

Report

of

**South Hopkins Water District
Dawson Springs, Kentucky**

For The Years Ended December 31, 2016 and 2015

TABLE OF CONTENTS

| | Pages |
|---|-------|
| Independent Auditors' Report | 1-2 |
| Required Supplementary Information: Management's Discussion and Analysis | 3-7 |
| Financial Statements: | |
| Statement of Net Position | 8 |
| Statement of Revenues, Expenses and Changes in Fund Net Position | 9 |
| Statement of Cash Flows | 10 |
| Notes to Financial Statements | 11-23 |
| Required Supplementary Information: | |
| Schedule of Proportionate Share of the Net Pension Liability | 25 |
| Schedule of District Contributions | 26 |
| 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 <i>Government Auditing Standards</i> | 27-29 |

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INDEPENDENT AUDITORS' REPORT

To the Commissioners
South Hopkins Water District
Dawson Springs, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of South Hopkins Water District as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of South Hopkins Water District as of December 31, 2016 and 2015, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Change in Accounting Principle

As described in Note M to the financial statements, in 2015, the District adopted new accounting guidance, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27 (GASB 68)*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-7 and pension schedules on pages 25-26 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 13, 2017, on our consideration of South Hopkins 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 South Hopkins Water District's internal control over financial reporting and compliance.

Alexander, Toney & Knight PLLC

Madisonville, Kentucky
March 13, 2017

SOUTH HOPKINS WATER DISTRICT
Management's Discussion and Analysis
December 31, 2016 and 2015

The discussion and analysis of the South Hopkins Water District's financial performance provides an overview and analysis of the District's financial activities for the years ended December 31, 2016 and 2015. It should be read in conjunction with the accompanying basic financial statements.

Financial Highlights for the Year 2016

- * The District's net position decreased \$140.2 thousand from \$1.769 million to \$1.628 million.

Overview Of The Financial Statements

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

Basic financial statements:

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

The Statements of Revenues, Expenses, and Changes in Net Position include the District's revenues and expenses for the years ended December 31, 2016 and 2015. This statement provides information on the District's operations and can be used to determine whether the District has recovered all of its actual and projected costs through user fees and other charges.

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

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

District Financial Analysis

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

Table 1
Condensed Statements of Net Position
(in thousands)

| | <u>2016</u> | <u>2015</u> | <u>dollar change</u> | <u>percent change</u> | <u>2014</u> | <u>dollar change</u> | <u>percent change</u> |
|--|------------------|--------------------|--------------------------|---------------------------|------------------|--------------------------|---------------------------|
| Current assets | \$ 336.1 | \$ 447.3 | (\$ 111.2) | (24.9%) | \$ 335.6 | \$ 111.7 | 33.3% |
| Capital assets | 2,388.1 | 2,271.6 | 116.5 | 5.1% | 2,275.7 | (4.1) | (0.2%) |
| Other noncurrent assets | <u>162.6</u> | <u>269.8</u> | (107.2) | (39.7%) | <u>258.8</u> | 11.0 | 4.3% |
| Total assets | <u>2,886.8</u> | <u>2,988.7</u> | (101.9) | (3.4%) | <u>2,870.1</u> | 118.6 | 4.1% |
| Total deferred outflows of resources | <u>143.6</u> | * <u>82.8</u> | 60.8 | 73.4% | <u>0.0</u> | 82.8 | 100.0% |
| Current liabilities | 98.1 | 85.7 | 12.4 | 14.5% | 85.4 | 0.3 | 0.4% |
| Long-term liabilities | <u>1,289.0</u> | * <u>1,192.5</u> | 96.5 | 8.1% | <u>668.9</u> | 523.6 | 78.3% |
| Total liabilities | <u>1,387.1</u> | <u>1,278.2</u> | 108.9 | 8.5% | <u>754.3</u> | 523.9 | 69.5% |
| Total deferred inflows of resources | <u>14.9</u> | * <u>24.7</u> | (9.8) | (39.7%) | <u>0.0</u> | 24.7 | 100.0% |
| Net position invested in capital assets, net of related debt | 1,857.5 | 1,722.6 | 134.9 | 7.8% | 1,709.3 | 13.3 | 0.8% |
| Net position restricted for debt service | 11.7 | 11.7 | 0.0 | 0.0% | 11.6 | 0.1 | 0.9% |
| Net position restricted for capital projects | 52.5 | 131.7 | (79.2) | (60.1%) | 124.6 | 7.1 | 5.7% |
| Unrestricted net position | (<u>293.3</u>) | (<u>97.5</u>) | (195.8) | (200.8%) | <u>270.3</u> | (367.8) | (136.1%) |
| Total net position | <u>\$1,628.4</u> | * <u>\$1,768.6</u> | (\$ 140.2) | (7.9%) | <u>\$2,115.8</u> | (\$ 347.2) | (16.4%) |

* as restated, see note M

Net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$1.63 million at the close of the current year.

2015 to 2016

As shown in table 1, the District's total assets decreased \$101,900 when compared to the prior year. Current assets decreased \$111,200 or 24.9% partly due to a \$44,921 decrease in unrestricted cash. Unrestricted cash decreased as the District incurred less cash flow provided by operating activities as seen on the Statement of Cash Flows. Inventory decreased \$20,035 as the District used more parts and supplies on hand. Prepaid expenses decreased \$33,602 as the District did not prepaid insurance for the upcoming year in December as usual. Other noncurrent assets decreased \$107,200 primarily due to use of restricted cash for renovations to pumps and tanks.

Deferred outflows of resources increased \$60,800 due to changes in the District's proportional changes in the County Employee Retirement System (CERS) measurements as required by GASB 68.

The District's total liabilities increased \$108,900. Long-term liabilities increased \$96,500. Net pension liability, the District's proportional share as determined by valuations of the County Employee Retirement System, increased \$118,000.

The District's total net position decreased \$140,200, which results from the net effect of the decreases in total assets and increases in total liabilities referred to above.

2014 to 2015

As shown in table 1, the District's total assets increased \$118,600 when compared to the prior year. Current assets increased \$111,700 or 33.3% primarily due to a \$79,000 increase in unrestricted cash. Unrestricted cash increased as the District received \$78,000 in November 2015 from the District's water supplier as a refund of prior year water cost as specified by contract. Other noncurrent assets increased \$11,000 primarily due to transfers of cash to restricted cash accounts.

The District's total liabilities increased \$523,900. Long-term liabilities increased \$523,600 as the District implemented the new requirements of GASB Statement 68 which increased net pension liability \$535,542.

The District's total net position decreased \$347,200, which results from the net effect of the increases in total assets and total liabilities referred to above.

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

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

| | <u>2016</u> | <u>2015</u> | <u>dollar change</u> | <u>percent change</u> | <u>2014</u> | <u>dollar change</u> | <u>percent change</u> |
|--|------------------|------------------|--------------------------|---------------------------|------------------|--------------------------|---------------------------|
| Operating revenues | \$1,427.9 | \$1,433.4 | (\$ 5.5) | (0.4%) | \$1,372.5 | \$ 60.9 | 4.4% |
| Nonoperating revenues | <u>15.4</u> | <u>83.3</u> | (67.9) | (81.5%) | <u>111.8</u> | (28.5) | (25.5%) |
| Total revenues | <u>1,443.3</u> | <u>1,516.7</u> | (73.4) | (4.8%) | <u>1,484.3</u> | 32.4 | 2.2% |
| Operating expenses | 1,576.3 | 1,407.0 | 169.3 | 12.0% | 1,439.6 | (32.6) | (2.3%) |
| Nonoperating expenses | <u>24.7</u> | <u>25.6</u> | (0.9) | (3.5%) | <u>26.3</u> | (0.7) | (2.7%) |
| Total expenses | <u>1,601.0</u> | <u>1,432.6</u> | 168.4 | 11.8% | <u>1,465.9</u> | (33.3) | (2.3%) |
| Income before capital contributions | (157.7) | 84.1 | (241.8) | (287.5%) | 18.4 | 65.7 | 357.1% |
| Capital contributions | <u>17.6</u> | <u>32.8</u> | (15.2) | (46.3%) | <u>55.9</u> | (23.1) | (41.3%) |
| Changes in net position | (140.1) | 116.9 | (257.0) | (219.8%) | 74.3 | 42.6 | 57.3% |
| Beginning net position * | <u>1,768.6</u> | <u>1,651.7</u> | 116.9 | 7.1% | <u>2,041.5</u> | (389.8) | (19.1%) |
| Ending net position | <u>\$1,628.4</u> | <u>\$1,768.6</u> | (\$ 140.2) | (7.9%) | <u>\$2,115.8</u> | (\$ 347.2) | (16.4%) |

* as restated, see note M.

2015 to 2016

The District's total revenues decreased \$73,400 or 4.8%. Water sales remained similar to prior year. Nonoperating revenues decreased \$67,900. In the prior year, the District received \$78,549 from its water supplier as the water supplier's remaining reserve balance at the end of a bond term provided that part of the balance may be allocated to the District.

The District's operating expenses increased \$169,300. Salaries and wages increased \$22,043. The District had duplication in office personnel as the long time office manager retired but stay on to train new personnel. Materials and supplies cost increased \$41,500 as higher repair costs were incurred. Employee benefits increased \$62,065. The District's proportional share of CERS pension expense increased \$38,000 from the prior year. Also, employee health insurance expense was \$22,300 higher.

Capital contributions decreased \$15,200 due to less received in customer contributions as there were no line extensions during the year.

Changes in net position decreased \$140,100 due to the net effect of the decreased total revenues and increased total expenses mentioned above.

2014 to 2015

The District's operating revenues increased \$60,900 or 4.4%. Water sales increased \$64,823 as the District had a approved rate increase during the year. Nonoperating revenues decreased \$28,500 as the District had a significant gain on disposition of its telemetry system in the prior year.

The District's operating expenses decreased \$32,600. The District's purchased water cost decreased \$17,120. Salaries and wages decreased \$10,975 as turnover of employees provided new employees at lower pay rates. Materials and supplies cost decreased \$18,545 as lower repair costs were incurred.

Capital contributions decreased \$23,100 due to less received in grant monies passed down from the Kentucky Transportation Cabinet, Department of Highways and as a pass through from the City of St. Charles.

Changes in net position increased \$42,600 due to the net effect of the increased total revenues and increased total expenses mentioned above.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2016, the District had \$2,388,120 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, office furniture and equipment, vehicles, and machinery and equipment. This amount represents a net increase (additions, retirements, depreciation) of \$116,458 from the prior year as depreciation expense was outpaced by new additions.

Significant additions during the year included \$21,953 for pump renovations, \$121,308 for tank renovations, \$33,354 in meters and installation, and \$26,115 of expenditures for hand held meter readers.

At December 31, 2015, the District had \$2,271,662 invested in capital assets, net of accumulated depreciation, including land, structures, improvements and water system, office furniture and equipment, vehicles, and machinery and equipment. This amount represents a net decrease (additions, retirements, depreciation) of \$3,911 from the prior year as depreciation expense outpaced new additions.

Significant additions during the year included \$11,928 for a line extension, \$19,323 for the purchase of a truck, \$32,312 in meters and installation, and \$8,886 of expenditures for septic tanks.

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

Long-Term Debt

At December 31, 2016, the District had \$530,600 in revenue bonds outstanding which was a decrease of \$18,400 from the prior year balance of \$549,000. Both of the District's bond issues were paid as scheduled. There were no new borrowings.

At December 31, 2015, the District had \$549,000 in revenue bonds outstanding which was a decrease of \$17,300 from the prior year balance of \$566,300. Both of the District's bond issues were paid as scheduled. There were no new borrowings.

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

Currently Known Facts, Decisions, or Conditions

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

Requests For Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the South Hopkins Water District, 129 South Main Street, Dawson Springs, Kentucky 42408.

South Hopkins Water District
Statement of Net Position
December 31, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|--------------------|--------------------|
| <u>Assets</u> | | |
| Current assets | | |
| Cash and cash equivalents | \$ 95,964 | \$ 155,601 |
| Accounts receivable | 159,807 | 157,841 |
| Other receivables | 1,656 | 1,536 |
| Material and parts inventory | 67,896 | 87,931 |
| Prepaid expenses | <u>10,753</u> | <u>44,355</u> |
| Total current assets | <u>336,076</u> | <u>447,264</u> |
| Noncurrent assets | | |
| Restricted cash and cash equivalents | 162,634 | 269,776 |
| Capital assets: | | |
| Nondepreciable | 34,496 | 37,423 |
| Depreciable, net of accumulated depreciation | <u>2,353,624</u> | <u>2,234,239</u> |
| Total noncurrent assets | <u>2,550,754</u> | <u>2,541,438</u> |
| Total assets | <u>2,886,830</u> | <u>2,988,702</u> |
| <u>Deferred outflows of resources</u> | | |
| Deferred outflows of resources-pensions (2015 restated, see note M) | <u>143,571</u> | <u>82,798</u> |
| Total deferred outflows of resources | <u>143,571</u> | <u>82,798</u> |
| <u>Liabilities</u> | | |
| Current liabilities payable from current assets | | |
| Accounts payable | 63,083 | 56,968 |
| Accrued taxes and other payables | 10,863 | 10,747 |
| Accumulated compensated absences | <u>16,038</u> | <u>10,970</u> |
| | <u>89,984</u> | <u>78,685</u> |
| Current liabilities payable from restricted assets | | |
| Customer deposits | <u>8,099</u> | <u>7,023</u> |
| | <u>8,099</u> | <u>7,023</u> |
| Total current liabilities | <u>98,083</u> | <u>85,708</u> |
| Long-term liabilities | | |
| Bonds payable | 530,600 | 549,000 |
| Net pension liability (2015 restated, see note M) | 653,911 | 535,542 |
| Customer deposits | 97,568 | 96,332 |
| Accumulated compensated absences | <u>6,925</u> | <u>11,617</u> |
| Total long-term liabilities | <u>1,289,004</u> | <u>1,192,491</u> |
| Total liabilities | <u>1,387,087</u> | <u>1,278,199</u> |
| <u>Deferred inflows of resources</u> | | |
| Deferred inflows of resources-pensions (2015 restated, see note M) | <u>14,884</u> | <u>24,741</u> |
| Total deferred inflows of resources | <u>14,884</u> | <u>24,741</u> |
| <u>Net Position</u> | | |
| Invested in capital assets, net of related debt | 1,857,520 | 1,722,662 |
| Restricted for: | | |
| Debt service | 11,701 | 11,651 |
| Capital projects | 52,509 | 131,724 |
| Unrestricted | <u>(293,300)</u> | <u>(97,477)</u> |
| Total net position | <u>\$1,628,430</u> | <u>\$1,768,560</u> |

The accompanying notes are an integral part of these statements.

South Hopkins Water District
Statement of Revenues, Expenses and Changes in Fund Net Position
Years Ended December 31, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|--------------------|--------------------|
| Operating revenues | | |
| Water sales | \$1,373,198 | \$1,378,321 |
| Other operating revenues | <u>54,702</u> | <u>55,049</u> |
| Total operating revenues | <u>1,427,900</u> | <u>1,433,370</u> |
| Operating expenses | | |
| Purchased water | 669,956 | 652,237 |
| Salaries and wages | 334,386 | 312,343 |
| Depreciation | 86,456 | 78,009 |
| Employee benefits (2015 restated, see note M) | 198,629 | 136,564 |
| Transportation | 19,892 | 19,043 |
| Contract services | 20,983 | 20,230 |
| Taxes | 29,717 | 27,369 |
| Purchased power | 54,701 | 58,035 |
| Materials and supplies | 98,688 | 57,163 |
| Insurance | 41,780 | 38,641 |
| Miscellaneous | 20,766 | 7,316 |
| Chemicals | <u>383</u> | <u>70</u> |
| Total operating expenses | <u>1,576,337</u> | <u>1,407,020</u> |
| Operating income (loss) | (148,437) | 26,350 |
| Nonoperating revenues (expenses) | | |
| Other income | 11,452 | 78,549 |
| Interest income | 2,477 | 3,074 |
| Interest expense | (24,722) | (25,572) |
| Gain (loss) on disposition of capital assets | <u>1,500</u> | <u>1,652</u> |
| Total nonoperating revenues (expenses) | (9,293) | 57,703 |
| Income (loss) before contributions and grants | (157,730) | 84,053 |
| Capital contributions-state and local | 0 | 5,472 |
| Capital contributions-tap fees | 17,600 | 15,200 |
| Capital contributions-customers | <u>0</u> | <u>12,102</u> |
| Change in net position | (140,130) | 116,827 |
| Total net position – beginning, as restated, see note M | <u>1,768,560</u> | <u>1,651,733</u> |
| Total net position - ending | <u>\$1,628,430</u> | <u>\$1,768,560</u> |

The accompanying notes are an integral part of these statements.

South Hopkins Water District
Statement of Cash Flows
Years Ended December 31, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|-------------------|-------------------|
| <u>Cash flows from operating activities</u> | | |
| Cash received from customers | \$1,360,107 | \$1,368,733 |
| Cash payments to suppliers for goods and services | (1,034,195) | (1,020,290) |
| Cash payments to employees for services | (334,386) | (312,343) |
| Other operating revenues | <u>54,702</u> | <u>55,049</u> |
| Net cash provided (used) by operating activities | 46,228 | 91,149 |
| <u>Cash flows from capital and related financing activities</u> | | |
| Refund of water cost | 11,453 | 78,549 |
| Acquisition and construction of capital assets | (202,915) | (74,097) |
| Principal paid on bond maturities | (18,400) | (17,300) |
| Interest paid on bonds | (24,705) | (25,484) |
| Interest paid on customer deposits | (17) | (88) |
| Proceeds from dispositions of assets | 1,500 | 1,652 |
| Capital contributions received from state and local | 0 | 5,472 |
| Capital contributions received from customers | <u>17,600</u> | <u>27,302</u> |
| Net cash provided (used) for capital and related financing activities | (215,484) | (3,994) |
| <u>Cash flows from investing activities</u> | | |
| Interest earned on bank deposits | <u>2,477</u> | <u>3,074</u> |
| Net cash provided (used) by investing activities | 2,477 | 3,074 |
| Net increase (decrease) in cash and cash equivalents | (166,779) | 90,229 |
| Cash and cash equivalents at beginning of year | <u>425,377</u> | <u>335,148</u> |
| Cash and cash equivalents at end of year | <u>\$ 258,598</u> | <u>\$ 425,377</u> |

| <u>Reconciliation of operating income to net cash provided (used) by operating activities</u> | | |
|---|------------------|------------------|
| Operating income (loss) | (\$ 148,437) | \$ 26,350 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 86,457 | 78,009 |
| Change in assets and liabilities: | | |
| (Increase) decrease in accounts receivable | (1,966) | (9,589) |
| (Increase) decrease in other receivables | (120) | 476 |
| (Increase) decrease in inventory | 20,035 | (16,922) |
| (Increase) decrease in prepaid expenses | 33,602 | (6,224) |
| (Increase) decrease in deferred outflows-pensions | (60,773) | 0 |
| Increase (decrease) in accounts payable | 6,120 | 972 |
| Increase (decrease) in taxes and other payables | 110 | 2,911 |
| Increase (decrease) in pension liability | 118,369 | 13,457 |
| Increase (decrease) in customer deposits | 2,312 | 1,958 |
| Increase (decrease) in accumulated compensated absences | 376 | (249) |
| Increase (decrease) in deferred inflows-pensions | <u>(9,857)</u> | <u>0</u> |
| Total adjustments | <u>194,665</u> | <u>64,799</u> |
| Net cash provided (used) by operating activities | <u>\$ 46,228</u> | <u>\$ 91,149</u> |

The accompanying notes are an integral part of these statements.

South Hopkins Water District
 Notes to Financial Statements
December 31, 2016 and 2015

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The Financial Reporting Entity

South Hopkins Water District (the "District") was created on May 6, 1965, under the provisions of chapter 74 of the Kentucky Revised Statutes of the Commonwealth of Kentucky. The principal office of the District is located at 129 South Main Street, Dawson Springs, Kentucky. The District is composed of three commissioners who are appointed by the Hopkins County Judge Executive and provides water to its members in and around southern Hopkins County, Kentucky.

In evaluating how to define the government, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GASB Statements No. 14 and 61. The District has no component units.

Basis of Presentation, Measurement Focus, and Basis of Accounting

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

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

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

South Hopkins Water District
 Notes to Financial Statements
December 31, 2016 and 2015

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

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

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

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

Cash and Cash Equivalents

All cash except for a small amount kept "on hand" is deposited in financial institutions. Deposits include interest bearing checking accounts and certificates of deposit. Unrestricted cash is available to be expended for normal operating expenses. Restricted cash is limited to payments of bond principal and interest, emergency capital improvements, and other designated purposes. Cash and cash equivalents are defined as being all monies on deposit in banks and investments with a maturity of 90 days or less. The District does not have a formal deposit and investment policy for credit risk, custodial credit risk, or limitations on deposits and investments.

Inventory

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

Capital Assets

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

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. No interest was capitalized during the years ended December 31, 2016 and 2015.

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

| | |
|---|----------------|
| Structures, improvements and water system | 10 to 65 years |
| Furniture, machinery and equipment | 3 to 20 years |
| Vehicles | 5 to 7 years |

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

Restricted Net Position

Restricted net position is cash set aside for the repayment of debt in compliance with bond covenants and cash restricted for future operations in compliance with escrow reserve agreements.

Long-Term Liabilities

Long-term debt and other long-term obligations are reported as liabilities in the statement of net position. Long-term debt is reported at face value plus applicable issuance premiums and net of applicable discounts and deferred amounts on refunding. Discounts on debt issuances and amounts deferred on refunding are deferred and amortized as interest expense over the remaining life of the old bonds, or the life of the new bonds, whichever is shorter. Premiums on debt issuances are deferred and amortized as a reduction of interest expense over the life of the bonds.

Deferred Outflows/Inflows of Resources

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

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

Pensions

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

Uncollectible Accounts

Accounts receivable are presented net of noncollectible accounts. The allowance for uncollectible accounts was \$8,411 at December 31, 2016 and \$7,962 at December 31, 2015.

Use of Estimates

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

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE B - DEPOSITS

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

Also by Kentucky law, the District is allowed to invest as specified in KRS 66.480 which includes U. S. Treasury and its Obligations, certain federal investments, repurchase agreements, commercial banks' certificates of deposits, and savings and loan deposits.

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

On December 31, 2016 the reconciled balance of the District's deposits totaled \$257,398 and the bank balances were \$288,295. Of the bank balances \$288,295 was covered by federal depository insurance (category 1).

On December 31, 2015 the reconciled balance of the District's deposits totaled \$424,177 and the bank balances were \$427,643. Of the bank balances \$422,001 was covered by federal depository insurance (category 1). Also of the bank balances, \$5,642 was collateralized by additional securities held by the pledging depository institutions' trust department or agent in the District's name (category 2).

NOTE C - PREPAID EXPENSES

Prepaid expenses include prepaid insurance which represents the amount of unexpired insurance which the District had previously paid for at the balance sheet date and prepaid employee benefits which represents the amount of employee health insurance for the one month subsequent to the balance sheet date but paid by the District as of the balance sheet date.

At December 31, 2016, the District's prepaid expenses consisted of \$10,753 of insurance. At December 31, 2015, the District's prepaid expenses consisted of \$37,548 of insurance and \$6,807 of employee benefits.

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE D - RESTRICTED CASH AND CASH EQUIVALENTS

The District has cash set aside for the repayment of debt in compliance with bond covenants, cash restricted for future operations in compliance with escrow reserve agreements, cash set aside for future capital assets, and cash set aside for repayment of customer deposits.

Restricted balances as of December 31 are as follows:

| | <u>2016</u> | <u>2015</u> |
|-----------------------------------|-------------------|-------------------|
| Bond and interest redemption fund | \$ 11,701 | \$ 11,651 |
| Bond depreciation fund | 52,509 | 129,000 |
| Meter deposit fund | 98,424 | 126,401 |
| Construction fund | <u>0</u> | <u>2,724</u> |
| Totals | <u>\$ 162,634</u> | <u>\$ 269,776</u> |

NOTE E - CAPITAL ASSETS

Capital asset activities for the years ended December 31, 2016 and 2015, were as follows:

| | <u>Balances</u> <u>12/31/14</u> | <u>Transfers/</u> <u>Additions</u> | <u>Transfers/</u> <u>Retirements</u> | <u>Balances</u> <u>12/13/15</u> | <u>Transfers/</u> <u>Additions</u> | <u>Transfers/</u> <u>Retirements</u> | <u>Balances</u> <u>12/31/16</u> |
|---|------------------------------------|---------------------------------------|---|------------------------------------|---------------------------------------|---|------------------------------------|
| Business-type activities: | | | | | | | |
| Capital assets not being depreciated | | | | | | | |
| Land & land rights | \$ 31,915 | \$ 0 | \$ 0 | \$ 31,915 | \$ 0 | \$ 0 | \$ 31,915 |
| Construction in progress | <u>10,600</u> | <u>24,290</u> | <u>29,382</u> | <u>5,508</u> | <u>1,956</u> | <u>4,883</u> | <u>2,581</u> |
| Total | <u>42,515</u> | <u>24,290</u> | <u>29,382</u> | <u>37,423</u> | <u>1,956</u> | <u>4,883</u> | <u>34,496</u> |
| Capital assets being depreciated | | | | | | | |
| Structures, improvements, & water system | 4,903,575 | 44,751 | 12,599 | 4,935,727 | 178,022 | 25,800 | 5,087,949 |
| Office furniture & equipment | 50,993 | 947 | 0 | 51,940 | 400 | 0 | 52,340 |
| Vehicles & equipment | 159,958 | 19,323 | 25,751 | 153,530 | 0 | 14,496 | 139,034 |
| Machinery & equipment | 221,355 | 5,283 | 0 | 226,638 | 27,420 | 0 | 254,058 |
| Other tangible property | <u>51,737</u> | <u>8,886</u> | <u>0</u> | <u>60,623</u> | <u>0</u> | <u>0</u> | <u>60,623</u> |
| Total | <u>5,387,618</u> | <u>79,190</u> | <u>38,350</u> | <u>5,428,458</u> | <u>205,842</u> | <u>40,296</u> | <u>5,594,004</u> |
| Total capital assets | <u>5,430,133</u> | <u>103,480</u> | <u>67,732</u> | <u>5,465,881</u> | <u>207,798</u> | <u>45,179</u> | <u>5,628,500</u> |
| Less accumulated depreciation for: | | | | | | | |
| Structures, improvements, & water system | 2,896,322 | 59,038 | 12,599 | 2,942,761 | 61,811 | 25,800 | 2,978,772 |
| Office furniture & equipment | 43,167 | 2,056 | 0 | 45,223 | 2,012 | 0 | 47,235 |
| Vehicles & equipment | 111,271 | 9,241 | 25,751 | 94,761 | 10,458 | 14,496 | 90,723 |
| Machinery & equipment | 102,437 | 5,604 | 0 | 108,041 | 9,751 | 0 | 117,792 |
| Other tangible property | <u>1,363</u> | <u>2,070</u> | <u>0</u> | <u>3,433</u> | <u>2,425</u> | <u>0</u> | <u>5,858</u> |
| Total accumulated depreciation | <u>3,154,560</u> | <u>78,009</u> | <u>38,350</u> | <u>3,194,219</u> | <u>86,457</u> | <u>40,296</u> | <u>3,240,380</u> |
| Total business-type activities capital assets, net | <u>\$2,275,573</u> | <u>\$ 25,471</u> | <u>\$ 29,382</u> | <u>\$2,271,662</u> | <u>\$ 121,341</u> | <u>\$ 4,883</u> | <u>\$2,388,120</u> |

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE F - LONG-TERM LIABILITIES

Long-term liability activity

Long-term liability activity for the years ended December 31, 2016 and 2015, were as follows:

| | Balances 12/31/14 | Additions | Reductions | Balances 12/31/15 | Additions | Reductions | Balances 12/31/16 | Amounts Due Within One Year |
|---|----------------------|------------------|------------------|----------------------|------------------|------------------|----------------------|-----------------------------------|
| Revenue Bonds: | | | | | | | | |
| Series 1994A | \$ 494,000 | \$ 0 | \$ 15,000 | \$ 479,000 | \$ 0 | \$ 16,000 | \$ 463,000 | \$ 0 |
| Series 1994B | <u>72,300</u> | <u>0</u> | <u>2,300</u> | <u>70,000</u> | <u>0</u> | <u>2,400</u> | <u>67,600</u> | <u>0</u> |
| Total Bonds | 566,300 | 0 | 17,300 | 549,000 | 0 | 18,400 | 530,600 | 0 |
| Customer Deposits | 101,397 | 10,350 | 8,392 | 103,355 | 10,755 | 8,443 | 105,667 | 8,099 |
| Accumulated Compensated Absences | <u>22,836</u> | <u>13,278</u> | <u>13,527</u> | <u>22,587</u> | <u>13,455</u> | <u>13,079</u> | <u>22,963</u> | <u>16,038</u> |
| Business-type Activities Long- Term Liabilities | <u>\$ 690,533</u> | <u>\$ 23,628</u> | <u>\$ 39,219</u> | <u>\$ 674,942</u> | <u>\$ 24,210</u> | <u>\$ 39,922</u> | <u>\$ 659,230</u> | <u>\$ 24,137</u> |

Description of debt

Waterworks Revenue Bonds, 1994 Series A and B

A bond resolution dated November 29, 1994 authorized issuance of \$670,000 (Series A) and \$100,000 (Series B) of waterworks revenue bonds maturing in annual installments through year 2035. Interest is payable semi-annually on January 1 and July 1 at 4.5% per annum and principal is payable annually on January 1.

The 1994 Series Bonds were issued and sold to the United States Department of Agriculture/Rural Development (formerly Rural Economic and Community Development). The bond resolutions provide for all revenue receipts to be deposited into a Water Revenue Fund with transfers to the following funds:

- a) Waterworks Bond and Interest Sinking Fund - Prorata monthly transfers of an amount equal to the next principal and/or interest payments.
- b) Depreciation Fund - Monthly transfers of \$380 until the fund equals at least \$45,600.
- c) Operation and Maintenance Fund - Monthly transfers of an amount equal to the monthly expense disbursement of the District.
- d) After meeting all the requirements of a) through c) above, the balance remaining in the Revenue Fund is to be transferred to the Depreciation Fund.

Withdrawals from the Depreciation Fund can be authorized by the commissioners for the cost of unusual or extraordinary maintenance, repairs, renewals, and replacements, including extensions and additions, not included in the annual budget of current expenses.

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE F - LONG-TERM LIABILITIES continued

Debt Maturity

Annual debt service requirements at December 31, 2016 are as follows:

| <u>Year Ended</u> <u>December 31</u> | <u>Business-type Activities</u> | |
|---|---------------------------------|-------------------|
| | <u>Principal</u> | <u>Interest</u> |
| 2017 | \$ 0 | \$ 12,353 |
| 2018 | 18,500 | 23,877 |
| 2019 | 20,600 | 23,045 |
| 2020 | 20,700 | 22,118 |
| 2021 | 21,900 | 21,186 |
| 2022-2026 | 127,400 | 90,144 |
| 2027-2031 | 161,400 | 58,572 |
| 2032-2035 | <u>160,100</u> | <u>18,396</u> |
| Totals | <u>\$ 530,600</u> | <u>\$ 269,691</u> |

NOTE G - ACCUMULATED COMPENSATED ABSENCES

It is the District's policy to permit employees to accumulate a limited amount of earned but unused sick leave.

NOTE H - EMPLOYEES' PENSION PLAN

General Information about the Pension Plan

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

Benefits provided. Kentucky Revised Statute Section 61.645 establishes the benefit terms and can be amended only by the Kentucky General Assembly. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under circumstances. Cost-of-living adjustments are provided at the discretion of the State legislature. There are currently three benefit tiers. Tier 1 members are those participating in the plan before 9/1/2008, Tier 2 members are those that began participation 9/1/2008 through 12/31/2013, and Tier 3 are those members that began participation on or after 1/1/2014.

NOTE H - EMPLOYEES' PENSION PLAN continued

Benefits provided-non hazardous. Tier 1 non-hazardous members are eligible to retire with an unreduced benefit at age 65 with four years of service credit or after 27 years of service credit regardless of age. Benefits are determined by a formula using the member's highest five consecutive year average compensation, which must contain at least 48 months. Reduced benefits for early retirement are available at age 55 and vested or 25 years of service credit. Members vest with five years of service credit. Service related disability benefits are provided after five years of service. Tier 2 non-hazardous members are eligible to retire based on the rule of 87: the member must be at least age 57 and age + earned service must equal 87 years at retirement or at age 65 with five years of service credit. Benefits are determined by a formula using the member's highest five consecutive year average compensation, which must be 60 months. Reduced benefits for early retirement are available at age 60 with 10 years of service. Tier 3 non-hazardous members are also eligible to retire based on the rule of 87. Benefits are determined by a life annuity calculated in accordance with actuarial assumptions and methods adopted by the board based on a member's accumulated account balance. Tier 3 members are not eligible for reduced retirement benefits.

Contributions. Per Kentucky Revised Statute 61.565, normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the year ended December 31, 2016, plan members were required to contribute 5% of their annual creditable compensation. Plan members hired subsequent to September 1, 2008 were required to contribute 6% of their annual creditable compensation. The District is required to contribute at an actuarial determined rate. The District was required to contribute 18.68%, 13.95% for pensions and 4.73% for insurance, of each employee's creditable compensation for the last six months of the year ended December 31, 2016. The District was required to contribute 17.06%, 12.42% for pensions and 4.64% for insurance, of each employee's creditable compensation for the first six months of the year ended December 31, 2016 and for the final six months of the year ended December 31, 2015. The District was required to contribute 17.67%, 12.75% for pensions and 4.92% for insurance, of each employee's creditable compensation for the first six months of the year ended December 31, 2015 and for the final six months of the year ended December 31, 2014. The District was required to contribute 18.89%, 13.74% for pensions and 5.15% for insurance, of each employee's creditable compensation for the first six months of the year ended December 31, 2014. The District's contributions to CERS for the years ended December 31, 2016, 2015 and 2014 were \$57,802, \$50,952, and \$56,737, respectively. The District's payable to the plan at December 31, 2016 and 2015 was \$5,827 and \$6,993, respectively, which consisted of employees' withholdings and legally required contributions for the month of December.

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

At December 31, 2016, the District reported a liability of \$653,911 for its proportionate share of the net pension liability. The District's net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate net pension liability was determined by an actuarial valuation as of that date. At December 31, 2015, the District reported a liability of \$535,542 for its proportionate share of the net pension liability. The District's net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate net pension liability was determined by an actuarial valuation as of that date.

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE H - EMPLOYEES' PENSION PLAN continued

For the year ended December 31, 2016, the District recognized pension expense of \$88,414. For the year ended December 31, 2015, the District recognized pension expense of \$50,396. At December 31, 2016 and 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | <u>12/31/2016</u> | | <u>12/31/2015</u> | |
|--|---------------------------------------|--------------------------------------|---------------------------------------|--------------------------------------|
| | <u>Deferred Outflows of Resources</u> | <u>Deferred Inflows of Resources</u> | <u>Deferred Outflows of Resources</u> | <u>Deferred Inflows of Resources</u> |
| Net difference between projected and actual earnings on pension plan investments | \$ 61,474 | \$ - | \$ 4,801 | \$ - |
| Net difference between expected and actual experience | 2,855 | - | 4,451 | - |
| Changes in proportional and differences between employer contributions and proportional share of contributions | 22,116 | 14,884 | - | 24,741 |
| Change of assumptions | 34,641 | - | 54,003 | - |
| District contributions subsequent to the measurement date | <u>22,485</u> | <u>-</u> | <u>19,543</u> | <u>-</u> |
| Total | <u>\$ 143,571</u> | <u>\$ 14,884</u> | <u>\$ 82,798</u> | <u>\$ 24,741</u> |

\$22,485 reported as deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| Year ended December 31: | |
|-------------------------|-----------|
| 2017 | \$ 44,977 |
| 2018 | 30,091 |
| 2019 | 29,308 |
| 2020 | 16,710 |

Actuarial assumptions.

The total pension liability in the June 30, 2016 and 2015 actuarial valuations using standard roll-forward techniques, was determined using the following actuarial assumptions, applied to all periods included in the measurement:

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

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

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE H - EMPLOYEES' PENSION PLAN continued

The actuarial assumption 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 KRS. 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 target asset allocation and best estimates of 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 Real Return (Diversified Inflation Strategies) | 19 | 1.50 |
| Real Estate | 10 | 3.50 |
| Absolute Return (Diversified Hedge Funds) | 5 | 4.50 |
| Private Equity | 10 | 4.25 |
| Cash Equivalent | 10 | 8.50 |
| Total | <u>2</u> 100% | (0.25) |

Discount rate. For CERS, the discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27 year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period. The discount rate does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through 2117.

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE H - EMPLOYEES' PENSION PLAN continued

Sensitivity of the District's proportionate share of the net pension liability to changes in the discount rate. The following presents the District's proportionate share of the net pension liability calculated using the discount rate of 7.50%, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75%) or 1-percentage-point higher (8.75%) than the current rate.

| | <u>1% Decrease</u> <u>(6.50%)</u> | <u>Discount Rate</u> <u>(7.50%)</u> | <u>1% Increase</u> <u>(8.50%)</u> |
|--|--------------------------------------|--|--------------------------------------|
| District's 2016 proportionate share of the net pension liability | \$ 814,811 | \$ 653,911 | \$ 515,886 |
| District's 2015 proportionate share of the net pension liability | \$ 683,914 | \$ 535,542 | \$ 408,806 |

2015

Change in assumptions. Since the prior measurement date, the demographic and economic assumptions that affect the measurement of the total pension liability have been updated. The changes are noted below:

- 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.

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

South Hopkins Water District
Notes to Financial Statements
December 31, 2016 and 2015

NOTE I - RISK MANAGEMENT

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

NOTE J - MAJOR SUPPLIER

The District purchases 98% of water resold from the City of Dawson Springs, Kentucky.

NOTE K - CONSTRUCTION IN PROGRESS

2015

Rialto Mine Road Extension:

The District has incurred costs of \$11,928 during the year and \$11,928 costs has been capitalized upon placement into service.

St. Charles Sewer Project:

The District is participating in a pilot program involving the placement of septic tanks. The District is receiving funds as a sub-recipient from the City of St. Charles whom has a grant agreement with the Kentucky Infrastructure Authority. The District has incurred costs of \$8,886 during the year and \$8,886 costs has been capitalized upon placement into service.

NOTE L – OTHER INCOME

The District's water supplier is the City of Dawson Springs, Kentucky. The District's water purchase contract, amended June 15, 1990, called for funding of a reserve fund for the water supplier. The monthly reserve amount was charged against the District as a component of water cost. At the end of the supplier bond terms, the contract allowed that the remaining reserve balance may be allocated to the supplier and the District in a proportional amount. The District received \$11,453 in December 2016 and \$78,549 in November 2015 as the supplier's bond terms have ended.

NOTE M – PRIOR PERIOD ADJUSTMENT AND RESTATEMENT OF COMPARATIVE STATEMENTS

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

The provisions of GASB 68 were effective for fiscal periods beginning after June 15, 2014. The District adopted GASB 68 for the year ended December 31, 2015 which was the first year of implementation for the District.

As originally reported, the adoption of the standard impacted the District's financial position and resulted in a restatement to reduce beginning net position in the amount of \$449,001.

As restated for December 31, 2015, Deferred Outflows of Resources-Pensions incorrectly included the insurance portion of current District contributions subsequent to the measurement date of June 30, 2015. Also, a measurement date of June 30, 2014 was incorrectly used. The measurement date of June 30, 2015, included with a valuation report which was not available at the time should have been used. Deferred Outflows of Resources-Pensions was understated \$31,848 and the correct amount of \$82,798 has been restated on the comparative 2015 Statement of Net Position. Net Pension Liability was understated \$100,542 and the correct amount of \$535,542 has been restated on the comparative 2015 Statement of Net Position. Deferred Inflows of Resources-Pensions was overstated \$24,259 and the correct amount of \$24,741 has been restated on the comparative 2015 Statement of Net Position. Employee Benefits was understated \$29,409 and the correct amount of \$136,564 has been restated on the comparative 2015 Statement of Revenues, Expenses and Changes in Fund Net Position. The net effect was a \$44,436 net reduction of Beginning Total Net Position.

Required Supplementary Information

South Hopkins Water District
 Schedule of Proportionate Share of the Net Pension Liability
 December 31, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|---|------------------|------------------|
| Total net pension liability for County Employees' Retirement System | \$ 6,639,559,678 | \$ 5,834,631,445 |
| District's proportion of the net pension liability (asset) | 0.01328% | 0.01246% |
| District's proportionate share of the net pension liability (asset) | \$ 653,911 | \$ 535,542 |
| District's covered-employer payroll | \$ 316,629 | \$ 290,612 |
| District's proportionate share of the net pension liability (asset) as a percentage of its covered-employer payroll | 206.52% | 184.28% |
| Total pension plan's fiduciary net position | \$ 8,151,568,466 | \$ 8,519,001,523 |
| Total pension plan's pension liability | \$14,791,128,144 | \$14,353,632,968 |
| Total Pension Plan's fiduciary net position as a percentage of the total pension liability | 55.11% | 59.35% |

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

South Hopkins Water District
 Schedule of District Contributions
December 31, 2016 and 2015

| | <u>2016</u> | <u>2015</u> |
|--|---------------|---------------|
| Actuarially determined contribution | \$ 54,017 | \$ 51,351 |
| Contributions in relation to the actuarially determined contribution | <u>54,017</u> | <u>51,351</u> |
| Contribution deficiency (excess) | \$ 0 | \$ 0 |
| | ===== | ===== |
| District's covered-employee payroll | \$ 316,629 | \$ 290,612 |
| Contributions as a percentage of covered-employee payroll | 17.06% | 17.67% |

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

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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
South Hopkins Water District
Dawson Springs, Kentucky

We have audited, 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, the financial statements of South Hopkins Water District as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, and have issued our report thereon dated March 13, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered South Hopkins 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 South Hopkins Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of South Hopkins 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 certain deficiencies in internal control, as discussed below, that we consider to be significant deficiencies.

2016-1 Segregation of Duties

Condition: The internal control relating to receipts and disbursements is inadequate due to a lack of segregation of duties.

Criteria: Adequate segregation of duties is essential to an adequate internal control over financial reporting by allocating various duties among employees.

Effect: The lack of proper segregation of duties may permit errors or irregularities to go undetected.

Cause: There is a small number of accounting personnel. The cost versus benefit relationship prevents the District from hiring enough accounting personnel to properly segregate key accounting functions.

Recommendation: While the small number of employees that exist will never provide proper segregation of duties, the District should continually review job responsibilities for better accounting controls.

Response: The District concurs with the recommendation and will continually review job responsibilities to improve accounting controls when possible.

2016-2 Lack of Financial Reporting Expertise

Condition: The District lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures. Management engaged the auditor to prepare draft financial statements, including the related notes to the financial statements. Management reviewed, approved and accepted responsibility for the financial statements prior to their issuance.

Criteria: The District is required to have internal controls in place that enable it to prepare complete financial statements, including note disclosures, in compliance with generally accepted accounting principles.

Effect: The absence of such controls may allow errors to go undetected.

Cause: There is a lack of personnel who possess the required knowledge.

Recommendation: We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements or review the financial statements as prepared by the auditor for compliance with generally accepted accounting principles.

Response: Management has determined that it is more cost effective to continue to engage the auditor to draft the financial statements and related notes.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether South Hopkins Water District's financial statements are free of 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*.

South Hopkins Water District's Response to Findings

South Hopkins Water District's response to the findings identified in our audit is described above. South Hopkins 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 result 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 purposes.

Alexander, Toney & Knight PLLC

Madisonville, Kentucky

March 13, 2017