

CANNONSBURG WATER DISTRICT
Cannonsburg, Kentucky

REPORT ON EXAMINATION OF FINANCIAL STATEMENTS
AND SUPPLEMENTAL INFORMATION
for the year ended December 31, 2016

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Cannonsburg Water District
Cannonsburg, Kentucky

We have audited the accompanying financial statements of the business-type activities of the Cannonsburg Water District as of and for the year ended December 31, 2016, which comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Cannonsburg Water District's management. Our responsibility is to an express opinion on these financial statements based on our audit.

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.

Management has elected to omit the Management's Discussion & Analysis which is required by the Governmental Accounting Standards Board.

Auditor's 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 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 the Cannonsburg Water District, as of December 31, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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 and historical context. Our opinion on the basic financial statements is not affected by this missing information.

The schedule of the water district's proportionate share of net pension liability and the schedule of water district contributions are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of the water district's proportionate share of net pension liability and schedule of water district contributions are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Cannonsburg Water District's basic financial statements. The comparative statement of revenues and expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the *Uniform Guidance*, and is also not a required part of the basic financial statements.

The comparative statement of revenues and expenses and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the comparative statement of revenues and expenses and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 25, 2017, on our consideration of the Cannonsburg Water 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 Cannonsburg Water District's internal control over financial reporting and compliance.

John T. Lane & Associates LLC

Mount Sterling, Kentucky

May 25, 2017

This report contains 23 pages.

Cannonsburg Water District
Statement of Net Position
Proprietary Fund Type
December 31, 2016

ASSETS

Current Assets	
Cash and cash equivalents - unrestricted	\$ 384,210
Cash and cash equivalents - restricted	1,043,565
Accounts receivable - net of allowance for doubtful accounts	278,928
Inventory	98,839
Prepaid expenses	<u>25,167</u>
Total Current Assets	<u>1,830,709</u>
Noncurrent Assets	
Capital assets: (note 1)	
Plant, equipment and lines	6,958,845
Construction in process	2,052,371
Less accumulated depreciation	<u>(3,954,301)</u>
Total Noncurrent Assets	<u>5,056,915</u>
Deferred Outflows of Resources	<u>209,523</u>
Total Assets and Deferred Outflow of Resources	<u>\$ 7,097,147</u>

LIABILITIES

Current Liabilities	
Accrued liabilities	\$ 224,925
Accrued interest	13,291
Deposits payable	12,500
Bonds/notes payable	<u>16,000</u>
Total Current Liabilities	<u>266,716</u>
Noncurrent Liabilities	
Accrued pension	858,552
Bonds/notes payable	<u>1,907,000</u>
Total Noncurrent Liabilities	<u>2,765,552</u>
Total Liabilities and Deferred Inflows of Resources	<u>3,032,268</u>

NET POSITION

Net investment in capital assets	3,133,915
Restricted	1,031,065
Unrestricted	<u>(100,101)</u>
Total Net Position	<u>\$ 4,064,879</u>

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

Cannonsburg Water District
Statement of Revenues, Expenses and Changes in Net Position
Proprietary Fund Type
For the year ended December 31, 2016

Operating Revenues	
Water sales	\$ 2,444,582
Penalties & charges	53,865
Other income	<u>9,803</u>
Total Operating Revenues	<u>2,508,250</u>
Operating Expenses	
Purchased water	1,206,150
Salaries & wages	428,368
Payroll taxes	30,185
Contractual services	15,965
Employee insurance	223,328
Retirement	140,529
Other insurance	54,666
Operations, maintenance, repairs & supplies	14,223
Utilities	60,065
Telephone	8,586
Materials & supplies	33,261
Fuel	24,314
Water testing	9,227
Depreciation	153,383
Other billing expenses	11,636
Bad debts	10,671
Miscellaneous expenses	<u>72,878</u>
Total Operating Expenses	<u>2,497,435</u>
Operating Income (Loss)	<u>10,815</u>
Nonoperating Revenues (Expenses)	
Capital grants	381,117
Nonoperating revenue - other	-
Tap fees	15,700
Gain on sale of capital assets	18,969
Interest income	3,022
Interest expense	<u>(32,457)</u>
Net Nonoperating Revenues (Expenses)	<u>386,351</u>
Change in Net Position	397,166
Total Net Position - beginning	3,769,649
Prior period adjustment	<u>(101,936)</u>
Total Net Position - ending	<u>\$ 4,064,879</u>

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

Cannonsburg Water District
Statement of Cash Flows
Proprietary Fund Type
December 31, 2016

CASH FLOWS FROM OPERATING ACTIVITIES:	
Operating revenues	\$ 2,517,738
Cash paid to employees	(428,368)
Cash paid for general and administrative expenses	<u>(1,896,154)</u>
Net Cash provided/(used) by operating activities	<u>193,216</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest earned	<u>3,022</u>
Net Cash provided/(used) by investing activities	<u>3,022</u>
CASH FLOWS FROM CAPITAL AND FINANCING ACTIVITIES:	
Capital grants	381,117
Tap fees	15,700
Bond/note payments	(46,300)
Bond/loan proceeds	372,749
Gain on sale of capital assets	18,969
Purchase of capital assets	(754,695)
Interest paid	<u>(32,457)</u>
Net Cash provided/(used) in capital and financing activities	<u>(44,917)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	151,321
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>1,276,454</u>
CASH AND CASH EQUIVALENTS - END OF THE YEAR	<u>\$ 1,427,775</u>
RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net Operating Income	\$ 10,815
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
(increase) in prepaid expenses	(1,142)
(increase) in inventory	(44,669)
depreciation	153,383
increase / (decrease) in pension expense due to GASB 68	68,111
decrease in accounts receivable	9,488
(decrease) in accounts payable	<u>(2,770)</u>
Net cash provided/(used) by operating activities	<u>\$ 193,216</u>

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

CANNONSBURG WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2016

The Cannonsburg Water District is a water utility which services areas of Boyd County. Its sales are primarily to residential customers. The District is a corporate body set forth in Kentucky Revised Statutes (KRS) 74.070 which was created November, 1961. The District began operations in 1956. The District is subject to the regulatory authority of the Kentucky Public Service Commission pursuant to KRS 278.040.

Note 1 - Summary of Significant Accounting Policies

The accounting policies of the District conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

The Reporting Entity

The District, for financial purposes, includes all of the funds relevant to the operations of the District. The financial statements presented herein do not include agencies which have been formed under applicable state laws or separate and distinct units of government apart from the Cannonsburg Water District.

The financial statements of the District would include those of separately administered organizations that are controlled by or dependent on the District. Control or dependence is determined on the basis of financial interdependency, selection of governing District, designation of management, ability to significantly influence operations, accountability of fiscal matters, scope of public service, and financing relations.

Based on the foregoing criteria there are no other organizations included in these financial statements.

Bond and Interest Sinking Fund - Monthly transfers are required to be made into this account in an amount equal to one-sixth (1/6) of the interest becoming due on the next succeeding interest due date for all outstanding bonds and one-twelfth (1/12) of the principal of all such bonds maturing on the next succeeding due date. The required balance of the fund at December 31, 2016 was \$65,000. The District had set aside \$415,089 into this fund at December 31, 2016.

Enterprise Funds

An enterprise fund distinguishes 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 the District's principal ongoing operations. The principal operating revenues of the District are operating grants and tenant rental revenue. Operating expenses of the District include the cost of producing the revenue 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.

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprise where the intent of the governing body is that the costs (expenses, 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 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 balance sheet. Net position (i.e., total assets net of total liabilities) are segmented into net investment in capital assets, restricted and unrestricted components. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, and then unrestricted resources as they are needed.

Basis of Accounting

The records of the District are maintained and the budgetary process is based on the accrual method of accounting.

Inventory

The cost of inventory is recorded as a disbursement at the time of payment for the purchase. Materials on hand are inventoried at year end and recorded as an asset at that time. They are valued at lower of cost or market and recorded using the FIFO method.

Deposits

The District considers all highly liquid investments with a maturity date of twelve months or less from date of purchase to be cash equivalents. Certificates of deposit that are redeemable immediately with little or no penalty are considered cash equivalents. At December 31, 2016, the carrying amount of the District's deposits was \$1,427,775 and the bank balance was \$1,431,388. Of the bank balance 100% was covered by federal deposit insurance or collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Capital Assets

Capital assets purchased are capitalized at the time of purchase. Such assets are recorded at cost. Donated assets are recorded at fair market value at the date of donation.

Depreciation of property and equipment is computed by the straight-line method based upon the estimated useful lives of the assets as follows:

<u>Class</u>	<u>Life</u>
Water lines, tanks	40-50 years
Equipment	5-10 years
Computers	3 years
Meters	15 years

The District's capitalization policy is as follows: expenditures costing more than \$1,000 with an estimated useful life greater than one year are capitalized: all others are expensed.

Net Position

Net position represents the difference between assets and liabilities. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any borrowing used for the acquisition, construction or improvement of those assets. Net position is recorded as restricted when there are limitations imposed on their use by external restrictions.

Accounts Receivable

The receivable reflected in the statements in the amount of \$278,928 are net of allowance for uncollectible in the amount of \$17,511.

Use of Estimates

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

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employees' Retirement System (CERS) and additions to/deductions from CERS' fiduciary net position 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.

Note 2 – Notes/Bonds Payable

The amount shown in the accompanying financial statements as notes payable represents the District's future obligation to make loan payments from future revenues. At December 31, 2016, three separate loans/bonds had outstanding balances. Details of each of these issues are summarized as follows:

Note A

Lender – Kentucky Rural Water Finance Corporation (KRWFC)
Balance of loan – \$255,000
Rate – 4.15-5.15%
Principal due January 01

Interest due January 01 and July 01

Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Schedule of payments:

	Principal	Interest	Trustee Fees	Total Payment
2017	\$ 16,000	\$ 13,001	\$ 250	\$ 29,251
2018	17,000	12,089	250	29,339
2019	17,000	10,150	250	27,400
2020	19,000	10,155	250	29,405
2021	23,000	9,038	250	32,288
2022-2025	163,000	16,737	1,000	180,737
Total	\$ 255,000	\$ 71,170	\$ 2,250	\$ 328,420

Note B

Lender – Town Square Bank
Balance of loan – \$0.00

Note C

Lender – United States Department of Agriculture (USDA)
Balance of loan – \$1,668,000
Rate – 2.50%
Principal payments due each year on January 01
Interest payments due each year on January 01
Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days notice.

Schedule of payments:

	Principal	Interest	Total Payment
2017	\$ -	\$ 54,210	\$ 54,210
2018	23,000	54,210	77,210
2019	24,000	53,462	77,462
2020	24,000	52,682	76,682
2021	25,000	51,902	76,902
2022-2026	140,000	246,674	386,674
2027-2031	165,000	222,299	387,299
2032-2036	192,000	193,829	385,829
2037-2041	225,000	160,516	385,516
2042-2046	263,000	121,581	384,581
2047-2051	310,000	75,885	385,885
2052-2055	277,000	22,456	299,456
Total	\$ 1,668,000	\$ 1,309,706	\$ 2,977,706

The following is a summary of changes in long-term obligations for the year:

	Outstanding 1/1/2016	Issued	Retired	Outstanding 12/31/2016	Due Within One Year
USDA	\$ 1,295,251	\$ 372,749	\$ -	\$ 1,668,000	\$ -
KRWFC	271,000	-	16,000	255,000	16,000
Town Square Bank	30,300	-	30,300	-	-
Total	<u>\$ 1,596,551</u>	<u>\$ 372,749</u>	<u>\$ 46,300</u>	<u>\$ 1,923,000</u>	<u>\$ 16,000</u>

Total interest paid during the year on long-term debt totaled \$32,457.

General Information About the Pension Plan

Plan description - Regular, full-time, employees of the Water District are provided with pensions through the County Employees' Retirement System (CERS)—a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System. The assets of CERS are pooled with two other retirement systems Kentucky Retirement System administers, KERS & SPRS. Although invested as a whole each system's assets are used only for the members of that plan. Kentucky Revised Statute (KRS) chapter 61 grants the authority to establish and amend the benefit terms to the Kentucky Retirement System's Board of Trustees (Board). Kentucky Retirement System issues a publicly available financial report that can be obtained on their website.

Benefits provided - CERS provides retirement, insurance, disability, and death benefits. Retirement benefits are determined from an average of the five highest years of compensation for those whose participation began before September 01, 2008. For those who began participation on or after September 01, 2008 retirement benefits are determined as an average of the last complete five years. A percentage is then taken from those averages based on the employee's months of service. Employees are eligible for service-related disability benefits with at least 60 months of service. If the member is receiving monthly benefits based on at least four years of service, then a \$5,000 death benefit is payable to the member's designated beneficiary. For those employees whose participation began prior to July 01, 2003, CERS will pay a portion of the monthly premium for single coverage based upon service credit accrued at retirement. For those employees whose participation began on or after July 01, 2003 and before September 01, 2008, employees are required to earn at least 10 years of service credit to be eligible for insurance benefits. Employees whose participation began on or after September 01, 2008 must earn at least 15 years of service credit to be eligible for insurance benefits.

Cost of living adjustments to monthly retirement allowance must be approved by the Kentucky State Legislature (Legislature) and requires the system to be either 100% funded or appropriations are made to cover the increase are by the Legislature.

Contributions - Employees are required to contribute 5% of their annual pay. Employees whose participation began on or after September 01, 2008 are required to contribute an additional 1%. This additional 1% is credited to the insurance fund and is non-refundable. The District's contractually required contribution rate for the year ended December 31, 2016 was 17.06%/18.68% (12.42/13.95% pension; 4.64/4.73% insurance) of annual payroll, actuarially determined as an amount that, when combined with employee contributions, is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Contributions to the pension plan from the District were \$69,796 for the year ended December 31, 2016. The contribution was allocated \$51,494 to the pension fund and \$18,302 to the insurance fund.

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

At December 31, 2016, the Water District reported a liability of \$858,552 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Water District's portion of the net pension liability was based on the Water District's proportionate share of retirement contributions for the fiscal year ended June 30, 2016. At June 30, 2016 the Water District's proportionate share was 0.017440%.

Since certain expense items are amortized over closed periods each year, the deferred portions of these items must be tracked annually. If the amounts serve to reduce pension expense they are labeled deferred inflows. If they will increase pension expense they are labeled deferred outflows. The amortization of these amounts is accomplished on a level dollar basis, with no interest included in the deferred amounts. Experience gains/losses and the impact of changes in actuarial assumptions, if any, are amortized over the average remaining service life of the active and inactive System members at the beginning of the fiscal year. Investment gains and losses are amortized over a fixed five-year period. For the year ended December 31, 2016, the Water District recognized

pension expense of \$140,529. At December 31, 2016, the Water District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net difference between projected and actual earnings on pension plan investments	\$ 80,713	\$ -0-
Differences between expected and actual Experience	3,748	-0-
Changes in assumptions	45,482	-0-
Changes in proportion and differences between employer contributions and proportionate share of contributions	52,489	-0-
Water District's contributions subsequent to the measure date	<u>27,091</u>	<u>-0-</u>
Total	\$ 209,523	\$ -0-

\$27,091 reported as deferred outflows of resources related to pensions resulting from the Water District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. The remaining amount of \$182,432 reported as the net effect of deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended</u>	<u>Amount</u>
December 31, 2017	\$ 67,764
December 31, 2018	45,336
December 31, 2019	44,157
December 31, 2020	25,175
December 31, 2021	-0-
Thereafter	<u>-0-</u>
Total	\$ 182,432

Actuarial assumptions - The total pension liability was determined by an actuarial valuation as of June 30, 2016 using standard roll-forward techniques, 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

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB

to 2013 (set back 4 years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.

The actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2008 – June 30, 2013. 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 long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for the System. 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 discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through year 2117. The target asset allocation and best estimates for arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Combined Equity	44%	5.40%
Combined Fixed Income	19%	1.50%
Real Return (Diversified Inflation Strategies)	10%	3.50%
Real Estate	5%	4.50%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.50%
Cash Equivalent	<u>2%</u>	-0.25%
	100%	

Discount rate - The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the Water District will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Water District's proportionate share of the net pension liability to changes in the discount rate - The following presents the net pension liability of the System, calculated using the discount rate of percent, as well as what the System's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.50 percent) or 1-percentage-point higher (8.50 percent) than the current rate for non-hazardous and (6.50 percent) or 1-percentage-point higher (8.50 percent) than the current rate for hazardous:

	1% Decrease <u>6.50%</u>	Current Discount Rate <u>7.50%</u>	1% Increase <u>8.50%</u>
Water District's proportionate share of the net pension liability	\$ 1,070,000	\$ 858,552	\$ 677,000

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

Note 4 – 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; injuries to employees; and natural disasters. The District carries commercial insurance coverage for the risks to the extent deemed prudent by District management.

Note 5 - Changes in Capital Assets

The following is a summary of changes in the capital assets for the fiscal year:

	Balance 1/1/2016	Additions/ Transfers	Deletions	Balance 12/31/2016
Land, non-depreciable	\$ 20,810	\$ -	\$ -	\$ 20,810
Utility plant and equipment	7,037,481	850	100,296	6,938,035
Construction in process, non-depreciable	<u>1,298,526</u>	<u>753,845</u>	<u>-</u>	<u>2,052,371</u>
	<u>\$ 8,356,817</u>	<u>\$ 754,695</u>	<u>\$ 100,296</u>	<u>\$ 9,011,216</u>
Accumulated depreciation	<u>\$ 3,901,214</u>	<u>\$ 153,383</u>	<u>\$ 100,296</u>	<u>\$ 3,954,301</u>
Capital assets, net of accumulated depreciation	<u>\$ 4,455,603</u>	<u>\$ 601,312</u>	<u>\$ -</u>	<u>\$ 5,056,915</u>

Note 6 - Revenue Bonds

Water and Revenue Bonds constitute special obligations of the District solely secured by a lien on and pledge of the net revenues of the water system. The revenue bonds are collateralized by the revenue of the water system and the various special funds established by the bond ordinances. The ordinances provide that the revenue of the system is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the revenue bond funds. Any remaining revenues may then be used for any lawful purpose. The ordinances also contain certain provisions, which require the District to maintain pledged revenues. The District must transfer monthly 1/6 of the next succeeding interest payment and 1/12 of the next succeeding principal payment from the operations and maintenance account into the bond and interest sinking account.

Note 7 - Restricted Cash

Restricted cash is composed of the following:

Depreciation reserve fund	\$ 16,867
Bond & interest	415,089
Sur charge PSC	519,446
Line replacement	92,137
Rural Development	<u>26</u>
	\$ 1,043,565

Note 8 – Contingencies

The District is subject to possible examinations made by Federal and State authorities who determine compliance with terms, conditions, laws, and regulations governing other grants given to the District in the current and prior years. There were no examinations for the year ended December 31, 2016. Areas of noncompliance, if any, as a result of examinations would be included as a part of the “Findings and Responses section of this report.

Note 9 – Prior Period Adjustment

A prior period adjustment was made in the amount of \$(101,936):

Debit | (Credit)

<u>Account</u>	<u>Amount</u>
Net pension liability	\$ (362,552)
Deferred inflows of resources	55,000
Deferred outflows of resources	137,505
Pension expense (retirement contr.)	<u>68,111</u>
Total	\$ (101,936)

REQUIRED SUPPLEMENTAL INFORMATION

**Cannonsburg Water District
Schedule of the Water District's Proportionate
Share of Net Pension Liability
December 31, 2016**

	<u>12/31/2015</u>	<u>12/31/2016</u>
Water District's proportion of the net pension liability	0.015284%	0.017440%
Water District's proportionate share of the net pension liability	\$ 496,000	\$ 858,552
Water District's covered employee payroll	\$ 386,145	\$ 390,679
Water District's proportionate of the net pension liability as a percentage of its covered employee payroll	128.45%	219.76%
Plan fiduciary net position as a percentage of the total pension liability	66.80%	55.50%

**Cannonsburg Water District
Schedule of Water District Contributions
December 31, 2016**

	<u>12/31/2015</u>	<u>12/31/2016</u>
Contractually required contribution	\$ 48,586	\$ 51,494
Contributions in relation to the contractually required contribution	<u>48,586</u>	<u>51,494</u>
Contribution deficiency	<u>\$ -</u>	<u>\$ -</u>
Water District's covered payroll	<u>\$ 386,145</u>	<u>\$ 390,679</u>
Contributions as a percentage of covered payroll	12.58%	13.18%

Cannonsburg Water District
NOTES TO THE REQUIRED SUPPLEMENTAL INFORMATION
For the year ended December 31, 2016

Method and assumptions used in calculations of actuarially determined contributions: The actuarially determined contribution rates are determined on a biennial basis beginning with the fiscal year ending 2018, determined as of July 01, 2016. The amortization period of the unfunded liability has been reset as of July 01, 2013 to a closed 30-year period. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

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

SUPPLEMENTAL INFORMATION

CANNONSBURG WATER DISTRICT
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 for the year ended December 31, 2016

<u>Program Title</u>	<u>Federal CFDA#</u>	<u>Federal Expenditures</u>
U.S. Department of Agriculture Rural Utilities Service Direct Program Waste & Waste Disposal Systems for Rural Communities	10.760	<u>\$ 753,866</u>
 Totals		 <u>\$ 753,866</u>

Notes to Schedule of Expenditures of Federal Awards

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The accompanying schedule of expenditures of federal awards is a summary of the activity of the District's federal award programs and does not present transactions that would be included in financial statements of the District presented on the accrual basis of accounting as contemplated by generally accepted accounting principles. The District elected not to use the 10% de minimis indirect cost rate.

NOTE B – LOANS

The District was awarded a loan from the United States Department of Agriculture in the amount of \$1,668,000. The District began making draws on this loan and expending the funds in July, 2016. The repayment schedule for this loan is located in the Notes to the Financial Statements under Note 2. The balance of the loan at December 31, 2016 was \$1,668,000.

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

Board of Commissioners
Cannonsburg Water District
Cannonsburg, Kentucky

Report on Compliance for Each Major Federal Program

We have audited Cannonsburg Water District's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Cannonsburg Water District's major federal programs for the year ended December 31, 2016. Cannonsburg Water District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Cannonsburg Water District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Cannonsburg Water District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Cannonsburg Water District's compliance.

Opinion on Each Major Federal Program

In our opinion, Cannonsburg Water District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2016.

Report on Internal Control over Compliance

Management of Cannonsburg Water District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Cannonsburg Water District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program

and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Cannonsburg Water District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

John T. Lane & Associates LLC

Mount Sterling, Kentucky

May 25, 2017

John T. Lane and Associates, LLC

Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Commissioners
Cannonsburg Water District
Cannonsburg, 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 the Cannonsburg Water District, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Cannonsburg Water District's basic financial statements, and have issued our report thereon dated May 25, 2017.

Internal Control Over Financial Reporting

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Cannonsburg Water District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

John T. Lane & Associates LLC

Mount Sterling, Kentucky

May 25, 2017

CANNONSBURG WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
December 31, 2016

A. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: *unmodified*

Internal control over financial reporting:
Material weakness(es) identified? _____ yes x no

Significant deficiency(ies) identified? _____ yes x no

Noncompliance material to financial statements noted? _____ yes x no

Federal Awards

Internal control over major programs:
Material weakness(es) identified? _____ yes x no

Significant deficiency(ies) identified? _____ yes x no

Type of auditor's report issued on compliance for major programs: *unmodified*

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? _____ yes x no

Identification of Major Programs

<u>CFDA Number(s)</u>	<u>Name of Federal Program</u>
10.760	Waste & Waste Disposal Systems for Rural Communities

Miscellaneous

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as low-risk auditee? _____ yes x no

B. Financial Statement Findings

PRIOR FINDINGS
None

CURRENT FINDINGS
None

C. Federal Award Findings & Questioned Costs
None

Cannonsburg Water District
Statement of Revenues, Expenses and Changes in Net Position
Proprietary Fund Type
For the years ended December 31, 2015 & December 31, 2016

	2015	2016
Operating Revenues		
Water sales	\$ 2,466,806	\$ 2,444,582
Penalties & charges	48,802	53,865
Other income	9,805	9,803
 Total Operating Revenues	 2,525,413	 2,508,250
Operating Expenses		
Purchased water	1,191,100	1,206,150
Salaries & wages	453,270	428,368
Payroll taxes	30,916	30,185
Contractual services	35,288	15,965
Employee insurance	185,897	223,328
Retirement	40,000	140,529
Other insurance	47,768	54,666
Operations, maintenance, repairs & supplies	16,162	14,223
Utilities	52,017	60,065
Telephone	7,476	8,586
Materials & supplies	106,083	33,261
Fuel	19,662	24,314
Water testing	8,332	9,227
Depreciation	158,427	153,383
Other billing expenses	11,702	11,636
Bad debts	18,728	10,671
Miscellaneous expenses	56,918	72,878
 Total Operating Expenses	 2,439,746	 2,497,435
 Operating Income (Loss)	 85,667	 10,815
Nonoperating Revenues (Expenses)		
Capital grants	-	381,117
Tap fees	12,150	15,700
Gain on sale of capital assets	-	18,969
Interest income	2,833	3,022
Interest expense	(15,529)	(32,457)
 Net Nonoperating Revenues (Expenses)	 (546)	 386,351
 Change in Net Position	 \$ 85,121	 \$ 397,166

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