debt Maturity in the Aggregate

<u>Year Ended December 31</u>	<u>Scheduled Interest</u>	<u>Scheduled Principal</u>
2016	\$ 62,237	\$ 40,800
2017	60,332	42,400
2018	58,370	45,500
2019	56,237	46,600
2020	54,071	49,700
2021-2025	232,940	287,300
2026-2030	158,869	324,300
2031-2035	97,319	214,700
2036-2040	58,865	184,500
2041-2045	27,868	106,500
2046-2050	14,816	92,500
2051-2053	2,496	60,500
Totals	<u>\$ 884,420</u>	<u>\$ 1,495,300</u>

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE G – BONDS PAYABLE (CONTINUED)

8. Changes in Long-term Liabilities

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Business-type Activities:</u>					
Revenue Bonds	\$ 1,526,500	\$	\$ 31,200	\$ 1,495,300	\$ 40,800
Business-type Activities Long-term Liabilities	\$ 1,526,500	\$ 0	\$ 31,200	\$ 1,495,300	\$ 40,800

The total interest expense incurred by the District during the current fiscal year was \$68,454.

NOTE H – 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. Benefit contributions and provisions are established by statute.

Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008 are required to contribute 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 17.67 percent for the first six months of 2015 and 17.06 percent for the last six months of 2015.

The District's contribution for calendar year 2013 was \$37,007, 2014 was \$36,524, and 2015 was \$35,697.

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:

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE H – RETIREMENT (Continued)

General Information about the Pension Plan (Continued)

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>	<u>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.

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.

Pension Liabilities

At December 31, 2015, the District has a liability of \$219,000 for its proportionate share of the net pension liability for non-hazardous retirement. The net pension liability was measured as of June 30, 2014, 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, 2014, the District's proportion was .006757%.

For the year ended December 31, 2015, the District recognized pension expense of \$18,000. At December 31, 2015 the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

SCHEDULE OF DEFERRED INFLOWS AND OUTFLOWS

NON-HAZARDOUS	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net Difference between Projected and Actual Earnings on Pension Plan Investments	\$	\$ 24,000
District Contributions Subsequent to the Measurement Date	<u>35,697</u>	
Total	<u>\$ 35,697</u>	<u>\$ 24,000</u>

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE H – RETIREMENT (Continued)

Pension Liabilities (Continued)

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	\$ (6,118)
Year 2	\$ (6,118)
Year 3	\$ (6,118)
Year 4	\$ (6,118)
Year 5	\$ 0
Thereafter	\$ 0

An amount of \$35,697 reported as deferred outflows of resources 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, 2016.

Actuarial Methods and Assumptions

The total pension liability in the June 30, 2014 actuarial valuation was determined using the following assumption, applied to all periods included in the measurement:

Inflation	3.5%
Salary Increases	4.5%, average, including inflation
Investment Rate of Return	7.75%, net of pension plan investment expense, including inflation

The rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward five years is used for the period after disability retirement.

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 2005 through 2008, is outlined in a report dated August 25, 2009. 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.

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE H – RETIREMENT (Continued)

Pension Liabilities (Continued)

Actuarial Methods and Assumptions (Continued)

Projected future benefit payments for all current plan members were projected through 2116.

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic Equity	30%	8.45%
International Equity	22%	8.85%
Emerging Market Equity	5%	10.50%
Private Equity	7%	1.25%
Real Estate	5%	7.00%
Core US Fixed Income	10%	5.25%
High Yield US Fixed Income	5%	7.25%
Non-US Fixed Income	5%	5.50%
Commodities	5%	7.75%
TIPS	5%	5.00%
Cash	1%	3.25%
Total	<u>100%</u>	

Discount Rate

The discount rate used to measure the total pension liability was 7.75 percent. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at statutory contribution rates. Projected inflows from investment earnings were calculated using the long-term assumed investment return of 7.75 percent. The long-term assumed investment rate of return was applied to all periods of projected of benefit payments to determine the total pension liability.

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 (6.75 percent) or one-percentage-point higher (8.75 percent) than the current rate for non-hazardous:

NON-HAZARDOUS	<u>1% Decrease (6.75%)</u>	<u>Current Discount Rate (7.75%)</u>	<u>1% Increase (8.75%)</u>
District's Net Pension Liability	\$ 288,482	\$ 219,223	\$ 158,030

**SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2015**

NOTE H – 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, 2015, is based on the June 30, 2014, actuarial valuation for the first year of implementation. As a result, there are no differences between expected and actual experience or changes in assumptions subject to amortization. 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.

NOTE I – INSURANCE COVERAGE

The District is exposed to various risks of loss. The District carries commercial insurance for risks of loss. As of December 31, 2015, there were no known losses for which an accrual was considered necessary and no estimated claims that have been incurred, but not reported. There have been no settlements that have exceeded insurance coverage for each of the past three fiscal years.

NOTE J – COMPENSATED ABSENCES

It is the District's policy to permit its employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave because the District does not have a policy to pay any amounts when employees separate from service with the District. The unused vacation or annual leave is considered a vested employee benefit.

In recognition of the resulting obligation, the District has accrued a liability for earned but unused vacation leave, having determined that payment of such compensation is probable and having developed a reasonable estimate based upon current salary costs and annual leave balances as of December 31, 2015. The liability for compensated absences at December 31, 2015 was \$6,319.

NOTE K – SUBSEQUENT EVENTS

Subsequent events have been evaluated through March 23, 2016, which is the date the financial statements were available to be issued.

NOTE L. PRIOR PERIOD ADJUSTMENT

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.

SUPPLEMENTAL INFORMATION

**SANDY HOOK WATER DISTRICT
SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE
NET PENSION LIABILITY
December 31, 2015**

	Non-Hazardous
June 30, 2014 District's Proportion of the Net Pension Liability (Asset)	0.006757%
June 30, 2014 District's Proportionate Share of the Net Pension Liability (Asset)	\$ 219,000
June 30, 2014 District's Covered-Employee Payroll	\$ 154,733
June 30, 2014 District's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Its Covered-Employee Payroll	141.53%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	66.80%

**SANDY HOOK WATER DISTRICT
 SCHEDULE OF THE DISTRICT'S CONTRIBUTIONS
 December 31, 2015**

	Non-Hazardous
June 30, 2014 Contractually Required Contribution	\$ 29,281
June 30, 2014 Contributions in Relation to the Contractually Required Contribution	37,349
Contribution Deficiency (Excess)	\$ (8,068)
District's Covered-Employee Payroll	\$ 154,733
Contributions as a Percentage of Covered-Employee Payroll	18.92%

Morgan-Franklin, LLC

Certified Public Accountants
PO Box 428, 749 Broadway Street
West Liberty, KY 41472

Brenda K. Morgan, CPA
Jody B. Franklin, CPA

Phone: (606) 743-1884
Fax: (606) 743-1895
office@morganfranklincpa.com

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
Sandy Hook Water District
Sandy Hook, 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 Sandy Hook Water District, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise Sandy Hook Water District's basic financial statements and have issued our report thereon dated March 23, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Sandy Hook Water 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 Sandy Hook Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of Sandy Hook Water 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 Sandy Hook 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying comments and recommendations as item 2015-001.

Sandy Hook Water District's Response to the Finding

Sandy Hook Water District's response to the finding identified in our audit is described in the accompanying comment and recommendation. The District'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 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

March 23, 2016

**SANDY HOOK WATER DISTRICT
COMMENT AND RECOMMENDATION
DECEMBER 31, 2015**

NONCOMPLIANCE

2015-001 The County Judge/Executive Appointed The Deputy County Judge/Executive To Serve As A Board Member Of The District

Condition: The county judge/executive appointed the deputy county judge/executive to serve as a board member of the district.

Criteria: OAG 78-651 states, A county judge/executive cannot legally serve at the same time as a water board commissioner, since that would involve a common-law incompatibility and would be against public policy and none of the other members of the fiscal court (that is, the magistrates or commissioners on the fiscal court) can legally serve as commissioners of a water board for the same year for the same reasons.

The deputy county judge/executive serves in the capacity of the county judge/executive except he is not permitted to preside over fiscal court meetings.

Effect: The appointment of the deputy county judge/executive may not have been a legal appointment.

Cause: Unknown

Recommendation: We recommend the District request a written legal opinion from their attorney regarding this matter.

District's Response: This has been reported to PSC & we will write another letter to PSC and Attorney General Office.