SANDY HOOK WATER DISTRICT

AUDIT OF FINANCIAL STATEMENTS

For The Year Ended December 31, 2016

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INDEPENDENT AUDITORS' REPORT

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Sandy Hook Water District, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Sandy Hook Water District, as of December 31, 2016, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2017, on our consideration of the 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 District's internal control over financial reporting and compliance.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky
March 27, 2017

SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2016

ASSETS		
CURRENT ASSETS		
Cash - Unrestricted	$	79,384
Cash - Restricted		362,269
Accounts Receivable		72,526
Prepaid Expenses		7,145
Total Current Assets		521,324
NONCURRENT ASSETS		
Capital Assets - Net of Accumulated Depreciation		
Land		146,998
Land Improvements		4,897
Buildings and Building Improvements		696,406
Wells and Springs		277,580
Electric Pumping Equipment		8,729
Transmission and Distribution		5,552,549
Treatment Plant		63,499
Miscellaneous Equipment		10,811
Transportation Equipment		48,392
Furniture and Fixtures		319
Total Noncurrent Assets		6,810,180
TOTAL ASSETS		7,331,504
DEFERRED OUTFLOWS OF RESOURCES		
Pension Contributions		102,615

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

SANDY HOOK WATER DISTRICT
STATEMENT OF NET POSITION
December 31, 2016

LIABILITIES AND NET POSITION	
CURRENT LIABILITIES	
Accrued Interest	31,170
Due to City of Sandy Hook	21,688
Accrued Taxes	1,524
Accrued Salaries	894
Unearned Revenues	2,833
Accrued Retirement	4,474
Accounts Payable	18,201
Bonds Payable	42,400
Total Current Liabilities	123,184
LONG-TERM LIABILITIES	
Bonds Payable	1,412,100
Compensated Absenses	6,319
Total Long-Term Liabilities	1,418,419
OTHER LIABILITIES	
Net Pension Liabilities	316,014
Customer Deposits	26,968
Total Other Liabilities	342,982
TOTAL LIABILITIES	1,884,585
DEFERRED INFLOWS OF RESOURCES	
Net Difference Between Projected and Actual	
Investment Earnings on Pension Plan Investments	0
NET POSITION	
Invested in Capital Assets, Net of Related Debt	5,355,680
Restricted for:	
Debt Service	173,521
Depreciation Reserve	126,212
Sewer Collections	21,688
Unrestricted	(127,567)
TOTAL NET POSITION	5,549,534
TOTAL LIABILITIES AND NET POSITION	$ 7,434,119

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

SANDY HOOK WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSTION
For The Year Ended December 31, 2016

OPERATING REVENUES		
Water Sales	$	620,482
Service Revenues		23,681
Miscellaneous Revenues		25,245
Total Operating Revenues		669,408
OPERATING EXPENSES		
Water Expenses		
Advertising		1,295
Depreciation		201,408
Dues and Subscriptions		3,631
Legal and Accounting Services		13,850
Miscellaneous		16,429
Office Supplies		3,891
Payroll Taxes		14,373
Postage		5,810
Professional Services		2,305
Insurance		41,573
Workers Comp		3,947
Repairs and Maintenance		64,086
Retirement		41,949
Salaries and Wages		218,034
Supplies and Testing		28,656
Taxes and Licenses		1,919
Telephone and Utilities		66,846
Travel and Automobile		8,616
Total Operating Expenses		738,618
NET OPERATING INCOME (LOSS)		(69,210)

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

SANDY HOOKWATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For The Year Ended December 31, 2016

NON OPERATING REVENUES (EXPENSES)	
Interest Expense	(61,436)
Interest Income	367
Total Non Operating Revenues (Expenses)	(61,069)
Net Change in Net Position	(130,279)
Net Position - Beginning	5,679,813
Total Net Position - Ending	$ 5,549,534

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

SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2016

CASH FLOWS FROM OPERATING ACTIVITIES		
Payments from Customers	$	657,400
Payments for Sewer Collection Fees		9,600
Payments to Vendors		(237,372)
Payments for Payroll and Related Expenses		(298,945)
Net Cash Provided (Used) by Operating Activities		130,683
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Interest Paid on Debt		(61,436)
Payments on Capital Debt		(40,800)
Net Cash Provided (Used) by Capital and Related Financing Activities		(102,236)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash Received from Interest		367
Net Cash Provided (Used) by Investing Activities		367
INCREASE (DECREASE) IN CASH		28,814
CASH AT BEGINNING OF YEAR		412,839
CASH AT END OF YEAR	$	441,653

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

SANDY HOOK WATER DISTRICT
STATEMENT OF CASH FLOWS
For The Year Ended December 31, 2016

Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:

Net Operating Income	$	(69,210)
Adjustments to Reconcile Net Operating Income to		
Net Cash Provided by Operating Activities:		
Depreciation		201,408
Changes in Assets/Liabilities:		
Accounts Receivable		(2,967)
Accounts Payable		(13,319)
Accrued Taxes		888
Accrued Retirement		4,474
Accrued Payroll Taxes		100
Due to City of Sandy Hook		2,654
Customer Deposits		559
Deferred Outflows		6,096
Net Cash Provided (Used) by Operating Activities	$	130,683

Supplementary Information

Interest Paid	$	61,436

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

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2016

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Sandy Hook Water District (the District) is presented to assist in understanding the District's financial statements. The financial statements and notes are representations of the District's management, who are responsible for their integrity and objectivity. These accounting policies, as applied to the aforementioned financial statements, conform to generally accepted accounting principles applicable to governmental units.

Regulatory Requirements

The District is subject to the regulatory authority of the Kentucky Public Service Commission ("PSC") pursuant to KRS 278.040.

Organization & Activity

The District was created in accordance with Chapter 74 of the Kentucky Revised Statutes in 1957. The purpose of the District is to provide water services to residents in Sandy Hook, Kentucky and the surrounding area.

Financial Reporting Entity

The District complies with GASB Statements No. 14, "The Financial Reporting Entity" and No. 39, "Determining Whether Certain Organizations Are Component Units." These Statements establish standards for defining and reporting on the financial reporting entity. They define component units as legally separate organizations for which the officials of the primary government are financially accountable and other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The District is not considered a component unit of any other governmental unit for financial reporting purposes.

The District considered all potential component units in determining what organizations should be included in its financial statements. Based on an evaluation of the established criteria, management determined that there were no component units to include in the District's financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The District's financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America.

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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

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 Statement of Net Position. Net Position is segregated into "invested in capital assets, net of related debt;" "restricted;" and "unrestricted" components.

The District's various bond resolutions or ordinances require the establishment of certain accounts, which are referred to as "funds". These required accounts are maintained as part of accounting records of the Water Fund. They include the Sinking Fund (Debt Service), Revenue Fund and Depreciation Reserve Fund (Repairs and Maintenance). These are not "funds" as the term is used in generally accepted accounting principles, but are separate "accounts" used to delineate the accounting and reporting for bond related money and repayment security requirements. The balances and activity that occur in these various accounts represent specific segments of the Water Utility enterprise fund as reported in the District's financial statements.

The enterprise fund used by the District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the District's ongoing operations. The principal operating revenues are charges to customers for sales and services that are provided to them. The District also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water system. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Budgeting

In accordance with Kentucky Revised Statute 65.065, the District is required to submit a balanced budget to the Elliott County Fiscal Court prior to December 1. The budget includes proposed expenditures and means of financing them for the upcoming year. Annual budgets are adopted on a basis consistent with generally accepted accounting principles. Expenditures may not legally exceed budgeted appropriations at the fund level. All appropriations lapse at calendar year end.

Allowance for Doubtful Accounts

No allowance for doubtful accounts has been established. The District considers all receivables to be fully collectible based on their strict cut-off policy. If amounts become uncollectible, the amounts due are offset by any customer deposit held and the balance charged to operations when that determination is made.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivables

Accounts receivables are stated at face amount and include billed and unbilled receivables due as of December 31, 2016. Unbilled receivables represent income earned during the current year, but not yet billed to the customer. The billing mailed on December 28, 2016 was for customer usage from approximately November 26 through December 25, 2016. The entire amount is considered accounts receivable as of December 31, 2016. The billing mailed on January 27, 2017 was for usage from approximately December 26, 2016 through January 25, 2017. Approximately five days of this billing is considered unbilled receivables at December 31, 2016.

Deposits and Investments

KRS 66.480 authorizes the District to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Property, Plant and Equipment

Capital assets, which include property, plant, equipment, and infrastructure assets, e.g., water distribution systems, and similar items, are reported as a component of noncurrent assets in the basic financial statements. Capital assets are generally defined by the District as being those assets with an initial individual cost of more than $5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

The reported value excludes the costs of normal maintenance and repairs that are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate.

Depreciation is charged as an expense against operations. Capital assets of the District are depreciated using the straight-line method over their estimated useful lives in years.

The depreciation expense provided on proprietary fund assets during the period ended December 31, 2016 is $201,408.

Capitalized Interest On Indebtedness

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is reflected in the capitalized value of the asset constructed. There was no capitalized interest in 2016.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

For the purpose of these financial statements, cash and cash equivalents consist of unrestricted and restricted cash on hand, demand and savings deposits and certificates of deposit.

Inventory and Prepaid Items

The District maintains an inventory of supplies to make minor repairs to the water district systems. It is the policy of the water district to expense the items as they are purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. An example of a prepaid item for the District is property and liability insurance premiums.

Restricted Net Position

Some of the District's assets have certain constraints that have been placed on how they can be used. By definition, restricted assets are cash or other assets, whose use in whole or in part are restricted for specific purposes bound by virtue of contractual agreements, legal requirements or enabling legislation.

Certain proceeds of the District's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because their use is limited by applicable bond covenants. The "debt service" accounts are used to segregate resources accumulated for debt service payments over the next twelve months. The "depreciation reserve" account is used to report resources set aside to meet unexpected contingencies or to fund asset renewals, replacements and extensions.

The District collects sewer revenues on behalf of the City of Sandy Hook. The amount owed to the City of Sandy Hook as of December 31, 2016 is reported as a component of restricted net position. The amount owed the City of Sandy Hook includes current collections due and unearned sewer revenues.

Federal Income Tax

The District is exempt from federal income tax since it is a governmental entity. Accordingly, the financial statements include no provision for income taxes.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B – RESTRICTIONS ON CASH

Bond Sinking Fund

Deposits into Bond Sinking Funds are required to be made monthly in order to accumulate funds for payment of bond principle and interest. At December 31, 2016, $102,732 was required to be on deposit to meet payments of interest and principal due on bonds at January 1, 2017. The balance in this account at December 31, 2016 was $173,521.

Depreciation Reserve

The Depreciation Reserve Account is being maintained as required in various bond documents. The District was required to deposit $2,760 per month into the account. At December 31, 2016, $105,480 was the required balance of the Depreciation Reserve account. The District had $126,212 in this account for the purpose of maintaining the water system.

Restricted Cash Accounts

The District is required to maintain special deposit accounts for customer deposits and long-term debt obligations. The following is a listing of restricted cash accounts of the District:

Customer Deposit Fees Account	$	30,581
Equipment Replacement Account		10,267
Sewer Revenue Held for the City of Sandy Hook		21,688
Bond and Interest Sinking Fund		173,521
Depreciation Reserve Fund		126,212
Total Restricted Cash Accounts	$	362,269

NOTE C – NET POSITION

Equity is classified as net position and displayed in three components:

- Invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets;
- Restricted net position - resulting from constraints placed on net position by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and
- Unrestricted net position - those assets that do not meet the definition of restricted net position or invested in capital assets.

NOTE D – CASH AND INVESTMENTS

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the District and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. As of December 31, 2016, these requirements were met.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the District's deposits may not be returned to it. As of December 31, 2016, the bank balance was $445,001.

The bank balances were either insured by FDIC or covered by pledged collateral as of December 31, 2016.

NOTE E – PROPERTY, PLANT, AND EQUIPMENT

The District's major classes of utility capital assets and accumulated depreciation are shown below:

	Balance 12/31/2015	Additions	Disposals	Balance 12/31/2016
Land	$ 146,998	$	$	$ 146,998
Land Improvements	16,320			16,320
Buildings and Building Improvements	906,007			906,007
Wells and Springs	328,896			328,896
Transmission and Distribution	7,945,363			7,945,363
Treatment Plant	420,514			420,514
Electric Pumping Equipment	30,344			30,344
Miscellaneous Equipment	96,287			96,287
Furniture and Fixtures	5,876		1,980	3,896
Transportation Equipment	85,325			85,325
Total	9,981,930		1,980	9,979,950

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2016

NOTE E – PROPERTY, PLANT, AND EQUIPMENT (Continued)

	Balance 12/31/2015	Additions	Disposals	Balance 12/31/2016
Accumulated Depreciation:				
Land Improvements	10,335	1,088		11,423
Buildings and Building Improvements	192,360	17,241		209,601
Wells and Springs	49,394	1,922		51,316
Transmission and Distribution	2,236,031	156,782		2,392,813
Treatment Plant	345,987	11,028		357,015
Electric Pumping Equipment	20,309	1,306		21,615
Miscellaneous Equipment	83,167	2,309		85,476
Furniture and Fixtures	5,504	53	1,980	3,577
Transportation Equipment	27,255	9,679		36,934
Total	2,970,342	201,408	1,980	3,169,770
Fixed Assets Net of A/D	$ 7,011,588	$ (201,408)	$ 0	$ 6,810,180

NOTE G – BONDS PAYABLE

1. Waterworks Revenue Series 1988

On May 25, 1988, the District entered into an agreement with Rural Development to issue $237,000 in Waterworks Revenue Bonds for the purpose of financing the cost of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 6.25% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2016, the principal balance outstanding was $145,000. Debt service requirements for year ending December 31, 2016, and thereafter are as follows:

NOTE G – BONDS PAYABLE (Continued)

1. Waterworks Revenue Series 1988 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 9,062	$ 8,000
2018	8,562	9,000
2019	8,000	9,000
2020	7,438	10,000
2021	6,812	11,000
2022-2026	23,128	65,000
2027-2028	3,124	33,000
Totals	$ 66,126	$ 145,000

2. Waterworks Revenue Bond Series 1991

On July 24, 1991, the District entered into an agreement with Rural Development to issue $316,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2016, the principal balance outstanding was $183,000. Debt service requirements for year ending December 31, 2016, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 9,150	$ 9,000
2018	8,700	10,000
2019	8,200	10,000
2020	7,700	11,000
2021	7,150	11,000
2022-2026	26,650	67,000
2027-2030	8,300	65,000
Totals	$ 75,850	$ 183,000

3. Waterworks Revenue Bond Series 1992

On May 27, 1992, the District entered into an agreement with Rural Development to issue $70,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2016, the principal balance outstanding was $45,000. Debt service requirements for year ending December 31, 2016, and thereafter are as follows:

NOTE G – BONDS PAYABLE (Continued)

3. Waterworks Revenue Bond Series 1992 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 2,250	$ 1,900
2018	2,156	2,000
2019	2,056	2,100
2020	1,950	2,200
2021	1,840	2,300
2022-2026	7,348	13,500
2027-2031	3,634	17,100
2032	196	3,900
Totals	$ 21,430	$ 45,000

4. Waterworks Revenue Bonds Series 1995

On April 27, 1995, the District entered into an agreement with Rural Development to issue $259,000 in Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2016, the principal balance outstanding was $178,000. Debt service requirements for year ending December 31, 2016, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 8,010	$ 6,500
2018	7,718	7,000
2019	7,402	7,000
2020	7,088	7,500
2021	6,750	8,000
2022-2026	28,058	45,500
2027-2031	16,988	55,500
2032-2034	3,758	41,000
Totals	$ 85,772	$ 178,000

NOTE G – BONDS PAYABLE (CONTINUED)

5. Waterworks Revenue Bonds Series 2001

On June 20, 2001, the District entered into an agreement with Rural Development to issue $495,000 Waterworks Revenue Bonds for the purpose of the construction of extensions, additions, and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 4.5% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2016, the principal balance outstanding was $407,000. Debt service requirements for year ending December 31, 2016, and thereafter are as follows:

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 18,316	$ 9,000
2018	17,910	9,500
2019	17,482	10,000
2020	17,032	10,500
2021	16,560	11,000
2022-2026	74,928	62,500
2027-2031	59,602	77,500
2032-2036	40,526	96,500
2037-2041	16,762	120,500
Totals	$ 279,118	$ 407,000

6. Waterworks Revenue Bonds Series 2014

On July 21, 2014, the District entered into an agreement with Rural Development to issue $504,000 Waterworks Revenue bonds for the purpose of the construction of extensions, additions and improvements to the existing waterworks system of the District. Semiannual interest payments at a rate of 2.75% are required on January 1 and June 1 with principal amount due each January 1. As of December 31, 2016, the principal balance outstanding was $496,500. Debt service requirements for year ending December 31, 2016, and thereafter are as follows:

SANDY HOOK WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the Year Ended December 31, 2016

NOTE G – BONDS PAYABLE (CONTINUED)

6. Waterworks Revenue Bonds Series 2014 (Continued)

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 13,544	$ 8,000
2018	13,324	8,000
2019	13,097	8,500
2020	12,863	8,500
2021	12,622	9,000
2022-2026	59,262	48,000
2027-2031	52,215	54,500
2032-2036	44,185	62,500
2037-2041	34,989	71,500
2042-2046	24,441	82,500
2047-2051	12,238	95,000
2052-2053	1,107	40,500
Totals	$ 293,887	$ 496,500

7. Long Term Debt Maturity in the Aggregate

Year Ended December 31	Scheduled Interest	Scheduled Principal
2017	$ 60,332	$ 42,400
2018	58,370	45,500
2019	56,237	46,600
2020	54,071	49,700
2021	51,734	52,300
2022-2026	219,374	301,500
2027-2031	143,863	302,600
2032-2036	88,665	203,900
2037-2041	51,751	192,000
2042-2046	24,441	82,500
2047-2051	12,238	95,000
2052-2053	1,107	40,500
Totals	$ 822,183	$ 1,454,500

NOTE G – BONDS PAYABLE (CONTINUED)

8. Changes in Long-term Liabilities

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Business-type Activities:					
Revenue Bonds	$ 1,495,300	$	$ 40,800	$ 1,454,500	$ 42,400
Business-type Activities Long-term Liabilities	$ 1,495,300	$ 0	$ 40,800	$ 1,454,500	$ 42,400

The total interest expense incurred by the District during the current fiscal year was $61,436.

NOTE H – RETIREMENT

General Information about the Pension Plan

The District has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement System. This is a cost-sharing multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Retirement benefits may be extended to beneficiaries of the plan members under certain circumstances. Benefit contributions and provisions are established by statute.

Nonhazardous covered employees are required to contribute five (5) percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008 are required to contribute six (6) percent of their salary to be allocated as follows: 5% will go to the member's account and 1% will go to the KRS insurance fund. The District's contribution rate for nonhazardous employees was 17.06 percent for the first six months of 2016 and 18.68 percent for the last six months of 2016.

In accordance with Senate Bill 2, signed by the Governor on April 4, 2013, plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own account. Members contribute 5% (nonhazardous) of their annual creditable compensation and 1% to the health insurance fund which is not credited to the member's account and is not refundable. The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of the member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. A member's account is credited with a 4% (nonhazardous) employer pay credit. The employer pay credit represents a portion of the employer contribution.

The District's contribution for calendar year 2014 was $36,524, and 2015 was $35,697, and FY 2016 was $35,853.

NOTE H – RETIREMENT (Continued)

General Information about the Pension Plan (Continued)

Benefits fully vest on reaching five (5) years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months credit.

CERS also provides post-retirement health care coverage as follows:

For member participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

Years of Service	% Paid by Insurance Fund	% Paid by Member through Payroll Deduction
20 or more	100%	0%
15-19	75%	25%
10-14	50%	50%
4-9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment, which is updated annually due to changes in the Consumer Price Index.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

Pension Liabilities

At December 31, 2016, the District has a liability of $316,014 for its proportionate share of the net pension liability for non-hazardous retirement. The net pension liability was measured as of June 30, 2015, the most recent audited information, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date by the Kentucky Retirement Systems. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2015, the District's proportion was .00735%.

For the year ended December 31, 2016, the District recognized pension expense of $41,949. At December 31, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

NOTE H – RETIREMENT (Continued)

Pension Liabilities (Continued)

SCHEDULE OF DEFERRED INFLOWS AND OUTFLOWS

NON-HAZARDOUS	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences Between Expected and Actual Experience	$ 2,626	$
Changes in assumptions	31,867	
Net Difference between Projected and Actual Earnings on Pension Plan Investments	2,833	
Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	15,300	
District Contributions Subsequent to the Measurement Date	49,989	
Total	$ 102,615	$ 0

The collective amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

	Non-Hazardous
Year 1	$ 12,787
Year 2	$ 12,787
Year 3	$ 6,053
Year 4	$ 5,699
Year 5	$ 0
Thereafter	$ 0

Actuarial Methods and Assumptions

The total pension liability in the June 30, 2015 actuarial valuation was determined using the following assumption, applied to all periods included in the measurement:

Inflation	3.25%
Salary Increases	4.0%, average, including inflation
Investment Rate of Return	7.5%, net of pension plan investment expense, including inflation

NOTE H – RETIREMENT (Continued)

Pension Liabilities (Continued)

Actuarial Methods and Assumptions (Continued)

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, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2008 – June 30, 2013.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for Kentucky Retirement Systems. 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.

Projected future benefit payments for all current plan members were projected through 2117.

Asset Class	Allocation	Real Rate of Return
Combined Equity	44%	5.40%
Combined Fixed Income	19%	1.50%
Real Return (Diversified Inflation Strategies)	10%	3.50%
Real Estate	5%	4.50%
Absolute Return (Diversified Inflation Strategies)	10%	4.25%
Private Equity	10%	8.50%
Cash Equivalent	2%	(.25)%
Total	100%	

NOTE H – RETIREMENT (Continued)

Pension Liabilities (Continued)

Discount Rate

The discount rate used to measure the total pension liability was 7.50 percent. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27 year amortization period of the unfunded actuarial accrued liability. The 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 following presents the net pension liability of the District, calculated using the discount rate of percent, as well as what the District's net pension liability would be if it were calculated using a discount rate that is one-percentage-point lower (6.50 percent) or one-percentage-point higher (8.50 percent) than the current rate for non-hazardous:

NON-HAZARDOUS	1% Decrease (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
District's Net Pension Liability	$ 403,433	$ 316,014	$ 241,150

Deferred Inflows and Outflows

The Schedule of Deferred Inflows and Outflows, and Pension Expense include only certain categories of deferred outflows of resources and deferred inflows of resources. These include differences between expected and actual experience, changes of assumptions and differences between projected and actual earnings on plan investments. The Schedule does not include deferred outflows/inflows of resources for changes in the employer's proportionate share of contributions or employer contributions made subsequent to the measurement date. The net pension liability as of December 31, 2016, is based on the June 30, 2015 actuarial valuation. Deferred outflows and inflows related to differences between projected and actual earnings on plan investments are netted and amortized over a closed five year period.

NOTE I – INSURANCE COVERAGE

The District is exposed to various risks of loss. The District carries commercial insurance for risks of loss. As of December 31, 2016, there were no known losses for which an accrual was considered necessary and no estimated claims that have been incurred, but not reported.

NOTE J – SUBSEQUENT EVENTS

Subsequent events have been evaluated through March 27, 2017, which is the date the financial statements were available to be issued.

NOTE K – COMPENSATED ABSENCES

It is the District's policy to permit its employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave because the District does not have a policy to pay any amounts when employees separate from service with the District. The unused vacation or annual leave is considered a vested employee benefit.

In recognition of the resulting obligation, the District has accrued a liability for earned but unused vacation leave, having determined that payment of such compensation is probable and having developed a reasonable estimate based upon current salary costs and annual leave balances as of December 31, 2016. The liability for compensated absences at December 31, 2016 was $6,319.

NOTE L – FAIR VALUE MEASUREMENT

GASB Statement No. 72, Fair Value Measurement and Application, became effective in fiscal year 2016 which requires the measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques.

The carrying amount of the following financial instruments approximate fair value because of the short maturity of the instruments: cash equivalents and accounts receivable.

SUPPLEMENTAL INFORMATION

SANDY HOOK WATER DISTRICT
SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE
NET PENSION LIBILITY
December 31, 2016

	Non-Hazardous	
(Actuarial Valuation Report Year)	2014	2015
District's Proportion of the Net Pension Liability (Asset)	0.006757%	0.007350%
District's Proportionate Share of the Net Pension Liability (Asset)	$ 219,000	$ 316,014
District's Covered-Employee Payroll	$ 154,733	$ 168,911
District's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Its Covered-Employee Payroll	141.53%	187.09%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	66.80%	57.52%

Note:
This schedule will eventually cover the ten (10) most recent fiscal years; however, this is the information available as of the implementation of GASB 68.

SANDY HOOK WATER DISTRICT
SCHEDULE OF THE DISTRICT'S PENSION CONTRIBUTIONS
December 31, 2016

	Non-Hazardous	
(Actuarial Valuation Report Year)	2014	2015
Contractually Required Pension Contribution	$ 21,298	$ 21,846
Pension Contributions in Relation to the Contractually Required Contribution	21,367	21,536
Pension Contribution Deficiency (Excess)	$ (69)	$ 310
District's Covered-Employee Payroll	$ 154,733	$ 168,911
Pension Contributions as a Percentage of Covered-Employee Payroll	13.76%	12.93%

Note:
This schedule will eventually cover the ten (10) most recent fiscal years; however, this is the information available as of the implementation of GASB 68.

SANDY HOOK WATER DISTRICT
NOTES TO REQUIRED SUPPLIEMENTARY INFORMATION
December 31, 2016

Note 1. Changes in Benefit Terms

The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2009: A new benefit tier for members who first participate on or after September 1, 2008 was introduced which included the following changes:

1. Tiered Structure for benefit accrual rates
2. New retirement eligibility requirements
3. Different rules for the computation of final average compensation

2014: As cash balance plan was introduced for members whose participation date is on or after January 1, 2014

Note 2. Changes of Assumption

The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2015:

- The assumed investment rate of return was decreased from 7.75% to 7.50%.
- The assumed rate of inflation was reduced from 3.50% to 3.25%.
- The assumed rate of wage inflation was reduced from 1.00% to 0.75%.
- Payroll growth assumption was reduced from 4.50% to 4.00%.
- 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 assumed rates of Retirement, Withdrawal, and Disability were updated to more accurately reflect experience.

C. Method and Assumptions Used in Calculations of Actuarially Determined Contributions

The actuarially determined contribution rates are determined on a annual basis beginning with the fiscal years ended 2018, determined as of July 1, 2016. The amortization period of the unfunded liability has been reset as of July 1, 2013 to a closed 30-year period. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

Note 2. Actuarially Determined Pension Contributions (Continued)

C. Method and Assumptions Used in Calculations of Actuarially Determined Contributions (Continued)

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

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Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

To the Commissioners
Sandy Hook Water District
Sandy Hook, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Sandy Hook Water District, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise Sandy Hook Water District's basic financial statements and have issued our report thereon dated March 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Sandy Hook 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Sandy Hook Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of Sandy Hook Water District's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, described in the accompanying comment and recommendation as item 2016-001 that we consider to be a significant deficiency.

Independent Auditors' 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*

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Sandy Hook 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 is required to be reported under *Government Auditing.*

Sandy Hook Water District's Response to the Finding

Sandy Hook Water District's response to the finding identified in our audit is described in the accompanying comment and recommendation. The 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.

Morgan - Franklin, LLC

Morgan-Franklin, LLC
West Liberty, Kentucky

March 27, 2017

SANDY HOOK WATER DISTRICT
COMMENT AND RECOMMENDATION
DECEMBER 31, 2016

SIGNIFICANT DEFICIENCY

2016-001 The District Lacks Adequate Internal Controls Over Disbursements

Condition: During our audit, we tested twenty-five disbursements and noted the following:
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- Three (3) instances in which an invoice was miscoded. In two (2) of the instances the invoices were coded to a fixed asset account rather than an expense account.
- One (1) instance in which a cancelled check number per the bank statement did not agree to the check number per the general ledger.
- Three (3) invoices in which sales tax was paid.
- One (1) instance in which payment of an invoice was not approved in the minutes.
- Eight (8) invoices with no purchase order.
- Ten (10) instances in which purchases orders were created after the date of the invoice.

Criteria: Good internal controls would dictate the following:

- Disbursements should be coded to an expense account and only asset purchases that meet the District's capitalization policy should be coded to a fixed asset account.
- Check numbers posted to the general ledger should be actual check numbers issued.
- The District is exempt from state sales tax and should not pay state sales tax on purchases.
- The board should approve all disbursements.
- Purchase orders are required by the District's policies.
- Purchase orders should be written and approved before a purchase is made. The intention of a purchase order is to ensure the expense is not in excess of the budget and funds are available for the expense.

Effect:

- Disbursement ledgers are inaccurate.
- State sales tax was paid.
- Payments were made without board approval.
- Purchase orders were ineffective.

Cause: Lack of adequate internal controls over disbursements.

Recommendation: We recommend the District reevaluate their controls over disbursements to determine the controls that would best address the findings listed under the condition section above. The District may determine the controls listed above under the criteria section are adequate or may decide to implement other controls to eliminate such internal control weaknesses in the future. We also recommend that the District reevaluate their policy on purchase orders. The District should either strengthen controls over their policy on purchase orders or revise the policy to better suit the needs of the District.

The District's Response: We agree and will implement processes to correct.