

NICHOLAS COUNTY WATER DISTRICT
Carlisle, Kentucky

REPORT ON EXAMINATION OF FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
for the year ended December 31, 2017

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John T. Lane and Associates, LLC

Certified Public Accountants

219 Young Lane, Suite 2
Mount Sterling, Kentucky 40353
(859) 498-9915
www.TheLaneCPA.com

Partners:
John T. Lane, CPA
Joel D. Lane, CPA

Member:
American Institute of CPAs
Kentucky Society of CPAs

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, 2017. 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 \$47,635 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 August 08, 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

August 08, 2019

This report contains 19 pages.

Nicholas County Water District
Statement of Net Position
Proprietary Fund
December 31, 2017

ASSETS and DEFERRED OUTFLOWS OF RESOURCES

Current Assets	
Cash and cash equivalents - unrestricted	\$ 265,640
Cash and cash equivalents - restricted	58,479
Accounts receivable - net of allowance for doubtful accounts	48,560
Inventory	17,399
Prepaid expenses	12,668
Total Current Assets	<u>402,746</u>
Noncurrent Assets	
Capital assets:	
Land	20,997
Construction in progress	350,842
Plant, equipment and lines	8,012,095
Accumulated depreciation	<u>(3,766,724)</u>
Total Noncurrent Assets	<u>4,617,210</u>
Other Assets	
Bond issue costs	59,929
Accumulated amortization	<u>(9,071)</u>
Total Other Assets	<u>50,858</u>
Deferred Outflows of Resources	<u>87,645</u>
Total Assets & Deferred Outflows of Resources	<u><u>\$ 5,158,459</u></u>

LIABILITIES and DEFERRED INFLOWS OF RESOURCES

Current Liabilities	
Accrued expenses	\$ 32,083
Bonds/loans payable	87,000
Customer deposits	29,855
Total Current Liabilities	<u>148,938</u>
Noncurrent Liabilities	
Bonds/loans payable	2,459,000
Net pension liability	292,782
Total Noncurrent Liabilities	<u>2,751,782</u>
Deferred Inflows of Resources	<u>33,765</u>
Total Liabilities & Deferred Inflows of Resources	<u>2,934,485</u>

NET POSITION

Net investment in capital assets	2,122,068
Restricted	28,624
Unrestricted	73,282
Total Net Position	<u><u>\$ 2,223,974</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, 2017

Revenues	
User fees	\$ 619,323
Other revenue	<u>6,344</u>
Total Revenues	<u>625,667</u>
Expenses	
Salaries	69,612
Employee benefits	21,174
Retirement	69,700
Water purchased	200,327
Power purchased	17,562
Materials and supplies	34,676
Water testing	4,300
Contractual services	42,639
Transportation expenses	2,407
Insurance	8,435
Miscellaneous expenses	51,863
Phone	7,564
Taxes	53,910
Depreciation and amortization	<u>189,088</u>
Total Operating Expenses	<u>773,257</u>
Operating Income (Loss)	<u>(147,590)</u>
Nonoperating Revenues (Expenses)	
Interest income	6
Interest expense	<u>(75,784)</u>
Net Nonoperating Revenues (Expenses)	<u>(75,778)</u>
Change in Net Position	(223,368)
Total Net Position - beginning	<u>2,447,342</u>
Total Net Position - ending	<u><u>\$ 2,223,974</u></u>

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

Nicholas County Water District
Statement of Cash Flows
Proprietary Fund
December 31, 2017

CASH FLOWS FROM OPERATING ACTIVITIES:	
Operating revenues	\$ 630,240
Cash paid to employees	(69,612)
Cash paid for general and administrative expenses	<u>(485,575)</u>
Net Cash provided / (used) by operating activities	<u>75,053</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest earned	6
Customer deposits	<u>3,710</u>
Net Cash provided / (used) by investing activities	<u>3,716</u>
CASH FLOWS FROM CAPITAL AND FINANCING ACTIVITIES:	
Bond/note payments - principal	(107,233)
Bond/note payments - interest	<u>(75,784)</u>
Net Cash provided / (used) by capital and financing activities	<u>(183,017)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(104,248)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>428,367</u>
CASH AND CASH EQUIVALENTS - END OF THE YEAR	<u><u>\$ 324,119</u></u>
RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net Operating Income	\$ (147,590)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
depreciation and amortization	189,088
GASB 68/75 pension expense adjustment	28,982
(increase) / decrease in accounts receivable	<u>4,573</u>
Net cash provided / (used) by operating activities	<u><u>\$ 75,053</u></u>

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

NICHOLAS COUNTY WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

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, 2017, the carrying amount of the District's deposits was \$321,630 and the bank balance was \$321,630. 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.

Summary of Cash & Cash Equivalents			
Description	Total	Restricted	Unrestricted
Certificates of deposit	\$ 236,525	\$ -	\$ 236,525
Farmers Deposit Bank	4,515	-	4,515
NCWD escrow	32,373	32,373	-
NCWD operations & maintenance	-	-	-
NCWD Revenue	2,853	-	2,853
NCWD Sinking Fund Whitaker	24,215	24,215	-
NCWD Savings	21,747	-	21,747
NCWD Phase 10 Water Project	186	186	-
NCWD Depreciation Reserve Fund	1,706	1,706	-
Totals	\$ 324,120	\$ 58,480	\$ 265,640

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 \$48,560 is net of allowance for uncollectible accounts in the amount of \$2,545.

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, 2017, 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 - \$1,670,000
 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:

	Principal	Interest	Trustee Fees	Total Payment
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	70,000	53,971	450	124,421
2023-2027	395,000	212,434	2,250	609,684
2028-2032	465,000	139,194	2,250	606,444
2033-2037	355,000	54,441	2,250	411,691
2038-2041	125,000	7,893	1,350	134,243
Total	\$ 1,670,000	\$ 696,761	\$ 10,350	\$ 2,377,111

(B)
 Lender – Kentucky Rural Water Finance Corporation (KRWFC)
 Original balance of loan - \$185,000
 Balance of loan - \$155,000
 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:

	Principal	Interest	Total Payment
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	20,000	5,860	25,860
2023-2025	60,000	3,190	63,190
Total	\$ 155,000	\$ 26,828	\$ 181,828

(C)
 Lender – United States Department of Agriculture (USDA) – Rural Development
 Original balance of loan - \$555,000
 Balance of loan - \$546,000
 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
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	9,500	13,908	23,408
2023-2027	52,500	65,361	117,861
2028-2032	60,000	57,626	117,626
2033-2037	69,000	48,773	117,773
2038-2042	79,000	38,598	117,598
2043-2047	90,000	27,020	117,020
2048-2052	103,000	13,779	116,779
2053-2054	47,000	1,341	48,341
Total	\$ 546,000	\$ 324,582	\$ 870,582

(D)
 Lender – United States Department of Agriculture (USDA) – Rural Development
 Original balance of loan - \$203,000
 Balance of loan - \$175,000
 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
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	4,000	6,456	10,456
2023-2027	24,000	29,535	53,535
2028-2032	29,500	24,173	53,673
2033-2037	35,500	17,594	53,094
2038-2042	43,500	9,652	53,152
2043-2044	23,500	1,238	24,738
Total	\$ 175,000	\$ 116,059	\$ 291,059

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

	Outstanding 1/1/2017	Issued	Retired	Outstanding 12/31/2017	Due Within One Year
Rural Development	\$ 736,500	\$ -	\$ 15,500	\$ 721,000	\$ 12,000
KRWFC	1,900,000	-	75,000	1,825,000	75,000
Whitaker Bank	16,733	-	16,733	-	-
Total	\$ 2,653,233	\$ -	\$ 107,233	\$ 2,546,000	\$ 87,000

Note 3 – 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, 2017 was 18.68/19.18% (13.95/14.48% pension; 4.73/4.70% 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 \$76,051 for the year ended December 31, 2017. The contribution was allocated \$57,115 to the pension fund and \$18,936 to the insurance fund.

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

At December 31, 2017, the Water District reported a liability of \$292,782 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017, 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, 2017. At June 30, 2017 the Water District’s proportionate share was 0.005002%.

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, 2017, the Water District recognized pension expense of \$47,407. At December 31, 2017, 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	\$ 23,188	\$ 19,567
Differences between expected and actual Liability Experience	363	7,432

Changes in assumptions	54,026	-0-
Changes in proportion and differences between employer contributions and proportionate share of contributions	736	6,766
Contributions subsequent to the measurement date	<u>9,334</u>	<u>-0-</u>
Total	\$ 87,647	\$ 33,765

\$9,334 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 \$44,548 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, 2018	\$ 20,082
December 31, 2019	19,719
December 31, 2020	8,506
December 31, 2021	(3,759)
December 31, 2022	-0-
Thereafter	<u>-0-</u>
Total	\$ 44,548

Actuarial assumptions - The total pension liability was determined by an actuarial valuation as of June 30, 2017 using standard roll-forward techniques, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.30%
Salary increases	2.00%
Investment rate of return	6.25%, 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, 2017 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 6.25%.

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 28-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 6.25%. 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 (5.25 percent) or 1-percentage-point higher (7.25 percent) than the current rate for non-hazardous:

	1% Decrease <u>5.25%</u>	Current Discount Rate <u>6.25%</u>	1% Increase <u>7.25%</u>
Water District’s proportionate share of the net pension liability	\$ 369,262	\$ 292,782	\$ 228,808

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 1/1/2017	Transfers/ Additions	Deletions	Balance 12/31/2017
Land, non-depreciable	\$ 20,997	\$ -	\$ -	\$ 20,997
Utility plant and equipment	8,012,095	-	-	8,012,095
Construction in process, non-depreciable	350,842	-	-	350,842
	<u>\$ 8,383,934</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,383,934</u>
Accumulated depreciation	<u>\$ 3,579,143</u>	<u>\$ 187,581</u>	<u>\$ -</u>	<u>\$ 3,766,724</u>
Capital assets, net of accumulated depreciation	<u>\$ 4,804,791</u>	<u>\$ (187,581)</u>	<u>\$ -</u>	<u>\$ 4,617,210</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, 2017. 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 20th 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 1st.

The District had set aside \$24,215 into the restricted account as of December 31, 2017. 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 – Subsequent Events

The District has evaluated subsequent events through August 08, 2019, and that is the date that the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION

Nicholas County Water District
Schedule of Employer's Proportionate Share of Net Pension Liability
December 31, 2017

	<u>6/30/2014</u>	<u>6/30/2015</u>	<u>6/30/2016</u>	<u>6/30/2017</u>
Proportion of the net pension liability (asset)	0.005218%	0.005180%	0.005230%	0.005002%
Proportionate share of the net pension liability (asset)	\$ 169,000	\$ 222,842	\$ 257,493	\$ 292,782
Covered employee payroll	\$ 190,000	\$ 123,000	\$ 113,000	\$ 121,781
Proportionate share of the net pension liability (asset) as a percentage of its covered employee payroll	88.95%	181.17%	227.87%	240.42%
Plan fiduciary net position as a percentage of the total pension liability (asset)	66.80%	59.97%	55.50%	55.50%

Nicholas County Water District
Schedule of Employer's Contributions - Net Pension Liability
December 31, 2017

	<u>12/31/2014</u>	<u>12/31/2015</u>	<u>12/31/2016</u>	<u>12/31/2017</u>
Contractually required contribution	\$ 22,615	\$ 15,474	\$ 14,858	\$ 18,424
Contributions in relation to the contractually required contribution	<u>22,615</u>	<u>15,474</u>	<u>14,858</u>	<u>18,424</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered employee payroll	<u>\$ 190,000</u>	<u>\$ 123,000</u>	<u>\$ 113,000</u>	<u>\$ 129,625</u>
Contributions as a percentage of covered payroll	11.90%	12.58%	13.15%	14.21%

Nicholas County Water District
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
For the year ended December 31, 2017

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, 2017. 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 | 28 years |
| • Asset valuation method | 20% of the difference between market value of assets and the expected actuarial value of assets recognized |
| • 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

John T. Lane and Associates, LLC

Certified Public Accountants

219 Young Lane, Suite 2
Mount Sterling, Kentucky 40353
(859) 498-9915
www.TheLaneCPA.com

Partners:
John T. Lane, CPA
Joel D. Lane, CPA

Member:
American Institute of CPA's
Kentucky Society of CPA's

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, 2017, 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 August 08, 2019. Our report disclaims an opinion on such financial statements because of alleged fraud perpetrated by the previous manager and \$47,635 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. [2017-002, 2017-003]

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. [2017-001]

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

August 08, 2019

NICHOLAS COUNTY WATER DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
December 31, 2017

PRIOR FINDINGS

2016-001 Lack of Segregation of Duties – Repeated as 2017-001

2016-002 Previous Manager Was Allegedly Stealing Money – Repeated as 2017-002

2016-003 Approximately \$160,000 in Uncategorized Expenses – Repeated as 2017-003 with different total.

CURRENT FINDINGS

2017-001 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.

2017-002 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.

2017-003 \$47,635 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.