

**HENRY COUNTY WATER DISTRICT #2**  
**BASIC FINANCIAL STATEMENTS,**  
**SUPPLEMENTARY INFORMATION,**  
**AND INDEPENDENT AUDITOR'S REPORTS**

**At December 31, 2017 and 2016**

**HENRY COUNTY WATER DISTRICT #2  
BASIC FINANCIAL STATEMENTS,  
SUPPLEMENTARY INFORMATION,  
AND INDEPENDENT AUDITOR'S REPORTS**

**Years Ended December 31, 2017 and 2016**

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# RAISOR, ZAPP & WOODS, PSC

## Certified Public Accountants

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### INDEPENDENT AUDITOR'S REPORT

To the Commissioners of the  
Henry County Water District #2  
Campbellsburg, Kentucky 40011

#### Report on the Financial Statements

We have audited the accompanying financial statements of Henry County Water District #2 as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Henry County Water District #2'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.

#### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Henry County Water District #2, as of December 31, 2017 and 2016, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Other Matters*

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Schedule of the District's Proportionate Share of the Net Pension Liability – County Employees Retirement System on page 25, and Schedule of the District's Contributions – County Employees Retirement System on page 26 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 28, 2018, on our consideration of the Henry County Water District #2'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 solely 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 effectiveness of the Henry County Water District #2's 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 Henry County Water District #2's internal control over financial reporting and compliance.

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP & WOODS, PSC  
Certified Public Accountants  
Carrollton, Kentucky

June 28, 2018

**HENRY COUNTY WATER DISTRICT #2**  
**STATEMENT OF NET POSITION**  
December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
Current Assets:		
Cash, Including Time Deposits	\$ 157,704	\$ 98,498
Accrued Interest Receivable	114	162
Accounts Receivable (Net)	410,473	416,586
Other Receivables	17,676	6,439
Inventory	114,678	98,399
Prepaid Expense	31,629	29,458
Total Current Assets	<u>\$ 732,274</u>	<u>\$ 649,542</u>
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 1,777,380	\$ 1,700,097
Accrued Interest Receivable	1,356	1,435
Capital Assets (Net)	17,149,885	16,588,784
Total Noncurrent Assets	<u>\$ 18,928,621</u>	<u>\$ 18,290,316</u>
Total Assets	<u>\$ 19,660,895</u>	<u>\$ 18,939,858</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Attributable to Employee Pension Plan	\$ 528,522	\$ 439,692
Deferred Loss - Early Debt Retirement	195,107	212,196
Total Deferred Outflows of Resources	<u>\$ 723,629</u>	<u>\$ 651,888</u>
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts Payable	\$ 79,233	\$ 62,869
Accounts Payable - Construction	224,360	44,191
Accrued Compensated Absences	26,967	23,734
Accrued Salaries, Wages & Benefits	20,984	20,224
Accrued Payroll Taxes/Employee Withholding	38,970	31,855
Utility Tax Payable	7,456	7,316
Sales Tax Payable	483	500
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Customer Deposits	1,583	547
Accrued Interest - Notes Payable	5,584	9,025
Revenue Bonds Payable	421,000	495,000
Notes Payable	177,978	93,990
Total Current Liabilities	<u>\$ 1,004,598</u>	<u>\$ 789,251</u>
Noncurrent Liabilities:		
Revenue Bonds Payable (Net of Unamortized Bond Discount & Premium of \$3,988 for 2017 and \$4,372 for 2016)	\$ 4,957,988	\$ 5,379,372
Notes Payable	3,650,945	3,352,190
Net Pension Liability	1,997,207	1,715,920
Noncurrent Liabilities Payable from Restricted Assets:		
Customer Deposits Payable	92,875	87,850
Total Noncurrent Liabilities	<u>\$ 10,699,015</u>	<u>\$ 10,535,332</u>
Total Liabilities	<u>\$ 11,703,613</u>	<u>\$ 11,324,583</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Attributable to Employee Pension Plan	\$ 83,373	\$ 36,652
Funds Held for Future Lines	-	21,600
Total Deferred Inflows of Resources	<u>\$ 83,373</u>	<u>\$ 58,252</u>
<b>NET POSITION</b>		
Net Investment in Capital Assets	\$ 8,126,022	\$ 7,448,633
Restricted for Capital Projects	397,249	295,758
Restricted for Debt Service	1,318,230	1,312,183
Unrestricted (deficit)	<u>(1,243,963)</u>	<u>(847,663)</u>
Total Net Position	<u>\$ 8,597,538</u>	<u>\$ 8,208,911</u>

**HENRY COUNTY WATER DISTRICT #2**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**  
For the Years Ended December 31, 2017 and 2016

Operating Revenues:	2017	2016
<b>Charges for Services:</b>		
Water Charges (Net of Estimated Bad Debts)	\$ 3,056,029	\$ 2,999,980
Wholesale Water Charges	268,955	240,056
Total Charges for Services	<u>\$ 3,324,984</u>	<u>\$ 3,240,036</u>
<b>Other Charges and Miscellaneous:</b>		
Reconnect and Disconnect Charges	\$ 33,275	\$ 35,030
Forfeited Discounts	81,107	80,992
Miscellaneous	22,999	26,828
Total Other Charges and Miscellaneous	<u>\$ 137,381</u>	<u>\$ 142,850</u>
<b>Total Operating Revenues</b>	<u>\$ 3,462,365</u>	<u>\$ 3,382,886</u>
<b>Operating Expenses:</b>		
Accounting and Collecting Labor	\$ 120,206	\$ 116,727
Chemicals	23,505	29,855
Commissioner Salaries	33,300	32,400
Continuing Education	1,844	7,132
Contractual Services-Maintenance of Mains/Distribution System	23,589	19,845
Dues	7,115	5,968
Insurance	46,058	45,526
Maintenance of Mains/Distribution System Expenses	176,744	311,866
Miscellaneous	3,676	7,493
Office Supplies and Expense	62,280	63,610
Operating Labor	573,148	662,459
Other Interest Expense	1,036	396
Payroll Taxes	67,876	68,070
Professional Services	54,866	53,804
Purchased Power	382,630	372,822
Regulatory Fees	6,770	6,682
Retirement Expense & Employee Benefits	517,257	431,060
Transportation Expense	27,110	26,634
Utilities	28,870	27,040
Depreciation Expense	737,034	694,431
Total Operating Expenses	<u>\$ 2,894,914</u>	<u>\$ 2,983,820</u>
<b>Net Operating Income</b>	<u>\$ 567,451</u>	<u>\$ 399,066</u>
<b>Nonoperating Revenue (Expense):</b>		
Investment Income	\$ 9,111	\$ 8,162
Interest Expense	(295,753)	(290,876)
Gain/Loss on Sale or Abandonment of Assets	2,912	-
Total Nonoperating Revenue (Expense)	<u>\$ (283,730)</u>	<u>\$ (282,714)</u>
<b>Income (Loss) Before Contributions</b>	<u>\$ 283,721</u>	<u>\$ 116,352</u>
<b>Capital Contributions</b>	<u>104,906</u>	<u>81,162</u>
<b>Change in Net Position</b>	<u>\$ 388,627</u>	<u>\$ 197,514</u>
<b>Net Position--Beginning of Year</b>	<u>8,208,911</u>	<u>8,011,397</u>
<b>Net Position--End of Year</b>	<u><u>\$ 8,597,538</u></u>	<u><u>\$ 8,208,911</u></u>

See accompanying notes to the basic financial statements.

**HENRY COUNTY WATER DISTRICT #2**  
**STATEMENT OF CASH FLOWS**  
For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from Customers	\$ 3,462,266	\$ 3,453,407
Payments to Suppliers	(1,193,098)	(1,401,836)
Payments to Employees	(722,661)	(806,676)
Other Receipts (Payments)	7,238	33,247
Net Cash Provided (Used) by Operating Activities	<u>\$ 1,553,745</u>	<u>\$ 1,278,142</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Proceeds from Sale of Capital Assets	\$ 4,358	\$ -
Purchase of Capital Assets (Including Work In Process)	(1,119,412)	(2,052,793)
Principal Paid on Capital Debt	(588,990)	(705,835)
Interest Paid on Capital Debt	(282,489)	(268,152)
Note Proceeds	476,733	1,476,276
Capital Contributions	83,306	98,422
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>\$ (1,426,494)</u>	<u>\$ (1,452,082)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Certificates of Deposit Redeemed During Year	\$ -	\$ 22,830
Interest Received	8,956	7,479
Net Cash Provided (Used) by Investing Activities	<u>\$ 8,956</u>	<u>\$ 30,309</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	 \$ 136,207	 \$ (143,631)
Balances-Beginning of the Year	<u>711,390</u>	<u>855,021</u>
Balances-End of the Year	<u><u>\$ 847,597</u></u>	<u><u>\$ 711,390</u></u>

	Balances Per December 31, 2017 Statement of Net Position	Balances Per December 31, 2017 Statement of Cash Flows
Cash	\$ 57,704	\$ 57,704
Certificates of Deposit	100,000	-
Restricted Cash	789,893	789,893
Restricted Certificates of Deposit	987,487	-
Total Cash and Cash Equivalents, End of Year	<u>\$ 1,935,084</u>	<u>\$ 847,597</u>

	Balances Per December 31, 2016 Statement of Net Position	Balances Per December 31, 2016 Statement of Cash Flows
Cash	\$ (1,502)	\$ (1,502)
Certificates of Deposit	100,000	-
Restricted Cash	712,892	712,892
Restricted Certificates of Deposit	987,205	-
Total Cash and Cash Equivalents, End of Year	<u>\$ 1,798,595</u>	<u>\$ 711,390</u>

(Continued)

**HENRY COUNTY WATER DISTRICT #2**  
**STATEMENT OF CASH FLOWS**  
For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>		
Operating Income (Loss)	\$ 567,451	\$ 399,066
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	737,034	694,431
Pension Expense	239,178	138,265
Change in Assets and Liabilities:		
Receivables, Net	6,113	(11,137)
Other Receivables	(11,237)	71,833
Inventories	(16,279)	16,767
Prepaid Expenses	(2,171)	635
Accounts Payable	16,364	(47,696)
Accrued Expenses	11,231	5,758
Customer Meter Deposits Payable	6,061	10,220
Net Cash Provided by Operating Activities	<u>\$ 1,553,745</u>	<u>\$ 1,278,142</u>

**SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

At December 31, 2017 and 2016, Henry County Water District #2 had \$224,360 and \$44,191, respectively, of capitalized expenditures for construction in accounts payable on the Statement of Net Position. At December 31, 2017 and 2016, Henry County Water District #2 had \$4,500 and \$0, respectively, of capital assets in accounts payable on the Statement of Net Position.



**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
December 31, 2017 and 2016

**NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES**

Description of entity: Henry County Water District #2 is a rural water company serving approximately 6,300 customers in the Kentucky counties of Henry, Trimble, Carroll, Oldham and Shelby, and is regulated by the Public Service Commission of the Commonwealth of Kentucky. The water district was formed under the laws of Henry County through its Fiscal Court and began operations in 1965.

In evaluating how to define Henry County Water District #2 for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The basic -- but not the only -- criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the District is able to exercise oversight responsibilities. Based upon the application of these criteria, the District has no component units.

A summary of the District's significant accounting policies follows:

**Basis of presentation and accounting:** As stated in Kentucky Revised Statutes (KRS) 278.015, "any water district shall be a public utility and shall be subject to the jurisdiction of the Public Service Commission." In KRS 278.220, it is outlined that the Public Service Commission may establish a system of accounts to be kept by the utilities subject to its jurisdiction, and may prescribe the manner in which such accounts shall be kept. The financial statements of the District are prepared in accordance with generally accepted accounting principles (GAAP). The District applies all relevant Governmental Accounting Standards Board (GASB) pronouncements.

All activities of the District are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (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.

Proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

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. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net position. Net position (total assets plus deferred outflows net of total liabilities and deferred inflows) is segregated into net investment in capital assets, restricted; and unrestricted components.

**Revenues and expenses:** Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the District. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities.

The District adheres to the use restrictions established by Bond Agreements when expenses are incurred for which both restricted and unrestricted net position is available. The District has no policy defining which resources (restricted or unrestricted) to use first.

HENRY COUNTY WATER DISTRICT #2  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2017 and 2016

**NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Property and equipment:** Property and equipment purchased or constructed is stated at cost. The District's policy is to capitalize asset purchases exceeding \$500 for office equipment and \$1,000 for service equipment. The cost of meters, including installation, is recorded at the Public Service Commission approved charge of \$1,120. Interest related to costs, and major improvements, renewals and replacements is capitalized as a cost of the project. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. The range of estimated useful lives by type of asset is as follows:

- Structures & Improvements	7-60 years
- Distribution System	7-50 years
- Machinery & Equipment	3-25 years

Construction in process represents costs related to various water line extensions being installed by District employees, as well as system improvements. Expenses for maintenance and repairs that do not increase the useful life of the asset are charged to operations as they are incurred.

As part of the rate increase study performed by the Public Service Commission (PSC) it was recommended to the District that the lives of distribution system assets be extended to reflect recommendations made by the PSC during its review. Depreciation Expense has been calculated using straight line depreciation as applied to the assets' historical costs over the revised asset lives.

**Inventory:** Inventories of supplies are valued at the lower of cost or market on a first-in, first-out basis.

**Bond Discount and Premium:** Bond discount and premium are amortized over the life of the bond issue.

**Debt Issuance Costs:** Such costs are expensed as incurred.

**Pension:** 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 Commonwealth of Kentucky's 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.

**Compensated Absences:** See Note 11 for the District's policy on vacation and sick pay.

**Income Taxes:** Henry County Water District #2 is not subject to income taxes.

**Contributed Capital:** Under the Governmental Accounting Standards Board's (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the District recognizes capital contributions as revenues, in the statement of revenues, expenses, and changes in fund net position. Capital contributions include donated property, impact fees, tap on fees and grants. Tap on fees and impact fees of \$87,230 and \$63,970 were received by the District for the years ended December 31, 2017 and 2016, respectively. \$17,676 and \$17,192 from the Kentucky Department of Transportation were received by the District for the years ended December 31, 2017 and 2016, respectively.

**Net Position:** Net position comprises the various net earnings from operating and non-operating revenues, expenses, and contributions of capital. Net position is classified in the following three components: net investment in capital assets, restricted, and unrestricted net position. Net investment in capital assets consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted net position consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net position consists of all other net position not included in the above categories.

**Deferred Outflows and Deferred Inflows:** Deferred Outflows of Resources and Deferred Inflows of Resources are not assets or liabilities; revenues or expenses. Rather, they represent resources or the use of resources related to future periods.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Estimates:** The preparation of financial statements 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.

**Statement of Cash Flows:** For the purpose of the Statement of Cash Flows, Henry County Water District #2 considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

**NOTE 2 – DEBT RESTRICTIONS AND COVENANTS**

The Bond and Interest Sinking Account was established with the original bond issue. Under the bond resolution which established this account, it was provided that a minimum balance be maintained in this account as security to the bondholders. In order to attain the minimum balance, the monthly transfer to be made into the account for the outstanding bond issues is as follows:

	one sixth (1/6) of the next semiannual interest payment
+	one twelfth (1/12) of next annual principal payment
=	monthly transfer

The transfers and/or segregated deposits were sufficient to meet the total obligation outstanding on all issues at December 31, 2017 and 2016. During calendar year 2016 all transfers were made timely as appropriate. During the calendar year 2017 sinking fund transfers were not made consistently.

Upon the issuance of the original bonds, a Depreciation Account was established to provide funds for extraordinary repairs and extensions to the system and/or make up any deficiency in the Bond and Interest Sinking Account. After monthly deposits are made into the Bond and Interest Account, monthly transfers are required to be made to the Depreciation Account. The 1996 Bond Resolution (which was refinanced with the 2003 Bond Issue) required a monthly transfer of \$3,845 to accumulate to a balance of \$461,400. The 2001, 2003, 2010 and 2013 Bond Resolutions ratify and confirm the creation of the 1996 Depreciation Fund. The Kentucky Infrastructure Authority Notes F13-039 and F15-014 require the establishment of a replacement reserve account. The KIA note F13-039 requires an annual transfer of \$7,100 to accumulate to a balance of \$71,000. The KIA note F15-014 requires an annual transfer of \$7,000, once the loan has closed, to accumulate to a balance of \$70,000. At December 31, 2017 and 2016, the Depreciation Account was fully funded.

**NOTE 3 – CASH AND INVESTMENTS**

KRS 66.480 authorizes the District to invest in obligations of the United States and its agencies and instrumentalities including repurchase agreements, through sources including national and state banks chartered in Kentucky, obligations and contracts for future delivery backed by the full faith of the United States or its Agency, certificates of deposit and interest bearing accounts in institutions insured by the Federal Depository Insurance Corporation and other investments described therein provided that approved securities are pledged to secure those funds on deposit in an amount equal to the amount of those funds. The District may also invest in mutual funds meeting the requirements of the statute.

**Custodial Credit Risk**

Custodial credit risk for deposits is the risk that in the event of a bank failure, the District's deposits may not be returned to it. As of December 31, 2017, and 2016 in accordance with District policy, \$1,368,139 and \$1,591,072 respectively, of the District's deposits were covered by federal depository insurance and \$1,190,482 and \$1,045,117, respectively, were collateralized by securities held by the pledging financial institution's agent or trust department in the District's name. Thus, the District had no deposits that were exposed to custodial credit risk.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2017 and 2016

**NOTE 3 – CASH AND INVESTMENTS (Continued)**

**Custodial Credit Risk (Continued)**

At December 31, 2017 and 2016, the District's deposits were as follows:

**December 31, 2017**

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Total Carrying Value</u>
Demand Deposits	\$ 22,226	\$ 22,226
Time & Savings	2,536,394	1,912,358
Total Deposits	<u>\$ 2,558,620</u>	<u>\$ 1,934,584</u>

**December 31, 2016**

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Total Carrying Value</u>
Demand Deposits	\$ 298,321	\$ 72,749
Time & Savings	2,337,868	1,706,146
Total Deposits	<u>\$ 2,636,189</u>	<u>\$ 1,778,895</u>

**Reconciliation to Statement of Net Position:**

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Unrestricted Cash, Including Time Deposits	\$ 157,704	\$ 98,498
Restricted Cash, Including Time Deposits	1,777,380	1,700,097
Less Cash on Hand	(500)	(19,700)
	<u>\$ 1,934,584</u>	<u>\$ 1,778,895</u>

**NOTE 4 – RESTRICTED ASSETS**

Restricted cash and time deposits consist of the following:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Bond and Interest Sinking Account	\$ 433,080	\$ 430,839
Debt Covenant	280,487	280,205
Depreciation Account	608,892	608,729
Customer Deposits & Impact Charge Escrow	57,672	84,566
Construction Account	397,249	295,758
Total	<u>\$ 1,777,380</u>	<u>\$ 1,700,097</u>

Restricted receivables consist of the following:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Interest Receivable	<u>\$ 1,356</u>	<u>\$ 1,435</u>

**NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE**

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$74,378 and \$59,647 at December 31, 2017 and 2016, respectively. The amount provided for bad debts represents the portion of the total amounts for which collection is unlikely, based on historical collection data.

Estimated unbilled water service revenue of \$129,913 and \$131,764 is included in accounts receivable at December 31, 2017 and 2016, respectively.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 6 – OTHER RECEIVABLES**

At December 31, 2017 the District recorded other receivables of \$17,676 from Kentucky Department of Transportation.

At December 31, 2016 the District recorded other receivables of \$6,439 that consisted of \$5,052 from Kentucky Department of Transportation and \$1,387 from a vendor for damages.

**NOTE 7 – CAPITAL ASSETS**

Capital asset activity for the years ended December 31, 2017 and 2016, was as follows:

	Balance at January 1, 2017	Additions	Disposals	Balance at December 31, 2017
Land & Land Rights	\$ 176,617	\$ 16,159	\$ -	\$ 192,776
Structures & Improvements	27,188,322	2,685,754	(178,558)	29,695,518
Distribution System	2,676,737	52,420	-	2,729,157
Machinery & Equipment	1,611,124	200,693	(18,605)	1,793,212
Construction in Process	1,994,071	1,046,468	(2,701,913)	338,626
<b>Totals at Historical Cost</b>	<b>\$ 33,646,871</b>	<b>\$ 4,001,494</b>	<b>\$ (2,899,076)</b>	<b>\$ 34,749,289</b>
 Less: Accumulated Depreciation				
Structures & Improvements	\$ (14,507,895)	\$ (611,546)	\$ 178,558	\$ (14,940,883)
Distribution System	(1,402,497)	(39,165)	-	(1,441,662)
Machinery & Equipment	(1,147,695)	(86,323)	17,159	(1,216,859)
<b>Total Accumulated Depreciation</b>	<b>\$ (17,058,087)</b>	<b>\$ (737,034)</b>	<b>\$ 195,717</b>	<b>\$ (17,599,404)</b>
 <b>Capital Assets, Net</b>	<b>\$ 16,588,784</b>	<b>\$ 3,264,460</b>	<b>\$ (2,703,359)</b>	<b>\$ 17,149,885</b>
	Balance at January 1, 2016	Additions	Disposals	Balance at December 31, 2016
Land & Land Rights	\$ 176,617	\$ -	\$ -	\$ 176,617
Structures & Improvements	27,134,749	53,573	-	27,188,322
Distribution System	2,602,240	74,497	-	2,676,737
Machinery & Equipment	1,499,127	111,997	-	1,611,124
Construction in Process	178,592	1,854,153	(38,674)	1,994,071
<b>Totals at Historical Costs</b>	<b>\$ 31,591,325</b>	<b>\$ 2,094,220</b>	<b>\$ (38,674)</b>	<b>\$ 33,646,871</b>
 Less: Accumulated Depreciation				
Structures & Improvements	\$ (13,925,323)	\$ (582,572)	\$ -	\$ (14,507,895)
Distribution System	(1,364,288)	(38,209)	-	(1,402,497)
Machinery & Equipment	(1,074,045)	(73,650)	-	(1,147,695)
<b>Totals Accumulated Depreciation</b>	<b>\$ (16,363,656)</b>	<b>\$ (694,431)</b>	<b>\$ -</b>	<b>\$ (17,058,087)</b>
 <b>Capital Assets, Net</b>	<b>\$ 15,227,669</b>	<b>\$ 1,399,789</b>	<b>\$ (38,674)</b>	<b>\$ 16,588,784</b>

Included under the District's capital assets were \$4,971,696 and \$4,885,311 of fully depreciated assets, at December 31, 2017 and 2016, respectively. Land and land rights and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$737,034 and \$694,431 in 2017 and 2016, respectively.

HENRY COUNTY WATER DISTRICT #2  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2017 and 2016

**NOTE 8 – CUSTOMER DEPOSITS/ESCROW**

Customer deposits are collected upon installation of water service. This amount is to be refunded to the customer upon discontinuation of service (after the customer's bill has been paid in full) or one year pending a satisfactory payment record. Deposits received from customers are held in an interest bearing account (which is included in the financial statements as restricted cash). Records are maintained which detail the accrued interest on each customer's deposit based on the current annual rate. Accrued interest is paid annually and when the deposit is refunded.

**NOTE 9 – DEFERRED OUTFLOWS OF RESOURCES**

In 2013, Henry County Water District adopted GASB 65, *Items Previously Reported as Assets and Liabilities*. Under GASBS No. 65 a consumption of net position by the District that is applicable to a future period is reported as a deferred outflow of resources.

The following is a summary of the District's deferred outflows of resources associated with early debt retirement:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Difference between the reacquisition price and the net carrying amount of the old bond issues refunded.		
2010 Bond Issue	\$ 128,605	\$ 140,999
2013 Bond Issue	66,502	71,197
	<u>\$ 195,107</u>	<u>\$ 212,196</u>

Amounts reported as deferred outflows of resources due to the advance refunding of old bond issues will be amortized over the shorter of the life of the old or new debt and recognized in interest expense as follows:

Year Ended December 31, 2017:	<u>Deferred Outflows of Resources</u>
2018	\$ 17,089
2019	17,089
2020	17,089
2021	17,089
2022	17,089
2023-2027	85,447
2028-2032	24,215
	<u>\$ 195,107</u>
Year Ended December 31, 2016:	<u>Deferred Outflows of Resources</u>
2017	\$ 17,089
2018	17,089
2019	17,089
2020	17,089
2021	17,089
2022-2026	85,447
2027-2031	40,521
2032	783
	<u>\$ 212,196</u>

The District's deferred outflows of resources attributable to the District's employee pension plan are detailed in Note 16.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 10 – LONG-TERM DEBT**

As of December 31, 2017 and 2016, the long-term debt payable consisted of the following:

***Notes Payable:***

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Kentucky Infrastructure Authority represents a 20 year secured loan by water revenues approved for \$2,800,000. Interest is charged at 1.75% per annum. In addition, a loan servicing fee of 0.25% of the annual outstanding balance will be payable to the authority as part of each interest payment. The loan had not closed at December 31, 2017. Total draws through December 31, 2017 were \$1,953,009. Semi-annual payments with final maturity December 1, 2037. An estimated amortization schedule based on loan draws has been presented.	\$ 1,953,009	\$ 1,476,276
Kentucky Infrastructure Authority represents a 20 year loan secured by water revenues. Interest is charged at 1.75% per annum. In addition, a loan servicing fee of 0.25% of the annual outstanding loan balance will be payable to the authority as part of each interest payment. Original loan amount was \$2,153,041. Semi-annual payments with final maturity December 1, 2034.	<u>1,875,914</u>	<u>1,969,904</u>
<b>Total Notes Payable</b>	<b>\$ 3,828,923</b>	<b>\$ 3,446,180</b>
<b>Current Portion</b>	<b>\$ 177,978</b>	<b>\$ 93,990</b>
<b>Noncurrent Portion</b>	<b>3,650,945</b>	<b>3,352,190</b>
<b>Total Notes Payable</b>	<b>\$ 3,828,923</b>	<b>\$ 3,446,180</b>

***Bonds Payable:***

2010 B Bond Issue, original issue amount of \$5,663,000, secured by water revenues. Interest is charged 3.20% to 4.33% per annum. Final maturity is January 1, 2028.	\$ 3,545,000	\$ 3,850,000
Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds (Flexible Term Program) Series 2013B, original issue (District Share) \$2,760,000, secured by water revenues. Interest is charged at the rates of 2.30% - 3.5% per annum. Final maturity is February 1, 2032.	<u>1,830,000</u>	<u>2,020,000</u>
<b>Total Bonds Payable</b>	<b>\$ 5,375,000</b>	<b>\$ 5,870,000</b>
<b>Current Portion</b>	<b>\$ 421,000</b>	<b>\$ 495,000</b>
<b>Noncurrent Portion</b>	<b>4,954,000</b>	<b>5,375,000</b>
<b>Total Bonds Payable</b>	<b>\$ 5,375,000</b>	<b>\$ 5,870,000</b>
<b>Unamortized Bond Premium</b>	<b>3,988</b>	<b>4,372</b>
<b>Total Bonds Payable Net of Unamortized Bond Premium and Discount</b>	<b>\$ 5,378,988</b>	<b>\$ 5,874,372</b>

***Accrued Compensated Absences:***

<b>Accrued Compensated Absences (All Current)</b>	<b>\$ 26,967</b>	<b>\$ 23,734</b>
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**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2017 and 2016

**NOTE 10 – LONG-TERM DEBT (Continued)**

**Kentucky Infrastructure Authority – Federally Assisted Drinking Water Revolving Loan Fund**

Kentucky Infrastructure Authority represents a 20 year secured loan by water revenues. Interest is charged at 1.75% per annum. Total loan amount available is \$2,800,000. In addition, a loan servicing fee of 0.25% of the annual outstanding balance will be payable to the authority as part of each interest payment. Loan proceeds will be used to construct a new 1 million gallon composite storage tank. The loan had not closed at December 31, 2017. Total draws through December 31, 2017 were \$1,953,009. An estimated amortization schedule has been presented based on current draws.

**Kentucky Infrastructure Authority – Federally Assisted Drinking Water Revolving Loan Fund**

On October 6, 2014 Henry County Water District closed a loan in the amount of \$2,153,041 with Kentucky Infrastructure Authority secured by water revenues. Interest is charged at 1.75% per annum. In addition a loan servicing fee of 0.25% of the annual outstanding loan balance will be payable to the authority as part of each interest payment. Proceeds from this loan were used to install approximately 24,000 linear feet of water main. Final maturity is December 1, 2034.

**2014 Shelby Energy Electric Cooperative Corporation Note Payable**

The original balance of the Shelby Energy Electric Cooperative Corporation note payable was \$200,000. The note was payable in monthly installments of \$5,642 through September 5, 2016. This loan was paid off in 2016.

**Kentucky Rural Water Finance Corporation Public Projects Revenue Bonds, Series 2010 B**

On May 13, 2010 Henry County Water District entered into a \$5,663,000 bond agreement with Kentucky Rural Water Finance Corporation. The proceeds of the bonds were used to refund the District's then outstanding Refunding Revenue Bonds, Series 1998 (principal, interest, and 1% redemption premium as required). Final maturity on the 2010 issue is January 1, 2028.

**Bonds Payable Kentucky Rural Water Finance Corporation Flexible Term Finance Program Series 2013B**

On February 27, 2013, Henry County Water District #2 issued \$2,760,000, Series 2013B Kentucky Rural Water Finance Corporation Public Projects Refunding Revenue Bonds with interest rates of 2.30% - 3.55% to advance refund \$370,000 Series 2001D and \$2,333,000 Series 2003 revenue bonds outstanding. The 2001D Series was originally issued at 2.4% to 4.75% per annum. The 2003 Series was issued at 4.06% to 4.81% per annum. The refunded bonds were redeemed on February 27, 2013 at a price equal to 100% of the principal amounts of the refunded bonds outstanding at that date. Bond issuance costs were \$61,389 which were expensed when incurred.

As a result of the advance refunding, the District reduced its total debt service requirements by \$476,674, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debts) of \$356,023. Final maturity on the 2013 issue is February 1, 2032.

**Changes in Long-term Debt**

The following is a summary of changes in long-term debt for the years ended December 31, 2017 and 2016.

**December 31, 2017**

	Balance at January 1, 2017	Additions	Retirements	Balance at December 31, 2017	Current Portion
Notes Payable	\$ 3,446,180	\$ 476,733	\$ 93,990	\$ 3,828,923	\$ 177,978
Bonds Payable	5,870,000	-	495,000	5,375,000	421,000
Accrued Compensated Absences	23,734	3,233	-	26,967	26,967
Total Enterprise Fund Debt	<u>\$ 9,339,914</u>	<u>\$ 479,966</u>	<u>\$ 588,990</u>	<u>\$ 9,230,890</u>	<u>\$ 625,945</u>



**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 10 – LONG-TERM DEBT (Continued)**

**December 31, 2016**

	Balance at January 1, 2016	Additions	Retirements	Balance at December 31, 2016	Current Portion
Notes Payable	\$ 2,190,739	\$ 1,476,276	\$ 220,835	\$ 3,446,180	\$ 93,990
Bonds Payable	6,355,000	-	485,000	5,870,000	495,000
Accrued Compensated Absences	25,660	-	1,926	23,734	23,734
<b>Total Enterprise Fund Debt</b>	<b>\$ 8,571,399</b>	<b>\$ 1,476,276</b>	<b>\$ 707,761</b>	<b>\$ 9,339,914</b>	<b>\$ 612,724</b>

The annual requirements for all long-term debt outstanding at December 31, 2017, are as follows:

	Note Payable	Note Payable Interest	Service Fee	Bonds	Bond Interest	Trustee Fees	Total Principal, Interest, Trustee Fee and Servicing Fee
2018	\$ 177,978	\$ 66,231	\$ 9,461	\$ 421,000	\$ 202,296	\$ 900	\$ 877,866
2019	181,107	63,103	9,015	442,000	188,189	900	884,314
2020	184,290	59,919	8,560	458,000	173,020	900	884,689
2021	187,530	56,681	8,097	480,000	155,394	900	888,602
2022	190,826	53,384	7,626	496,000	136,914	900	885,650
2023-2027	1,005,634	215,415	30,776	2,483,000	383,796	4,500	4,123,121
2028-2032	1,097,174	123,875	17,697	595,000	51,777	1,800	1,887,323
2033-2037	804,384	32,503	4,642	-	-	-	841,529
	<b>\$ 3,828,923</b>	<b>\$ 671,111</b>	<b>\$ 95,874</b>	<b>\$ 5,375,000</b>	<b>\$ 1,291,386</b>	<b>\$ 10,800</b>	<b>\$ 11,273,094</b>

\$1,953,009 of Notes Payable were not closed at December 31, 2017. An estimated amortization schedule for this is included above.

The annual requirements for all long-term debt outstanding at December 31, 2016, are as follows:

	Note Payable	Note Payable Interest	Service Fee	Bonds	Bond Interest	Trustee Fees	Total Principal, Interest, Trustee Fee and Servicing Fee
2017	\$ 93,990	\$ 34,064	\$ 4,866	\$ 495,000	\$ 217,342	\$ 900	\$ 846,162
2018	95,641	32,412	4,630	421,000	202,296	900	756,879
2019	97,322	30,731	4,390	442,000	188,189	900	763,532
2020	99,033	29,020	4,146	458,000	173,020	900	764,119
2021	100,774	27,280	3,897	480,000	155,394	900	768,245
2022-2026	531,069	109,198	15,601	2,589,000	485,055	4,500	3,734,423
2027-2031	579,410	60,857	8,695	985,000	87,432	2,700	1,724,094
2032-2034	372,665	11,495	1,641	-	-	-	385,801
	<b>\$ 1,969,904</b>	<b>\$ 335,057</b>	<b>\$ 47,866</b>	<b>\$ 5,870,000</b>	<b>\$ 1,508,728</b>	<b>\$ 11,700</b>	<b>\$ 9,743,255</b>

\$1,476,276 of Notes Payable were not closed at December 31, 2016 and have therefore not been presented in the above amortization schedule.

**NOTE 11 – COMPENSATED ABSENCES**

Vacation and sick pay are considered expenditures in the year earned.

**Vacation Days**

All full time employees earn one week of vacation time at the beginning of the first whole calendar year of employment and one additional day per year up to the maximum of four weeks. Only two weeks of unused vacation time may be carried over to the next year. If there is still any vacation leave remaining, the employee will be paid straight time for that portion not carried over in January of the following year. If an employee has

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 11 – COMPENSATED ABSENCES**

**Vacation Days (Continued)**

accumulated vacation leave at time of retirement or resigning, he may have the option to use the leave time or receive payment at his/her regular rate. A terminated employee will be compensated for any accrued vacation time.

At December 31, 2017 and 2016, a liability for accrued vacation was recorded in the amount of \$26,967 and \$23,734, respectively.

**Sick and Personal Days**

All full time employees earn 1 sick day per month. An employee may carry over any sick leave accrued during the year that was not used, without limit. If and when the employee retires or resigns, there will be no pay for unused sick leave. Full time personnel earn 4 personal days per year with no carry-over or pay for any unused time.

At December 31, 2017 and 2016, the District had an unrecorded sick pay liability to its employees of \$119,298 and \$114,500, respectively. The estimated liabilities include required salary related payments.

**NOTE 12 – FUND EQUITY- RESTRICTED NET POSITION**

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Restricted for Capital Projects:		
Monies Reserved for Future System Improvements	\$ 397,249	\$ 295,758
Total Restricted for Capital Projects	<u>\$ 397,249</u>	<u>\$ 295,758</u>
Restricted for Debt Service:		
2010 and 2013 Bond Issues & KIA Notes Payable		
Cash	\$ 1,322,458	\$ 1,319,773
Add: Accrued Interest Receivable	1,356	1,435
Less: Accrued Interest Payable	(5,584)	(9,025)
Total Restricted for Debt Service	<u>\$ 1,318,230</u>	<u>\$ 1,312,183</u>

**NOTE 13 – BAD DEBT EXPENSE**

Water revenue charges have been netted with an estimated bad debt expense of \$14,862 and \$9,122 at December 31, 2017 and 2016, respectively.

**NOTE 14 – INTEREST EXPENSE**

Interest expense incurred for the years ended December 31, 2017 and 2016 was \$310,587 and \$297,424, respectively. Capitalized interest in 2017 and 2016 was \$13,798 and \$6,152, respectively.

**NOTE 15 – INSURANCE AND RELATED ACTIVITIES**

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risks is covered through the purchase of commercial insurance. The District is also subject to the risks associated with employee injury. These risks are covered through premiums paid to Kentucky Employers' Mutual Insurance, a commercial insurance company.

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**

Entry into the Commonwealth of Kentucky's County Employees' Retirement System (CERS) was authorized by the Commissioners. Electing employees and all new employees of the District may participate in the System.

HENRY COUNTY WATER DISTRICT #2  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2017 and 2016

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
(Continued)

Under the provision of Kentucky Revised Statute (“KRS”) Section 61.645, the Board of Trustees of the Kentucky Retirement System administers CERS and has the authority to establish and amend benefit provisions. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for CERS. The most recent financial report, dated June 30, 2017, may be obtained from <https://kyret.ky.gov/About/Internal-Audit/Documents/2017%20Audited%20Financial%20Statements%20and%20Independent%20Auditor's%20Reports.pdf>. Additionally, the Kentucky Retirement System issues a publicly available financial report that includes the Schedules of Employer Allocations and Pension amounts by Employer. The most recent report, dated June 30, 2017 may be obtained from <https://kyret.ky.gov/Employers/GASB/Audited%20Reports/DRAFT%202017%20Pension%20Proportionate%20Share%20Audit%20Report.pdf>. The Kentucky CERS GASB 68 Actuarial Report prepared by Gabriel, Roeder, Smith and Co. (GRS) may be obtained at [https://kyret.ky.gov/Employers/GASB/GASB%2068%20and%2075%20Actuary%20Reports/GASB68 Actuarial Information CERS FY2017.pdf](https://kyret.ky.gov/Employers/GASB/GASB%2068%20and%2075%20Actuary%20Reports/GASB68%20Actuarial%20Information%20CERS%20FY%202017.pdf).

**Plan Description** – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers all regular full-time members employed in non-hazardous duty positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Prior to July 1, 2009, COLAs 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. After July 1, 2009, 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.

**Basis of Accounting** – CERS’s financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the plan. Premium payments are recognized when due and payable in accordance with the terms of the plan. Administrative and investment expenses are recognized when incurred.

**Method Used to Value Investments** – Investments of the plan are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Short-term investments are reported at cost, which approximates fair value. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the dividend date. Gain (loss) on investments includes KRS’ gains and losses on investments bought and sold as well as held during the fiscal year.

**Benefits provided** – CERS provides retirement, health insurance, death and disability benefits to Plan employees and beneficiaries. Employees are vested in the plan after five years’ service. For retirement purposes, employees are grouped into three tiers, based on hire date:

Tier 1	Participation date	Before September 1, 2008
	Unreduced retirement	27 years service or 65 years old
	Reduced retirement	At least 5 years service and 55 years old
Tier 2	Participation date	September 1, 2008 – December 31, 2013
	Unreduced retirement	At least 5 years service and 65 years old or age 57+ and sum of service years plus age equal 87
	Reduced retirement	At least 10 years service and 60 years old

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
**(CONTINUED)**

Tier 3	Participation date	After December 31, 2013
	Unreduced retirement	At least 5 years service and 65 years old or age 57+ and sum of service years plus age equal 87
	Reduced retirement	Not available

Retirement is based on a factor of the number of years' service and hire date multiplied by the average of the highest five years' earnings. Reduced benefits are based on factors of both of these components. Participating employees become eligible to receive the health insurance benefit after at least 180 months of service. Death benefits are provided for both death after retirement and death prior to retirement. Death benefits after retirement are \$5,000 in lump sum. Five years' service is required for death benefits prior to retirement and the employee must have suffered a duty-related death. The decedent's beneficiary will receive the higher of the normal death benefit and \$10,000 plus 25% of the decedent's monthly final rate of pay and any dependent child will receive 10% of the decedent's monthly final rate of pay up to 40% for all dependent children. Five years' service is required for nonservice-related disability benefits.

**Contributions** - Participating employers are 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 the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the fiscal years ended June 30, 2017 and 2016, participating employers contributed 18.68% and 17.06%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2017 and 2016, were 18.68% and 17.06%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

Employer contributions for the year ended June 30, 2017, were allocated 13.95% to CERS's pension fund and 4.73% to CERS' OPEB (health insurance) fund, respectively. Employer contributions for the year ended June 30, 2016, were allocated 11.91% to CERS's pension fund and 5.15% to CERS' OPEB (health insurance) fund, respectively.

For the fiscal years ended June 30, 2017 and 2016, plan members who began participating prior to September 1, 2008, were required to contribute 5% of their annual creditable compensation. These members were classified in the Tier 1 structure of benefits. Plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. These members were classified in the Tier 2 structure of benefits. Five percent of the contribution was deposited to the member's account while the 1% was deposited to an account created for the payment of health insurance benefits under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%.

If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, for plan members who began participating on, or after, September 1, 2008, the 1% contribution to the 401(h) account is non-refundable and is forfeited.

Plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. These members were classified in the Tier 3 structure of benefits. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own account. Non-hazardous members contribute 5% of their annual creditable compensation and an additional 1% to the health insurance fund which is not credited to the member's account and is not refundable. The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of the member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. For non-hazardous members, their account is credited with a 4% employer pay credit. The employer pay credit represents a portion of the employer contribution.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2017 and 2016

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
(Continued)

***Methods and Assumptions Used in Calculation of Actuarially Determined Contributions***

Per the GASB Statement No. 68 Report for the County Employees Retirement System prepared as of June 30, 2017, the actuarially determined contribution rates effective for fiscal year ending 2017 are calculated as of June 30, 2015. Based on the June 30, 2015 actuarial valuation report (produced by the prior actuary, Cavanaugh Macdonald Consulting, LLC), the actuarial methods and assumptions used to calculate these contribution rates are as follows:

Item	CERS Non-Hazardous
Actuarial Cost Method:	Entry Age Normal
Asset Valuation Method:	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized.
Amortization Method:	Level Percent of Pay
Amortization Period:	28 Years, Closed
Investment Return:	7.50%
Inflation:	3.25%
Salary Increases:	4.00%, average
Mortality:	RP-2000 Combined Mortality Table, projected to 2013 with Scale BB (set back 1 year for females)

In general, the assumptions and methods used in the valuation (as shown above) are based on the actuarial experience study for the five-year period ending June 30, 2013, submitted April 30, 2014, and adopted by the Board on December 4, 2014. The investment return, price inflation, and payroll growth assumption were adopted by the Board in May and July 2017 for use with the June 30, 2017 valuation in order to reflect future economic expectations.

These changes in assumptions since the prior valuation are as follows:

The assumed investment return was changed from 7.50% to 6.25%. The price inflation assumption was changed from 3.25% to 2.30%, which also resulted in a 0.95% decrease in the salary increase assumption at all years of service. The payroll growth assumption (applicable for the amortization unfunded actuarial accrued liabilities) was changed from 4.00% to 2.00%.

There were no changes in benefit terms during the years ended June 30, 2017 and 2016.

The investment objectives of the portfolios are to produce results that exceed the stated goals over both short-term and long-term periods.

- **Shorter-Term (5 years and less):** The returns of the particular asset classes of the managed funds of the Systems, measured on an annual basis, should exceed the return achieved by a policy benchmark portfolio composed of comparable unmanaged market indices.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
**(Continued)**

***Methods and Assumptions Used in Calculation of Actuarially Determined Contributions (Continued)***

- **Medium-Term (5 to 30 years):** The returns of the particular asset classes of the managed funds of the Systems, measured on a rolling year basis should exceed the returns achieved by a policy benchmark portfolio composed of comparable unmanaged market indices and perform above the median of an appropriate peer universe, if there is one.
- **Longer-Term:** The total assets of the Systems should achieve a return of 6.25% for CERS pension and insurance plans. This is measured over 30 to 40 years which exceeds the actuarially required rate of return while also exceeding the return achieved by its total fund benchmark.

**Asset Allocation Board Policy as of June 30, 2017 and 2016 were as follows:**

	<b>2017</b>	<b>2016</b>
Combined Equity	50.80%	44.00%
Combined Fixed Income	14.00%	19.00%
Private Equity	10.00%	10.00%
Absolute Return	10.00%	10.00%
Real Return	8.00%	10.00%
Real Estate	5.00%	5.00%
Cash	2.20%	2.00%
	100.00%	100.00%

**Total fund return for the years ended June 30, 2017 and 2016 were 13.47% and (0.52%), respectively.**

The total pension liability is based on an actuarial valuation date of June 30, 2016. The total pension liability was rolled-forward from the valuation date to the plan's fiscal year ending June 30, 2017, using generally accepted actuarial principles. Gabriel, Roeder, Smith & Co (GRS) did not conduct the June 30, 2016, actuarial valuation; however, GRS did replicate the prior actuary's valuations results on the same assumption, methods, and data, as of that date. The roll-forward is based on the results of their replication. Information disclosed for years prior to June 30, 2017, was prepared by KRS's prior actuary, Cavanaugh Macdonald Consulting, LLC.

For the year ended June 30, 2016 the actuarial valuation date upon which the total pension liability was based was June 30, 2015. An expected total pension liability was determined as of June 30, 2016, using standard roll forward techniques. The roll forward calculation adds the annual cost (also called the service cost), subtracts the actual benefit payments and refunds for the plan year, then applies the expected investment rate of return for the year. No update procedures were used to determine the total pension liability as of June 30, 2015.

***Mortality Assumption:***

**Pre-retirement mortality:** RP-2000 Combined Mortality Table projected with Scale BB to 2013. Male mortality rates are multiplied by 50% and female mortality rates are multiplied by 30%.

**Post-retirement mortality (non-disabled) :** RP-2000 Combined Mortality Table projected with Scale BB to 2013. Female mortality rates are set back one year.

**Post-retirement mortality (disabled):** RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013. Male mortality rates are set back four years.

**These mortality assumptions assume a margin for future mortality improvement.**

HENRY COUNTY WATER DISTRICT #2  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2017 and 2016

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
(Continued)

*Methods and Assumptions Used in Calculation of Actuarially Determined Contributions (Continued)*

The single discount rate of 6.25% was used to measure the total pension liability for the fiscal year ending June 30, 2017. This single discount rate was based on the expected rate of return on pension plan investments. Based on the stated assumptions and the projection of cash flows as of each fiscal year ending, the pension plan's fiduciary net position and future contributions were projected to be sufficient to finance all the future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of the projected benefit payments to determine the total pension liability. The projection of cash flows used to determine the single discount rate assumes that the participating employers in the System contribute the actuarially determined contribution rate in all future years. The discount rate of 7.50% was used for the year ended June 30, 2016. The discount rate determination does not use a municipal bond rate.

*Sensitivity of the District's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate*

The following table presents the net pension liability of CERS [as reported in its publicly available financial statements for the years ended June 30, 2017 and 2016], calculated using the discount rates of 6.25% and 7.5% for the years ended June 30, 2017 and 2016, respectively, as well as what CERS' net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the approved rate:

As of June 30, 2017	1% Decrease [5.25%]	Current Discount [6.25%]	1% Increase [7.25%]
Net Pension Liability	\$ 7,382,285,860	\$ 5,853,307,443	\$ 4,574,328,530
District's Proportionate Share	2,518,910	1,997,207	1,560,807

As of June 30, 2016	1% Decrease [6.5%]	Current Discount [7.5%]	1% Increase [8.5%]
Net Pension Liability	\$ 6,135,625,606	\$ 4,923,618,237	\$ 3,884,686,628
District's Proportionate Share	2,138,341	1,715,920	1,353,844

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to the County Employee Retirement System Pension*

At December 31, 2017, and 2016 the District reported a liability of \$1,997,207 and \$1,715,920 respectively for its proportionate share of the net pension liability. The net pension liability for CERS was measured as of June 30, 2017, and 2016 and was based on the actual liability of the employees and former employees relative to the total liability of the system as determined by an actuarial valuation as of those dates. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2017, and 2016 the District's proportion was 0.034121 and 0.034851 percent, respectively, which is a decrease of 0.00073% for the year ended June 30, 2017 and an increase of 0.00345% for the year ended June 30, 2016.

The District's total payroll for the fiscal year ended December 31, 2017 was \$827,099. Contributions to CERS were based on \$787,500 (eligible gross wages). The total employer contributions for the year ended December 31, 2017 were \$148,281.

The District's total payroll for the fiscal year ended December 31, 2016, was \$892,532. Contributions to CERS were based on \$851,267 (eligible gross wages). The total employer pension contributions for the year ended December 31, 2016, were \$152,815.

All contributions were made as required during these years.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2017 and 2016

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
(Continued)

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to the County Employee Retirement System Pension (Continued)*

The District's contribution for the County Employees' Retirement System's year(s) ended December 31, 2017, and 2016 was 0.034121 and 0.034851 percent, respectively, of the System's total contribution requirements for all employers.

For the years ended December 31, 2017 and December 31, 2016, the District recognized pension expense of \$397,032 and \$290,718, respectively. At December 31, 2017 and 2016 the District reported deferred outflows of resources and deferred inflows of resources related to CERS pensions from the following sources:

	December 31, 2017		December 31, 2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Expected and Actual Experience	\$ 2,477	\$ 50,698	\$ 7,491	\$ -
Change in Assumptions	368,539	-	90,900	-
Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	54,109	32,675	92,485	36,652
Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	24,703	-	161,314	-
District Contributions Made Subsequent to the NPL Measurement Date	78,694	-	87,502	-
<b>Total</b>	<b>\$ 528,522</b>	<b>\$ 83,373</b>	<b>\$ 439,692</b>	<b>\$ 36,652</b>

\$78,694 and \$87,502 reported as deferred outflows of resources related to pensions arising from District contributions made subsequent to the measurement date will be recognized as a reduction in the net pension liability in the years ended December 31, 2017 and 2016. Amounts reported as deferred inflows and outflows of resources due to the net difference between projected and actual investment earnings on pension plan investments will be netted and amortized over five years and recognized in pension expense. Amounts reported as deferred outflows of resources due to the difference between expected and actual experience, change of assumptions, and changes in proportion and differences between employer contributions and proportionate share of contributions will be amortized and recognized in pension expense over the expected remaining service lives of all employees. Total amortization to be recognized in pension expense is presented below as follows:

Year Ended December 31, 2017:	Increase (Decrease) to Pension Expense
2018	\$ 170,534
2019	158,627
2020	62,940
2021	(25,646)
	<b>\$ 366,455</b>



**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 16 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN**  
**(Continued)**

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to the County Employee Retirement System Pension (Continued)*

Year Ended December 31, 2016:		Increase (Decrease) to Pension Expense
	2017	\$ 104,363
	2018	97,234
	2019	77,787
	2020	36,154
		<u>\$ 315,538</u>

***Payable to the Pension Plan***

At December 31, 2017 and 2016, the District reported a payable of \$26,857 and \$26,068, respectively for the outstanding amount of contributions required for the years then ended. These amounts represent the employee withholding and employer match for the last month of the years then ended. The payable includes both pension and insurance contributions.

**NOTE 17 – DEFICIT NET POSITION**

An unrestricted net position deficit of \$1,243,963 and \$847,663 existed at December 31, 2017 and 2016, respectively. The deficit resulted from the recognition of net pension liability and related deferred outflows of resources and deferred inflows of resources due to the implementation of GASB Statement No. 68.

Unrestricted net position was reduced by \$239,178 and \$138,265 for the years ended December 31, 2017 and 2016, respectively, as a result of the transactions recorded by the District to reflect its proportionate share of the County Employees Retirement System's Net Pension Liability. The accounts affected were as follows:

	2017	2016
Increase (Decrease) in Deferred Outflows of Resources	\$ 88,830	\$ 203,350
(Increase) Decrease in Deferred Inflows of Resources	(46,721)	24,273
(Increase) Decrease in Net Pension Liability	(281,287)	(365,888)
Net Decrease in Unrestricted Net Position	<u>\$ (239,178)</u>	<u>\$ (138,265)</u>

**NOTE 18 – ECONOMIC DEPENDENCY**

Henry County Water District #2 provides water services to residential and commercial customers in the Kentucky counties of Henry, Trimble, Carroll, Oldham and Shelby. The District also supplies water for resale to the cities of Eminence and New Castle located in Henry County. It should be noted that 8.1% and 7.4% of the total water charges for services revenue was received from these cities for the years ended December 31, 2017 and 2016, respectively. The wholesale rate is \$2.58 per 1,000 gallons. Also, the District supplies water for resale to West Carroll Water District at the same wholesale rate.

**NOTE 19 – FUNDS HELD FOR FUTURE LINES AND CONTRIBUTED CAPITAL – IMPACT FEES**

The District collects funds from developers for their allocable cost of line extensions. The amount is calculated based on the size of the line and the number of estimated hook-ups. As others pay to hook-up to the line, portions of these funds are refunded to the developer. Once a line has been completed, the developer's cost of the line is recorded as capital contributions from customers. The District held \$0 and \$21,600 for future lines at December 31, 2017 and 2016, respectively.

**HENRY COUNTY WATER DISTRICT #2**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
**December 31, 2017 and 2016**

**NOTE 20 – COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS**

The District completed work on the new 1 million gallon composite storage tank on US Highway 42 financed through Kentucky Infrastructure Authority during calendar year 2017. The District is seeking liquidated damages for delay from the contractor and is withholding payment of retainage until a settlement has been reached.

**NOTE 21 – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In June 2015, the GASB issued Statement 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, effective for fiscal years beginning after June 15, 2017 [District year beginning January 1, 2018]. This statement requires the liability of employers to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. The District is evaluating the requirements of this statement.

Reporting requirements in regards to OPEB became effective for the Kentucky Retirement System for its year ended June 30, 2017. In its financial report including Schedules of Employer Allocations a net OPEB liability of \$685,949 was reported as attributable to the Henry County Water District.

**HENRY COUNTY WATER DISTRICT #2**

**SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY  
County Employees Retirement System**

**Last Four Fiscal Years\***

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
District's proportion of the net pension liability (asset)	0.034121%	0.03485%	0.031399%	0.033750%
District's proportionate share of the net pension liability (asset)	\$ 1,997,207	\$ 1,715,920	\$ 1,350,032	\$ 1,095,000
District's covered-employee payroll	\$ 787,500	\$ 851,267	\$ 843,338	\$ 766,921
District's proportionate share of the net pension liability (asset) as a percentage of its of its covered-employee payroll	253.61%	201.57%	160.08%	142.78%
Plan fiduciary net position as a percentage of the total pension liability	53.3%	55.5%	59.97%	66.80%

\*Calculations are based on reports of the Kentucky Retirement Systems', County Employees Retirement Systems' Schedule of Employer Allocations and Pension Amounts by Employer for the fiscal years ended June 30, shown. District payroll is reported for its' covered calendar years ending December 31, 2014 through 2017.

GASB 68 requires the District to present the above information for 10 years. The information will be expanded annually until a full 10-year trend is compiled.

There were no changes of benefit terms. However the investment return, price inflation and payroll growth assumptions were adopted by the Board of Trustees in May and July, 2017 for use with the June 30, 2017 valuation.

- The assumed investment rate of return was decreased from 7.50% to 6.25%.
- The assumed rate of inflation was reduced from 3.25% to 2.30%.
- Payroll growth assumption was reduced from 4.0% to 2.0%.
- 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 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.

**HENRY COUNTY WATER DISTRICT #2****SCHEDULE OF THE DISTRICT'S CONTRIBUTIONS****County Employees Retirement System****Fiscal Years Ended December 31**

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Contractually required contributions	\$ 148,281	\$ 152,815	\$ 146,269	\$ 140,535	\$ 143,614
Contributions in relation to the contractually required contributions	148,281	152,815	146,269	140,535	143,614
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
District's covered-employee payroll	\$ 787,500	\$ 851,267	\$ 843,338	\$ 766,921	\$ 746,795
Contributions as a percentage of covered-employee payroll	18.83%	17.95%	17.34%	18.32%	19.23%

The District's contributions above include the total contributions to the County Employees Retirement System. No allocation has been made between contributions to the CERS Pension Fund and the CERS Insurance Fund.

# RAISOR, ZAPP & WOODS, PSC

## 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

To the Commissioners of the  
Henry County Water District #2  
Campbellsburg, KY 40011

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Henry County Water District #2 as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise Henry County Water District #2's basis financial statements, and have issued our report thereon dated June 28, 2018.

#### INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered Henry County Water District #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 Henry County Water District #2's internal control. Accordingly, we do not express an opinion on the effectiveness of Henry County Water District #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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as Items 2017-001 and 2017-002 that we consider to be material weaknesses.

#### COMPLIANCE AND OTHER MATTERS

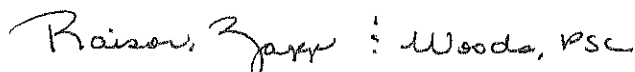
As part of obtaining reasonable assurance about whether Henry County Water District #2's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a 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*.

#### HENRY COUNTY WATER DISTRICT #2'S RESPONSE TO FINDINGS

Henry County Water District #2's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Henry County Water District #2's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

#### PURPOSE OF THIS REPORT

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



RAISOR, ZAPP, & WOODS P.S.C  
Certified Public Accountants  
Carrollton, Kentucky

June 28, 2018

**HENRY COUNTY WATER DISTRICT #2  
SCHEDULE OF FINDINGS AND RESPONSES  
For the Year Ended December 31, 2017**

**A. SUMMARY OF AUDITOR'S RESULTS**

1. The auditor's report expresses an unmodified opinion on whether the financial statements of Henry County Water District #2 were prepared in accordance with GAAP.
2. Two deficiencies in internal control related to the audit of the financial statements are reported in the 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. Items 2017-001 and 2017-002 were reported as material weaknesses.
3. No instances of noncompliance material to the financial statements of Henry County Water District #2, were disclosed during the audit.

**B. FINDINGS - FINANCIAL STATEMENTS AUDIT**

**GOVERNMENT AUDITING STANDARDS**

**DEFICIENCIES IN INTERNAL CONTROL**

**2017-001 SIZE OF ENTITY, CROSS-TRAINING AND CHECKING PROCEDURES**

**CONDITION:**

Due to the size of the entity, cross-training and checking procedures are not in place for certain administrative positions. This limits internal control. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2016 as Item 2016-001.

**CRITERIA:**

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and allow timely preparation of financial data consistent with management assertions.

**CAUSE:**

Responsibilities associated with individual positions limit the availability of individuals to rotate duties and implement checking procedures.

**EFFECT:**

This limitation may affect the ability to timely and effectively record, process, summarize and report financial data.

**RECOMMENDATION:**

Management should strive to provide cross-training for administrative staff and implement checking processes.

**RESPONSE:**

We concur with the recommendation. Management believes adequate resources have been expended and control procedures implemented, that are commensurate with the staff size and responsibility of financial personnel.

**HENRY COUNTY WATER DISTRICT #2  
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)  
For the Year Ended December 31, 2017**

**B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)**

**GOVERNMENT AUDITING STANDARDS (Continued)**

**DEFICIENCIES IN INTERNAL CONTROL (Continued)**

**2017-002 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED  
NOTE DISCLOSURES**

**CONDITION:**

District financial statements, including the required disclosures, are prepared as part of the annual audit. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2016 as Item 2016-002.

**CRITERIA:**

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that financial statements and required notes are prepared in accordance with generally accepted accounting principles.

**CAUSE:**

The draft financial statements and disclosures are prepared during the audit process.

**EFFECT:**

Management engaged the auditor's assistance to prepare the draft of the financial statements, including the related notes to the financial statements. Management reviewed, approved, and accepted responsibility for the financial statements prior to their issuance.

**RECOMMENDATION:**

District management should continue to enhance its knowledge of reporting requirements in providing oversight of this service.

**RESPONSE:**

The outsourcing of this service is a result of management's cost benefit decision to avoid incurring internal resource costs. We concur with the recommendation and will continue to improve our overall accounting knowledge in performing our oversight responsibilities. We are aware of our responsibilities for the financial statements. We have reviewed and approved the financial statements as presented.

**COMPLIANCE AND OTHER MATTERS**

None