Laurel County Water District No. 2
London, Kentucky
* * * * *
Independent Auditors' Report
And Financial Statements
For the Years Ended
December 31, 2016 and 2015

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Independent Auditors' Report

To the Commissioners
Laurel County Water District No. 2
London, Kentucky

**Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of the Laurel County Water District No. 2, (the District), as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

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

***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the 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 Laurel County Water District No. 2, as of December 31, 2016 and 2015, 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 and the Schedule of District's Pension Contributions on pages 25-26 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 requires 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 September 22, 2017 on our consideration of the Laurel County Water District No. 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 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 the Laurel County Water District No. 2's internal control over financial reporting and compliance.

*Christian Sturgeon & Associates, PSC*

Christian Sturgeon & Associates, PSC
London, Kentucky

September 22, 2017

Laurel County Water District No. 2
Statements of Net Position
December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | $ 1,524,831 | $ 1,618,280 |
| Receivables, less allowance | 215,205 | 166,974 |
| Unbilled accounts receivable | 120,591 | 94,386 |
| Inventories | 110,523 | 145,156 |
| Prepaid expenses | 1,686 | 5,140 |
| Other current assets | 38 | 38 |
| Total Current Assets | 1,972,874 | 2,029,974 |
| Noncurrent Assets | | |
| Restricted Assets | | |
| Customer deposits | 89,296 | 86,627 |
| Grant monies | 157,654 | 188,659 |
| Depreciation reserves - cash | 532,464 | 486,748 |
| Depreciation reserves - certificates of deposit | 125,100 | 125,100 |
| Bond and interest funds | 215,725 | 146,713 |
| Plant escrow | 95,643 | 95,595 |
| Total Restricted Assets | 1,215,882 | 1,129,442 |
| Capital Assets | | |
| Land and improvements | 506,586 | 506,586 |
| Buildings and improvements | 692,086 | 662,936 |
| Source of supply and pumping | 3,560,392 | 3,560,392 |
| Water treatment equipment | 124,722 | 123,333 |
| Transmission and distribution plant | 14,872,008 | 14,590,949 |
| Vehicles and other equipment | 1,176,804 | 1,111,790 |
| Construction in progress | - | 18,063 |
| Less: accumulated depreciation | (6,982,793) | (6,603,722) |
| Net Capital Assets | 13,949,805 | 13,970,327 |
| Total Noncurrent Assets | 15,165,687 | 15,099,769 |
| Total Assets | 17,138,561 | 17,129,743 |
| Deferred Outflows of Resources | | |
| Bond issuance costs, net of amortization | 7,212 | 9,227 |
| Differences between expected and actual experience related to pensions | 4,921 | 8,569 |
| Differences between projected and actual earnings on pension plan investments | 105,972 | 9,243 |
| Changes of assumptions related to pensions | 59,715 | 103,978 |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | 10,000 | 16,623 |
| Pension contributions subsequent to measurement date | 40,017 | 65,045 |
| Total Deferred Outflows of Resources | 227,837 | 212,685 |

See accompanying notes to financial statements.

Laurel County Water District No. 2
Statements of Net Position (Continued)
December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Liabilities | | |
| Current Liabilities | | |
| Accounts payable | 48,755 | 56,144 |
| Accounts payable - construction | 95,546 | 95,546 |
| Accrued interest payable | 348 | 592 |
| Accrued salaries and taxes payable | 27,479 | 20,642 |
| Current portion of notes payable and long-term debt | 198,349 | 314,591 |
| Other current liabilities | 50,467 | 29,086 |
| Total Current Liabilities | 420,944 | 516,601 |
| Noncurrent Liabilities | | |
| Customer deposits | 86,790 | 85,150 |
| Net pension liability | 1,127,240 | 1,031,130 |
| Notes payable and long-term debt, less current portion | 8,400,508 | 8,598,857 |
| Total Noncurrent Liabilities | 9,614,538 | 9,715,137 |
| Total Liabilties | 10,035,482 | 10,231,738 |
| Deferred Inflows of Resources | | |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | 29,152 | - |
| Total Deferred Inflows of Resources | 29,152 | - |
| Net Position | | |
| Net investment in capital assets | 5,350,948 | 5,056,879 |
| Restricted | 1,215,882 | 1,129,442 |
| Unrestricted (as restated) | 734,934 | 924,369 |
| Total Net Position | $ 7,301,764 | $ 7,110,690 |

Laurel County Water District No. 2
Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Operating Revenues | | |
| Water sales | $ 2,384,157 | $ 2,151,200 |
| Service charges | 105,222 | 93,026 |
| Tap fees | 28,500 | 20,475 |
| Penalties | 46,978 | 48,176 |
| Other revenues | 18,179 | 15,624 |
| Total Operating Revenues | 2,583,036 | 2,328,501 |
| Operating Expenses | | |
| Salaries and wages | 623,194 | 603,163 |
| Employee benefits | 553,445 | 443,047 |
| Purchased water | 416 | 116 |
| Purchased power | 154,580 | 165,138 |
| Utilities | 22,014 | 24,343 |
| Chemicals | 72,710 | 73,038 |
| Materials and supplies | 63,280 | 71,309 |
| Contracted services | 57,268 | 68,157 |
| Vehicle and equipment expenses | 28,018 | 36,816 |
| Insurance | 33,751 | 27,006 |
| Bad debt expense, net of recoveries | 11,914 | 13,589 |
| Depreciation | 421,809 | 530,697 |
| Amortization | 2,016 | 2,018 |
| Other operating expenses | 90,965 | 87,764 |
| Total Operating Expenses | 2,135,380 | 2,146,201 |
| Operating Income | 447,656 | 182,300 |
| Non-operating Revenues (Expenses) | | |
| Interest income | 2,211 | 2,247 |
| Grant revenue | 57,078 | 554,435 |
| Rental income | 15,055 | 10,125 |
| Gain (loss) on disposition of equipment | 4,285 | - |
| Interest expense | (335,211) | (347,909) |
| Total Non-operating Revenues (Expenses) | (256,582) | 218,898 |
| Change in Net Position | 191,074 | 401,198 |
| Net Position, Beginning of Year (as previously reported) | 7,110,690 | 6,749,479 |
| Prior period adjustment | - | (39,987) |
| Net Position, Beginning of Year (as restated) | 7,110,690 | 6,709,492 |
| Net Position, End of Year | $ 7,301,764 | $ 7,110,690 |

See accompanying notes to financial statements.

Laurel County Water District No. 2
Statements of Cash Flows
For the Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Cash Flows From Operating Activities | | |
| Receipts from customers | $ 2,480,147 | $ 2,316,099 |
| Receipts from other activities | 18,179 | 15,624 |
| Payments to employees | (508,262) | (586,292) |
| Payments to suppliers | (933,403) | (938,107) |
| Payments for other activities | (90,965) | (87,764) |
| Net Cash Provided by Operating Activities | 965,696 | 719,560 |
| Cash Flows From Capital and Related Financing Activities | | |
| Purchases of property, plant and equipment | (401,288) | (686,473) |
| Proceeds from sales of property, plant and equipment | 4,285 | - |
| Principal payments on debt | (314,591) | (217,836) |
| Interest payments on debt | (335,455) | (348,190) |
| Federal and state grants | 57,078 | 592,370 |
| Other receipts | 15,055 | 10,125 |
| Net Cash Used by Capital and Related Financing Activities | (974,916) | (650,004) |
| Cash Flows From Investing Activities | | |
| Interest on certificates of deposits | 2,211 | 2,247 |
| Net Cash Provided by Investing Activities | 2,211 | 2,247 |
| Net Increase (Decrease) in Cash and Cash Equivalents | (7,009) | 71,803 |
| Cash and Cash Equivalents at Beginning of Year | 2,622,622 | 2,550,819 |
| Cash and Cash Equivalents at End of Year | $ 2,615,613 | $ 2,622,622 |

| | | |
|---|---|---|
| Reconciliation of cash per Statements of Net Position to cash per Statements of Cash Flows: | | |
| Cash and cash equivalents | $ 1,524,831 | $ 1,618,280 |
| Restricted cash and cash equivalents: | | |
| Customer deposits | 89,296 | 86,627 |
| Grant monies | 157,654 | 188,659 |
| Depreciation reserves-cash | 532,464 | 486,748 |
| Plant escrow | 95,643 | 95,595 |
| Bond and interest funds | 215,725 | 146,713 |
| Cash and Equivalents per Statements of Cash Flows | $ 2,615,613 | $ 2,622,622 |

See accompanying notes to financial statements.

Laurel County Water District No. 2
Statements of Cash Flows (Continued)
For the Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Reconciliation of Operating Income to Net Cash Provided by Operating Activities: | | |
| Operating income | $ 447,656 | $ 182,300 |
| Adjustments to reconcile operating income to net cash provided by operating activities | | |
| Depreciation and amortization | 423,825 | 532,715 |
| (Increase) decrease in operating assets | | |
| Accounts receivable | (74,436) | 13,570 |
| Inventory | 34,633 | (33,139) |
| Prepaid expenses | 3,454 | (681) |
| Deferred pension ouflows | (17,167) | (243,445) |
| Increase (decrease) in operating liabilities | | |
| Accounts payable | (7,389) | 2,248 |
| Accrued expenses | 28,218 | 1,705 |
| Customer deposits | 1,640 | 3,241 |
| Deferred pension inflows | 29,152 | - |
| Net pension liability | 96,110 | 261,046 |
| Net Cash Provided by Operating Activities | $ 965,696 | $ 719,560 |

See accompanying notes to financial statements.

## Note 1 – Summary of Significant Accounting Policies

### Reporting Entity

Laurel County Water District No. 2, of Laurel County, Kentucky ("District") was created in 1963 under Chapter 74 of the Kentucky Revised Statutes. The District is governed by a five person Board of Commissioners appointed by the Laurel County Fiscal Court. The District is regulated by the Kentucky Public Service Commission.

Laurel County Water District No. 2's financial statements include the operations of all entities for which the District exercises oversight responsibility. Oversight responsibility includes, but is not limited to, financial interdependency, selection of the governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters. There are no other entities that are subject to the District's oversight responsibility as indicated above.

### Basis of Accounting, Financial Presentation and Measurement Focus

The basic financial statements of the District have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

The Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position display information about the District as a whole. These statements include all funds of the District. The statements distinguish between governmental and business-type activities. The District does not have any governmental activities.

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating income reported by the District includes revenues and expenses related to the continuing operation of water service for its customers. Principal operating revenues are charges to customers for services. Principal operating expenses are the costs of providing the services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

### Cash and Cash Equivalents

The District considers demand deposits and certificates of deposits with maturities of 90 days or less to be cash equivalents.

### Inventories and Prepaid Expenses

Inventories consist of expendable supplies held for consumption stated on a weighted average cost basis. They are reported at cost and are recorded as an expenditure at the time individual items are used. Prepaid expenses include payments to vendors that benefit future reporting periods and are reported on the consumption basis.

Note 1 - Summary of Significant Accounting Policies (Continued)

Capital Assets

The District's property, plant and equipment with useful lives of more than one year are stated at historical cost. The costs of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized. Capital assets are depreciated using the straight-line method. When assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in operations.

Estimated useful lives for depreciable assets are as follows:

| Asset Classification | Range of Lives |
|---|---|
| Structures and improvements | 35-40 years |
| Transmission distribution mains | 50-75 years |
| Plant equipment | 20-60 years |
| Meters and services | 30-60 years |
| Other equipment and vehicles | 7-25 years |

Accounts Receivable

Receivables include amounts due from customers for water services. These receivables are due at the time the services are billed. Billing is completed monthly and accounts are considered past due on the sixteenth day after the end of each billing period. Accounts receivable are presented net of uncollectible accounts. The allowance amount is estimated using a percentage of accounts past due more than 90 days. The balance of the allowance at December 31, 2016 and 2015 was $10,000.

Unbilled Accounts Receivable

Estimated unbilled revenues from water sales are recognized at the end of each fiscal year on a pro rata basis. The estimated amount is based on billing during the month following the close of the fiscal year.

Net Position

Net position is comprised of the various net earnings from operating income, non-operating revenues and expenses, and capital contributions. Net position is classified in the following three components:

Net investment in capital assets – This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted – This component of net position consists of restricted assets less liabilities and deferred inflows of resources related to those assets. Restricted assets are those with limits on their use that are externally imposed constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted – This component of net position consists of net amounts of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the net investment in capital assets or the restricted component of net position.

Note 1 - Summary of Significant Accounting Policies (Continued)

Net Position (Continued)

When an expense is incurred for purposes for which both restricted and unrestricted net position are available, the District would typically use restricted assets first, but reserves the right to selectively spend unrestricted assets first.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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.

Pensions

For purposes of measuring net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employees Retirement System (CERS) and additions to/deductions from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. The plan's financial statements are prepared using the accrual basis of accounting and are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) that apply to governmental accounting for fiduciary funds. Investments are reported at fair value.

Note 2 – Restricted Assets

Under the terms of all loan resolutions, the District is required to maintain certain accounts and funds for the benefit and protection of the creditors. In addition, the District is also required to collect reasonable and sufficient rates and charges for services rendered, prohibited from selling, leasing or mortgaging any part of the system without prior approval, required to maintain the operating system in good condition and to carry adequate insurance on all properties to protect against loss or damage.

The resolutions require the District to establish a depreciation fund or reserve to be used to finance the cost of unusual repairs, renewals and replacements not included in the annual budget and to pay for future system extensions. The balance of these accounts at December 31, 2016 and 2015 was $968,932 and $854,156, respectively. Restricted assets also include customer deposits of $89,296 and $86,627 held at December 31, 2016 and 2015, respectively and grant monies of $157,654 and $188,659 held at December 31, 2016 and 2015, respectively.

## Note 3 – Kentucky Revised Statute

At December 31, 2016 and 2015, all of the cash of the District was covered by federal depository insurance and securities pledged as collateral on behalf of the District. In accordance with Kentucky Revised Statute (KRS) 91A.060, the deposits are to be insured by the Federal Depository Insurance Corporation or collateralized to the extent uninsured by any obligations permitted by KRS 41.240(4). According to KRS 41.240(4), financial institutions shall either pledge or provide as collateral securities or other obligations having an aggregate current face value or current quoted market value at least equal to the deposits. According to KRS 91A.060, the District is allowed to invest in obligations of the U.S. Treasury and U.S. agencies, repurchase agreements, obligations of the Commonwealth of Kentucky and its agencies, interest bearing deposits of insured savings and loans, or interest bearing deposits of insured national or state banks. For additional cash descriptive information, see Note 1.

## Note 4 – Concentrations of Credit Risks

At December 31, 2016 and 2015, 12.35% and 12.76%, respectively, of the District's accounts receivable were due from one customer.

13.85% and 13.06% of the District's water sales during 2016 and 2015, respectively, were generated from one customer.

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk. As of December 31, 2016 and 2015, $2,576,290 and $2,533,679, respectively, of the District's total deposits at banks of $3,076,290 and $3,033,679, respectively, were exposed to custodial credit risk as follows:

| | 2016 | 2015 |
|---|---|---|
| Uninsured and uncollateralized | $ - | $ - |
| Uninsured and collateral held by pledging bank | 2,576,290 | 2,533,679 |
| Uninsured and collateral held by pledging bank's trust department not in the District's name | - | - |
| Total | $ 2,576,290 | $ 2,533,679 |

Note 5 – Capital Assets

The following is a summary of capital asset transactions for the year ended December 31, 2016:

| | Balance Dec. 31, 2015 | Additions | Dispositions | Balance Dec. 31, 2016 |
|---|---|---|---|---|
| Land and improvements | $ 506,586 | $ - | $ - | $ 506,586 |
| Building and improvements | 662,936 | 29,150 | - | 692,086 |
| Source of supply and pumping | 3,560,392 | - | - | 3,560,392 |
| Water treatment equipment | 123,333 | 1,389 | - | 124,722 |
| Transmission and distribution plant | 14,590,949 | 281,059 | - | 14,872,008 |
| Vehicles and other equipment | 1,111,790 | 107,752 | 42,738 | 1,176,804 |
| Construction in progress | 18,063 | 84,779 | 102,842 | - |
| Totals at historical cost | 20,574,049 | 504,129 | 145,580 | 20,932,598 |
| Less accumulated depreciation for: | | | | |
| Land and improvements | 6,171 | 1,077 | - | 7,248 |
| Building and improvements | 436,613 | 8,090 | - | 444,703 |
| Source of supply and pumping | 566,424 | 68,368 | - | 634,792 |
| Water treatment equipment | 92,105 | 3,966 | - | 96,071 |
| Transmission and distribution plant | 4,932,767 | 290,535 | - | 5,223,302 |
| Vehicles and other equipment | 569,642 | 49,773 | 42,738 | 576,677 |
| Total accumulated depreciation | 6,603,722 | 421,809 | 42,738 | 6,982,793 |
| Capital assets - net | $ 13,970,327 | $ 82,320 | $ 102,842 | $ 13,949,805 |

Note 5 – Capital Assets (Continued)

The following is a summary of capital asset transactions for the year ended December 31, 2015:

| | Balance Dec. 31, 2014 | Additions | Dispositions | Balance Dec. 31, 2015 |
|---|---|---|---|---|
| Land and improvements | $ 506,586 | $ - | $ - | $ 506,586 |
| Building and improvements | 592,657 | 70,279 | - | 662,936 |
| Source of supply and pumping | 3,560,392 | - | - | 3,560,392 |
| Water treatment equipment | 123,333 | - | - | 123,333 |
| Transmission and distribution plant | 14,404,695 | 186,254 | - | 14,590,949 |
| Vehicles and other equipment | 694,413 | 417,377 | - | 1,111,790 |
| Construction in progress | 5,500 | 12,563 | - | 18,063 |
| Totals at historical cost | 19,887,576 | 686,473 | - | 20,574,049 |
| Less accumulated depreciation for: | | | | |
| Land and improvements | 5,034 | 1,137 | - | 6,171 |
| Building and improvements | 426,882 | 9,731 | - | 436,613 |
| Source of supply and pumping | 479,407 | 87,017 | - | 566,424 |
| Water treatment equipment | 87,517 | 4,588 | - | 92,105 |
| Transmission and distribution plant | 4,544,683 | 388,084 | - | 4,932,767 |
| Vehicles and other equipment | 529,502 | 40,140 | - | 569,642 |
| Total accumulated depreciation | 6,073,025 | 530,697 | - | 6,603,722 |
| Capital assets - net | $ 13,814,551 | $ 155,776 | $ - | $ 13,970,327 |

Note 6 – Notes Payable and Long-Term Debt

The following is a summary of long-term debt transactions for the year ended December 31, 2016:

| | Balance Dec. 31, 2015 | Additions | Payments | Balance Dec. 31, 2016 | Due Within One Year |
|---|---|---|---|---|---|
| Loan payable to Kentucky Infrastructure Authority, principal and interest at the rate of 1.6%, payable on a semi-annual basis, with final payment due December 1, 2025. | $ 182,448 | $ - | $ 16,091 | $ 166,357 | $ 16,349 |
| Loan payable to Kentucky Infrastructure Authority, payable monthly in varying principal amounts, with final payment due June 1, 2017; interest payable on semi-annual basis at rates graduated from 3.75% to 5.325% over the life of the loan. | 90,000 | - | 60,000 | 30,000 | 30,000 |

Note 6 – Notes Payable and Long-Term Debt (Continued)

| | Balance Dec. 31, 2015 | Additions | Payments | Balance Dec. 31, 2016 | Due Within One Year |
|---|---|---|---|---|---|
| Loan payable to GMAC Commercial Mortgage Corporation, payable annually in varying principal amounts, with final payment due January 1, 2019; interest payable on a semi-annual basis at the rate of 5.0%. | 55,000 | - | 27,000 | 28,000 | 28,000 |
| Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2036; interest payable on a semi-annual basis at the rate of 4.5%. | 405,500 | - | 12,000 | 393,500 | 12,500 |
| Line of credit payable to the First National Bank of London, payable monthly at a rate of 66% of the Wall Street prime rate, maturing March 15, 2016. | 92,500 | - | 92,500 | - | - |
| Loan payable to United States Department of Agriculture, payable annually in varying principal amounts with final payment due January 1, 2051. Interest payable on semi-annual basis at the rate of 4.125%. | 5,867,000 | - | 72,000 | 5,795,000 | 75,500 |
| Loan payable to United States Department of Agriculture, payable annually in varying principal amounts with final payment due January 1, 2051. Interest payable on semi-annual basis at the rate of 3.00%. | 2,221,000 | - | 35,000 | 2,186,000 | 36,000 |
| | $ 8,913,448 | $ - | $ 314,591 | $ 8,598,857 | $ 198,349 |

Note 6 – Notes Payable and Long-Term Debt (Continued)

The following is a summary of long-term debt transactions for the year ended December 31, 2015:

| | Balance Dec. 31, 2014 | Additions | Payments | Balance Dec. 31, 2015 | Due Within One Year |
|---|---|---|---|---|---|
| Loan payable to Kentucky Infrastructure Authority, principal and interest, at the rate of 1.6%, payable on a semi-annual basis, with final payment due December 1, 2025. | $ 198,284 | $ - | $ 15,836 | $ 182,448 | $ 16,091 |
| Loan payable to Kentucky Infrastructure Authority, payable monthly in varying principal amounts, with final payment due June 1, 2017; interest payable on a semi-annual basis at rates graduated from 3.75% to 5.325% over the life of the loan. | 147,500 | - | 57,500 | 90,000 | 60,000 |
| Loan payable to GMAC Commercial Mortgage Corporation, payable annually in varying principal amounts, with final payment due January 1, 2019; interest payable on a semi-annual basis at the rate of 5.0%. | 80,000 | - | 25,000 | 55,000 | 27,000 |
| Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2036; interest payable on a semi-annual basis at the rate of 4.5%. | 417,000 | - | 11,500 | 405,500 | 12,000 |
| Line of credit payable to the First National Bank of London, payable monthly at a rate of 66% of the Wall Street prime rate, maturing March 15, 2015. | 97,500 | - | 5,000 | 92,500 | 92,500 |

Note 6 – Notes Payable and Long-Term Debt (Continued)

| | Balance Dec. 31, 2014 | Additions | Payments | Balance Dec. 31, 2015 | Due Within One Year |
|---|---|---|---|---|---|
| Loan payable to United States Department of Agriculture, payable annually in varying principal amounts with final payment due January 1, 2051. Interest payable on semi-annual basis at the rate of 4.125%. | 5,936,000 | - | 69,000 | 5,867,000 | 72,000 |
| Loan payable to United States Department of Agriculture, payable annually in varying principal amounts with final payment due January 1, 2051. Interest payable on semi-annual basis at the rate of 3.00%. | 2,255,000 | - | 34,000 | 2,221,000 | 35,000 |
| | $ 9,131,284 | $ - | $ 217,836 | $ 8,913,448 | $ 314,591 |

All revenues from water sales are pledged as collateral on the loans payable to the Kentucky Infrastructure Authority.

The aggregate annual principal repayments on long-term debt are summarized as follows:

| Due the year ending December 31, | Principal | Interest | Total |
|---|---|---|---|
| 2017 | $ 198,349 | $ 328,288 | $ 526,637 |
| 2018 | 145,612 | 320,200 | 465,812 |
| 2019 | 150,878 | 314,951 | 465,829 |
| 2020 | 157,650 | 309,502 | 467,152 |
| 2021 | 163,425 | 303,791 | 467,216 |
| 2022-2026 | 906,943 | 1,425,026 | 2,331,969 |
| 2027-2031 | 1,012,000 | 1,248,200 | 2,260,200 |
| 2032-2036 | 1,243,000 | 1,035,068 | 2,278,068 |
| 2037-2041 | 1,359,500 | 786,598 | 2,146,098 |
| 2042-2046 | 1,668,000 | 503,794 | 2,171,794 |
| 2047-2051 | 1,593,500 | 155,974 | 1,749,474 |
| | $ 8,598,857 | $ 6,731,392 | $ 15,330,249 |

Note 7 – Retirement Plan

Laurel County Water District No. 2 is a participating employer of the County Employee's Retirement System (CERS). Under the provisions of Kentucky Revised Statute Section 61.645, the Board of Trustees of the Kentucky Retirement Systems (KRS) administers CERS. The plan issues a publicly available financial report that includes financial statements and required supplementary information. That report may be downloaded from the Kentucky Retirement Systems website or may be obtained by writing to Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, Kentucky 40601.

*Plan Description*

CERS is a cost sharing, multiple-employer, defined benefit, pension plan that covers substantially all regular full-time members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in the System.

*Benefits Provided*

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. Benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the Plan documents. Cost-of-living adjustments (COLA) are provided at the discretion of state legislature.

*Contributions*

Funding for the plan is provided through payroll withholdings and contributions by the District. All employees meeting the requirements for membership are required to contribute a percentage of their gross wages. For the years ended December 31, 2016 and 2015, plan members in non-hazardous positions were required to contribute 5% of the employee's total compensation subject to contribution. Employees hired after September 1, 2008 are required to contribute an additional 1% to cover the cost of medical insurance that is provided through CERS. Participating employers are required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565, normal contribution and past service contribution rates shall be determined by the Kentucky Retirement Systems Board of Trustees on the basis of the annual actuarial valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of July 1 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 in accordance with the actuarial basis adopted by the Board. The District's required contribution rates for the year ended December 31, 2016 were 17.06% (January through June 2016) and 18.68% (July through December 2016). The District's required contribution rates for the year ended December 31, 2015 were 17.67% (January through June 2015) and 17.06% (July through December 2015). Required contribution rates were actuarially determined and adopted by the KRS Board of Trustees. Administrative costs of the Kentucky Retirement System are financed through employer contributions and investment earnings.

Plan members who began participating on or after January 1, 2014 are required to contribute to the Cash Balance Plan. 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. A Cash Balance Plan resembles a defined contribution plan because it determines the value of benefits for each participant based on individual accounts. However, the assets of the plan remain in a single investment pool like a traditional defined benefit plan. A Cash Balance Plan resembles a defined benefit plan since it uses a specific formula to determine benefits. Members and employers contribute specified percentages of the member's wages each month to the member's account. Non-hazardous plan members are required to contribute 5% of wages to their individual account. All members are required to contribute 1% to the health insurance fund. The employer contribution rate is set annually by the Board based on an actuarial valuation. Each month, when employer contributions are received, an Employer Pay Credit is deposited to the member's account.

Note 7 – Retirement Plan (Continued)

*Contributions (continued)*

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. The account earns a guaranteed amount of interest, 4% on both the member contributions and the Employer Pay Credit balance, at the end of each fiscal year. If the member contributed to the plan during the fiscal year, there may be additional interest credit added to the member's account depending on Kentucky Retirement Systems' investment returns. This "upside" interest sharing is based on the 5-year average geometric investment return. If it exceeds 4% the member's account will be credited with 75% of the amount of the returns over 4% on the account balance as of June 30 of the previous year. For the year ended June 30, 2016, the interest earned on CERS non-hazardous plans was 4.870%.

The District's payroll for the years ended December 31, 2016, 2015, and 2014 was $623,781, $611,970, and $625,359, respectively, of which $590,264, $578,096, and $598,382, respectively was covered by CERS. The District's contribution requirements for CERS for the years ended December 31, 2016, 2015, and 2014 were $105,609 ($77,948 allocated to the CERS pension fund and $27,661 allocated to the CERS insurance fund), $100,359 ($72,739 allocated to the CERS pension fund and $27,620 allocated to the CERS insurance fund), and $109,296 ($79,184 allocated to the CERS pension fund and $30,112 allocated to the CERS insurance fund), respectively. The District contributed 100% of their required contributions for the years ended December 31, 2016, 2015, and 2014.

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

At December 31, 2016 and 2015, the District reported a liability of $1,127,240 and $1,031,130, respectively for their proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016 and 2015, respectively, and the total pension liability used to calculate net pension liability was 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 plan members, as actuarially determined. At the June 30, 2016 and 2015 measurement dates, the District's proportion was 0.02289% and 0.02398%, respectively.

Since the prior measurement date, the demographic and economic assumptions that affect the measurement of the total pension liability have not been updated.

Note 7 – Retirement Plan (Continued)

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions (Continued)*

The District recognized pension expense of $148,112 and $122,633 for the years ended December 31, 2016 and 2015, respectively. At December 31, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Difference between expected and actual experience | $ 4,921 | $ - |
| Net difference between projected and actual investment earnings on pension plan investments | 105,972 | - |
| Changes of assumptions | 59,715 | - |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | 10,000 | 29,152 |
| Employer contributions subsequent to the measurement date | 40,017 | - |
| Total | $ 220,625 | $ 29,152 |

Deferred outflows and inflows related to differences between projected and actual earnings on plan investments are netted and amortized over a closed five-year period. Deferred outflows and inflows related to experience gains/losses, the impact of changes in actuarial assumptions, changes in the employer's proportionate share of net pension liability, and differences between employer contributions and the proportionate share of contributions are amortized over the average remaining service life of the active and inactive System members at the beginning of the fiscal year.

$40,017 reported as deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2017. Other amounts reported as deferred outflows of resources related to pensions will be recognized in pension expense as follows:

| Year ended December 31: | |
|---|---|
| 2017 | $ 57,899 |
| 2018 | 33,679 |
| 2019 | 36,336 |
| 2020 | 23,542 |
| 2021 | - |
| Thereafter | - |
| Total | $ 151,456 |

Note 7 – Retirement Plan (Continued)

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions (Continued)*

At December 31, 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Difference between expected and actual experience | $ 8,569 | $ - |
| Net difference between projected and actual investment earnings on pension plan investments | 9,243 | - |
| Changes of assumptions | 103,978 | - |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | 16,623 | - |
| Employer contributions subsequent to the measurement date | 65,045 | - |
| Total | $ 203,458 | $ - |

*Actuarial Assumptions*

Total pension liability was determined by applying procedures to the actuarial valuation as of June 30, 2016. The financial reporting actuarial valuation as of June 30, 2016, used the following actuarial methods and assumptions, applied to all prior periods included in the measurement:

| | |
|---|---|
| Valuation Date | June 30, 2016 |
| Experience Study | July 1, 2008 - June 30, 2013 |
| Actuarial Cost Method | Entry Age Normal |
| Amortization Method | Level percentage of payroll, closed |
| Remaining Amortization Period | 27 years |
| Asset Valuation Method | 5-year smoothed market |
| Inflation | 3.25% |
| Salary Increase | 4.00%, average, including inflation |
| Investment Rate of Return | 7.50%, net of pension plan investment expense, including inflation |

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

Note 7 – Retirement Plans (Continued)

*Actuarial Assumptions (Continued)*

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for the System. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated December 3, 2015. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Combined equity | 44% | 5.40% |
| Combined fixed income | 19% | 1.50% |
| Real return (diversified inflation strategies) | 10% | 3.50% |
| Real estate | 5% | 4.50% |
| Absolute return (diversified hedge funds) | 10% | 4.25% |
| Private equity | 10% | 8.50% |
| Cash equivalent | 2% | -0.25% |
| Total | 100% | |

*Discount Rate*

The discount rate used to measure the total pension liability was 7.50 percent. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27 year amortization period of the unfunded actuarial accrued liability. The discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through 2117.

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

The following presents the net pension liability of the District's CERS pension plan, calculated using the discount rate of 7.50 percent, as well as what the CERS's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.50 percent) or 1-percentage-point higher (8.50 percent) than the current rate:

| | 1% Decrease (6.50%) | Current Discount Rate (7.50%) | 1% Increase (8.50%) |
|---|---|---|---|
| District's net pension liability | $ 1,404,724 | $ 1,127,240 | $ 889,382 |

Note 7 – Retirement Plans (Continued)

*Payable to the Pension Plan*

At December 31, 2016 and 2015, the District reported payables of $15,217 and $12,556 for the outstanding amounts of contributions to the pension plan required for the years ended December 31, 2016 and 2015, respectively.

Note 8 – Prior Period Adjustment

The District adopted new accounting guidance, *GASB Statement No. 68, Accounting and Financial Reporting for Pensions* during the year ended December 31, 2015. In accordance with GASB 68, contributions made after the measurement date of the net pension liability must be deferred and shown in the Statement of Net Position. The contributions contain a pension component that should be deferred and an insurance component that should not be deferred. Due to information that existed at the time the financial statements for the year ended December 31, 2015 were prepared, the full amount of contributions made after the measurement date were deferred. A prior period adjustment of $39,987 was made to reduce beginning net position to correct the deferral of prior year contributions for the District.

Note 9 – Risk Management

The District is exposed to various risks of loss related to limited torts; theft of, damage to and destruction of assets; errors and omissions and natural disasters for which the District carries commercial insurance. There have been no significant reductions in coverage for the year and settlements have not exceeded coverage in the past three years.

Note 10 - Subsequent Events

Date of Management Evaluation

Management of the District has evaluated subsequent events through September 22, 2017, the date on which the financial statements were available to be issued.

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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
Laurel County Water District No. 2
London, 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 Audit Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Laurel County Water District No. 2 as of and for the year ended December 31, 2016 and the related notes to the financial statements, which collectively comprise the Laurel County Water District No. 2's basic financial statements, and have issued our report thereon dated September 22, 2017.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. 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 Laurel County Water District No. 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*.

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.

*Christian Sturgeon & Associates, PSC*

Christian Sturgeon & Associates, PSC
London, Kentucky

September 22, 2017

Laurel County Water District No. 2
Schedule of the District's Proportionate Share of the Net Pension Liability
County Employee's Retirement System (CERS) Pension Plan
Last Ten Fiscal Years*

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| District's proportion of the net pension liability (asset) | 0.02289% | 0.02398% | 0.02334% |
| District's proportionate share of the net pension liability (asset) | $ 1,127,240 | $ 1,031,130 | $ 757,169 |
| District's covered-employee payroll | $ 590,264 | $ 578,096 | $ 598,382 |
| District's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll | 190.97% | 178.37% | 126.54% |
| Plan fiduciary net position as a percentage of the total pension liability | 55.50% | 59.97% | 66.80% |

Source: Kentucky Retirement Systems

Notes: There were no changes in benefit terms, size or composition of the population covered by the benefit terms, or the assumptions used in the last two years.

This schedule is presented to illustrate the requirement to show information for ten years. However, until a full ten year trend is compiled, the District will present information for those years for which information is available.

* The amounts presented for each year were determined (measured) as of the fiscal year-end that occurred within the previous calendar year.

See independent auditors' report.

Laurel County Water District No. 2
Schedule of the District's Pension Contributions
County Employee's Retirement System (CERS) Pension Plan
Last Ten Fiscal Years*

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Contractually required contribution | $ 77,948 | $ 72,739 | $ 79,184 |
| Contributions in relation to the contractually required contribution | (77,948) | (72,739) | (79,184) |
| Contribution deficiency (excess) | $ - | $ - | $ - |
| District's covered-employee payroll | $ 623,781 | $ 611,970 | $ 625,359 |
| Contributions as a percentage of covered-employee payroll | 12.50% | 11.89% | 12.66% |

Source: Kentucky Retirement Systems

Notes: There were no changes in benefit terms, size, or composition of the population covered by the benefit terms, or the assumptions used in the last two years.

Contractually required employer contributions exclude the portion of contributions paid to CERS but allocated to the insurance fund of the CERS. The above contributions only include those contributions allocated directly to the CERS pension fund.

This schedule is presented to illustrate the requirement to show information for ten years. However, until a full ten year trend is compiled, the District will present information for those years for which information is available.

* The amounts presented for each calendar year were determined as of the fiscal year-end that occurred within the calendar year.