

NICHOLAS COUNTY WATER DISTRICT  
Carlisle, Kentucky

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

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## INDEPENDENT AUDITOR'S REPORT

Board of Commissioners  
Nicholas County Water District  
Carlisle, Kentucky

We were engaged to audit the accompanying financial statements of the Nicholas County Water District as of and for the year ended December 31, 2016. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion of these financial statements based on conducting an audit in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion section, however, we were not able to obtain sufficient, appropriate evidence to provide a basis for an audit opinion.

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

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### ***Basis for Disclaimer of Opinion***

The District's previous manager was allegedly stealing money by maintaining custody of cash when some customers paid with cash. There was approximately \$160,000 in uncategorized expenses.

### ***Disclaimer of Opinion***

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

### ***Other Matters***

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

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

The Schedule of Employer's Proportionate Share of Net Pension Liability and the Schedule of Employer's Contributions – Net Pension Liability are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Employer's Proportionate Share of Net Pension Liability and the Schedule of Employer's Contributions – Net Pension Liability are fairly stated in all material respects in relation to the basic financial statements as a whole.

**Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated January 22, 2019, on our consideration of the Nicholas County Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Nicholas County Water District's internal control over financial reporting and compliance.

*John T. Lane & Associates LLC*

Mount Sterling, Kentucky

January 22, 2019

This report contains 21 pages.

Nicholas County Water District  
Statement of Net Position  
Proprietary Fund  
December 31, 2016

**ASSETS and DEFERRED OUTFLOWS OF RESOURCES**

<b>Current Assets</b>	
Cash and cash equivalents - unrestricted	\$ 376,273
Cash and cash equivalents - restricted	52,092
Accounts receivable - net of allowance for doubtful accounts	53,133
Inventory	17,399
Prepaid expenses	12,668
<b>Total Current Assets</b>	<u>511,566</u>
<b>Noncurrent Assets</b>	
Capital assets:	
Land	20,997
Construction in progress	350,842
Plant, equipment and lines	8,012,095
Accumulated depreciation	<u>(3,579,143)</u>
<b>Total Noncurrent Assets</b>	<u>4,804,791</u>
<b>Other Assets</b>	
Bond issue costs	59,929
Accumulated amortization	<u>(7,564)</u>
<b>Total Other Assets</b>	<u>52,365</u>
Deferred Outflows of Resources	<u>48,124</u>
<b>Total Assets &amp; Deferred Outflows of Resources</b>	<u><u>\$ 5,416,846</u></u>

**LIABILITIES and DEFERRED INFLOWS OF RESOURCES**

<b>Current Liabilities</b>	
Accrued expenses	\$ 32,083
Bonds/loans payable	110,233
Customer deposits	26,145
<b>Total Current Liabilities</b>	<u>168,461</u>
<b>Noncurrent Liabilities</b>	
Bonds/loans payable	2,543,000
Net pension liability	257,493
<b>Total Noncurrent Liabilities</b>	<u>2,800,493</u>
Deferred Inflows of Resources	<u>551</u>
<b>Total Liabilities &amp; Deferred Inflows of Resources</b>	<u>2,969,505</u>

**NET POSITION**

Net investment in capital assets	2,203,923
Restricted	25,947
Unrestricted	<u>217,470</u>
<b>Total Net Position</b>	<u><u>\$ 2,447,340</u></u>

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

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

<b>Revenues</b>	
User fees	\$ 713,839
Other revenue	27,930
	741,769
<b>Total Revenues</b>	
	741,769
<b>Expenses</b>	
Salaries	133,428
Employee benefits	51,062
Retirement	35,239
Water purchased	198,652
Power purchased	17,766
Materials and supplies	47,035
Water testing	4,858
Contractual services	32,879
Transportation expenses	3,815
Insurance	25,071
Miscellaneous expenses	1,615
Phone	7,842
Taxes	68,627
Depreciation and amortization	192,621
	820,510
<b>Total Operating Expenses</b>	820,510
<b>Operating Income (Loss)</b>	(78,741)
<b>Nonoperating Revenues (Expenses)</b>	
Tap fees	7,245
Interest income	1,027
Interest expense	(99,466)
	(91,194)
<b>Net Nonoperating Revenues (Expenses)</b>	(91,194)
<b>Change in Net Position</b>	(169,935)
<b>Total Net Position - beginning</b>	2,934,236
<b>Prior period adjustment</b>	(316,961)
	(316,961)
<b>Total Net Position - ending</b>	\$ 2,447,340

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

Nicholas County Water District  
Statement of Cash Flows  
Proprietary Fund  
December 31, 2016

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<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Operating revenues	\$ 754,849
Cash paid to employees	(133,428)
Prior period adjustment to cash and cash equivalents	(122,227)
Cash paid for general and administrative expenses	<u>(488,330)</u>
Net Cash provided / (used) by operating activities	<u>10,864</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Interest earned	1,027
Customer deposits	<u>(1,852)</u>
Net Cash provided / (used) by investing activities	<u>(825)</u>
<b>CASH FLOWS FROM CAPITAL AND FINANCING ACTIVITIES:</b>	
Bond payments	(76,099)
Tap fees income	7,245
Purchase of capital assets	(29,161)
Interest paid	<u>(102,617)</u>
Net Cash provided / (used) by capital and financing activities	<u>(200,632)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(190,593)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>618,959</u>
CASH AND CASH EQUIVALENTS - END OF THE YEAR	<u><u>\$ 428,366</u></u>
<b>RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
Net Operating Income	\$ (78,741)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
(increase) / decrease in prepaid expenses	(9,728)
depreciation and amortization	192,621
Prior period adjustment to cash and cash equivalents	(122,227)
GASB 68/75 pension expense adjustment	15,186
(increase) / decrease in accounts receivable	13,080
increase / (decrease) in accounts payable	<u>673</u>
Net cash provided by operating activities	<u><u>\$ 10,864</u></u>

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

NICHOLAS COUNTY WATER DISTRICT  
NOTES TO THE FINANCIAL STATEMENTS  
December 31, 2016

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The Nicholas County Water District is a water utility which services areas of Nicholas County. Its sales are primarily to residential customers. The District is a corporate body set forth in Kentucky Revised Statutes (KRS) 74.070 which was created in 1966. The District began operations in 1966. The District is subject to the regulatory authority of the Kentucky Public Service Commission pursuant to KRS 278.040.

**Note 1 - Summary of Significant Accounting Policies**

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

**The Reporting Entity**

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

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

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

**Enterprise Funds**

An enterprise fund distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are operating grants and tenant rental revenue. Operating expenses of the District include the cost of producing the revenue and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprise where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net position (i.e., total assets net of total liabilities) is segmented into net investment in capital assets, restricted and unrestricted components. When both restricted and unrestricted resources are available for use, it is the District's policy to use unrestricted resources first, and then restricted resources as they are needed.

**Basis of Accounting**

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

**Inventory**

The cost of inventory is recorded as a disbursement at the time of payment for the purchase.

**Deposits**

The District considers all highly liquid investments with a maturity date of twelve months or less from the date of purchase to be cash equivalents. Certificates of deposit that are redeemable immediately with little or no penalty are considered cash equivalents. At December 31, 2016, the carrying amount of the District's deposits was \$428,366 and the bank balance was \$209,459. Of the bank balance, 100% was covered by federal deposit insurance or collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.



<b>Summary of Cash &amp; Cash Equivalents</b>			
<b>Description</b>	<b>Total</b>	<b>Restricted</b>	<b>Unrestricted</b>
Certificates of deposit	\$ 236,242	\$ -	\$ 236,242
Farmers Deposit Bank	9,692	-	9,692
NCWD escrow	30,123	30,123	-
NCWD operations & maintenance	22,110	-	22,110
NCWD Revenue	16,056	-	16,056
NCWD Sinking Fund Whitaker	2,260	2,260	-
NCWD Savings	92,174	-	92,174
NCWD Phase 10 Water Project	6	6	-
NCWD Depreciation Reserve Fund	19,703	19,703	-
<b>Totals</b>	<b>\$ 428,365</b>	<b>\$ 52,092</b>	<b>\$ 376,273</b>

**Capital Assets**

Capital assets purchased are capitalized at the time of purchase. Such assets are recorded at cost. Donated assets are recorded at fair market value at the date of donation. Depreciation of property and equipment is computed by the straight-line method based upon the estimated useful lives of the assets as follows:

<u>Class</u>	<u>Useful Life</u>
Water lines, tanks	40-50 years
Equipment	5-10 years

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

**Amortization**

Bond issue costs are being amortized and charged to expense over the life of the outstanding revenue bonds by use of the straight-line method.

**Net Position**

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

**Accounts Receivable**

The receivable reflected in the statements in the amount of \$53,133 is net of allowance for uncollectible accounts in the amount of \$4,662.

**Use of Estimates**

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

**Pensions**

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employees' Retirement System (CERS) and additions to/deductions from CERS' fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

**Note 2 - Notes Payable**

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

(A)  
 Lender – Kentucky Rural Water Finance Corporation (KRWFC)  
 Original loan amount - \$1,775,000  
 Balance of loan - \$1,730,000  
 Rate – 2.10-4.10%  
 Principle due January 1  
 Interest due January 1 and July 1  
 Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days' notice.

Schedule of future payments:

	<u>Principal</u>	<u>Interest</u>	<u>Trustee Fees</u>	<u>Total Payment</u>
2017	\$ 60,000	\$ 62,526	\$ 450	\$ 122,976
2018	60,000	60,666	450	121,116
2019	65,000	58,103	450	123,553
2020	65,000	56,088	450	121,538
2021	70,000	53,971	450	124,421
2022-2026	380,000	226,350	2,250	608,600
2027-2031	450,000	155,474	2,250	607,724
2032-2036	405,000	69,196	2,250	476,446
2037-2041	175,000	14,043	2,150	191,193
<b>Total</b>	<b>\$ 1,730,000</b>	<b>\$ 756,417</b>	<b>\$ 11,150</b>	<b>\$ 2,497,567</b>

(B)  
 Lender – Kentucky Rural Water Finance Corporation (KRWFC)  
 Original balance of loan - \$185,000  
 Balance of loan - \$170,000  
 Rate – 2.10-4.10%  
 Principle due January 1  
 Interest due January 1 and July 1  
 Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days' notice.

Schedule of future payments:

	<u>Principal</u>	<u>Interest</u>	<u>Total Payment</u>
2017	\$ 15,000	\$ 5,913	\$ 20,913
2018	15,000	5,448	20,448
2019	20,000	4,730	24,730
2020	20,000	4,110	24,110
2021	20,000	3,490	23,490
2022-2025	80,000	5,860	85,860
<b>Total</b>	<b>\$ 170,000</b>	<b>\$ 29,551</b>	<b>\$ 199,551</b>

(C)  
 Lender – United States Department of Agriculture (USDA) – Rural Development  
 Original balance of loan - \$555,000  
 Balance of loan - \$555,000  
 Rate – 2.75%  
 Principle due January 1  
 Interest due January 1 and July 1  
 Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days' notice.

Continued on next page

Schedule of future payments:

	Principal	Interest	Total Payment
2017	\$ 8,500	\$ 15,146	\$ 23,646
2018	8,500	14,912	23,412
2019	9,000	14,671	23,671
2020	9,000	14,424	23,424
2021	9,500	14,169	23,669
2022-2026	51,000	66,784	117,784
2027-2031	58,500	59,255	117,755
2032-2036	67,000	50,643	117,643
2037-2041	77,000	40,743	117,743
2042-2046	87,500	29,461	116,961
2047-2051	100,000	16,570	116,570
2052-2054	69,500	29,500	99,000
<b>Total</b>	<b>\$ 555,000</b>	<b>\$ 366,278</b>	<b>\$ 921,278</b>

(D)  
 Lender – United States Department of Agriculture (USDA) – Rural Development  
 Original balance of loan - \$203,000  
 Balance of loan - \$181,500  
 Rate – 4.125%  
 Principle due January 1  
 Interest due January 1 and July 1  
 Prepayment provision - subject to payment prior to its stated maturity without penalty or premium, at any time upon ten (10) days' notice.

Schedule of future payments:

	Principal	Interest	Total Payment
2017	\$ 10,000	\$ 14,582	\$ 24,582
2018	3,500	7,074	10,574
2019	3,500	6,930	10,430
2020	4,000	6,786	10,786
2021	4,000	6,621	10,621
2022-2026	23,000	30,484	53,484
2027-2031	28,000	25,328	53,328
2032-2036	34,500	19,017	53,517
2037-2041	41,500	11,364	52,864
2042-2044	29,500	2,455	31,955
<b>Total</b>	<b>\$ 181,500</b>	<b>\$ 130,641</b>	<b>\$ 312,141</b>

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

	Outstanding 1/1/2016	Issued	Retired	Outstanding 12/31/2016	Due Within One Year
Rural Development	\$ 736,500	\$ -	\$ -	\$ 736,500	\$ 18,500
KRWFC	1,960,000	-	60,000	1,900,000	75,000
Whitaker Bank	28,889	-	12,156	16,733	16,733
<b>Total</b>	<b>\$ 2,725,389</b>	<b>\$ -</b>	<b>\$ 72,156</b>	<b>\$ 2,653,233</b>	<b>\$ 110,233</b>

Note 2 – Defined Benefit Pension Plan

**General Information About the Pension Plan**

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

Kentucky Retirement System's Board of Trustees (Board). Kentucky Retirement System issues a publicly available financial report that can be obtained on their website.

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

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

*Contributions* - Employees are required to contribute 5% of their annual pay. Employees whose participation began on or after September 01, 2008 are required to contribute an additional 1%. This additional 1% is credited to the insurance fund and is non-refundable. The District's contractually required contribution rate for the year ended December 31, 2016 was 17.06%/18.68% (12.42/13.95% pension; 4.64/4.73% insurance) of annual payroll, actuarially determined as an amount that, when combined with employee contributions, is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Contributions to the pension plan from the District were \$20,053 for the year ended December 31, 2016. The contribution was allocated \$14,773 to the pension fund and \$5,280 to the insurance fund.

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

At December 31, 2016, the Water District reported a liability of \$257,493 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Water District's portion of the net pension liability was based on the Water District's proportionate share of retirement contributions for the fiscal year ended June 30, 2016. At June 30, 2016 the Water District's proportionate share was 0.005230%.

Since certain expense items are amortized over closed periods each year, the deferred portions of these items must be tracked annually. If the amounts serve to reduce pension expense they are labeled deferred inflows. If they will increase pension expense they are labeled deferred outflows. The amortization of these amounts is accomplished on a level dollar basis, with no interest included in the deferred amounts. Experience gains/losses and the impact of changes in actuarial assumptions, if any, are amortized over the average remaining service life of the active and inactive System members at the beginning of the fiscal year. Investment gains and losses are amortized over a fixed five-year period. For the year ended December 31, 2016, the Water District recognized pension expense of \$35,239. At December 31, 2016, the Water District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net difference between projected and actual earnings on pension plan investments	\$ 24,207	\$ -0-
Differences between expected and actual Experience	1,124	-0-

Changes in assumptions	13,641	-0-
Changes in proportion and differences between employer contributions and proportionate share of contributions	1,254	551
Contributions subsequent to the measurement date	<u>7,898</u>	<u>-0-</u>
Total	\$ 48,124	\$ 551

\$7,898 reported as deferred outflows of resources related to pensions resulting from the Water District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2017. The remaining amount of \$39,675 reported as the net effect of deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended</u>	<u>Amount</u>
December 31, 2017	\$ 14,737
December 31, 2018	9,860
December 31, 2019	9,603
December 31, 2020	5,475
December 31, 2021	-0-
Thereafter	<u>-0-</u>
Total	\$ 39,675

*Actuarial assumptions* - The total pension liability was determined by an actuarial valuation as of June 30, 2016 using standard roll-forward techniques, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	4.00% average including inflation
Investment rate of return	7.50%, net of pension plan investment expense including inflation

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.

The actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2008 – June 30, 2013. The discount rate used to measure the total pension liability was 7.50%.

The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27-year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for the System. The most recent analysis, performed for the period covering fiscal years 2008 through 2013 is

outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term rate of return assumption including long term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years. The discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through year 2117. The target asset allocation and best estimates for arithmetic real rates of return for each major asset class are summarized in the following table:

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

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

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

	<u>1% Decrease</u> <u>6.50%</u>	<u>Current Discount Rate</u> <u>7.50%</u>	<u>1% Increase</u> <u>8.50%</u>
Water District's proportionate share of the net pension liability	\$ 321,000	\$257,493	\$ 203,000

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

**Note 4 - Leave Policies**

The Nicholas County Water District's vacation policy entitles an employee to two weeks of vacation time after one full year of employment., three with fifteen years of service and four weeks with twenty years of service. At the end of each year, employees are paid for any unused vacation time.

The District's personal/sick leave policy allows for six personal days and six sick days after one year of full-time employment. Employees may carry over no more than fifteen personal and sick days from one year to the next. Any unused personal days will be transferred to vacation days in December to replace any vacation days used and employees are compensated accordingly. Any unused sick days over the fifteen are lost at the end of each year.



**Note 5 - Changes in Capital Assets**

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

	Balance 1/1/2016	Transfers/ Additions	Deletions	Balance 12/31/2016
Land, non-depreciable	\$ 20,997	\$ -	\$ -	\$ 20,997
Utility plant and equipment	8,012,095	-	-	8,012,095
Construction in process, non-depreciable	321,681	29,161	-	350,842
	<u>\$ 8,354,773</u>	<u>\$ 29,161</u>	<u>\$ -</u>	<u>\$ 8,383,934</u>
Accumulated depreciation	<u>\$ 3,388,030</u>	<u>\$ 191,113</u>	<u>\$ -</u>	<u>\$ 3,579,143</u>
Capital assets, net of accumulated depreciation	<u>\$ 4,966,743</u>	<u>\$ (161,952)</u>	<u>\$ -</u>	<u>\$ 4,804,791</u>

**Note 6 - Revenue Bonds**

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

**Note 7 – Contingencies**

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

**Note 8 – Risk Management**

The District is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance coverage for the risks to the extent deemed prudent by District management.

**Note 9 – Compliance with Bond Ordinance**

On or before the 20<sup>th</sup> day of each month and after the required payment to the Operation and Maintenance account, the District is required to set aside an amount into a special account known as the Nicholas County Water District, Bond and Interest Sinking Fund. The amount to be set aside and paid into the Sinking Fund each month shall be sums equal to the following amounts:

1. A sum equal to one-sixty (1/6) of the interest coming due on the next succeeding interest due date, with respect to all outstanding bond issues.
2. A sum equal to one-twelfth (1/12) of the principal of all such bonds maturing on the next succeeding January 1<sup>st</sup>.

The District had set aside \$2,260 into the restricted account as of December 31, 2016. All deposits required above were made by the District during the year.

**Note 10 – Kentucky State Police Report**

We attempted to obtain a copy of the Kentucky State Police report that's related to the investigation of the previous manager. We requested a copy of this report through an open records request. We were told that we would receive a copy of the report no later than December 21, 2018. As of the date of this audit report, we have not received a copy of the police report.

Note 11 on next page.

**Note 11 – Prior Period Adjustment**

(1)  
 Pension was adjusted in accordance with GASB Statement 68. A prior period adjustment was made in the amount of \$194,734 as a reduction to net position:

Debit | (Credit)

<u>Account</u>	<u>Amount</u>
Net pension liability	\$ (257,493)
Deferred inflows of resources	(551)
Deferred outflows of resources	48,124
Pension expense (retirement contr.)	<u>15,186</u>
Total	<u>\$ 194,734</u>

(2)  
 Cash and cash equivalents was adjusted to reflect the reconciled balances of deposit accounts at December 31, 2015. A prior period adjustment was made in the amount of \$122,227 as a reduction to net position.

Total prior period adjustments - \$316,961



**REQUIRED SUPPLEMENTARY INFORMATION**

**Nicholas County Water District**  
**Schedule of Employer's Proportionate Share of Net Pension Liability**  
**December 31, 2016**

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	<u>6/30/2014</u>	<u>6/30/2015</u>	<u>6/30/2016</u>
Proportion of the net pension liability	0.005218%	0.005180%	0.005230%
Proportionate share of the net pension liability	\$ 169,000	\$ 222,842	\$ 257,493
Covered employee payroll	\$ 190,000	\$ 123,000	\$ 113,000
Proportionate share of the net pension liability as a percentage of its covered employee payroll	88.95%	181.17%	227.87%
Plan fiduciary net position as a percentage of the total pension liability	66.80%	59.97%	55.50%

**Nicholas County Water District**  
**Schedule of Employer's Contributions - Net Pension Liability**  
**December 31, 2016**

	<u>12/31/2014</u>	<u>12/31/2015</u>	<u>12/31/2016</u>
Contractually required contribution	\$ 22,615	\$ 15,474	\$ 14,858
Contributions in relation to the contractually required contribution	<u>22,615</u>	<u>15,474</u>	<u>14,858</u>
Contribution deficiency	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered payroll	<u>\$ 190,000</u>	<u>\$ 123,000</u>	<u>\$ 113,000</u>
Contributions as a percentage of covered payroll	11.90%	12.58%	13.15%

Nicholas County Water District  
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION  
For the year ended December 31, 2016

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

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

**SUPPLEMENTARY INFORMATION**

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Kentucky Society of CPA's

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

Board of Commissioners  
Nicholas County Water District  
Carlisle, Kentucky

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Nicholas County Water District, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Nicholas County Water District's basic financial statements and have issued our report thereon dated January 22, 2019. Our report disclaims an opinion on such financial statements because of alleged fraud perpetrated by the previous manager and approximately \$160,000 in uncategorized expenses.

### **Internal Control over Financial Reporting**

In connection with our engagement to audit the financial statements of the Nicholas County Water District, we considered the Nicholas County Water District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Nicholas County Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of the Nicholas County Water District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses. [2016-002, 2016-003]

*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. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency. [2016-001]

## **Compliance and Other Matters**

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

## **Nicholas County Water District's Response to Findings**

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

## **Purpose of this Report**

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

*John T. Lane & Associates LLC*

Mount Sterling, Kentucky

January 22, 2019

NICHOLAS COUNTY WATER DISTRICT  
SCHEDULE OF FINDINGS AND RESPONSES  
December 31, 2016

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**PRIOR FINDINGS**

None

**CURRENT FINDINGS**

**2016-001 Lack of Segregation of Duties**

**Condition:** The District has an inadequate segregation of duties within its internal control process.

**Criteria:** All governmental entities should design their internal control to provide an adequate segregation of duties.

**Cause:** The District does not have sufficient employees to adequately design its internal control.

**Recommendation:** The District should continue to design and implement its internal control policies to provide the maximum segregation of duties possible.

**Response:** We will do as recommended.

**2016-002 Previous Manager Was Allegedly Stealing Money**

**Condition:** The previous manager was allegedly stealing money by maintaining custody of cash when some customers were paying with cash.

**Criteria:** All governmental entities should design their internal controls to mitigate the risk of management or employees perpetrating fraud or abuse.

**Cause:** Unknown.

**Recommendation:** We recommend that the District redesign and implement its internal controls to provide for a greater segregation of duties to greatly reduce the risk of fraud and abuse.

**Response:** We will do as recommended.

**2016-003 Approximately \$160,000 in Uncategorized Expenses**

**Condition:** The District's previous manager allegedly deleted the QuickBooks data file that contained the general ledger. The missing data was retroactively recorded in the general ledger as uncategorized expenses.

**Criteria:** All governmental entities should maintain a reliable general ledger and maintain a backup process for protecting the data from loss.

**Cause:** Unknown.

**Recommendation:** We recommend that the District backup its accounting software at least weekly. We recommend that the District restrict access to the backup files.

**Response:** We will do as recommended.