

THE GARRARD COUNTY WATER ASSOCIATION, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

WITH

INDEPENDENT AUDITORS' REPORT

THE GARRARD COUNTY WATER ASSOCIATION, INC.

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Robinson, Hughes & Christopher, P.S.C.
Certified Public Accountants
459 West M.L. King Blvd., P.O. Box 880
Danville, Kentucky 40423
Telephone 859-236-6628 (Fax 859-236-6660)

INDEPENDENT AUDITORS' REPORT

Board of Directors
The Garrard County Water Association, Inc.

We have audited the accompanying financial statements of The Garrard County Water Association, Inc. (a nonprofit organization), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of income, fund equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility For Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes performing procedures to obtain audit evidence about amounts and disclosures in the financial statements. The procedures selected depend upon 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Garrard County Water Association, Inc. as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Robinson, Hughes & Christopher, P.S.C.

ROBINSON, HUGHES & CHRISTOPHER, P.S.C.
Certified Public Accountants

February 7, 2017

THE GARRARD COUNTY WATER ASSOCIATION, INC.
BALANCE SHEETS

	<u>December 31,</u> 2016	<u>December 31,</u> 2015
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash on hand	\$ 300	\$ 300
Cash on deposit	1,126,773	507,210
Accounts receivable - trade (net of allowances for uncollectible accounts of \$9,008 and \$9,039 respectively)	146,682	122,362
Tap on fees receivable	5,000	-
Interest and dividends receivable	11,321	7,049
Prepaid insurance	14,608	15,026
Total Current Assets	<u>1,304,684</u>	<u>651,947</u>
RESTRICTED ASSETS:		
Cash in bank - Extension Escrow Account	500	500
Total Restricted Assets	<u>500</u>	<u>500</u>
INVESTMENTS:		
Certificates of deposit - held to maturity	2,934,487	3,277,586
Debt and equity securities	580,706	536,717
Total Investments	<u>3,515,193</u>	<u>3,814,303</u>
FIXED ASSETS, LESS DEPRECIATION	<u>8,230,826</u>	<u>8,407,321</u>
TOTAL ASSETS	<u>\$ 13,051,203</u>	<u>\$ 12,874,071</u>
 <u>LIABILITIES AND FUND EQUITY</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 87,097	\$ 116,219
Payroll taxes payable	2,450	2,264
Contributions in advance of new connections	1,450	-
Total Current Liabilities	<u>90,997</u>	<u>118,483</u>
LIABILITIES PAYABLE FROM RESTRICTED CASH:		
Payable from extension escrow deposits	500	500
Total Liabilities Payable from Restricted Cash	<u>500</u>	<u>500</u>
FUND EQUITY:		
Contributed capital	9,456,602	9,412,092
Retained earnings	3,503,104	3,342,996
Total Fund Equity	<u>12,959,706</u>	<u>12,755,088</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 13,051,203</u>	<u>\$ 12,874,071</u>

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.

INCOME STATEMENTS

	For The Year Ended December 31,	
	2016	2015
OPERATING REVENUE:		
Water sales - metered	\$ 1,847,725	\$ 1,768,708
Service charges	87,824	85,500
Bulk water sales	2,548	2,617
Machine hire and labor	3,380	2,820
Hydrant fees	1,150	1,925
Miscellaneous	451	273
Total Operating Revenue	<u>1,943,078</u>	<u>1,861,843</u>
OPERATING EXPENSES:		
Purchased water	830,928	866,566
Depreciation	424,682	414,382
Salaries (net of capitalized labor)	288,496	281,522
Repairs and maintenance	77,094	72,513
Group insurance	38,050	35,932
Postage	31,135	32,443
Insurance	29,718	29,555
Utilities and telephone	27,347	27,557
Legal and accounting	25,572	16,635
Payroll taxes	24,852	23,769
Directors' fees	22,250	22,500
Bad debts	21,171	19,073
Water sampling	12,977	20,698
Bill processing fees	11,599	6,463
Gas and oil	11,238	12,648
Pension expense	10,578	10,029
PSC assessment	3,735	3,630
Office supplies	3,401	10,650
Collection fees - loading stations	1,224	1,431
Other	14,369	8,822
Total Operating Expenses	<u>1,910,416</u>	<u>1,916,819</u>
OPERATING INCOME	32,662	(54,976)
OTHER INCOME (EXPENSE):		
Investment income	108,954	51,925
Investment fees	(2,558)	(1,676)
Rent income	4,100	9,000
Gain on disposition of equipment	16,950	1,500
NET INCOME	<u>\$ 160,108</u>	<u>\$ 5,773</u>

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.
 STATEMENTS OF FUND EQUITY
 FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	<u>Contributed Capital</u>	<u>Retained Earnings</u>	<u>Total Fund Equity</u>
Beginning balance January 1, 2015	\$ 9,384,770	\$ 3,337,223	\$ 12,721,993
CONTRIBUTED CAPITAL:			
Contributions in aid of construction received or credited	27,015		27,015
Refunds to developers for line construction costs	(493)		(493)
Computer donated	800		800
NET INCOME FOR THE PERIOD		5,773	5,773
Ending balance December 31, 2015	<u>9,412,092</u>	<u>3,342,996</u>	<u>12,755,088</u>
CONTRIBUTED CAPITAL:			
Contributions in aid of construction received or credited	44,875		44,875
Refunds to developers for line construction costs	(365)		(365)
NET INCOME FOR THE PERIOD		160,108	160,108
Ending balance December 31, 2016	<u><u>\$ 9,456,602</u></u>	<u><u>\$ 3,503,104</u></u>	<u><u>\$ 12,959,706</u></u>

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.

STATEMENTS OF CASH FLOWS

	For The Year Ended December 31,	
	2016	2015
Cash Flows From Operating Activities:		
Net income	\$ 160,108	\$ 5,773
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	424,682	414,382
Gain on disposition of equipment	(16,950)	(1,500)
Unrealized (gain) or loss on investments	(23,969)	29,712
Change in:		
Accounts receivable	(24,320)	4,087
Other receivables	(5,000)	42
Interest receivable	(4,272)	(2,672)
Prepaid expenses	418	277
Accounts payable and accrued expenses	(28,936)	39,218
Net Cash Provided By Operating Activities	<u>481,761</u>	<u>489,319</u>
Cash Flows From Investing Activities:		
Fixed assets purchased	(231,237)	(49,207)
Proceeds from sale of fixed assets	-	1,500
Proceeds from investments sold and matured	947,001	-
Investments purchased	(623,922)	(324,411)
Net Cash Provided By (Used In) Investing Activities	<u>91,842</u>	<u>(372,118)</u>
Cash Flows From Financing Activities:		
Contributions from customers in aid of meter installations	39,875	27,015
Contributions from customers in advance of meter installations	1,450	-
Refunds to developers for line construction costs	(365)	(493)
Change in receivable from the KY Department of Transportation	-	6,385
Customer contributions in aid of extension construction	5,000	-
Net Cash Provided By Financing Activities	<u>45,960</u>	<u>32,907</u>
Net increase in cash	619,563	150,108
Cash at beginning of year	<u>507,510</u>	<u>357,402</u>
Cash at end of year	<u>\$ 1,127,073</u>	<u>\$ 507,510</u>

Supplemental Schedule of Noncash Investing and Financing Activities:

During 2015, a computer valued at \$800 was donated to the Association.

During 2016, two fully depreciated trucks were traded in on new trucks. The trade-in allowances received totaled \$16,950.

"See accompanying notes."

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE I - Nature of Activities and Summary of Significant Accounting Policies

Nature of Activities

The Garrard County Water Association, Inc. (the Association) was incorporated on February 3, 1970. The Association sells water to residential, agricultural, and commercial customers in much of rural Garrard County and parts of Madison, Lincoln, and Rockcastle Counties, Kentucky.

Basis of Accounting

The financial statements of the Association have been prepared in accordance with generally accepted accounting principles (GAAP) and accordingly, reflect all significant receivables, payables and other liabilities.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows, all bank deposits and repurchase agreements purchased with a maturity of three months or less are considered to be cash equivalents. Overdrafts are treated as components of cash if the bank has the right of offset against other deposits.

Accounts Receivable - Trade

Receivables for water sales are recorded monthly following the reading of meters and verification of those readings.

On a quarterly basis, the Association's board of directors is provided with a listing of accounts deemed to be uncollectible. Generally, this listing is comprised of customers who have moved without paying their water bill and for which no forwarding address can be found. After reviewing the listing, the board approves charging off the accounts.

The allowance for doubtful accounts is calculated using the percentage of sales charged off over the the most recent five years multiplied by the customer accounts receivable outstanding.

Inventory

Materials and supplies are expensed when purchased with no inventory account being maintained. Management considers such inventories immaterial in relation to the financial statements taken as a whole.

Investments

Investments in certificates of deposit and repurchase agreements which the Association has both the intention and ability to hold to maturity are reported at cost.

Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value on the balance sheet.

Investment income consists of interest and dividend income on investments as well as realized and unrealized gains. Investment fees are recognized as an expense.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE I - Nature of Activities and Summary of Significant Accounting Policies (continued)

Fixed Assets

Fixed assets purchased by the Association are recorded at cost. New line additions received from subdivision developers and others are recorded at the cost incurred to construct the additions. Other fixed assets donated to the Association are recorded at fair value at the time of the donation. Fixed asset additions costing less than \$500 are charged to expense as purchases are made. Fixed assets are reported on the financial statements net of an allowance for depreciation. Depreciation expense has been calculated on the straight-line basis over the estimated useful lives of the assets.

Contributed Capital

Customer connection fees received for existing lines, grants received, and service lines contributed by others have been accorded the same treatment in these statements as that required by the Public Service Commission. This policy results in such amounts being credited directly to contributed capital rather than being recorded as income. Connection fees received for new lines are recorded as liabilities until construction is completed.

Reimbursements to developers for partial cost of line additions are offset against contributed capital.

Income Taxes

The Association has been classified as exempt from income taxes under IRC Section 501(c)(12) and will retain this exemption as long as at least 85% of its gross income consists of amounts collected from members for the sole purpose of meeting losses and expenses. Management monitors to make certain that the 85% test described above is met and that all income not collected from members is excluded from tax under IRC Sections 512, 513, or 514. Accordingly, management has determined that no provision for income taxes is needed and that no significant exposure to risk of assessment of income or excise taxes currently exists. The federal returns for the current and preceding three years remain subject to examination.

NOTE II - Deposits

A. Accounts Maintained

The Association maintains the following accounts - Revenue Funds, Operation and Maintenance and Depreciation Reserve.

All income collected, with the exception of interest credited to other interest bearing checking accounts, is deposited to the Revenue Funds Account.

An amount sufficient to pay reasonable and necessary current expenses is to be maintained in the Operation and Maintenance Account. The Association transfers funds from the Revenue Funds Account at the beginning of each month in order to meet these expenses.

The Association has also established a Depreciation Reserve Account to be drawn against for large and non-recurring expenditures.

B. Deposit Security

The Association maintains its deposits with various banks. At December 31, 2016, \$3,083,408 of the balance was covered by standard federal depository insurance and \$978,343 was secured by securities under a repurchase agreement described on the next page.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE II - Deposits (continued)

Pursuant to a sweep account agreement with a local bank, a balance of \$25,000 is maintained in a non-interest bearing checking account. On a daily basis, funds are either swept out of or into the account as necessary to maintain the \$25,000 balance. The funds in excess of \$25,000 are placed in retail repurchase agreements (Repos). The Repos evidence a borrowing by the bank to be fully collateralized by securities which are the direct obligation of, or the principal and interest of which are fully guaranteed by, the United States, one of its agencies, or investment grade securities or investment grade corporate bonds. All securities which are part of the repurchase agreement are held by a third party custodian which serves as agent for the Association.

C. Summary of Account Balances

	<u>Cash on Deposit</u>			<u>Certificates of Deposit Included in Investments</u>	<u>Total Deposits</u>
	<u>Non-Interest Bearing</u>	<u>Interest Bearing</u>	<u>Total</u>		
Revenue Funds	\$ 25,000	\$ 978,343	\$ 1,003,343	\$ -	\$ 1,003,343
Operations and Maintenance	72,279	-	72,279	-	72,279
Depreciation Reserve	-	51,151	51,151	2,934,487	2,985,638
Total Unrestricted Deposits	<u>97,279</u>	<u>1,029,494</u>	<u>1,126,773</u>	<u>2,934,487</u>	<u>4,061,260</u>
Restricted - Extension escrow	500	-	500	-	500
Total deposits	<u>\$ 97,779</u>	<u>\$ 1,029,494</u>	<u>\$ 1,127,273</u>	<u>\$ 2,934,487</u>	<u>\$ 4,061,760</u>

D. Maturities - Certificates of Deposit

A breakdown of certificates of deposit by year of maturity is as follows:

2017	\$ 900,000
2018	588,487
2019	247,000
2020	300,000
2021	799,000
2022	100,000
	<u>\$ 2,934,487</u>

E. Restricted Cash

The Association requires developers of new subdivisions and others desiring to add privately sponsored extensions to make deposits to an Extension Escrow Account to cover the cost of waterline extensions. The waterline construction costs are then paid from the Escrow Account as incurred. Any deposits remaining at the end of the construction are refunded to the sponsor of the extension.

Note III - Investments - Debt and Equity Securities

In addition to investments in certificates of deposit described in Note II, the Association has invested in various debt and equity securities. As previously stated, these investments are reported at fair value on the balance sheet.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

Note III - Investments - Debt and Equity Securities (continued)

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. GAAP also establishes a fair value hierarchy that requires the Association to maximize the use of observable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Association's market assumptions. The three levels to the fair value hierarchy are as follows:

Level 1 - Quoted prices for identical assets or liabilities in active markets.

Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; or market-corroborated inputs.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

During 2016 and 2015, all of the Association's debt and equity securities were measured using either level 1 or level 2 inputs. The following table represents debt and equity investments that are measured at fair value on a recurring basis at December 31, 2016 and 2015:

	December 31, 2016		
	Total	Level 1	Level 2
Money market fund	\$ 6,192	\$ 166,930	
Mutual funds investing in interest bearing securities	220,115	59,377	
Corporate bonds and notes	195,110		195,110
Equity mutual funds	81,519	81,519	
Mutual funds - real estate	42,646	42,646	
Closed end utility fund	19,642	19,642	
Exchange traded fund - S&P U.S. Preferred Stock Index	13,395	13,395	
Mutual fund - balanced fund	2,087	2,087	
Total	<u>\$ 580,706</u>	<u>\$ 385,596</u>	<u>\$ 195,110</u>
	December 31, 2015		
	Total	Level 1	Level 2
Money market fund	\$ 8,882	\$ 8,882	\$ -
Mutual funds investing in interest bearing securities	191,486	191,486	-
Corporate bonds and notes	191,485	-	191,485
Equity mutual funds	75,131	75,131	-
Mutual funds - real estate	38,544	38,544	-
Closed end utility fund	17,203	17,203	-
Exchange traded fund - S&P U.S. Preferred Stock Index	13,986	13,986	-
Total	<u>\$ 536,717</u>	<u>\$ 345,232</u>	<u>\$ 191,485</u>

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE IV - Investment Income

Investment income consisted of the following:

	<u>For the year ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Interest income	\$ 74,383	\$ 71,559
Dividends	9,964	10,078
Unrealized gain (loss) on investments	24,607	(29,712)
Total	<u>\$ 108,954</u>	<u>\$ 51,925</u>

NOTE V - Accounts Receivable - Trade

As of December 31, 2016, the outstanding trade accounts receivable consisted of the following.

	<u>Current</u>	<u>Period Since Due Date</u>			<u>Total</u>
		<u>30-59 Days</u>	<u>60-89 Days</u>	<u>90 Days and Over</u>	
Customers	\$140,534	\$ 8,985	\$ 3,988	\$ 1,120	\$ 154,627
Miscellaneous	262			801	1,063
Total	<u>\$140,796</u>	<u>\$ 8,985</u>	<u>\$ 3,988</u>	<u>\$ 1,921</u>	<u>\$ 155,690</u>

NOTE VI - Fixed Assets

Fixed assets consisted of the following at December 31, 2016 and 2015:

	<u>Depreciable Lives -Years</u>	<u>Historical Cost Basis</u>	
		<u>2016</u>	<u>2015</u>
Land and land rights	N/A	\$ 99,907	\$ 99,907
Land held for rental	N/A	24,004	24,004
Distribution reservoirs and standpipes	40 - 50	1,247,443	1,176,467
Transmission and distribution mains	40 - 50	12,530,428	12,510,136
Fire mains	50	6,803	6,803
Meters and meter installations	40 -50	1,568,653	1,534,371
Hydrants	40 -50	8,859	8,859
Maintenance equipment	5 - 10	248,555	205,292
Loading station equipment	10	2,750	2,750
Buildings	25 - 40	133,644	133,644
Rental building	40	53,758	53,758
Office equipment	5	36,394	36,394
Construction in process	N/A	25,105	-
Total		<u>15,986,303</u>	<u>15,792,385</u>
Less: Accumulated depreciation		<u>7,755,477</u>	<u>7,385,064</u>
Total Fixed Assets		<u>\$ 8,230,826</u>	<u>\$ 8,407,321</u>

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE VII - Pension Expense

The Association provides pension benefits to eligible employees through a 401-K plan. Employees must be age 21 or over with one year of service as of either of the plan entrance dates of January 1 and July 1 to be eligible to participate. Employee participation is elective. Employees under age 50 may elect to contribute up to \$18,000 annually. Employees age 50 or over may elect to contribute up to \$24,000 annually. Employee elective contributions are matched by the employer up to 5% of employee compensation.

Under the plan, employees are immediately vested in the contributions made by the employee and are vested in the employer contributions over a five year period beginning with the date of employment as follows:

0 - 1 year	0%	3 years	60%
1 year	20%	4 years	80%
2 years	40%	5 years	100%

The Association's policy is to fund the pension expense as the liability accrues.

NOTE VIII - Insurance In Force

In order to secure itself against various unexpected losses, the Association maintains insurance coverage as described below:

<u>Description</u>	<u>Amount</u>
Workers compensation	Statutory Limit
Kentucky Association of Counties All Lines Fund	
General liability	\$ 3,000,000
Real and personal property	15,000,000
Public officials	3,000,000
Auto liability	3,000,000
Auto comprehensive and collision	ACV
Public officials and employee fidelity	150,000
ERISA bond	100,000

NOTE IX - Commitments and Contingencies

In connection with the construction of additional water lines, the Association has received various grants. Terms of the grants include repayment of the grant funds in the event of the Association's default on its representations and warranties as specified in the grant agreements.

NOTE X - Source of Water Supply

The Association purchases most of its water (71.8% during 2016) from the City of Lancaster under a contract dated March 25, 1970. It is, therefore, dependent upon the continuing ability of the City of Lancaster to provide a sufficient supply of treated water.

THE GARRARD COUNTY WATER ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE XI - Rent Income

Effective September 1, 2014, the Association entered into a contract for lease and potential sale of a building and lot owned by the Association and located next to the Association's headquarters. Under the terms of the agreement, the lessee can pay \$750 per month for five years for use of the property and will have the right to purchase the property for \$50,000 at the end of the five-year period. During 2016, the lessee exercised its right to terminate the lease before the end of the five-year period. Accordingly, all rights to purchase the property were forfeited and none of the payments that had been made to that point were refunded to them.

NOTE XII- Concentration of Credit Risk

The Association is subject the credit risks associated with selling water to residential, agricultural, and commercial customers in an area where the economy is largely agricultural based.

NOTE XIII - Water Losses

During 2016, the Association incurred the following water loss:

	Gallons (1,000's)	Percent
Water purchased	371,294	100.00 %
Less: metered sales to customers	(306,758)	(82.62)
unmetered sales to customers (loading stations)	(511)	(0.14)
water used by Association	(3,542)	(0.95)
Water loss	<u>60,483</u>	<u>16.29 %</u>

Breakdown of water loss:

Line leaks	51,823	13.96 %
Line breaks	<u>8,660</u>	<u>2.33</u>
Total water loss	<u>60,483</u>	<u>16.29 %</u>

NOTE XIV- Subsequent Events

Events subsequent to December 31, 2016 have been evaluated to determine their potential impact on the financial statements. Events through February 7, 2017, the date the financial statements were available to be issued, were considered.

There were no events occurring during this period requiring disclosure in the financial statements.