HARDIN COUNTY WATER DISTRICT NO. 2

INDEPENDENT AUDITOR'S REPORT
ON FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

YEARS ENDED DECEMBER 31, 2015 AND 2014

HARDIN COUNTY WATER DISTRICT NO. 2

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LETTER OF TRANSMITTAL

A Message from the General Manager

I am pleased to submit the Annual Report for Hardin County Water District No. 2 for the year ended December 31, 2015. The year was marked by challenges never before faced by the District. As the year came to a close, the employees proved once again just how elite they are.

The Chloramine Conversion was a major effort for the year. In preparation for a connection with Louisville Water Company, the District needed to complete capital improvements at both the White Mills and City Springs water treatment plants. A temporary system was also required at the Freeman Lake water treatment plant. Kenvirons oversaw the contract for the White Mills upgrade and the $1.4 million project was ready for operation by the first of September. The District staff completed the City Springs upgrade as an in-house project at a cost of $350K plus labor. The City Springs project was completed in October. Hardin County Water became a chloramine system on November 30, 2015. Within 2 weeks, the free chlorine water had been flushed from the system and the conversion was complete. There were no calls from the public regarding any change in water quality.

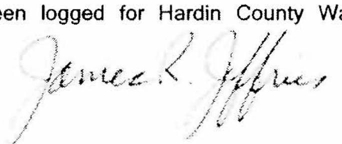
Our water professionals were recognized by Kentucky's Governor as the District earned its second Governor's Safety Award. This was achieved by completing 250,000 hours without a lost time accident. A perfect safety record for more than 3 years is required to reach this target. Our District is the only utility company in the state to receive the Governor's Safety Award twice. Also, the Central Kentucky chapter of KWWOA selects an "Operator of the Year" and this year they chose Mr. Paul Goncher, our Distribution Manager, for the recognition. Our employees continue to be the leaders of our industry.

The District acquired the customer base of the City of Elizabethtown on November 1, 2014. By the beginning of 2015, the District was in full control of the additional 9,800 customers. Our first efforts included upgrading all customer connections. Over 3800 customer connections were upgraded to match PSC standards throughout the year.

A second effort of the District was to get control of the City's 30% leak percentage. The immediate effect of the assimilation of the two distribution systems was to drive the overall leak percentage to over 25% for the first half of 2015. Through the connection upgrades and the overall maintenance efforts of the distribution department, this leak rate was reduced to 14.1% by the fourth quarter.

Day to day operations advanced to a new level during the year. The addition of two billing cycles essentially doubled the customer service activity. Every week brings a new meter reading cycle, billing date, due date, penalty date, and turn off date. District crews installed 216 new meters taps and laid over 8,300 feet of new water mains. Included in these activities was the completion of the Shepherdsville Road extension project and the repair of 344 leaks. Also completed was the Pear Orchard and Eastview Tanks rehab projects.

As the demands of our business grow, our employees continue to meet those demands. Another great year has been logged for Hardin County Water, and we look forward to the future.



James R. Jeffries
General Manager

INDEPENDENT AUDITOR'S REPORT

Chris R. Carter, CPA
Ann M. Fisher, CPA
Scott Kisselbaugh, CPA
Brian S. Woosley, CPA

Stiles, Carter & Associates
Certified Public Accountants

American Institute of CPAs
Kentucky Society of CPAs

INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Hardin County Water District No. 2 as of and for the years ended December 31, 2015 and 2014, 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.

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

2901 Ring Road East, P.O. Box 622 · Elizabethtown, KY 42702-0622 / Phone 270-769-6371 · Fax 270-765-7934 · www.scacpa.com

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Hardin County Water District No. 2, as of December 31, 2015 and 2014, and the respective changes in financial position and cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 1 to the financial statements, during the year ended December 31, 2015, the District adopted Governmental Accounting Standards Board Statement 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*, Statement 69, *Government Combinations and Disposals of Government Operations,* Statement 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees* and Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68.* Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 to 9, schedule of proportionate share of the net pension liability on page 30 and schedule of contributions on page 31 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Hardin County Water District No. 2's basic financial statements. Schedules I and II are presented for purposes of additional analysis and are not a required part of the basic financial statements.

Schedules I and II 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, Schedules I and II are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The letter of transmittal and Schedule III have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 16, 2016, on our consideration of Hardin County Water District No. 2's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Hardin County Water District No. 2's internal control over financial reporting and compliance.

Stiles, Carter & Associates

Certified Public Accountants
Elizabethtown, Kentucky
June 16, 2016

REQUIRED SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2015

The discussion and analysis of Hardin County Water District No. 2's financial performance provides an overall review of the District's financial activities for the year ended December 31, 2015. The intent of this discussion and analysis is to review the District's financial performance as a whole. Readers should also review the basic financial statements and notes to the basic financial statements to enhance their understanding of the District's financial performance.

FINANCIAL HIGHLIGHTS

- The ending cash and investment balance for the District was $21.3 million. The balance at December 31, 2014, was $20.5 million. This reflects an increase in cash and investments during the year of $.8 million.

- The District continued capital construction projects to improve the water system and ensure the future water supply.

- The District adopted the provisions of GASB Statement 68 related to pensions.

- The District invested approximately $3.7 million in capital assets during the year.

USING THIS ANNUAL REPORT

The basic financial statements report information about the District using full accrual accounting methods as utilized by similar business activities in the private sector. The basic financial statements include a statement of net position; a statement of revenues, expenses, and changes in fund net position; a statement of cash flows; and notes to the basic financial statements.

The ***statement of net position*** presents the financial position of the District on a full accrual historical cost basis. The statement presents information on all of the District's assets, deferred outflows of resources and liabilities, with the difference reported as net position. Over time, increases and decreases in net position are one indicator of whether the financial position of the District is improving or deteriorating.

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the ***statement of revenues, expenses, and changes in fund net position*** presents the results of the District's activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the District's recovery of its costs. Rate setting policies use different methods of cost recovery not fully provided for by generally accepted accounting principles. The primary objectives of the rate model are to improve equity among customer classes and to ensure that capital costs are allocated on the basis of long-term capacity needs, ensuring that growth pays for growth.

The ***statement of cash flows*** presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The ***notes to the basic financial statements*** provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the District's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

ENTITY-WIDE FINANCIAL ANAYLSIS

Net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows exceeded liabilities and deferred inflows by $60.8 million and $57.4 million as of December 31, 2015 and 2014.

The largest portion of the District's net position reflects its investment in infrastructure and capital assets (e.g., land, buildings, vehicles, equipment, transmission and distribution systems and construction in progress), less any related debt used to acquire those assets that is outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets.

(Table 1)
Summary of Net Position
as of December 31, 2015 and 2014

	2015	2014
Assets		
Current and		
Other Assets	$ 22,982,887	$ 21,818,186
Capital Assets	62,638,515	61,485,222
Total Assets	85,621,402	83,303,408
Deferred Outflows of Resources	1,989,472	622,570
Liabilities		
Long-term liabilities	25,079,834	24,241,078
Other Liabilities	1,745,936	2,012,189
Total Liabilities	26,825,770	26,253,267
Deferred Inflows of Resources	-	320,000
Net Position		
Net investment in capital assets	41,263,420	38,846,294
Restricted for debt service	2,088,360	2,006,032
Unrestricted	17,433,324	16,500,385
Total Net Position	$ 60,785,104	$ 57,352,711

Unrestricted net position, the portion of net position that can be used to finance day-to-day operations (without constraints established by debt covenants, enabling legislation or other legal requirements), increased $2.4 million (6.2%) at December 31, 2015. Restricted net position increased $82 thousand (4.1%). Net investment in capital assets increased by $933 thousand (5.7%).

(Table 2)
Changes in Net Position
Years Ended December 31, 2015 and 2014

	2015	2014
OPERATING REVENUES:		
Water sales	$ 11,955,417	$ 8,482,080
Other operating income	623,142	321,111
Total operating revenues	12,578,559	8,803,191
OPERATING EXPENSES:		
Power purchased	687,301	474,905
Pumping and treatment labor	983,616	556,230
Purification supplies and expense	539,324	448,327
Transmission and distribution labor	1,459,524	1,228,917
Transmission and distribution supplies and expense	272,431	198,600
Transmission and distribution maintenance and repairs	48,499	64,717
Equipment rental	9,401	777
Transportation expense	141,980	168,124
Water treatment maintenance and expense	169,791	101,864
General and administrative expenses	2,441,559	1,842,189
CERS pension adjustment	(107,955)	(62,904)
Depreciation	2,572,838	1,995,999
Total operating expenses	9,218,309	7,017,745
OPERATING INCOME	3,360,250	1,785,446
NON-OPERATING REVENUES (EXPENSES):		
Investment income	306,412	1,178,209
Other income	123,778	93,878
Gain (loss) on disposal of capital assets	3,636	(131,126)
Interest expense on long-term debt	(705,596)	(562,819)
Interest expense on customer deposits	(568)	(528)
Amortization of bond discount	(68,514)	(62,308)
TOTAL NON-OPERATING REVENUES (EXPENSES)	(340,852)	515,306
Capital contributions	412,995	1,563,591
Increase in net position	3,432,393	3,864,343
Net position, beginning	57,352,711	53,488,368
Net position, ending	$ 60,785,104	$ 57,352,711

Operating revenue increased 42.8% as compared to the prior year as the acquisition of the City of Elizabethtown water system was in operation the entire year. Total operating expenses increased 23.9%, which was due to increased depreciation expense and operating costs for the City of Elizabethtown acquisition. Interest expense on long-term debt increased by $142 thousand which was principally interested on notes payable. The District continues to receive capital contributions through the State of Kentucky, the Federal government, other governments and individual developers.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2015 and 2014, the District had $62.6 million and $61.5 million invested in a variety of capital assets, as reflected in the following table:

(Table 3)
Capital Assets (Net of Depreciation)
as of December 31, 2015 and 2014

	2015	2014
Non-Depreciable Assets:		
Land and land rights	$ 687,483	$ 687,483
Depreciable Assets:		
Structures and improvements	7,834,477	6,059,219
Supply mains	750,267	794,366
Water treatment plant	6,826,493	7,058,960
Standpipes, tanks and foundations	7,696,650	7,008,601
Transmission and distribution mains	29,469,797	30,314,967
Services and meters	5,266,191	3,962,808
Hydrants	30,918	38,463
Office furniture and fixtures	158,953	213,043
Transportation equipment	612,062	652,247
Other property and equipment	251,132	260,889
Capital assets in service	59,584,423	57,051,046
Construction in progress	3,054,092	4,434,176
Total capital assets, net of depreciation	$ 62,638,515	$ 61,485,222

(Table 4)
Changes in Capital Assets
Years Ended December 31, 2015 and 2014

	2015	2014
Beginning balance	$ 61,485,222	$ 52,318,346
Additions	3,726,131	11,518,799
Retirements	-	(355,924)
Depreciation	(2,572,838)	(1,995,999)
Ending balance	$ 62,638,515	$ 61,485,222

Debt

At December 31, 2015 and 2014, the District had $15.3 million and $15.9 million, in revenue bonds outstanding and $5.9 million and $6.1 million of notes payable. A total of $.9 million is due within the 2016 calendar year.

(Table 5)
Outstanding Debt
as of December 31, 2015 and 2014

	2015	2014
Revenue bonds	$ 15,343,000	$ 15,991,000
Notes payable	5,861,021	6,093,748
Unamortized discount/premium	(158,455)	(181,574)
	$ 21,045,566	$ 21,903,174

District Challenges for the Future

The District continues to be financially sound. However, the current state and national financial climate requires the District to remain prudent.

The District will continue to use careful planning and monitoring of finances to provide quality services to its customers.

Contacting the District's Financial Management

This financial report is designed to provide our customers, investors and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives and spends. If you have questions about this report or need additional financial information, contact James Jeffries, General Manager, 360 Ring Road, Elizabethtown, Kentucky 42701, (270) 737-1056.

BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF NET POSITION

DECEMBER 31, 2015 AND 2014

	2015	2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,649,105	$ 2,290,894
Investments	15,126,155	14,864,389
Accounts receivable, net	1,139,535	955,844
Prepaid insurance	50,000	-
Materials and supplies	518,605	386,876
TOTAL CURRENT ASSETS	19,483,400	18,498,003
NONCURRENT ASSETS:		
Restricted cash and cash equivalents	2,521,149	2,341,845
Restricted investments	978,338	978,338
Non-depreciable capital assets	3,741,575	5,121,659
Depreciable capital assets, net of accumulated depreciation	58,896,940	56,363,563
TOTAL NONCURRENT ASSETS	66,138,002	64,805,405
TOTAL ASSETS	85,621,402	83,303,408
DEFERRED OUTFLOWS OF RESOURCES		
Deferred amount on debt refundings	251,764	287,429
Deferred amount on CERS pension	1,552,831	140,533
Utility acquisition adjustments	184,877	194,608
TOTAL DEFERRED OUTFLOWS OF RESOURCES	1,989,472	622,570
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	160,885	143,252
Construction projects payable	329,529	735,754
Accrued taxes	73,367	25,738
Accrued liabilities	66,851	53,452
Accrued vacation	123,268	111,390
Customer deposits	49,671	38,626
Customer advances for construction	34,250	23,250
Bonds payable	669,000	648,000
Notes payable	239,115	232,727
TOTAL CURRENT LIABILITIES	1,745,936	2,012,189
NONCURRENT LIABILITIES:		
Customer deposits	447,040	347,631
Net pension liability - CERS	4,495,343	2,871,000
Bonds payable	14,515,545	15,161,426
Notes payable	5,621,906	5,861,021
TOTAL NONCURRENT LIABILITIES	25,079,834	24,241,078
TOTAL LIABILITIES	26,825,770	26,253,267
DEFERRED INFLOWS OF RESOURCES		
Deferred amount on CERS pension	-	320,000
TOTAL DEFERRED INFLOWS OF RESOURCES	-	320,000
NET POSITION		
Net investment in capital assets	41,263,420	38,846,294
Restricted for debt service	2,088,360	2,006,032
Unrestricted	17,433,324	16,500,385
TOTAL NET POSITION	$ 60,785,104	$ 57,352,711

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

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION

YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
OPERATING REVENUES:		
Water sales	11,955,417	8,482,080
Other operating income	623,142	321,111
TOTAL OPERATING REVENUES	12,578,559	8,803,191
OPERATING EXPENSES:		
Power purchased	687,301	474,905
Pumping and treatment labor	983,616	556,230
Purification supplies and expense	539,324	448,327
Transmission and distribution labor	1,459,524	1,228,917
Transmission and distribution supplies and expense	272,431	198,600
Transmission and distribution maintenance and repairs	48,499	64,717
Equipment rental	9,401	777
Transportation expense	141,980	168,124
Water treatment maintenance and expense	169,791	101,864
General and administrative expenses	2,441,559	1,842,189
CERS pension adjustment	(107,955)	(62,904)
Depreciation	2,572,838	1,995,999
TOTAL OPERATING EXPENSES	9,218,309	7,017,745
OPERATING INCOME	3,360,250	1,785,446
NON-OPERATING REVENUES (EXPENSES):		
Investment income	306,412	1,178,209
Other income	123,778	93,878
Gain/(Loss) on disposal of capital assets	3,636	(131,126)
Interest expense on long-term debt	(705,596)	(562,819)
Interest expense on customer deposits	(568)	(528)
Amortization of bond discount and utility acquisition	(68,514)	(62,308)
TOTAL NON-OPERATING REVENUES (EXPENSES)	(340,852)	515,306
CAPITAL CONTRIBUTIONS	412,995	1,563,591
CHANGE IN NET POSITION	3,432,393	3,864,343
NET POSITION, beginning of year, as restated	57,352,711	53,488,368
NET POSITION, end of year	$ 60,785,104	$ 57,352,711

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

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$ 12,394,868	$ 8,575,468
Payments to suppliers	(3,605,793)	(2,621,679)
Payments to employees	(2,943,149)	(2,283,211)
NET CASH PROVIDED BY OPERATING ACTIVITIES	5,845,926	3,670,578
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Principal payments on bonds	(648,000)	(1,037,000)
Principal payments on notes	(232,727)	-
Acquisition of capital assets	(4,542,596)	(4,257,467)
Contributions in aid of construction	412,995	563,591
Interest on long-term debt	(705,596)	(562,819)
Sale of capital assets	3,636	18,347
Customer deposit interest	(568)	(528)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(5,712,856)	(5,275,876)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(261,766)	(495,074)
Other income	123,778	93,878
Investment income	542,433	542,113
NET CASH PROVIDED BY INVESTING ACTIVITIES	404,445	140,917
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	537,515	(1,464,381)
CASH AND CASH EQUIVALENTS, beginning of year	4,632,739	6,097,120
CASH AND CASH EQUIVALENTS, end of year	$ 5,170,254	$ 4,632,739
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 3,360,250	$ 1,785,446
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	2,572,838	1,995,999
Provision for bad debts	53,491	28,322
GASB 68 pension expense	(107,955)	(62,906)
(Increase) in accounts receivable	(183,691)	(227,723)
(Increase) decrease in prepaids	(50,000)	64,386
Increase in accounts payable	17,633	13,442
Increase in customer deposits	110,454	45,314
Increase (decrease) in accrued taxes payable	47,629	(341)
Increase in accrued liabilities	13,399	9,882
Increase in accrued vacation	11,878	18,757
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 5,845,926	$ 3,670,578
SCHEDULE OF NON-CASH TRANSACTIONS:		
CERS Pensions	$ 107,955	$ 62,906

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

NOTES TO BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Brief history - The Hardin County Water District No. 2 was organized pursuant to the provisions of Kentucky Revised Statutes KRS 74.010 and KRS 44.020 in order to provide a water supply for the residents of Hardin County, Kentucky.

The District's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The District follows the accounting policies and procedures set forth by the National Association of Regulatory Utility Commissioners and the guidance provided by the American Water Works Association in *Water Utility Accounting* and is regulated by the Kentucky Public Service Commission. The more significant accounting policies established in GAAP and used by the District are discussed below.

A. REPORTING ENTITY

These financial statements present the District's financial activities. As defined by GASB No. 14, *The Financial Reporting Entity,* as amended by GASB No. 39, *Determining Whether Certain Organizations Are Component Units* the criteria for inclusion in the reporting entity involve those cases where the District or its officials appoint a voting majority of an organization's governing body, and is either able to impose its will on the organization or there is a potential for the organization to provide specific financial benefits to or to impose specific financial burdens on the District or the nature and significance of the relationship between the District and the organization is such that exclusion would cause the District's financial statements to be incomplete. Applying this definition, the District does not include any component units in its reporting entity.

B. BASIC FINANCIAL STATEMENTS

All activities of the District are accounted for within a single proprietary (enterprise) fund. The focus of proprietary fund measurement is upon determination of operating income, changes in net position, financial position, and cash flows. The GAAP applicable are those similar to businesses in the private sector. Enterprise funds are required to be used to account for operations for which a fee is charged to external users for goods or services and the activity is financed with debt that is solely secured by a pledge of the net revenues.

C. BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues or expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied. The proprietary fund financial statements are presented on the accrual basis of accounting. Nonexchange revenues, including intergovernmental revenues and grants, are reported when all eligibility requirements have been met. Fees and charges and other exchange revenues are recognized when earned and expenses are recognized when incurred.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

D. FINANCIAL STATEMENT AMOUNTS

1. Cash and investments – The District's cash balances are held at multiple financial institutions. Investments are stated at fair value based on quoted market prices.

2. Cash and cash equivalents – The District has defined cash and cash equivalents to include cash on hand and demand deposits. The District considers all highly liquid debt instruments (including restricted assets) purchased with a maturity of three months or less to be cash equivalents.

3. Restricted Assets – Restricted assets consist of demand deposit savings accounts and certificates of deposit. The cost basis approximates market value.

4. Materials and supplies – Materials and supplies is composed of items used in the capital construction process.

5. Accounts Receivable - The allowance method is used to record uncollectible accounts.- At December 31, 2015 and 2014, accounts receivable was stated net of an allowance for uncollectible accounts of $60,000 and $60,000. Bad debt expense for 2015 was $53,491 and 2014 was $28,322. The District does not believe there is any credit risk associated with these receivables due to the large customer base and small individual account balances.

6. Capital Assets – Capital assets in service and construction in progress with an original cost of $5,000 or more are recorded at historical cost, if purchased or constructed. Assets acquired through contributions from developers or other customers are capitalized at their estimated fair market value, if available, or at engineers' estimated fair market value or cost to construct at the date of the contribution. Maintenance and repairs, which do not significantly extend the value or life of property, plant and equipment, are expensed as incurred. Assets are depreciated on the straight-line method. Depreciation is calculated using the following estimated useful lives:

	Years
Source of supply equipment	15-50
Water treatment plant	10-40
Transmission and distribution systems	10-50
Equipment	3-20
Structures and improvements, including buildings	10-50
Office furniture, equipment and vehicles	3-20
Meters	10-20

7. Compensated absences – The District accrues unpaid vacation when earned by the employee.

8. Defining Operating Revenues and Expenses – The District distinguishes between operating and non-operating revenue and expenses. Operating revenues and expenses consist of charges for services and the costs of providing those services, including depreciation and excluding interest cost. All other revenues and expenses are reported as non-operating.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

9. Net Position – Net position is divided into three components:

   a. Net investment in capital assets – consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
   b. Restricted net position – consist of net position that is restricted by the District's creditors (for example, through debt covenants), by grantors (federal, state and local) and by other contributors.
   c. Unrestricted – all other net position is reported in this category.

10. Use of Restricted Resources – When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the District's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.

11. Amortization – Bond discounts/premiums and deferred amounts on refundings are being amortized using the interest method over the life of each respective bond issue.

12. Capital Contributions – Contributions are recognized in the Statement of Revenues, Expenses and Changes in Fund Net Position when earned. Contributions include capacity fees, capital grants, and other supplemental support by other utilities and industrial customers and federal, state and local grants in support of system improvements.

13. Long-term Obligations – Long-term obligations are reported at face value, net of applicable premiums and discounts.

14. Use of Estimates - 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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

15. Restatement – During the year ended December 31, 2015, the District adopted the provisions of GASB Statement 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*. The District presents comparative financial statements so the restatement was made through the December 31, 2014 amounts. The effect of the restatement was to record deferred outflows of $140,533, deferred inflows of $320,000, a net pension liability of $2,871,000, a change to beginning net position of $3,113,370 and a decrease in pension expense of $62,904 which was reflected through the change in net position.

16. Pensions – For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the County Employees Retirement System (CERS) and additions to/deductions from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS except that CERS's fiscal year end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

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17. Impact Of Recently Issued Accounting Principles

Recently Issued And Adopted Accounting Principles
In June 2012, the GASB issued Statement 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement 27*. GASB 68, as amended by GASB 71 addresses accounting and financial reporting for pensions that are provided to the employees of state and local governmental employers through pension plans that are administered through trusts that have the following characteristics:

- Contributions from employers and non-employer contributing entities to the pension plan and earnings on those contributions are irrevocable.
- Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.
- Pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members.

The Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, the Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. This statement was adopted during the fiscal year ended June 30, 2015 and required a restatement to net position.

In March 2014, the GASB issued Statement 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees.* GASB 70 requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. This statement was adopted during the fiscal year ended June 30, 2015 and did not have an impact on the District's financial statements.

Recently Issued Accounting Pronouncements
In January 2014, the GASB issued Statement 69, *Government Combinations and Disposals of Government Operations*. GASB 69 establishes accounting and financial reporting standards related to government combinations and disposals of government operations. This statement is effective for periods beginning after December 15, 2014. The statement was adopted during the year and there was no effect on the financial statements.

In February 2015, the GASB issued Statement 72, *Fair Value Measurement and Application*. GASB 69 establishes accounting and financial reporting standards related to fair value measurements. This statement is effective for periods beginning after June 15, 2015. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

In June 2015, the GASB issued Statement 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This statement is effective for periods beginning after June 15, 2016. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In June 2015, the GASB issued Statement 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement is effective for periods beginning after June 15, 2016. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In June 2015, the GASB issued Statement 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This statement is effective for periods beginning after June 15, 2017. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

NOTE 2 – ELIZABETHTOWN WATER SYSTEM ACQUISITION

On October 23, 2014, the Kentucky Public Service Commission approved an asset purchase agreement between the District and the City of Elizabethtown, Kentucky, for the District's purchase of certain water system assets of the City. The transaction closed on October 31, 2014. The agreement requires the District to pay a note to the City of $8,000,000 in twenty annual installments of $400,000 beginning in 2015. The note carries no specified interest rate, but interest was imputed at a rate of 2.745 percent resulting in a net principal amount of $6,093,748 and a resulting interest amount of $1,906,252 over the life of the note (See note 5). The assets acquired were recorded at cost as well as the corresponding accumulated depreciation (See note 4). The transaction resulted in a $1,000,000 capital contribution from the City and a utility acquisition adjustment of $194,608 which is presented as a deferred outflow of resources in the Statement of Net Position. This amount is being amortized over 20 years at $9,731 per year. The unamortized amount at December 31, 2015 and 2014 was $184,877 and $194,608.

NOTE 3 – DEPOSITS AND INVESTMENTS

DEPOSITS

Custodial Credit Risk—Deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned or that the District will not be able to recover collateral securities in the possession of an outside party. As of December 31, 2015 and 2014, $4,921,205 and $4,259,098 of the District's bank balance of $5,563,590 and $4,759,098 was exposed to custodial credit risk. For 2015 and 2014, of the amount exposed to custodial credit risk, the entire amount was collateralized by securities held by the pledging financial institution.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

INVESTMENTS

At December 31, 2015 and 2014, the District had the following investments and maturities:

	12/31/2015 Fair Value	Average Credit Quality/Ratings	Maturities
Bond Mutual Funds	$ 4,734,748	Unrated	6.5 years average
Bond Mutual Funds	1,093,947	Unrated	8.5 years average
Bond Mutual Funds	5,977,924	Unrated	4.9 years average
Bond Mutual Funds	3,319,536	Unrated	11 years average
Treasury Money Market Fund	853,282	Unrated	Less than 1 year
Total Investments	$ 15,979,437		

	12/31/2014 Fair Value	Average Credit Quality/Ratings	Maturities
Bond Mutual Funds	$ 4,667,919	Unrated	8.3 years average
Bond Mutual Funds	1,112,787	Unrated	8.2 years average
Bond Mutual Funds	5,831,446	Unrated	5.15 years average
Bond Mutual Funds	3,252,237	Unrated	10.82 years average
Treasury Money Market Fund	841,262	Unrated	Less than 1 year
Total Investments	$ 15,705,651		

The funds listed above are not rated. The individual investments within the funds are rated no lower than BBB.

Investment Policies

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

District Policy

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Generally, the District's investing activities are under the custody of the District Commissioners. Investing policies comply with the State Statutes. Kentucky Revised Statute 66.480 defines the following items as permissible investments:

- Obligations of the United States and of its agencies and instrumentalities;
- Obligations of any corporation of the United States Government;
- Obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or a United States government agency;
- Uncollateralized certificates of deposit issued by any bank or savings and loan institution rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- 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 or similar entity or which are collateralized, to the extent uninsured, by any obligations, including surety bonds, permitted by KRS 41.240(4)
- Bankers' acceptances for banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- Commercial paper rated in the highest category by a nationally recognized rating agency;
- Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities;
- Securities issued by a state or local government, or any instrumentality of agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a nationally recognized rating agency; and
- Shares of mutual funds, each of which shall have the following characteristics:
    1. The mutual fund shall be an open-end diversified investment company registered under the Federal Investment Company Act of 1940, as amended;
    2. The management company of the investment company shall have been in operation for at least five (5) years; and
    3. All of the securities in the mutual fund shall be eligible investments pursuant to this section.

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. The District policy provides that, to the extent practicable, investments are matched with anticipated cash flows. Investments are diversified to minimize the risk of loss resulting from over-concentration of assets in a specific maturity period, a single issuer, or an individual class of securities. **Concentration of Credit Risk** is the risk of loss attributed to the magnitude of the District's investment in a single issuer. U.S. Government securities and investments in mutual funds are excluded from this risk. The District does not have more than 5% or more of investments subject to the concentration of credit risk disclosure in any one issuer.

Custodial Credit Risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District did not have any investments in securities at December 31, 2015 and 2014.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

NOTE 3 - RESTRICTED CASH

The District has restricted cash for various purposes at December 31, 2015 and 2014 as follows:

Restricted For	December 31, 2015	December 31, 2014
Debt service	$ 1,235,078	$ 1,164,770
Depreciation fund	465,068	338,560
Escrow	21,850	10,735
Construction	500,484	644,976
Customer deposits	423,724	319,880
	$ 2,646,204	$ 2,478,921

NOTE 4 – CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2015 follows.

	Balance at December 31, 2014	Additions	Retirements	Balance at December 31, 2015
Non-Depreciable Assets:				
Land and land rights	$ 687,483	$ -	$ -	$ 687,483
Construction in progress	4,434,176	1,737,642	(3,117,726)	3,054,092
Total Capital Assets Not Being Depreciated	5,121,659	1,737,642	(3,117,726)	3,741,575
Capital Assets Being Depreciated:				
Structures and improvements	8,784,688	2,049,866	-	10,834,554
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	11,113,289	-	-	11,113,289
Standpipes, tanks and foundations	9,949,534	950,897	-	10,900,431
Transmission and distribution mains	43,555,967	116,949	-	43,672,916
Services and meters	7,066,108	1,814,719	(217,368)	8,663,459
Hydrants	261,775	-	-	261,775
Office furniture and fixtures	479,702	-	-	479,702
Transportation equipment	1,580,835	136,229	(49,313)	1,667,751
Other property and equipment	568,630	37,555	-	606,185
Total Capital Assets Being Depreciated at historical cost	85,124,493	5,106,215	(266,681)	89,964,027
Less accumulated depreciation:				
Structures and improvements	2,725,469	274,608	-	3,000,077
Supply mains	969,599	44,099	-	1,013,698
Water treatment plant	4,054,329	232,467	-	4,286,796
Standpipes, tanks and foundations	2,940,933	262,848	-	3,203,781
Transmission and distribution mains	13,241,000	962,119	-	14,203,119
Services and meters	3,103,300	511,336	(217,368)	3,397,268
Hydrants	223,312	7,545	-	230,857
Office furniture and fixtures	266,659	54,090	-	320,749
Transportation equipment	928,588	176,414	(49,313)	1,055,689
Other property and equipment	307,741	47,312	-	355,053
Total accumulated depreciation	28,760,930	2,572,838	(266,681)	31,067,087
Total other capital assets, net	56,363,563	2,533,377	-	58,896,940
Capital assets, net	$ 61,485,222	$4,271,019	$(3,117,726)	$ 62,638,515

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

Capital asset activity for the year ended December 31, 2014 follows.

	Balance at December 31, 2013	Elizabethtown Water System Addition	Other Additions	Retirements	Balance at December 31, 2014
Non-Depreciable Assets:					
Land and land rights	$ 687,483	$ -	$ -	$ -	$ 687,483
Construction in progress	1,785,250	-	2,855,377	(206,451)	4,434,176
Total Capital Assets Not Being Depreciated	2,472,733	-	2,855,377	(206,451)	5,121,659
Capital Assets Being Depreciated:					
Structures and improvements	4,195,964	4,530,650	58,074	-	8,784,688
Supply mains	1,763,965	-		-	1,763,965
Water treatment plant	11,108,519	-	4,770	-	11,113,289
Standpipes, tanks and foundations	8,691,805	1,438,024	89,854	(270,149)	9,949,534
Transmission and distribution mains	37,467,925	5,775,955	312,087	-	43,555,967
Services and meters	6,106,059	439,380	624,421	(103,752)	7,066,108
Hydrants	243,280	-	18,495	-	261,775
Office furniture and fixtures	396,462	-	83,240	-	479,702
Transportation equipment	1,210,610	-	435,878	(65,653)	1,580,835
Communication equipment	-	-	-	-	-
Other property and equipment	431,963	-	137,462	(795)	568,630
Total Capital Assets Being Depreciated at historical cost	71,616,552	12,184,009	1,764,281	(440,349)	85,124,493
Less accumulated depreciation:					
Structures and improvements	1,212,724	1,379,646	133,099	-	2,725,469
Supply mains	925,500	-	44,099	-	969,599
Water treatment plant	3,821,862	-	232,467	-	4,054,329
Standpipes, tanks and foundations	2,291,415	552,442	224,514	(127,438)	2,940,933
Transmission and distribution mains	9,501,775	2,947,712	791,513	-	13,241,000
Services and meters	2,452,427	405,068	349,557	(103,752)	3,103,300
Hydrants	214,227	-	9,085	-	223,312
Office furniture and fixtures	220,823	-	45,836	-	266,659
Transportation equipment	857,332	-	130,147	(58,891)	928,588
Communication equipment	-	-	-		-
Other property and equipment	272,854	-	35,682	(795)	307,741
Total accumulated depreciation	21,770,939	5,284,868	1,995,999	(290,876)	28,760,930
Total other capital assets, net	49,845,613	6,899,141	(231,718)	(149,473)	56,363,563
Capital assets, net	$ 52,318,346	$ 6,899,141	$2,623,659	$ (355,924)	$ 61,485,222

During the years ended December 31, 2015 and 2014, the District capitalized no interest in either year and expensed $706,164 and $563,347 of interest.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

NOTE 5 – LONG-TERM OBLIGATIONS

The construction costs of the District's water facilities have been financed by issuance of revenue bonds authorized under Kentucky Revised. All assets of the District are pledged as collateral for these bonds. Information relating to the outstanding bond issues is summarized below:

Issue	Interest Rate	Face Amount	Bonds Due 12/31/2015	Bonds Due 12/31/2014
2004 Series A	2.0% - 4.0%	2,940,000	$ 1,765,000	$ 1,890,000
2005 Series B	4.1%	1,775,000	1,125,000	1,210,000
2007 Series A	4.00%	2,480,000	2,328,000	2,361,000
2010 Series A	2.0% - 4.125%	5,625,000	4,635,000	4,855,000
2012 Series	1.0% - 3.75%	6,070,000	5,490,000	5,675,000
			$ 15,343,000	$ 15,991,000

The District requires new customers to provide a $60 deposit for initial water service. Current customers in good standing who add additional service locations are not required to pay an additional deposit.

Long-term liability activity for the year ended December 31, 2015, was as follows:

	Balance at December 31, 2014	Additions	Reductions	Balance at December 31, 2015	Amount Due Within One Year
Bonds and notes payable:					
Revenue bonds	$ 15,991,000	$ -	$ (648,000)	$ 15,343,000	$ 669,000
Notes	6,093,748	-	(232,727)	5,861,021	239,115
Unamortized bond premium/discount	(181,574)	-	23,119	(158,455)	
Total bonds and notes payable	21,903,174	-	(857,608)	21,045,566	908,115
Other liabilities:					
Customer deposits	386,257	215,501	(105,047)	496,711	49,671
Accrued vacation	111,390	123,268	(111,390)	123,268	123,268
Customer advances for construction	23,250	27,000	(16,000)	34,250	34,250
Total other liabilities	520,897	365,769	(232,437)	654,229	207,189
Long-term liabilities	$ 22,424,071	$ 365,769	$ (1,090,045)	$ 21,699,795	$ 1,115,304

Long-term liability activity for the year ended December 31, 2014, was as follows:

	Balance at December 31, 2013	Additions	Reductions	Balance at December 31, 2014	Amount Due Within One Year
Bonds and notes payable:					
Revenue bonds	$ 17,028,000	$ -	$ (1,037,000)	$ 15,991,000	$ 648,000
Notes	-	6,093,748	-	6,093,748	232,727
Unamortized bond premium/discount	(206,072)	-	24,498	(181,574)	
Total bonds and notes payable	16,821,928	6,093,748	(1,012,502)	21,903,174	880,727
Other liabilities:					
Customer deposits	340,943	101,460	(56,146)	386,257	38,626
Accrued vacation	92,633	111,390	(92,633)	111,390	111,390
Customer advances for construction	43,250		(20,000)	23,250	23,250
Total other liabilities	476,826	212,850	(168,779)	520,897	173,266
Long-term liabilities	$ 17,298,754	$ 6,306,598	$ (1,181,281)	$ 22,424,071	$ 1,053,993

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

Bond and note maturities and Sinking Fund requirements in each of the next five years and in five year increments thereafter are as follows at December 31, 2015:

	Revenue Bonds			Notes		
Year	Principal	Interest	Totals	Principal	Interest	Totals
2016	$ 669,000	$ 520,328	$ 1,189,328	$ 239,115	$ 160,885	$ 400,000
2017	696,000	500,611	1,196,611	245,679	154,321	400,000
2018	717,000	479,515	1,196,515	252,423	147,577	400,000
2019	749,000	457,050	1,206,050	259,352	140,648	400,000
2020	770,000	432,815	1,202,815	266,471	133,529	400,000
2021-2025	4,373,000	1,741,758	6,114,758	1,446,172	553,828	2,000,000
2026-2030	3,239,000	1,072,180	4,311,180	1,655,860	344,140	2,000,000
2031-2035	2,027,000	559,145	2,586,145	1,495,949	104,051	1,600,000
2036-2040	1,229,000	271,914	1,500,914	-	-	-
2041-2045	511,000	125,380	636,380	-	-	-
2046-2048	363,000	22,300	385,300	-	-	-
Total	$ 15,343,000	$ 6,182,996	$ 21,525,996	$ 5,861,021	$ 1,738,979	$ 7,600,000

Year	Sinking Fund Requirements
2016	$ 1,589,328
2017	1,596,611
2018	1,596,515
2019	1,606,050
2020	1,602,815
2021-2025	8,114,758
2026-2030	6,311,180
2031-2035	4,186,145
2036-2040	1,500,914
2041-2045	636,380
2046-2048	385,300
Total	$ 29,125,996

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

Under covenants of the bond ordinances, certain funds have been established. These funds and their current financial requirements are presented as follows:

Revenue Fund
All receipts for services are deposited into this fund and, subsequently, disbursed into the following required funds:

Bond and Interest Redemption Funds
There is to be a monthly deposit of an amount equal to 1/12 of the next ensuing principal payment due and 1/6 of the next ensuing interest payment due for the 2002 Series C, 2004 Series A, 2005 B, 2007 Series A, and 2010 Series A and 2012 Series and 1/12 of the next ensuing principal and interest payment on the note payable.

Depreciation Fund
This fund receives, on a monthly basis, $150,000. This fund also receives the proceeds from the sale of any property or equipment. This fund may be used to purchase new or replacement property and equipment.

Operation and Maintenance Fund
This fund receives, on a monthly basis, sufficient amounts to pay current expenses from the Revenue Fund after the above transfers have been made. This fund is used to pay operating expenditures. This account is funded until it reaches 2 months of forecasted operating expenses. Any surplus left may be added to the Bond and Interest Redemption Fund.

NOTE 6 - RETIREMENT PLAN

Plan Description
The District participates in the County Employees' Retirement System (CERS), a component unit of the Commonwealth of Kentucky which is a cost-sharing multiple-employer defined benefit plan. CERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Under the provisions of KRS Section 61.645, the Board of Trustees of Kentucky Retirement Systems (KERS) administers the CERS. The CERS issues a publicly available financial reports that include financial statements and required supplementary information. CERS' report may be obtained at www.kyret.ky.gov.

Benefits Provided
The system provides for retirement, disability, and death benefits to system members. Retirement benefits may be extended to beneficiaries of members under certain circumstances. Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. On July 1, 2013, the COLA was not granted. Effective July 1, 2009, and on July 1 of each year thereafter through June 30, 2014, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the 12 months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce the COLA if, in its judgment, the welfare of the Commonwealth so demands. No COLA has been granted since July 1, 2011.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

Contributions

For the calendar year ended December 31, 2015, plan members who began participating prior to September 1, 2008, were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.545(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. The District's contractually required contribution rate for the calendar year ended December 31, 2015, was 17.67 percent of creditable compensation from January 1 to June 30 and 17.06 percent of creditable compensation from July 1 to December 31. Contributions to the pension plan from the District were $491,530.

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

At December 31, 2015, the District reported a liability of $4,495,343 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all, actuarially determined. At June 30, 2015, the District's proportion was 0.104554 percent, which was an increase of .01606 percent from its proportion measured as of June 30, 2014.

For the year ended December 31, 2015, the District recognized pension expense of $236,086. At December 31, 2015, the District reported its proportionate share of the CERS deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	$ 37,358	$ -
Changes in actuarial assumptions	453,306	-
Difference between projected and actual investment earnings	40,297	-
Changes in proportion	414,192	-
Changes in proportionate share of contributions	428,497	-
Contributions paid to CERS subsequent to the measurement date	179,181	-
	$ 1,552,831	$ -

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

The amount reported as deferred outflows for District contributions subsequent to the measurement date of $179,181 will be recognized as a reduction of the net pension liability in the year ending December 31, 2016. Changes in proportionate share of contributions reported as deferred outflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31	Pension Expense Amount
2016	$ 107,124
2017	107,124
2018	107,124
2019	107,125
	$ 428,497

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

Inflation	3.25 percent
Salary increases	4.0 percent, average, including inflation
Investment rate of return	7.50 percent, 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 for one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.

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

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for the Systems. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term 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.

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

Discount Rate

The discount rate used to measure the total pension liability as of the Measurement Date was 7.5%. 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 7.5%. The long-term assumed investment rate of return was applied to all periods of projected of benefit payments to determine the total pension liability.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2015 AND 2014

Sensitivity Of The District's Proportionate Share Of The Net Pension Liability To Changes In The Discount Rate

The following presents the District's proportionate share of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5 percent) or 1-percentage-point higher (8.5 percent) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
District's proportionate share of the net pension liability	5,738,842	4,495,343	3,430,364

Pension Plan Fiduciary Net Position

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

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

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

Years of Service	% paid by Insurance Fund	% Paid by Member through
20 or more	10	0%
15-19	7	25%
10-14	5	50%
4-9	2	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.

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NOTE 8 – CAPITAL CONTRIBUTIONS

The following schedule details the sources of capital contributions for the years ended December 31, 2015 and 2014:

Source	2015	2014
State of Kentucky	$ 270,273	$ 425,318
City of Elizabethtown, Kentucky	-	1,000,000
Tap Fees	141,533	123,783
Developers	1,189	14,490
	$ 412,995	$ 1,563,591

NOTE 9 – RENTAL AGREEMENTS

The District has entered into agreements to lease space on its water towers to various customers. Rental income during the years ended December 31, 2015 and 2014 was $82,507 and $81,787. The following schedule represents future payments to be received. Each agreement provides for optional renewals. The schedule below reflects payments to be received under current agreements and does not include renewals after the current term.

2016	$ 82,577
2017	82,577
2018	28,566
Total	$ 193,720

NOTE 10 – COMMITMENTS

The District has entered into construction commitments toward its construction projects. Also, the District has received certain funding commitments from governmental agencies for current and planned construction projects.

NOTE 11 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The District was insured for workers' compensation, general liability and automobile liability coverage under a retrospectively rated commercial policy.

NOTE 12 – SUBSEQUENT EVENTS

In February 2016, the Commissioners voted to refund the Series 2004A, 2005B, and 2007A bonds. The bonds are anticipated to sell in June 2016.

REQUIRED SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE CERS NET PENSION LIABILITY

December 31, 2015

Last 10 Years *

		2015
Proportion of the net pension liability		0.104554%
Proportionate share of the net pension liability	$	4,495,343
Covered - employee payroll	$	2,939,133
Proportionate share of the net pension liability as percentage of covered payroll		152.9%
Plan fiduciary net position as a percentage of the total pension liability		59.97%

* Calendar year 2015 was the first year of implementation, therefore, only one year is shown.

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE OF CONTRIBUTIONS TO CERS

December 31, 2015

Last 10 Years *

	2015
Contractually required contribution (actuarially determined)	$ 312,163
Contribution in relation to the actuarially determined contributions	312,163
Contribution deficiency (excess)	$ -
Covered employee payroll	$ 2,939,133
Contributions as a percentage of covered employee payroll	10.62%

* Calendar year 2015 was the first year of implementation, therefore, only one year is shown.

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

FOR THE YEAR ENDED DECEMBER 31, 2015

Changes of benefit terms. There were no changes in benefit terms.

Changes of assumptions. The following changes in assumption s were made:

»»The assumed investment rate of return was decreased from 7.75% to 7.5%.
»»The assumed rate of inflation was reduced from 3.5% to 3.25%.
»»The assumed rate of wage inflation was reduced from 1% to .75%.
»»Payroll growth assumption was reduced from 4.5% to 4%.
»»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 (setback one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four 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.
»»Assumed rates of retirement, withdrawal, and disability were updated to more accurately reflect experience.

OTHER SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2015

	$ 2,940,000 2004 SERIES A		$ 1,775,000 2005 SERIES B	
	BOND	INTEREST	BOND	INTEREST
2016	$ 135,000	$ 66,158	$ 85,000	$ 44,383
2017	145,000	61,113	90,000	40,795
2018	155,000	55,563	95,000	37,003
2019	160,000	49,575	105,000	32,903
2020	170,000	43,140	105,000	28,598
2021	175,000	36,413	115,000	24,088
2022	190,000	29,200	120,000	19,270
2023	200,000	21,400	130,000	14,145
2024	215,000	13,100	135,000	8,713
2025	220,000	4,400	145,000	2,973
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2048				
	$ 1,765,000	$ 380,062	$ 1,125,000	$ 252,871

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HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2015

(CONTINUED)

	$ 2,480,000 2007 SERIES A		$ 5,625,000 2010 SERIES A	
	BOND	INTEREST	BOND	INTEREST
2016	$ 34,000	$ 92,440	$ 225,000	$ 162,122
2017	36,000	91,040	230,000	156,288
2018	37,000	89,580	235,000	149,894
2019	39,000	88,060	245,000	142,987
2020	40,000	86,480	250,000	135,250
2021	42,000	84,840	260,000	126,800
2022	44,000	83,120	265,000	117,940
2023	46,000	81,320	275,000	108,656
2024	47,000	79,460	290,000	98,588
2025	49,000	77,540	300,000	87,707
2026	51,000	75,540	310,000	76,075
2027	54,000	73,440	325,000	63,772
2028	56,000	71,240	340,000	50,676
2029	58,000	68,960	345,000	36,976
2030	60,000	66,600	360,000	22,876
2031	63,000	64,140	380,000	7,833
2032	66,000	61,560		
2033	68,000	58,880		
2034	71,000	56,100		
2035	74,000	53,200		
2036	77,000	50,180		
2037	80,000	47,040		
2038	84,000	43,760		
2039	87,000	40,340		
2040	91,000	36,780		
2041	94,000	33,080		
2042	98,000	29,240		
2043	102,000	25,240		
2044	106,000	21,080		
2045	111,000	16,740		
2046	115,000	12,220		
2047	120,000	7,520		
2048	128,000	2,560		
	$ 2,328,000	$ 1,869,320	$ 4,635,000	$ 1,544,440

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2015

(CONTINUED)

	$ 6,070,000 2012 SERIES		TOTAL ALL ISSUES	
	BOND	INTEREST	BOND	INTEREST
2016	$ 190,000	$ 155,225	$ 669,000	$ 520,328
2017	195,000	151,375	696,000	500,611
2018	195,000	147,475	717,000	479,515
2019	200,000	143,525	749,000	457,050
2020	205,000	139,347	770,000	432,815
2021	210,000	134,806	802,000	406,947
2022	215,000	129,891	834,000	379,421
2023	220,000	124,725	871,000	350,246
2024	230,000	119,238	917,000	319,099
2025	235,000	113,425	949,000	286,045
2026	245,000	107,119	606,000	258,734
2027	245,000	100,381	624,000	237,593
2028	255,000	93,506	651,000	215,422
2029	265,000	86,356	668,000	192,292
2030	270,000	78,663	690,000	168,139
2031	280,000	70,063	723,000	142,036
2032	295,000	60,719	361,000	122,279
2033	300,000	50,675	368,000	109,555
2034	210,000	41,750	281,000	97,850
2035	220,000	34,225	294,000	87,425
2036	230,000	26,063	307,000	76,243
2037	235,000	17,344	315,000	64,384
2038	250,000	8,250	334,000	52,010
2039	85,000	1,969	172,000	42,309
2040	10,000	188	101,000	36,968
2041			94,000	33,080
2042			98,000	29,240
2043			102,000	25,240
2044			106,000	21,080
2045			111,000	16,740
2046			115,000	12,220
2047			120,000	7,520
2048			128,000	2,560
	$ 5,490,000	$ 2,136,303	$ 15,343,000	$ 6,182,996

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE II - GENERAL AND ADMINISTRATIVE EXPENSES

YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
Salaries	$ 1,067,634	$ 886,496
Commissioner's salaries	30,276	30,276
Employee benefits	494,661	406,357
Materials and supplies	87,904	55,335
Professional fees and contractual services	281,434	79,307
Insurance	136,110	94,573
Advertising	3,738	6,501
Provision for bad debts	53,491	28,322
Other general and administrative	286,311	255,022
	$ 2,441,559	$ 1,842,189

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE III - ORGANIZATION DATA

DECEMBER 31, 2015

WATER COMMISSIONERS

Michael Bell - Chairman
Morris Miller - Secretary/Treasurer
Cordell Tabb - Member
John Effinger - Member
Tim Davis - Member

ATTORNEY

Stoll, Keenon, Ogden, PLLC

GENERAL MANAGER

James Jeffries

CALENDAR YEAR

January 1 to December 31

INTERNAL CONTROL AND FISCAL COMPLIANCE

Chris R. Carter, CPA
Ann M. Fisher, CPA
Scott Kisselbaugh, CPA
Brian S. Woosley, CPA

Stiles, Carter & Associates
CERTIFIED PUBLIC ACCOUNTANTS

American Institute of CPAs
Kentucky Society of CPAs

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

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, 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 Hardin County Water District No. 2, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise Hardin County Water District No. 2's basic financial statements and have issued our report thereon dated June 16, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Hardin County Water District No. 2'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 Hardin County Water District No. 2's internal control. Accordingly, we do not express an opinion on the effectiveness of Hardin County Water District No. 2'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 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 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.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hardin County Water District No. 2's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 District'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.

Stiles Carter & Associates

Certified Public Accountants
Elizabethtown, Kentucky
June 16, 2016