

SOUTHERN MADISON WATER DISTRICT

AUDITED FINANCIAL STATEMENTS

December 31, 2016

Prepared by:

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White & Associates, PSC

CERTIFIED PUBLIC ACCOUNTANTS

1407 Lexington Road

Richmond, Kentucky 40475

INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners of the Southern Madison Water District
Berea, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the enterprise fund of the Southern Madison Water District (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.

Auditor's 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 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the enterprise fund of the District, as of December 31, 2016, and the respective changes in financial position, and where

applicable, 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 schedule of contributions information as 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 remaining 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 requires to be presented to supplement the basic financial statements. Such missing information, although not a part of the financial statements is required by the Governmental Accounting Standards Board, who consider 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 May 26, 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.

White & Associates, PSC

White & Associates, PSC
Richmond, Kentucky
May 26, 2017

Southern Madison Water District
STATEMENT OF NET POSITION
December 31, 2016

| | 2016 |
|--|--------------|
| ASSETS: | |
| Current assets: | |
| Cash and investments | \$ 911,281 |
| Accounts receivable | 153,939 |
| Inventory | 174,758 |
| Prepaid expenses | 12,351 |
| Total current assets | 1,252,329 |
| Noncurrent assets: | |
| Capital assets not being depreciated | 89,690 |
| Capital assets, net of accumulated depreciation | 4,990,401 |
| Other assets | 2,020 |
| Total noncurrent assets | 5,082,111 |
| Deferred outflows of resources: | |
| Deferred outflows of resources related to pensions | 122,857 |
| Total Assets | \$ 6,457,296 |
| LIABILITIES: | |
| Current liabilities: | |
| Accounts payable | \$ 80,779 |
| Accrued liabilities: | |
| Payroll taxes | 11,543 |
| Other | 9,665 |
| Interest | 285 |
| Customer deposits | 198,480 |
| Total current liabilities | 300,752 |
| Noncurrent liabilities: | |
| Net pension liability | 613,826 |
| Total noncurrent liabilities | 613,826 |
| Total Liabilities | 914,578 |
| Deferred Inflows of Resources | |
| Inflow of resources related to pensions | 49,409 |
| Total deferred outflows of resources | 49,409 |
| NET POSITION | |
| Net Investment in capital assets | 5,080,091 |
| Unrestricted | 413,218 |
| Total net position | 5,493,309 |
| Total liabilities and net position | \$ 6,457,296 |

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

Southern Madison Water District
STATEMENT OF REVENUES, EXPENSES and CHANGES in NET POSITION
For the Year Ended December 31, 2016

| | 2016 |
|---|---------------------|
| OPERATING REVENUES: | |
| Water sales | \$ 1,673,418 |
| Other sales: | |
| Late charges | 34,096 |
| Miscellaneous | 43,364 |
| Total operating revenues | 1,750,878 |
| OPERATING EXPENSES: | |
| Salaries and wages | 339,395 |
| Employee benefits | 97,041 |
| Payroll taxes | 24,226 |
| Purchased water | 848,344 |
| Dues & subscription | 2,493 |
| Office expenses | 35,993 |
| Accounting & legal | 19,205 |
| Repairs & maintenance | 106,491 |
| Truck & equipment expense | 21,831 |
| Insurance | 57,217 |
| Utilities | 35,955 |
| Depreciation | 259,907 |
| Miscellaneous | 13,060 |
| Total operating expenses | 1,861,156 |
| OPERATIONS INCOME (LOSS) | (110,278) |
| NONOPERATING REVENUES (EXPENSES) | |
| Earnings on investments | 2,221 |
| Miscellaneous income | 3,518 |
| Interest expense | (764) |
| Total nonoperating revenues (expenses) | 4,975 |
| INCOME (LOSS) BEFORE CONTRIBUTIONS | (105,303) |
| Capital contributions | 118,203 |
| Total capital contributions | 118,203 |
| CHANGE IN NET POSITION | 12,900 |
| NET POSITION, BEGINNING | 5,457,515 |
| Prior period adjustments | 22,894 |
| NET POSITION, RESTATED | 5,480,409 |
| NET POSITION, ENDING | \$ 5,493,309 |

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

Southern Madison Water District
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2016

| | 2016 |
|---|--------------|
| Cash flows from operating activities: | |
| Cash received from customers and other sources | \$ 1,727,573 |
| Cash payments to suppliers for goods and services | (1,097,462) |
| Cash payments for employees and benefits | (460,461) |
| Net cash provided (used) by operating activities | 169,649 |
| Cash flows from capital and related financing activities: | |
| Purchases and construction of capital assets | (268,247) |
| Proceeds from capital contributions | 118,203 |
| Other cash flows | 3,518 |
| Interest on customer deposits | (764) |
| Net cash provided (used) by capital and related financing activities | (147,291) |
| Cash flows from investing activities: | |
| Investment income received | 2,221 |
| Net cash provided (used) by investing activities | 2,221 |
| Net increase (decrease) in cash and investments | 24,580 |
| Cash and investments, beginning of year | 886,701 |
| Cash and investments, end of year | \$ 911,281 |
| Reconciliation of operating income (loss) to net cash provided (used) by operating activities: | |
| Operating income (loss) | \$ (110,278) |
| Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities: | |
| Depreciation/Amortization | 259,907 |
| Actuarial pension expense | 22,290 |
| (Increase) decrease in assets: | |
| Accounts receivable | (23,305) |
| Inventory | 3,738 |
| Prepaid expenses | (968) |
| Increase (decrease) in liabilities: | |
| Accounts payable | 18,066 |
| Accrued liabilities | 370 |
| Customer deposits | (170) |
| Net cash provided (used) by operating activities | \$ 169,649 |

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

Southern Madison Water District
NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2016

NOTE 1 – Reporting entity and significant accounting policies

(a) *Description of the reporting entity*

Southern Madison Water District (District) was formed in 1969 by the Madison County, Kentucky Fiscal Court under Kentucky Revised Statute Chapter 74 for the purpose of providing potable drinking water to residents and businesses in southern Madison County. At December 31, 2016 and 2015, the District had 5,079 and 4,985 customers, respectively. The District is overseen by a three member board of commissioners appointed by the county judge/executive and approved by the Fiscal Court. The District is self-supporting through the charges it makes for water sold. The Fiscal Court makes no financial contribution to the District nor do they have any management function with the District. The District is subject to the Public Service Commission of the Commonwealth of Kentucky as to what rates it may charge for water and other service fees. The District is also subject to safe drinking water regulations issued by the Division of Water. The District purchases treated water, ready for distribution, from the City of Berea, Kentucky.

(b) *Basis of accounting*

The District operates and reports as an enterprise utilizing the accrual method of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as subsidies, taxes, and investment earnings result from non-exchange transactions or ancillary activities.

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.

(c) *Applicable accounting standards*

The Governmental Accounting Standards Board (GASB) establishes accounting and financial reporting standards for financial statements of state and local governments. The District has elected to follow all pronouncements of the GASB.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise fund's principal ongoing operations. The principal operating revenues of the District's enterprise funds are charges to customers for services. Operating expenses for enterprise funds include the cost of services, administrative expenses, and depreciation of capital

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

(d) *Restricted cash and cash equivalents*

Restricted cash and cash equivalents represent amounts held in trust at the bank and are set aside for bond sinking, operation and depreciation funds as required by the bond ordinance. Currently, the District has no restricted cash and cash equivalents.

(e) *Investments*

Investments are reported in the accompanying statement of net position at fair value, except for certificates of deposit and investment contracts that are reported at cost because they are not transferable and they have terms that are not affected by changes in market interest rates.

Changes in fair value that occur during a fiscal year are recognized as investment income reported for that year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

In accordance with the District's investment policy, the District may invest in the following:

Certificates of Deposit

(f) *Accounts receivable*

The District accounts for the billings to customers as accounts receivable. Management considers accounts receivable to be fully collectible/ accordingly no allowance for doubtful accounts is required. If accounts receivable become uncollectible, they will be charged-off when that determination is made.

(g) *Inventory*

The District maintains a detailed inventory of supplies needed to maintain the water infrastructure. Inventory is stated at the lower of cost or market. Cost is determined principally by the first-in, first-out method.

(h) *Prepaid expenses*

Payments made by the District that benefit periods beyond December 31st are classified as prepaid expenses. A current asset is recorded at the time of purchase and an expense is made per the consumption method. The prepayment of expenses is for the numerous insurances required on behalf of the District's employees' and its infrastructure.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

(i) *Capital assets*

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the date received.

All reported capital assets are depreciated with the exception of land and construction in progress. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives:

| <u>Description</u> | <u>Estimated Lives</u> |
|----------------------------|------------------------|
| Transmission main lines | 50-75 years |
| Meters and settings | 20-25 years |
| Hydrants and flush valves | 40-50 years |
| Buildings | 40 years |
| Vehicles | 3-5 years |
| Equipment | 7-20 years |
| Office furniture, fixtures | 5-10 years |

(j) *Customer deposits*

Deposits are required by the District for each customer to receive services. The deposits are maintained by the District and returned when services are no longer used or other qualifying event by the District's policy.

(k) *Net investment in capital assets*

Net investment in capital assets is the net amount of the capital assets less the amounts payable for long-term debt financing those capital assets.

(l) *Statement of cash flows*

For the purposes of the statement of cash flows, cash and cash equivalents are defined to be cash on hand, demand deposits, restricted cash and cash equivalents, and highly liquid investments with a maturity of three months or less from the date of purchase. For financial statement presentation purposes, cash and cash equivalents are shown as cash and cash equivalents and restricted cash and cash equivalents.

(m) *Use of estimates*

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the District's management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues, expenses, and disclosure of contingent assets and

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

liabilities at the date of the financial statements. Actual results could differ from those estimates.

(n) *Capital contributions*

Capital contributions include the amounts paid by state and local governments that arise from contributions of capital assets, or from grants or outside contributions of resources restricted to capital acquisition and construction.

(o) *Pensions*

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

NOTE 2 – Budgetary data

The District's Board of Commissioners receives and approves an annual budget from management each calendar year fulfilling the requirement to prepare an annual budget as required by all Special Purpose Governmental Entities for the Kentucky Department of Local Government.

NOTE 3 – Cash and investments

Cash and investments as of December 31, 2016 are classified in the accompanying financial statements as follows:

Statement of Net Position:

| | |
|----------------------|------------|
| Cash and investments | \$ 911,281 |
|----------------------|------------|

Cash and investments as of December 31, 2016 consist of the following:

| | |
|--------------------------------------|-------------------|
| Cash on hand | \$ 400 |
| Deposits with financial institutions | 510,056 |
| Certificates of deposit | <u>400,825</u> |
| Total cash and investments | <u>\$ 911,281</u> |

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

Custodial risk

Custodial risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of a another party. As of December 31st, the District's deposits and investments with financial institutions have limited insurance coverage with the federal deposit insurance corporation (FDIC) up to \$250,000. Deposits in excess of \$250,000 are fully secured by the local institutions pledged securities.

NOTE 4 – Capital assets

Capital asset activity for the calendar year ended December 31, 2016, was as follows:

| | <u>12/31/2015</u> | | <u>Additions</u> | | <u>Deductions</u> | | <u>12/31/2016</u> |
|--|---------------------|----|------------------|----|-------------------|----|---------------------|
| Land | \$ 70,788 | \$ | - | \$ | - | \$ | 70,788 |
| Construction in progress | - | | 68,608 | | 49,706 | | 18,902 |
| Total capital assets, not being Depreciated | <u>70,788</u> | | <u>68,608</u> | | <u>49,706</u> | | <u>89,690</u> |
| Buildings | 355,645 | | - | | - | | 355,645 |
| Distribution & Storage | 8,578,266 | | 249,346 | | - | | 8,827,611 |
| Vehicles & Equipment | 551,531 | | - | | - | | 551,531 |
| Capital assets, being depreciated | <u>9,485,442</u> | | <u>249,346</u> | | <u>-</u> | | <u>9,734,787</u> |
| Less: Accumulated Depreciation | <u>4,484,479</u> | | <u>259,907</u> | | <u>-</u> | | <u>4,744,386</u> |
| Total capital assets, depreciated | <u>5,000,963</u> | | <u>(10,562)</u> | | <u>-</u> | | <u>4,990,401</u> |
| Capital Assets-net | \$ <u>5,071,751</u> | \$ | \$ <u>58,046</u> | \$ | \$ <u>49,706</u> | \$ | \$ <u>5,080,091</u> |

Depreciation expense was \$259,907 for the year.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

NOTE 5 – Pension Plan

General information about the County Employees Retirement System Non-Hazardous (“CERS”)

Plan description—Employees whose positions do not require a degree beyond a high school diploma are covered by the CERS, a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System, an agency of the Commonwealth of Kentucky. Under the provisions of the Kentucky Revised Statute (“KRS”) Section 61.645, the Board of Trustees of the Kentucky Retirement System administers CERS and has the authority to establish and amend benefit provisions. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for CERS. That report may be obtained from <http://kyret.ky.gov/>.

Benefits provided—CERS provides retirement, health insurance, death and disability benefits to Plan employees and beneficiaries. Employees are vested in the plan after five years’ service. For retirement purposes, employees are grouped into three tiers, based on hire date:

| | | |
|----------------------|---------------------|---|
| Tier 1 | Participation date | Before September 1, 2008 |
| Unreduced retirement | | 27 years service or 65 years old |
| Reduced retirement | | At least 5 years service and 55 years old |
| | | At least 25 years service and any age |
| Tier 2 | Participation date, | September 1, 2008 – December 31, 2015 |
| Unreduced retirement | | At least 5 years service and 65 years old |
| | | Or age 57+ and sum of service years plus age equal 87 |
| Reduced retirement | | At least 10 years service and 60 years old |
| Tier 3 | Participation date | After December 31, 2015 |
| Unreduced retirement | | At least 5 years service and 65 years old |
| | | Or age 57+ and sum of service years plus age equal 87 |
| Reduced retirement | | Not available |

Cost of living adjustments are provided at the discretion of the General Assembly. Retirement is based on a factor of the number of years’ service and hire date multiplied by the average of the highest five years’ earnings. Reduced benefits are based on factors of both of these components. Participating employees become eligible to receive the health insurance benefit after at least 180 months of service. Death benefits are provided for both death after retirement and death prior to retirement. Death benefits after retirement are \$5,000 in lump sum. Five years’ service is required for death benefits prior to retirement and the employee must have suffered a duty-related death. The decedent’s beneficiary will receive the higher of the normal death benefit and \$10,000 plus 25% of the decedent’s monthly final rate of pay and any dependent child

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

will receive 10% of the decedent's monthly final rate of pay up to 40% for all dependent children. Five years' service is required for non-service-related disability benefits.

Contributions—Required contributions by the employee are based on the tier:

| | | <u>Required contribution</u> |
|------|---|------------------------------|
| Tier | 1 | 5% |
| Tier | 2 | 5% + 1% for insurance |
| Tier | 3 | 5% + 1% for insurance |

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 for its proportionate share of the net pension liability for CERS. The amount recognized by the District as its proportionate share of the net pension liability is as follows:

District's proportionate share of CERS's net pension liability \$ 613,826

The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

The District's proportion of the net pension liability for CERS was based on the actual liability of the employees and former employees relative to the total liability of the System as determined by the actuary. At June 30, 201, the District's proportion was .01428% (percent).

For the year ended December 31, 2016, the District recognized pension expense of \$16,325 related to CERS. At December 31, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

| | <u>Deferred Outflows of Resources</u> | <u>Deferred Inflows of Resources</u> |
|---|---|--|
| Differences between expected and actual experience | \$ 5,101 | \$ - |
| Changes of assumptions | 61,898 | - |
| Net difference between projected and actual earnings on pension plan investments | 5,502 | - |
| Changes in proportion and differences between District contributions and proportionate share of contributions | - | 49,409 |
| District contributions subsequent to the measurement date | <u>50,356</u> | |
| | \$ <u>122,857</u> | \$ <u>49,409</u> |

\$50,356 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 related to pensions will be recognized in pension expense as follows:

| | <u>Year Ended June 30,</u> |
|------|--------------------------------|
| 2017 | \$ 33,305 |
| 2018 | 33,305 |
| 2019 | 11,886 |
| 2020 | <u>11,070</u> |
| | \$ <u>89,567</u> |

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

| | <u>CERS</u> | <u>KTRS</u> |
|--|-------------|-------------|
| Inflation | 3.50% | 3.50% |
| Projected salary increases | 4.50% | 4.0-8.2% |
| Investment rate of return, net of investment expense & inflation | 7.75% | 7.50% |

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

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

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

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 contributions from plan employees and employers will be made at statutory contribution rates. Projected inflows from investment earnings were calculated using the long-term assumed investment return of 7.50%. The long-term investment rate of return was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of CERS proportionate share of net pension liability to changes in the discount rate—The following table presents the net pension liability of the District, calculated using the discount rates selected by the pension system, as well as what the District’s net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate:

| | 1% Decrease | Current Discount Rate | 1% Increase |
|--|------------------------|--------------------------------------|--------------------|
| CERS | 6.50% | 7.50% | 8.50% |
| District's proportionate share of net pension liability | 2,795,557 | 613,826 | 1,671,030 |

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

Pension plan fiduciary net position—detailed information about the pension plan’s fiduciary net position is available in the separately issued financial reports of CERS.

NOTE 6-Cafeteria plan

Effective October 1, 1995, the District adopted a cafeteria plan in accordance with Section 125 of the U.S. Internal Revenue Code. The plan allows eligible employees to reduce their taxable compensation by allocating an amount from each pay period to pay health insurance premiums. Total contributions to the plan in 2016 and 2015 were \$18,965 and \$18,963, respectively. The District pays for the cost of a single person plan and any additional coverage is paid by the employee.

NOTE 7 – Risk management

The District is exposed to various risks of loss related to illegal acts, torts, theft/damage/ destruction of assets, errors and omissions, injuries to employees, and natural disasters. To obtain insurance for workers’ compensation, errors and omission, and general liability coverage, the District purchased commercial insurance coverage.

NOTE 8-Prior period adjustments

Prior period adjustments were made as follows:

| | |
|---|--------------------|
| Net Position, Beginning July 1, 2015 | \$5,457,515 |
| Overstated Net Pension Liability | 88,826 |
| Overstated Deferred Outflows of Resources | (55,837) |
| Overstated Interest Receivable | (5,650) |
| Overstated Prepaid Computer Fees | <u>(4,445)</u> |
| Total Prior Period Adjustment | <u>22,894</u> |
| Net Position, Restated July 1, 2015 | <u>\$5,480,409</u> |

The prior period adjustment had no effect on the District’s current year change in net position.

NOTE 9 – Subsequent events

The District has evaluated subsequent events through May 26, 2017, the date the financial statements were available to be issued.

Southern Madison Water District
REQUIRED SUPPLEMENTARY INFORMATION -
SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
For the Year Ended December 31, 2016

| | Reporting Fiscal Year (Measurement Date) 2016 (2015) | Reporting Fiscal Year (Measurement Date) 2015 (2014) |
|---|---|---|
| | <hr/> | <hr/> |
| COUNTY EMPLOYEE'S RETIREMENT SYSTEM: | | |
| Districts' proportion of the net pension liability | 0.05% | 0.05% |
| District's proportionate share of the net pension liability | \$ 613,826 | \$ 525,000 |
| State's proportionate share of the net pension liability associated with the District | - | - |
| Total | <u>\$ 613,826</u> | <u>\$ 525,000</u> |
| District's covered-employee payroll | \$ 339,395 | \$ 350,444 |
| District's proportionate share of the net pension liability as a percentage of its covered-employee payroll | 180.86% | 149.81% |
| Plan fiduciary net position as a percentage of the total pension liability | 59.97% | 66.80% |

Note: Schedule is intended to show information for the last 10 fiscal years. Additional years will be displayed as they become available.

See the accompanying notes to the required supplementary information.

SOUTHERN MADISON WATER DISTRICT
REQUIRED SUPPLEMENTARY INFORMATION - SCHEDULE OF CONTRIBUTIONS
For the Year Ended December 31, 2016

| | <u>2016</u> | <u>2015</u> | <u>2014</u> |
|--|-----------------|-----------------|-----------------|
| COUNTY EMPLOYEE'S RETIREMENT SYSTEM: | | | |
| Contractually required contribution | \$ 74,493 | \$ 79,446 | \$ 86,329 |
| Contributions in relation to the contractually required contribution | <u>74,493</u> | <u>79,446</u> | <u>86,329</u> |
| Contribution deficiency (excess) | <u><u>-</u></u> | <u><u>-</u></u> | <u><u>-</u></u> |
| District's covered-employee payroll | \$ 339,395 | \$ 350,444 | \$ 346,960 |
| District's proportionate share of the required contributions as a percentage of it's covered-employee payroll | 21.95% | 22.67% | 24.88% |

Note: Schedule is intended to show information for the last 10 fiscal years. Additional years will be displayed as they become available.

See the accompanying notes to the required supplementary information.

SOUTHERN MADISON WATER DISTRICT
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

For the Year Ended December 31, 2016

Changes in benefit terms – There were no changes in benefit terms that affected measurement of the total pension liability during the measurement period.

Changes in assumptions – The District’s proportionate share of changes in actuarial assumptions was \$61,898. \$16,325 was recognized in pension expense for the year.

White & Associates, PSC

CERTIFIED PUBLIC ACCOUNTANTS

1407 Lexington Road

Richmond, Kentucky 40475

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

To the Board of Commissioners of the Southern Madison Water District
Berea, 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 enterprise fund of Southern Madison Water District (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, and have issued our report thereon dated May 26, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

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.

White & Associates, PSC

White & Associates, PSC
Richmond, Kentucky
May 26, 2017

SOUTHERN MADISON WATER DISTRICT
SCHEDULE OF FINDINGS
Year Ended December 31, 2016

SECTION I – SUMMARY OF AUDITORS’ RESULTS

| | |
|---|----------------------|
| What type of report was issued for the financial statements? | Unmodified |
| Were there significant deficiencies in internal control disclosed? If so, was any significant deficiencies material (GAGAS)? | None reported N/A |
| Was any material noncompliance reported (GAGAS)? | No |

SECTION II – FINANCIAL STATEMENT FINDINGS

There were no findings.

SOUTHERN MADISON WATER DISTRICT
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Year Ended December 31, 2016

There were no findings from the prior year.