

**Report**

**of**

**Muhlenberg County Water District #3  
Bremen, Kentucky**

**For The Years Ended December 31, 2015 and 2014**

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# Alexander, Toney & Knight PLLC

CERTIFIED PUBLIC ACCOUNTANTS

28 Court Street

Madisonville, Kentucky 42431

(270) 821-4824

FAX: (270) 825-4554

Email: atkcpas@yahoo.com

Larry R. Alexander, CPA  
Harold R. Toney, Jr., CPA  
Anthony Knight, CPA

Members  
American Institute of Certified Public Accountants  
Kentucky Society of Certified Public Accountants

## INDEPENDENT AUDITORS' REPORT

To the Commissioners  
Muhlenberg County Water District Number 3  
Bremen, Kentucky

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Muhlenberg County Water District Number 3 as of and for the years ended December 31, 2015 and 2014, and the related notes to the 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 opinions 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 opinions.

## ***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Muhlenberg County Water District Number 3 as of December 31, 2015 and 2014, and the 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.

## ***Emphasis of Matter***

### **Change in Accounting Principle**

As discussed in Note L to the financial statements, the District adopted Statement No. 68, Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27 (GASB 68). The implementation resulted in a restatement of prior year net position. Our opinion is not modified with respect to this matter.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-7 and pension schedules on pages 23-24 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated February 11, 2016, on our consideration of Muhlenberg County Water District Number 3'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 Muhlenberg County Water District Number 3's internal control over financial reporting and compliance.

*Alexander, Toney & Knight PLLC*

Madisonville, Kentucky  
February 11, 2016

MUHLENBERG COUNTY WATER DISTRICT NUMBER 3  
Management's Discussion and Analysis  
December 31, 2015 and 2014

The discussion and analysis of the Muhlenberg County Water District Number 3's financial performance provides an overview and analysis of the District's financial activities for the years ended December 31, 2015 and 2014. It should be read in conjunction with the accompanying basic financial statements.

Financial Highlights for the Year 2015

- \* Income before capital contributions was \$98.2 thousand for the year ended December 31, 2015.
- \* The District implemented the new requirements of GASB Statement No. 68, Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27. This resulted in the reduction in beginning net position of \$312,000.

Overview Of The Financial Statements

This report consists of this management's discussion and analysis, basic financial statements, and notes to the financial statements. The basic financial statements are reported using the full accrual basis of accounting.

Basic financial statements:

The Statements of Net Position include information on the District's assets, deferred outflows of resources, liabilities, and deferred inflows of resources and provide information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). In simple terms, this statement presents a snap-shot view of the assets the District owns, the liabilities it owes and the net difference. The net difference is further separated into amounts restricted for specific purposes and unrestricted amounts.

The Statements of Revenues, Expenses, and Changes in Fund Net Position include the District's revenues and expenses for the years ended December 31, 2015 and 2014. This statement provides information on the District's operations and can be used to determine whether the District has recovered all of its actual and projected costs through user fees and other charges.

The Statements of Cash Flows include information on the District's cash receipts and payments and the changes in cash balances resulting from operating activities, investing activities, and financing activities.

The notes to the financial statements provide additional disclosures required by governmental accounting standards and provide information to assist the reader in understanding the District's financial condition.

## District Financial Analysis

A summary of the District's Statements of Net Position is presented below.

Table 1  
Condensed Statements of Net Position  
(in thousands)

	<u>2015</u>	<u>2014</u>	<u>dollar change</u>	<u>percent change</u>	<u>2013</u>	<u>dollar change</u>	<u>percent change</u>
Current assets	\$1,033.8	\$1,096.8	(\$ 63.0)	( 5.7%)	\$ 654.1	\$ 442.7	67.7%
Capital assets	1,995.9	1,974.5	21.4	1.1%	1,927.8	46.7	2.4%
Other noncurrent assets	<u>199.9</u>	<u>98.7</u>	101.2	24.8%	<u>407.6</u>	( 308.9)	( 75.8%)
Total assets	<u>3,229.6</u>	<u>3,170.0</u>	59.6	1.9%	<u>2,989.5</u>	180.5	6.0%
Total deferred outflows of resources	<u>42.1</u>	<u>0.0</u>	42.1	100.0%	<u>0.0</u>	0.0	0.0%
Current liabilities	84.8	99.6	( 14.8)	( 14.9%)	71.1	71.1	40.1%
Long-term liabilities	<u>315.7</u>	<u>22.6</u>	293.1	1,296.9%	<u>13.8</u>	8.8	63.8%
Total liabilities	<u>400.5</u>	<u>122.2</u>	278.3	227.7%	<u>84.9</u>	37.3	43.9%
Total deferred inflows of resources	<u>34.0</u>	<u>0.0</u>	34.0	100.0%	<u>0.0</u>	0.0	0.0%
Net assets invested in capital assets, net of related debt	1,986.8	1,944.6	42.2	2.2%	1,925.5	19.1	1.0%
Unrestricted net position	<u>850.5</u>	<u>1,103.2</u>	( 252.7)	( 22.9%)	<u>979.1</u>	124.1	12.7%
Total net position	<u>\$2,837.3</u>	<u>\$3,047.8</u>	(\$ 210.5)	( 6.9%)	<u>\$2,904.6</u>	\$ 143.2	4.9%

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$2.837 million at the close of the current year.

### 2014 to 2015

As shown in table 1, the District's total assets increased by \$59,600 from \$3,170,000 to \$3,229,600. Current assets decreased \$63,000. This was due in part to decreases in cash and cash equivalents which decreased \$26,000. The District had an overall increase in cash of \$75,000 and also reclassified previously unrestricted cash to restricted cash, thus moving those cash amounts from current assets to other noncurrent assets. Accounts receivable decreased \$15,000 as the District had lower water sales at year end when compared to the prior year. Inventory decreased \$21,000 as the District has decided to keep less on hand considering their close proximity to suppliers. Capital assets increased \$21,400 as capital asset acquisitions out paced depreciation expense. Other noncurrent assets, which includes restricted cash, increased \$101,200 as the District moved cash into the construction fund.

The District's long-term liabilities increased \$293,100 as the District implemented GASB 68 during the year resulting in a net pension liability of \$302,000.

The District's total net position decreased \$210,500 due to the net effect of the increase in total assets and increase in total liabilities referred to above.

#### 2013 to 2014

As shown in table 1, the District's total assets increased by \$180,500 from \$2,989,500 to \$3,170,000. Current assets increased \$442,700 primarily due to increases in cash and cash equivalents which increased \$400,000. The District reclassified previously restricted cash to unrestricted cash, thus moving those cash amounts from other noncurrent assets to current assets. The same cash was previously restricted by bond agreements of which the District made final payments retiring the debt a few years ago. The District also had an \$98,609 increase of cash due to a positive cash flow during the year. Capital assets increased \$46,700 as capital asset acquisitions out paced depreciation expense. Other noncurrent assets, which includes restricted cash, decreased \$308,900 as mentioned earlier.

The District's current liabilities increased \$28,500 due to an increase of \$9,000 in accounts payable and a increase of \$20,800 in capital lease payable. Accounts payable were higher then the prior year as the District's water purchase cost was higher at year end due to higher quantity of water purchased. The District purchased equipment this year under a capital lease which it did not have in the prior year.

The District's total net position increased \$143,200 due to the net effect of the increase in total assets and increase in total liabilities referred to above.

A summary of the District's Statements of Revenues, Expenses and Changes in Net Position is presented below.

Table 2  
Condensed Statements of Revenues, Expenses and Changes in Net Position  
(in thousands)

	<u>2015</u>	<u>2014</u>	<u>dollar change</u>	<u>percent change</u>	<u>2013</u>	<u>dollar change</u>	<u>percent change</u>
Operating revenues	\$1,411.2	\$1,450.9	(\$ 39.7)	( 2.7%)	\$1,252.4	\$ 198.5	15.8%
Nonoperating revenues	<u>7.5</u>	<u>5.0</u>	2.5	48.1%	<u>5.4</u>	( 0.4)	( 7.4%)
Total revenues	<u>1,418.7</u>	<u>1,455.9</u>	( 37.2)	( 2.6%)	<u>1,257.8</u>	198.1	15.7%
Operating expenses	1,320.2	1,378.1	( 57.9)	( 4.2%)	2,208.9	169.2	14.0%
Nonoperating expenses	<u>0.3</u>	<u>0.5</u>	( 0.2)	( 40.0%)	<u>0.4</u>	0.1	25.0%
Total expenses	<u>1,320.5</u>	<u>1,378.6</u>	( 58.1)	( 4.2%)	<u>1,209.3</u>	169.3	14.0%
Income (loss) before capital contributions	98.2	77.3	20.9	27.0%	48.5	28.8	59.4%
Capital contributions	<u>3.3</u>	<u>65.9</u>	( 62.6)	( 95.0%)	<u>39.8</u>	26.1	65.6%
Changes in net position	101.5	143.2	( 41.7)	( 29.1%)	88.3	54.9	62.2%
Beginning net position	* <u>2,735.8</u>	<u>2,904.6</u>	( 168.8)	( 5.8%)	<u>2,816.3</u>	88.3	3.1%
Ending net position	<u>\$2,837.3</u>	<u>\$3,047.8</u>	(\$ 210.5)	( 6.9%)	<u>\$2,904.6</u>	\$ 143.2	4.9%

\* as restated, see note L.

### 2014 to 2015

As shown in table 2, the District's total revenues decreased \$37,200. Resale water sales decreased \$33,600 during the year.

The District's total expenses decreased \$58,100 from the prior year. Purchased water decreased \$33,800 which is in part to less water sold as well as less water loss during the year. Employee benefits decreased \$14,000, the effect of implementing GASB 68 during the year.

Capital contributions decreased \$62,600 due to not receiving any state grant monies during the current year. The District had received grant monies in the prior year in connection with construction projects.

Changes in net position increased \$101,500 due to the net effect of the above changes.

### 2013 to 2014

As shown in table 2, the District's total revenues increased \$198,100. Water sales increased \$198,500 as the District sold more water during the year. There was an increase in quantity sold as well as a substantial decrease in water loss. The District began the year with water loss percentage of 21% and was down to single digit percentage loss at year end.

The District's total expenses increased \$169,300 from the prior year. Purchased water increased \$90,600 as the District sold more water during the year thus purchased more also. Salaries and wages increased \$20,000 due to additional employees during the year. Materials and supplies increased \$18,000 as the District experienced a lower rate of repair work during the prior year. Contract services increased \$10,000 compared to the prior year as the prior year contract services, as with materials and supplies, were down in the prior year.

Capital contributions increased \$26,000 due to increased activity for a line replacement project. The District is receiving state grant monies for this project.

Changes in net position increased \$143,200 due to the net effect of the above changes.

## Capital Assets and Debt Administration

### Capital Assets

At December 31, 2015 the District had \$1,995,943 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net increase (additions, retirements, depreciation) of \$21,352 from the prior year.

Significant expenditures during the year included expenditures on meters for \$15,891 and the purchases of two trucks for \$38,858.

At December 31, 2014 the District had \$1,974,591 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, and office furniture and equipment. This amount represents a net increase (additions, retirements, depreciation) of \$46,836 from the prior year.

Significant expenditures during the year included purchases of an excavator for \$42,500 and a truck for \$21,300.

A comparison of the District's capital assets over the past three years is presented in Note E of the financial statements.

#### Long-Term Debt

At December 31, 2015, the District had \$28,150, net reductions of \$34,559, in long-term liabilities which included customer deposits and a capital lease. There were no new borrowings.

At December 31, 2014, the District had \$48,605, net additions of \$29,635, in long-term liabilities which included customer deposits and a capital lease. New borrowings during the year include the addition of a capital lease.

Additional information on the District's long-term debt can be found in Note F of the financial statements.

#### Currently Known Facts, Decisions, or Conditions

There are no currently known facts, decisions, or conditions that District management expects to have a significant effect on financial position or results of operations.

#### Requests For Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Muhlenberg County Water District Number 3, 4789 Main Street, Bremen, Kentucky 42325.

Muhlenberg County Water District Number 3  
Statement of Net Position  
December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<u>Assets</u>		
Current assets		
Cash and cash equivalents	\$ 840,230	\$ 866,032
Accounts receivable	158,804	173,609
Material and parts inventory	24,330	45,486
Prepaid expenses	<u>10,421</u>	<u>11,671</u>
Total current assets	<u>1,033,785</u>	<u>1,096,798</u>
Noncurrent assets		
Restricted cash and cash equivalents	199,945	98,650
Capital assets:		
Nondepreciable	153,026	96,846
Depreciable, net of accumulated depreciation	<u>1,842,917</u>	<u>1,877,746</u>
Total noncurrent assets	<u>2,195,888</u>	<u>2,073,242</u>
Total assets	<u>3,229,673</u>	<u>3,170,040</u>
<u>Deferred outflows of resources</u>		
Deferred outflows of resources-pensions	<u>42,127</u>	<u>0</u>
Total deferred outflows of resources	<u>42,127</u>	<u>0</u>
<u>Liabilities</u>		
Current liabilities payable from current assets		
Accounts payable	61,767	64,434
Accrued taxes and other payables	2,220	2,298
Accrued interest payable	11	17
Capital lease-due within one year	9,180	20,832
Accumulated compensated absences	<u>6,360</u>	<u>6,840</u>
	<u>79,538</u>	<u>94,421</u>
Current liabilities payable from restricted assets		
Customer deposits	<u>5,239</u>	<u>5,215</u>
	<u>5,239</u>	<u>5,215</u>
Total current liabilities	<u>84,777</u>	<u>99,636</u>
Long-term liabilities		
Capital lease-due after one year	0	9,188
Net pension liability	302,000	0
Customer deposits	<u>13,731</u>	<u>13,370</u>
Total noncurrent liabilities	<u>315,731</u>	<u>22,558</u>
Total liabilities	<u>400,508</u>	<u>122,194</u>
<u>Deferred inflows of resources</u>		
Deferred inflows of resources-pensions	<u>34,000</u>	<u>0</u>
Total deferred inflows of resources	<u>34,000</u>	<u>0</u>
<u>Net Position</u>		
Invested in capital assets, net of related debt	1,986,763	1,944,555
Unrestricted	<u>850,529</u>	<u>1,103,291</u>
Total net position	<u>\$2,837,292</u>	<u>\$3,047,846</u>

The accompanying notes are an integral part of these statements.

Muhlenberg County Water District Number 3  
Statement of Revenues, Expenses and Changes in Fund Net Position  
Years Ended December 31, 2015 and 2014

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	<u>2015</u>	<u>2014</u>
Operating revenues		
Water sales	\$1,363,462	\$1,406,002
Other operating revenues	<u>47,763</u>	<u>44,893</u>
Total operating revenues	<u>1,411,225</u>	<u>1,450,895</u>
Operating expenses		
Purchased water	704,048	737,878
Salaries and wages	255,996	258,597
Depreciation	98,200	103,654
Employee benefits	63,276	77,367
Transportation	15,332	18,439
Contract services	27,925	34,096
Taxes	21,389	19,772
Purchased power	31,058	27,868
Materials and supplies	46,133	44,314
Insurance	18,996	18,641
Miscellaneous	32,296	31,462
Regulatory commission expense	2,758	2,445
Uncollectible accounts	<u>2,784</u>	<u>3,546</u>
Total operating expenses	<u>1,320,191</u>	<u>1,378,079</u>
Operating income (loss)	91,034	72,816
Nonoperating revenues (expenses)		
Interest income	4,597	5,001
Interest expense	( 384)	( 391)
Gains (losses) on disposition of capital assets	<u>2,952</u>	<u>( 77)</u>
Total nonoperating revenues (expenses)	<u>7,165</u>	<u>4,533</u>
Income (loss) before contributions	98,199	77,349
Capital contributions-state	0	57,873
Capital contributions-tap fees	3,250	5,850
Capital contributions-customers	<u>0</u>	<u>2,190</u>
Change in net position	101,449	143,262
Net position beginning of year, as restated, see note L	<u>2,735,843</u>	<u>2,904,584</u>
Net position end of year	<u>\$2,837,292</u>	<u>\$3,047,846</u>

The accompanying notes are an integral part of these statements.

Muhlenberg County Water District Number 3  
Statement of Cash Flows  
Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<u>Cash flows from operating activities</u>		
Cash received from customers	\$1,378,267	\$1,383,456
Cash payments to suppliers for goods and services	( 964,404)	(1,018,845)
Cash payments to employees for services	( 255,996)	( 258,597)
Other operating revenues	<u>47,763</u>	<u>44,893</u>
Net cash provided (used) by operating activities	205,630	150,907
<u>Cash flows from capital and related financing activities</u>		
Acquisition and construction of capital assets	( 119,712)	( 110,331)
Interest paid on customer deposits	( 26)	( 21)
Interest paid on capital lease	( 358)	( 353)
Principal paid on capital lease	( 20,840)	( 12,507)
Capital contributions received from customers	3,250	8,040
Capital contributions from state	0	57,873
Proceeds received on disposition of capital assets	<u>2,952</u>	<u>0</u>
Net cash provided (used) for capital and related financing activities	( 134,734)	( 57,299)
<u>Cash flows from investing activities</u>		
Interest earned on bank deposits	<u>4,597</u>	<u>5,001</u>
Net cash provided (used) for investing activities	4,597	5,001
Net increase (decrease) in cash and cash equivalents	75,493	98,609
Cash and cash equivalents at beginning of year	<u>964,682</u>	<u>866,073</u>
Cash and cash equivalents at end of year	<u>\$1,040,175</u>	<u>\$ 964,682</u>

Reconciliation of operating income to net cash provided (used) by operating activities

Operating income (loss)	\$ 91,034	\$ 72,816
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	98,200	103,654
(Gain) loss on asset dispositions	160	0
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	14,805	( 19,000)
(Increase) decrease in inventory	21,156	( 13,400)
(Increase) decrease in prepaid expenses	1,250	( 2,683)
Increase (decrease) in accounts payable	( 2,667)	9,388
Increase (decrease) in accrued expenses	( 84)	582
Increase (decrease) in pension liability	( 18,127)	0
Increase (decrease) in customer deposits	383	( 385)
Increase (decrease) in accumulated compensated absences	( 480)	( 65)
Total adjustments	<u>114,596</u>	<u>78,091</u>
Net cash provided by operating activities	<u>\$ 205,630</u>	<u>\$ 150,907</u>

The accompanying notes are an integral part of these statements.

#### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Muhlenberg County Water District Number 3 (the "District") conform to Generally Accepted Accounting Principles (GAAP) as applicable to governments. The District's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. The following is a summary of the more significant policies:

##### The Financial Reporting Entity

Muhlenberg County Water District Number 3 was created on April 24, 1967, under the provisions of Chapter 74 of the Kentucky Revised Statutes of the Commonwealth of Kentucky. The principal office of the District is located at Bremen, Kentucky. The District is composed of three commissioners who are appointed by the Muhlenberg County Judge Executive and provides water to its members in and around Muhlenberg County, Kentucky.

In evaluating how to define the government, 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 GASB Statement No. 14 - *The Financial Reporting Entity*.

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

The accounts of the District are organized in accordance with the uniform system of accounts adopted by the Public Service Commission of Kentucky. Those accounts are organized on the basis of a proprietary fund type, specifically an enterprise fund. Enterprise Funds account for activities 1) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or 2) that are required by laws or regulations that the activities costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or 3) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net position. Net position is required to be displayed in three components: 1) invested in capital assets, net of related debt, 2) restricted, and 3) unrestricted. Invested in capital assets, net of related debt is capital assets net of accumulated depreciation and reduced by outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Restricted net position are those with constraints placed on their use by either: 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation. Net position not otherwise classified as restricted, are shown as unrestricted. The statements of revenue, expenses, and changes in net position present increases (revenues) and decreases (expenses) in net position.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The accounts of the District are maintained on the accrual basis of accounting. Its revenues are recognized when they are earned, and its expenses are recognized when they are incurred.

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues and expenses of the District's enterprise fund are charges to customers for sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Unbilled water receivables for utility services provided through December 31 are included in the financial statements.

When both restricted and unrestricted resources are available for use, the District generally first uses restricted resources, then unrestricted resources as they are needed.

Cash and Cash Equivalents

All cash except for a small amount kept "on hand" is deposited in financial institutions. Deposits are interest bearing checking accounts and certificates of deposit. Unrestricted cash is available to be expended for normal operating expenses. Restricted cash is limited to payments of bond principal and interest, emergency capital improvements, and other designated purposes. Cash and cash equivalents are defined as being all monies on deposit in banks and investments with a maturity of 90 days or less.

Inventory

Inventory consists primarily of replacement parts and supplies. Inventory is stated at the lower of cost or market. Cost is determined primarily by the first-in, first-out method.

Capital Assets

Capital assets, which include property, plant, and equipment, are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. No interest was capitalized during the years ended December 31, 2015 and 2014.

Capital assets of the District are depreciated using a straight-line method over the following estimated useful lives:

Structures, improvements and water system	10 to 65 years
Furniture, machinery and equipment	2 to 10 years
Vehicles	5 years

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2015 and 2014

NOTE A - SUMMARY OF ACCOUNTING POLICIES continued

Restricted Net Position

Restricted net position is cash set aside for the repayment of debt in compliance with bond covenants and cash restricted for future operations in compliance with escrow reserve agreements. The District currently doesn't have any restricted net position.

Long-Term Liabilities

Long-term debt is reported as liabilities in the statement of net position. Long-term debt is reported at face value.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources, and pension expense, information about the fiduciary net position of the County Employees Retirement System Non-Hazardous (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. Investments are reported at fair value.

Uncollectible Accounts

All accounts receivable are considered by management to be collectible, therefore no provision for uncollectible accounts has been established. Uncollectible accounts are expensed using the direct write-off method.

Use of Estimates

The preparation of financial statements in accordance with accounting principals generally accepted in the United States requires management to make estimates that affect amounts reported in the financial statements during the reporting period. Actual results could differ from those estimates.

#### NOTE B - DEPOSITS

The District maintains deposits with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to law, the depository institution should pledge sufficient securities as collateral which, together with FDIC insurance, equals or exceeds the amount on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge of securities should be evidenced by an agreement that is (1) in writing, (2) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (3) an official record of the depository institution. This agreement, signed by both parties, must be sufficient to create an enforceable and perfected security interest in the collateral under Kentucky law.

Deposits are categorized to give an indication of risk assumed by the District at the end of the year. Category 1 includes deposits that are insured, Category 2 includes collateralized deposits held by the pledging institution's trust department or agent in the District's name, and Category 3 includes uncollateralized and uninsured deposits.

On December 31, 2015, the reconciled balance of the District's deposits totaled \$1,040,175 and the bank balances were \$1,049,307. Of the bank balances \$613,849 was covered by federal depository insurance (category 1). Also of the bank balances, \$435,458 was collateralized by additional securities held by the pledging depository institution's trust department or agent in the District's name (category 2).

On December 31, 2014, the reconciled balance of the District's deposits totaled \$964,682 and the bank balances were \$975,408. Of the bank balances \$593,525 was covered by federal depository insurance (category 1). Also of the bank balances, \$381,883 was collateralized by additional securities held by the pledging depository institution's trust department or agent in the District's name (category 2).

#### NOTE C - PREPAID EXPENSES

Prepaid expenses include prepaid insurance, which represents the amount of unexpired insurance, which the District had previously paid for at the balance sheet date. Prepaid expenses also include prepaid payroll taxes, which have been paid prior to employee withholding.

At December 31, 2015, the District's prepaid expenses consisted of \$10,421 of insurance. At December 31, 2014, the District's prepaid expenses consisted of \$9,219 of insurance and \$2,452 of payroll taxes.

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2015 and 2014

NOTE D - RESTRICTED CASH AND CASH EQUIVALENTS

The District has cash set aside for the repayment of debt (which has been fully paid), cash restricted for future operations, cash set aside for future capital assets, and cash set aside for repayment of customer deposits.

Restricted balances as of December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Customer meter deposit fund	\$ 23,128	\$ 22,722
Construction fund	<u>176,817</u>	<u>75,928</u>
Totals	<u>\$ 199,945</u>	<u>\$ 98,650</u>

NOTE E - CAPITAL ASSETS

Capital asset activities for the years ended December 31, 2015 and 2014, were as follows:

	<u>Balances</u> <u>12/31/13</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>Balances</u> <u>12/31/14</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>Balances</u> <u>12/31/15</u>
Business-type activities:							
Capital assets not being depreciated							
Land & land rights	\$ 22,950	\$ 0	\$ 0	\$ 22,950	\$ 0	\$ 0	\$ 22,950
Construction in progress	<u>18,980</u>	<u>54,916</u>	<u>0</u>	<u>73,896</u>	<u>56,180</u>	<u>0</u>	<u>130,076</u>
Total	<u>41,930</u>	<u>54,916</u>	<u>0</u>	<u>96,846</u>	<u>56,180</u>	<u>0</u>	<u>153,026</u>
Capital assets being depreciated							
Structures, improvements, & water system	3,250,736	3,024	1,107	3,252,653	21,170	1,350	3,272,473
Office furniture & equipment	50,320	14,368	10,473	54,215	2,165	0	56,380
Vehicles & equipment	79,548	27,588	0	107,136	39,287	26,105	120,318
Machinery & equipment	<u>403,287</u>	<u>50,671</u>	<u>0</u>	<u>453,958</u>	<u>910</u>	<u>0</u>	<u>454,868</u>
Total	<u>3,783,891</u>	<u>95,651</u>	<u>11,580</u>	<u>3,867,962</u>	<u>63,532</u>	<u>27,455</u>	<u>3,904,039</u>
Total capital assets	<u>3,825,821</u>	<u>150,567</u>	<u>11,580</u>	<u>3,964,808</u>	<u>119,712</u>	<u>27,455</u>	<u>4,057,065</u>
Less accumulated depreciation for:							
Structures, improvements, & water system	1,608,824	72,587	1,030	1,680,381	59,690	1,189	1,738,882
Office furniture & equipment	41,692	3,875	10,473	35,094	3,679	0	38,773
Vehicles & equipment	79,489	3,501	0	82,990	8,596	26,106	65,480
Machinery & equipment	<u>168,061</u>	<u>23,691</u>	<u>0</u>	<u>191,752</u>	<u>26,235</u>	<u>0</u>	<u>217,987</u>
Total accumulated depreciation	<u>1,898,066</u>	<u>103,654</u>	<u>11,503</u>	<u>1,990,217</u>	<u>98,200</u>	<u>27,295</u>	<u>2,061,122</u>
Total business-type activities capital assets, net	<u>\$1,927,755</u>	<u>\$ 46,913</u>	<u>\$ 77</u>	<u>\$1,974,591</u>	<u>\$ 21,512</u>	<u>\$ 160</u>	<u>\$1,995,943</u>

Muhlenberg County Water District Number 3  
 Notes to Financial Statements  
December 31, 2015 and 2014

NOTE F – LONG-TERM LIABILITIES

During 2014, the District entered into an agreement with a financial institution to finance the leasing of equipment. The lease agreement qualifies as a capital lease for accounting purposes. The equipment has an original cost of \$42,527. Monthly payments of \$1,772, including interest at a rate of 2.1038% began in June 2014 and will continue through May 2016. The debt service requirements to maturity are as follows:

Year Ended <u>December 31</u>	
2016	<u>9,238</u>
Total minimum lease payments	9,238
Less amounts representing interest	( 58)
Present value of minimum lease payments	<u>\$ 9,180</u>

Amortization expense associated with capital leases is presented with depreciation expense. The gross amount of equipment leased under capital leases is \$42,527 with accumulated depreciation of \$6,379 as of December 31, 2015 and of \$2,126 as of December 31, 2014.

Long-term liability activity

Long-term liability activity for the years ended December 31, 2015 and 2014, were as follows:

	Balances <u>12/31/13</u>	<u>Additions</u>	<u>Reductions</u>	Balances <u>12/31/14</u>	<u>Additions</u>	<u>Reductions</u>	Balances <u>12/31/15</u>	Amounts Due Within <u>One Year</u>
Capital Lease	\$ 0	\$ 42,527	\$ 12,507	\$ 30,020	\$ 0	\$ 20,840	\$ 9,180	\$ 9,180
Customer Deposits	18,970	5,005	5,390	18,585	5,251	18,970	18,970	5,239
Business-type Activities Long- Term Liabilities	<u>\$ 18,970</u>	<u>\$ 47,532</u>	<u>\$ 17,897</u>	<u>\$ 48,605</u>	<u>\$ 5,251</u>	<u>\$ 39,810</u>	<u>\$ 28,150</u>	<u>\$ 14,419</u>

NOTE G - ACCUMULATED COMPENSATED ABSENCES

Effective March 2011 employees are no longer permitted to accumulate earned but unused vacation days beyond one year. The employees must use or cash out their yearly allotment of vacation time earned by the annual anniversary date of their employment.

## NOTE H - EMPLOYEES' PENSION PLAN

### General Information about the Pension Plan

*Plan Description.* The District and covered employees contribute to the County Employers Retirement System (CERS), a cost-sharing, multiple-employer defined benefit plan administered by the Board of Trustees of the Kentucky Retirement Systems (KRS). Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of the Kentucky Retirement Systems. The CERS financial statements and other supplementary information are contained in the publicly available annual financial report of the Kentucky Retirement Systems. Copies of the report are sent to each participating employer as well as distributed to legislative personnel, state libraries and other interested parties. Copies may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West 1260 Louisville Road, Frankfort, Kentucky 40601 or by calling 1-502-564-4646.

*Benefits provided.* Kentucky Revised Statute Section 61.645 establishes the benefit terms and can be amended only by the Kentucky General Assembly. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living adjustments are provided at the discretion of the State legislature.

*Contributions.* Per Kentucky Revised Statute 61.565, normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems 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 year ended December 31, 2015, plan members were required to contribute 5% of their annual creditable compensation. Plan members hired subsequent to September 1, 2008 were required to contribute 6% of their annual creditable compensation. The District is required to contribute at an actuarially determined rate. The District was required to contribute 17.06% of each employee's creditable compensation for the last six months of the year ended December 31, 2015. The District was required to contribute 17.67% of each employee's creditable compensation for the first six months of the year ended December 31, 2015 and for the final six months of the year ended December 31, 2014. The District was required to contribute 18.89% of each employee's creditable compensation for the first six months of the year ended December 31, 2014 and for the final six months of the year ended December 31, 2013. The District was required to contribute 19.55% of each employee's creditable compensation for the first six months of the year ended December 31, 2013. The District's contributions to CERS for the years ended December 31, 2015, 2014 and 2013 were \$42,341, \$37,814, and \$40,375, respectively.

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

At December 31, 2015, the District reported a liability of \$302,000 for its proportionate share of the net pension liability. The District's net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate net pension liability was determined by an actuarial valuation as of June 30, 2014.

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2015 and 2014

NOTE H - EMPLOYEES' PENSION PLAN continued

For the year ended December 31, 2015, the District recognized pension expense of \$24,000. At December 31, 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net difference between projected and actual earnings on pension plan investments	\$ -	\$ 34,000
District contributions subsequent to the measurement date	<u>42,127</u>	<u>-</u>
Total	<u>\$ 42,127</u>	<u>\$ 34,000</u>

\$42,127 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, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	
2016	\$ 8,500
2017	8,500
2018	8,500
2019	8,500

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

Inflation	3.5%
Salary increases	4.5%, average, including inflation
Investment rate of return	7.75%, net of pension plan investment expense, including inflation

The rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward 5 years is used for the period after disability retirement.

The actuarial assumption used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the period July 1, 2005 – June 30, 2008.

Muhlenberg County Water District Number 3  
Notes to Financial Statements  
December 31, 2015 and 2014

NOTE H - EMPLOYEES' PENSION PLAN continued

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for KRS. The most recent analysis, performed for the period covering fiscal years 2005 through 2008, is outlined in a report dated August 25, 2009. Several factors are considered in evaluating the long-term rate of return assumption including long term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe. The assumption is intended to be a long term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic equity	30%	8.45%
International equity	22	8.85
Emerging market equity	5	10.50
Private equity	7	1.25
Real estate	5	7.00
Core US fixed income	10	5.25
High yield US fixed income	5	7.25
Non-US fixed income	5	5.50
Commodities	5	7.75
TIPS	5	5.00
Cash	1	3.25
Total	<u>100%</u>	

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

Muhlenberg County Water District Number 3  
 Notes to Financial Statements  
December 31, 2015 and 2014

NOTE H - EMPLOYEES' PENSION PLAN continued

*Sensitivity of the District's proportionate share of the net pension liability to changes in the discount rate.* The following presents the District's proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75%) or 1-percentage-point higher (8.75%) than the current rate.

	<u>1% Decrease</u> <u>(6.75%)</u>	<u>Discount Rate</u> <u>(7.75%)</u>	<u>1% Increase</u> <u>(8.75%)</u>
District's proportionate share of the net pension liability	\$ 398,000	\$ 302,000	\$ 218,000

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

NOTE I - RISK MANAGEMENT

The District is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. The District purchases commercial insurance for all risks of losses. Settlements resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE J - CONSTRUCTION IN PROGRESS AND CONSTRUCTION PROJECTS PAYABLE

During 2015, the District incurred \$35,284 in labor, excavating, legal, and materials cost related to the Clark Street Line Replacement project. These costs are considered construction in progress until the line replacement is complete and in service. Also, during 2015, the District incurred \$20,895 in land, legal, and materials cost related to the the new office building project.

During 2014, the District incurred \$53,316 in labor, excavating, legal, and materials cost related to the Clark Street Line Replacement project. These costs are considered construction in progress until the line replacement is complete.

#### NOTE K – CAPITAL CONTRIBUTIONS-STATE

##### 2014

The District has entered into an utility relocation contract with the Kentucky Transportation Cabinet, Department of Highways in regards to the HWY 431 Water Line Relocation project that has been completed. The District incurred and paid for \$26,659 of engineering costs during 2012 and 2013 and this amount was reimbursed during and subsequent to year end of 2013.

Also, The District has entered into an utility replacement contract with the Commonwealth of Kentucky, Kentucky Infrastructure Authority through Muhlenberg County Fiscal Court in regards to the Clark Street Line Replacement project. In 2014, the District incurred and paid \$53,316 of labor, excavating, legal, and materials cost and \$56,445 has been reimbursed during the year. In 2013, the District incurred and paid for \$18,980 of engineering costs and \$18,555 has been reimbursed during and subsequent to year end.

#### NOTE L – ACCOUNTING CHANGES

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement no. 68, “Accounting and Financial Reporting for Pensions” (GASB 68). GASB 68 replaced the requirements of GASB 27, “Accounting for Pensions by State and Local Governmental Employers” and GASB 50, “Pension Disclosures”, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. GASB 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pensions benefits as a liability to more comprehensively and comparably measure the annual costs of pension benefits. Cost-sharing governmental employers, such as the District, are required to report a net pension liability, pension expense and pension-related assets and liabilities based on their proportionate share of the collective amounts for all governments in the plan.

The provisions of GASB 68 are effective for fiscal periods beginning after June 15, 2014. The District adopted GASB 68 for the year ended December 31, 2015. The adoption of the standard did impact the District's financial position and resulted in a restatement to reduce beginning net position in the amount of \$312,000.

## Required Supplementary Information

Muhlenberg County Water District Number 3  
 Schedule of Proportionate Share of the Net Pension Liability  
 December 31, 2015 and 2014

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	<u>2015</u>
District's proportion of the net pension liability (asset)	0.009312%
District's proportionate share of the net pension liability (asset)	\$ 302,000
District's covered-employer payroll	\$ 242,744
District's proportionate share of the net pension liability (asset) as a percentage of its covered-employer payroll	124.41%
Total Pension Plan's fiduciary net position as a percentage of the total pension liability	66.80%

Note: This schedule is intended to present a 10-year trend per GASB 68. Additional years will be reported as incurred

Muhlenberg County Water District Number 3  
 Schedule of District Contributions  
December 31, 2015 and 2014

	<u>2015</u>
Actuarially determined contribution	\$ 42,127
Contributions in relation to the actuarially determined contribution	<u>42,127</u>
Contribution deficiency (excess)	\$ 0 =====
 District's covered-employee payroll	 \$ 242,744
 Contributions as a percentage of covered-employee payroll	 17.35%

Note: This schedule is intended to present a 10-year trend per GASB 68. Additional years will be reported as incurred