

HENDERSON WATER UTILITY

***FINANCIAL STATEMENTS
AND
SUPPLEMENTARY INFORMATION
Year Ended June 30, 2018***

(With Independent Auditor's Report Thereon)

CONTENTS

	<u>Pages</u>
Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-10
Financial Statements:	
Statement of Net Position	11-12
Statement of Revenues, Expenses, and Changes in Net Position	13
Statement of Cash Flows	14-15
Notes to Financial Statements	16-39
Required Supplementary Information:	
Pension and Other Postemployment Benefits (OPEB) Schedules:	
Schedule of Proportionate Share of the Net Pension Liability	40
Schedule of Pension Contributions	41
Schedule of Proportionate Share of the Net OPEB Liability	42
Schedule of OPEB Contributions	43
Notes to Required Supplementary Information	44
Supplementary Information:	
Schedule of Revenues, Expenses, and Changes in Net Position by Division	45
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 <i>Government Auditing Standards</i>	46-47
Schedule of Findings and Responses	48



INDEPENDENT AUDITOR'S REPORT

Water and Sewer Commission of the City of Henderson
Henderson Water Utility

Report on the Financial Statements

We have audited the accompanying financial statements of the Henderson Water Utility (Utility), a component unit of the City of Henderson, Kentucky, as of and for the year ended June 30, 2018, 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 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Henderson Water Utility, as of June 30, 2018, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 13 to the financial statements, net position at June 30, 2017, has been restated to correct a material misstatement. Our opinion is not modified with respect to this matter.

Change in Accounting Principle

As discussed in Note 13 to the financial statements, in fiscal year 2018 the Utility adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. 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 through 10, and the Pension and Other Postemployment Benefits (OPEB) Schedules on pages 40 through 44, 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 Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Revenues, Expenses, and Changes in Net Position by Division is presented for purposes of additional analysis and is not a required part of the financial statements.

The Schedule of Revenues, Expenses, and Changes in Net Position by Division is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Revenues, Expenses, and Changes in Net Position by Division is fairly stated in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2018, on our consideration of the Utility'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 solely 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 the effectiveness of the Utility's 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 Utility's internal control over financial reporting and compliance.

Owensboro, Kentucky
November 14, 2018

Ringhart CPA's PSC

HWU

Henderson Water Utility

WATER • WASTEWATER • STORMWATER

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Henderson, KY 42420

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Henderson Water Utility (Utility), we offer readers of the Utility's financial statement this overview and analysis of the financial activities of the Utility for the fiscal year ended June 30, 2018. The Utility is in the business of providing water, wastewater and stormwater services for the City of Henderson, Kentucky, as well as parts of Henderson, Webster and McLean counties. It is our intent that these comments provide all parties interested in the Utility's financial condition, especially the citizens of Henderson, a better understanding of the Utility's operations and financial condition. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in the Utility's financial statements, which begin on page 11 of this report.

Financial Highlights

- The Utility's total assets increased by 0.2% from \$93,797,262 at June 30, 2017, to \$94,023,737 at June 30, 2018, primarily due to the expenditure of cash to continue the various capital projects.
- Operating revenues increased \$1,629,150 or 8.5% from \$19,057,876 to \$20,687,026 due primarily to the fixed stormwater charges that went into effect in July 2017 in addition to overall increased usage (residential continues downward trend, offset by increases in commercial and industrial sectors).
- Operating expenses increased by \$1,102,568 or 6.1% from \$17,962,584 to \$19,065,152 due primarily to higher personnel related expenses (wages and benefits), materials and depreciation. This increase in expense was outpaced by the change in operating revenues resulting in a \$526,583 or 48.1% increase in operating income compared to the year ago.
- The Utility produced a negative cash flow of \$329,889 for the year. The Utility generated approximately \$7.2 million in cash from operations, investments and proceeds from asset sales. The sources of cash were exceeded by capital expenditures of approximately \$4.0, debt-related payments of approximately \$3.1 million and the distribution to the City of \$400,000.
- During the fiscal year ending June 30, 2018, the Utility implemented GASB Statement No. 75, which required the Utility to report and fully disclose its proportionate share of net other postemployment benefit liability and related deferred outflows and inflows of resources and OPEB expense from the Utility's participation in the County Employer Retirement System (CERS). The Utility's net OPEB liability recorded was approximately \$3.3 million. For more information on current year pension and OPEB activity, please refer to Note 6 of these financial statements.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Utility's financial statements. These financial statements are comprised of four components: 1) the financial statements, 2) notes to the financial statements, 3) required supplemental information, and 4) supplemental information.

The Utility is a business-type activity and the Utility's financial statements include: the *Statement of Net Position*, the *Statement of Revenues, Expenses and Changes in Net Position* and the *Statement of Cash Flows*. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB) and can be found on pages 11-15 of this report.

The *Statement of Net Position* presents information on all of the Utility's assets, deferred outflows of resources, liabilities and deferred inflows of resources, with the difference reported as net position. Net position is an important measure of the Utility's overall financial health and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Utility's creditors (liabilities). It also provides the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of Utility. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Utility is improving or deteriorating.

The *Statement of Revenues, Expenses and Changes in Net Position* presents information on how the Utility's net position changed, including operating revenues, operating expenses, non-operating income and expenses, capital contributions, and any other changes in net position during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. This statement measures the success of the Utility's operations over the past year and can be used to determine whether the entity has successfully recovered all of its costs through water and wastewater charges, has earned a profit, and has maintained credit worthiness.

The *Statement of Cash Flows* presents information showing how the Utility's cash and cash equivalents position changed during the fiscal year. The primary purpose of this statement is to provide information about the Utility's cash receipts, cash payments, and net changes in cash resulting from operations, investing, capital and financing activities and provides information on the sources and uses of cash and the changes in cash balances during the year.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 16-39.

In addition to the financial statements and accompanying notes, this report also presents certain required supplementary information concerning the Utility's funding of its obligation to provide pension and health insurance benefits to its employees. The required supplementary information can be found on pages 40-44 of this report. Other supplementary information reporting revenues, expenses, and changes in net position by division can be found on pages 45.

Condensed Comparative Financial Statements

Statements of Net Position

	(in thousands)			
	6/30/2018	6/30/2017	Increase (Decrease)	Percent Change
Assets:				
Current Assets	\$ 10,898	\$ 11,183	\$ (285)	-2.5%
Non-Current Assets	234	270	(36)	-13.3%
Capital Assets	82,892	82,344	548	0.7%
Total Assets	<u>94,024</u>	<u>93,797</u>	<u>227</u>	<u>0.2%</u>
Deferred Outflows of Resources	<u>4,313</u>	<u>2,207</u>	<u>2,106</u>	<u>95.4%</u>
Liabilities:				
Current Liabilities	5,067	4,498	569	12.7%
Long-term Liabilities	46,375	43,938	2,437	5.5%
Total Liabilities	<u>51,442</u>	<u>48,436</u>	<u>3,006</u>	<u>6.2%</u>
Deferred Inflows of Resources	<u>1,070</u>	<u>-</u>	<u>1,070</u>	
Net Position:				
Invested in capital assets, net of related debt	47,420	44,777	2,643	5.9%
Unrestricted	<u>(1,595)</u>	<u>2,791</u>	<u>(4,386)</u>	<u>-157.1%</u>
Total Net Position	<u>\$ 45,825</u>	<u>\$ 47,568</u>	<u>\$ (1,743)</u>	<u>-3.7%</u>

Summary

The Utility's assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources by \$45.8 million at fiscal year-end, a decrease of \$1,742,457 or 3.7% from the prior year. The decrease in net position was driven by the implementation of GASB 75 and the recording of the OPEB liability in addition to increases in the pension related liability and associated deferred inflows of resources offset by changes in related deferred outflows of resources and an overall positive change in net position for the fiscal year.

Assets and Deferred Outflows of Resources

Total assets increased by \$226,475 or 0.2% from the prior period. An increase in capital assets was offset by a reduction in current and other assets. The decrease in current assets was primarily due to a decrease in cash and inventory. The Utility's capital expenditures for the fiscal year were approximately \$4.2 million compared to annual depreciation expense of \$3.7 million. Deferred outflows of resources increased \$2.1 million and was driven by pension and OPEB related adjustments from the Utility's participation in County Employee Retirement System (CERS).

Condensed Comparative Financial Statements, Continued

Liabilities and Deferred Inflows of Resources

Total liabilities increased \$3,005,377 or 6.2% due primarily to an increase in the net pension liability of \$1.5 million and the net OPEB liability of \$3.3 million from the Utility's participation in CERS. The Utility had deferred inflows of resources of \$1.07 million related to pension and OPEB related adjustments associated with the Utility's CERS participation.

Net Position

There are two components of the Utility's net position. The largest portion, Invested in Capital Assets, Net of Related Debt, represents the Utility's investment in capital assets, net of any related debt (debt used to finance the purchase of capital assets) and reflects the Utility's investment in capital assets. The remaining Unrestricted Net Position is available to the Utility to meet its ongoing obligations. The Utility's overall net position is simply a function of its assets and deferred outflows of resources minus its liabilities and deferred inflows of resources. During the period, the Utility's net position decreased as previously noted.

Statement of Revenues, Expenses and Changes in Net Position

	(in thousands)			
	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Operating revenues	\$ 20,687	\$ 19,058	\$ 1,629	8.5%
Operating expenses	<u>19,065</u>	<u>17,963</u>	<u>1,102</u>	<u>6.1%</u>
Operating income	1,622	1,095	527	48.1%
Net nonoperating activity	<u>(669)</u>	<u>(863)</u>	<u>194</u>	<u>-22.5%</u>
Change in net position before contributions and distribution	953	232	721	310.8%
Distribution	(400)	(400)	-	0.0%
Capital contributions	<u>112</u>	<u>1,537</u>	<u>(1,425)</u>	<u>-92.7%</u>
Change in net position	665	1,369	(704)	-51.4%
Net position at beginning of year as restated (1)	<u>45,160</u>	<u>46,199</u>	<u>(1,039)</u>	<u>-2.2%</u>
Net position at end of year	<u>\$ 45,825</u>	<u>\$ 47,568</u>	<u>\$ (1,743)</u>	<u>-3.7%</u>

(1) The Utility restated net position at June 30, 2017, for implementation of a new accounting standard and a prior period adjustment. See Note 13 in the accompanying financial statements.

Condensed Comparative Financial Statements, Continued

Summary

The Utility's operating revenues increased 8.5% and operating expenses increased 6.1% resulting in an increase in operating income of 48.1% or \$526,583. Nonoperating activity (net) improved by 22.4% due to decreases in interest expense and gains realized on capital asset activity and investment earnings. Additionally, Utility received capital contributions of fixed assets of approximately \$75,000 and cash of \$36,892 towards two projects. Change in net position decreased \$704,967 compared to a year ago.

Operating Revenues

Operating revenues increased by approximately \$1.6 million or 8.5%. The increase in sales and charges was primarily due to the implementation of fixed stormwater charges (starting at \$5 per month per meter) and overall usage increase by Utility customers. Fee and surcharge income were consistent with prior years for commercial and industrial customers for various regulatory and contractual issues.

<u>Operating Revenues</u>				
(in thousands)				
	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
North:				
Water sales	\$ 5,776	\$ 5,305	\$ 471	8.9%
Wastewater sales	8,362	8,207	155	1.9%
Stormwater fixed charges	735	-	735	
Penalties, fees and surcharges	427	394	33	8.4%
Total North	<u>15,300</u>	<u>13,906</u>	<u>1,394</u>	<u>10.0%</u>
South				
Water sales	2,209	2,098	111	5.3%
Wastewater sales	3,058	2,906	152	5.2%
Penalties, fees and surcharges	120	148	(28)	-18.9%
Total South	<u>5,387</u>	<u>5,152</u>	<u>235</u>	<u>4.6%</u>
Total operating revenues	<u>\$ 20,687</u>	<u>\$ 19,058</u>	<u>\$ 1,629</u>	<u>8.5%</u>

Operating Expenses

Operating expenses increased by approximately \$1.1 million or 6.1%. The key components of operating expenses are: Operation and maintenance expenses and depreciation expense. Operation and maintenance expenses increased by approximately \$1.1 million primarily due to increased personnel related costs (wages, health insurance and retirement) and supplies/materials.

Condensed Comparative Financial Statements, Continued

Operating Expenses				
(in thousands)				
	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Salaries and benefits	\$ 8,151	\$ 7,234	\$ 917	12.7%
Contractual services	2,168	2,114	54	2.6%
Supplies and materials	2,022	1,834	188	10.3%
Utilities	1,891	1,863	28	1.5%
Repairs and maintenance	543	672	(129)	-19.2%
Other services and expenses	612	613	(1)	-0.2%
Depreciation	3,678	3,633	45	1.2%
Total operating expenses	<u>\$ 19,065</u>	<u>\$ 17,963</u>	<u>\$ 1,102</u>	<u>6.1%</u>

Capital Assets

Utility staff has prepared a Strategic Plan for Capital Spending in the water, wastewater and stormwater systems. This document provides an overview of the anticipated needs of the Henderson Water Utility to repair, replace and add to our existing infrastructure for the period through fiscal year 2029. This plan will be updated annually and will assist in the annual capital budgeting process.

The Utility entered into a Consent Judgment with the Commonwealth of Kentucky's Environmental & Public Protection Cabinet (EPPC) in 2007 related to reducing the negative environmental impacts of the City's combined sewer system on water quality. An Agreed Order was also issued by the U.S. EPA.

Under that Consent Judgment, the Utility was required to prepare and submit a Long-Term Control Plan (LTCP) to the EPPC and EPA in early 2009. The LTCP and the projects incorporated in the plan were approved by both regulatory agencies in April 2012. The Utility was required by the Agreed Order to complete all components of the LTCP before December 2017. The purpose of the LTCP is to mitigate the negative environmental impacts of the City's combined sewer system on water quality in the Ohio River and Canoe Creek. All components of the LTCP have been completed with a final cost of approximately \$42 million. The Division of Water agreed to the Termination of our Consent Judgment and action was entered in Franklin Circuit Court on July 11, 2018, to finalize the termination.

The major concern of focusing all our capital investments on the LTCP to meet the Consent Judgment requirements is that for several years, we were unable to fund other necessary infrastructure and operating needs at desired levels. The Utility's treatment plants, water distribution system, sewer and stormwater collection systems must be routinely repaired, replaced and upgraded. With extremely limited funds available for other capital needs outside

Capital Assets, Continued

the LTCP projects, we have been forced to delay investments in other critical infrastructure. Plans have been prepared for various projects including a new pre-stressed concrete clearwell, upgrades of the water plant, switching to a membrane filtration system and others. In July 2017, the Utility approved and awarded a contract on a \$3.5 million project to renovate and upgrade three aeration basins at the South Wastewater facility in response to liner failure and ongoing aeration equipment maintenance and performance issues. This project will be completed in December 2018. The focus of our capital plan has shifted to tank painting and repair projects, and to construction of new water and sanitary sewer lines that replace, upgrade and reinforce our water and wastewater systems.

Stormwater needs are ongoing, and the Utility has completed several small drainage projects over the previous fiscal year. We maintain a prioritized list of future projects. One notable project that is now underway is the Countryview Subdivision Stormwater Project to reduce flooding issues that have been ongoing. Project is being funded by both the Utility and the City. We are also entering the planning and design phases for several small drainage and sewer separation projects that will be done with assistance from engineering consultants. A list of projects in the Strategic Plan “pipeline” for the next 3 to 5 years is also being put out for statements of qualifications from interested engineering firms, and those projects will be moving forward to design and permitting, so that plans are available to continue fulfilling the Strategic Plan.

Our challenge continues to be to balance these competing capital needs while providing our customers with quality water and services at a reasonable and competitive price.

The Utility’s investment in capital assets as of June 30, 2018, amounted to approximately \$47.6 million (net of accumulated depreciation and related debt). The investment in capital assets includes land, buildings, improvements, machinery and equipment, vehicles, construction in progress and infrastructure acquired and disposed since the Utility’s inception. The Utility’s net capital assets for the current fiscal year increased approximately \$548,000 or 0.6% due to current year acquisitions, exceeding current year depreciation expense. The Utility expended approximately \$4.1 million in the current fiscal year on the acquisition and construction of capital assets.

Major capital events of the current fiscal year included the following:

- Construction of various water and wastewater projects totaling approximately \$4.0 million. Main projects consisted of Aeration Basin remodel at SWWTP of \$2.2 million, continued work on the NWWTP Clarifier project for approximately \$670,000, completed rehab of College Tank for approximately \$447,000, in addition to numerous smaller water and stormwater projects.
- Expended approximately \$80,000 on various equipment (IT, lab, pumps/motors, etc.) and approximately \$99,000 on upgrades to buildings (lab remodel, IT infrastructure and security).

Additional information on the Utility’s capital assets can be found in Note 4 of this report.

Long-Term Debt

At June 30, 2018, the Utility had no principal outstanding in bonded debt. The Utility's Series 2006A Revenue Bonds were refunded during the prior year. The Utility also had other debt of \$35,032,480 which consists of various notes to the City of Henderson issued in conjunction with the City's General Obligation Bond Series 2010B, 2012A, 2013A, 2014A, 2015B, 2015C, 2016B and 2017B. These bonds were issued to finance the Utility's various Long-Term Control Plan (LTCP) capital projects, necessary water plant improvements and refinance various Utility debt issues (revenue bonds, KADD & KIA notes, and KACO leases). The Utility has committed to reimbursing the City for all debt service payments made for these issuances.

Additional information on the Utility's debt can be found in Note 5 of this report.

Economic Factors and Next Year's Budgets and Rates

Water and wastewater revenues for the fiscal year ending June 30, 2019, are budgeted to increase approximately 7.16% from fiscal year 2018 budgeted revenues based primarily due to implementation of fixed water charges on July 1, 2018, (charges start at \$7.50 monthly per meter). Operation and maintenance expenses in the fiscal year ending June 30, 2019, are budgeted to increase by approximately \$202,000 or 1.1% from the fiscal year 2018 budget, primarily based on increased depreciation, contractual services and material costs. Utility made reduction in staffing levels to reduce labor costs (salaries and benefits) due to ongoing uncertainty related to future pension costs from the Utility's participation in the Kentucky County Employees Retirement System (CERS).

Management is continually monitoring our rates and rate structure in relation to capital, debt and operational needs, as well as weighing cost to our customers compared to other utilities. The Utility elected to forego a previously approved volumetric rate increase scheduled for July 1, 2018. In lieu of this, the Utility approved a fixed fee schedule for water and wastewater (variable based on meter size) that went in effect July 1, 2018 and that will subsequently increase on July 1, 2019. This fee is estimated to generate approximately \$1 million in the first year and \$2 million annually thereafter. The Utility continues to evaluate and balance available revenue against expenditures, regulatory requirements and service levels and to seek operating efficiencies. Management emphasizes sound financial and operational decision-making with a focus on strategic thinking and planning. Key objectives at present include focusing on future capital needs, managing salary and benefit costs and staffing levels, and development of a budgets that approaches both revenues and expenses conservatively and that focuses on long-term sustainability.

Request for Information

The financial report is designed to provide our citizens, ratepayers, customers and creditors with a general overview of the Utility's finances and to show its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Utility at 111 Fifth Street, Henderson, Kentucky, 42420.

HENDERSON WATER UTILITY

STATEMENT OF NET POSITION

June 30, 2018

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Current assets:

Cash and cash equivalents	\$	6,457,276
Investments		46,067
Accounts receivable		1,977,125
Unbilled revenue		1,528,172
Accrued interest receivable		452
Inventories		810,537
Prepaid expenses		78,139

Total current assets 10,897,768

Noncurrent assets:

Capital assets:

Non-depreciable		1,466,482
Depreciable, net of accumulated depreciation		76,507,887
Construction in progress		4,917,432

Total capital assets 82,891,801

Other noncurrent assets 234,168

Total noncurrent assets 83,125,969

Total assets 94,023,737

Deferred outflows of resources:

Deferred outflows related to pensions		3,276,535
Deferred outflows related to other postemployment benefits		909,392
Deferred loss on refunding of bonds payable		127,515

Total deferred outflows of resources 4,313,442

Total assets and deferred outflows of resources \$ 98,337,179

HENDERSON WATER UTILITY

STATEMENT OF NET POSITION, Continued

June 30, 2018

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

Current liabilities:	
Accounts payable	\$ 733,931
Accrued liabilities	1,269,468
Accrued interest payable	145,340
Compensated absences	389,240
Current portion of long-term debt	2,306,297
Retainage payable	<u>222,320</u>
Total current liabilities	<u>5,066,596</u>
Noncurrent liabilities:	
Consumer deposits	113,295
Compensated absences	242,641
Net pension liability	9,637,646
Net other postemployment benefits liability	3,310,089
Long-term debt	<u>33,071,181</u>
Total noncurrent liabilities	<u>46,374,852</u>
Total liabilities	<u>51,441,448</u>
Deferred inflows of resources:	
Deferred inflows related to pensions	897,009
Deferred inflows related to other postemployment benefits	<u>173,307</u>
Total deferred inflows of resources	<u>1,070,316</u>
Net position:	
Investment in capital assets, net of related debt	47,419,518
Unrestricted	<u>(1,594,103)</u>
Total net position	<u>45,825,415</u>
Total liabilities, deferred inflows of resources, and net position	\$ <u><u>98,337,179</u></u>

See Accompanying Notes to Financial Statements

HENDERSON WATER UTILITY

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Year Ended June 30, 2018

Operating revenues:	
Water sales	\$ 7,984,941
Water penalties, surcharges and fees	73,567
Wastewater fees	11,420,284
Wastewater penalties, surcharges and fees	473,313
Stormwater fees	734,921
	<hr/>
Total operating revenues	20,687,026
Operating expenses:	
Water pumps and tanks	151,577
Water intake and treatment	3,498,794
Water transmission and distribution	2,624,833
Wastewater lines and collection	1,693,607
Wastewater pumping stations	1,485,827
Wastewater pretreatment and treatment	4,736,993
Stormwater	1,195,485
Depreciation	3,678,036
	<hr/>
Total operating expenses	19,065,152
Operating income	<hr/> 1,621,874
Nonoperating revenues (expenses):	
Gain on disposal of capital assets	64,238
Investment income	97,205
Miscellaneous revenue	66,473
Interest expense	(897,249)
	<hr/>
Total nonoperating revenues (expenses)	(669,333)
Income before distribution and capital contributions	952,541
Distribution to the City of Henderson	(400,000)
Capital contributions	111,715
	<hr/>
Change in net position	664,256
Net position, beginning of year, as previously reported	46,092,187
Restatement of beginning net position	<hr/> (931,028)
Net position, beginning of year, restated	<hr/> 45,161,159
Net position, end of year	<hr/> <hr/> \$ 45,825,415

See Accompanying Notes to Financial Statements

HENDERSON WATER UTILITY

STATEMENT OF CASH FLOWS

Year Ended June 30, 2018

Cash flows from operating activities:	
Receipts from customers	\$ 20,807,023
Payments to suppliers for goods or services	(6,996,687)
Payments to or on behalf of employees	(6,870,080)
	<u>6,940,256</u>
Cash flows from noncapital financing activities	
Distributions to the City of Henderson	<u>(400,000)</u>
	<u>(400,000)</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(3,991,425)
Principal paid on long-term debt	(2,253,613)
Interest paid on long-term debt	(894,917)
Proceeds from capital contributions	36,892
Proceeds from sale of capital assets	70,100
	<u>(7,032,963)</u>
Cash flows from investing activities:	
Investment income	<u>162,818</u>
	<u>162,818</u>
Net decrease in cash and cash equivalents	(329,889)
Cash and cash equivalents, beginning of year	<u>6,787,165</u>
Cash and cash equivalents, end of year	<u>\$ 6,457,276</u>

See Accompanying Notes to Financial Statements

HENDERSON WATER UTILITY
STATEMENT OF CASH FLOWS, Concluded
Year Ended June 30, 2018

Reconciliation of operating income to net cash provided by operating activities:

Operating income	\$ 1,621,874
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	3,678,036
Change in assets and liabilities:	
Decrease (increase) in assets and deferred outflows:	
Accounts receivable	(115,438)
Unbilled revenue	(52,486)
Inventories	127,437
Prepaid expenses	(13,993)
Deferred outflows of resources	(2,133,081)
Increase (decrease) in liabilities and deferred inflows:	
Accounts payable	110,424
Accrued liabilities	275,413
Consumer deposits	26,297
Compensated absences	(63,191)
Net pension and OPEB liabilities	2,219,027
Deferred inflows of resources	<u>1,259,937</u>
Net cash provided by operating activities	<u><u>\$ 6,940,256</u></u>

Noncash investing, capital and financing activities:

Unrealized gain (loss) on investments	\$ (9,674)
Non-cash capital contributions	\$ 74,823

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. **Organization and Summary of Significant Accounting Policies**

The accounting policies of the Henderson Water Utility (Utility) conform to governmental accounting and financial reporting principles for enterprise units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following summary of the more significant accounting policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

Reporting Entity

The Henderson Water Utility is a component unit of the City of Henderson, Kentucky. Its purpose is to construct, operate, and maintain water and sewer service facilities and supply water to the City of Henderson and surrounding areas. It is legally separate from the City of Henderson but its governing body is appointed by the City Commission of Henderson. The financial statements presented here are also included in the comprehensive annual financial report of the City of Henderson, Kentucky.

Basis of Accounting

The Utility is accounted for as a proprietary (enterprise) fund. The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recorded when earned, and expenses are recognized as soon as they result in liabilities for the benefits provided. Proprietary funds are used to account for operations (a) that are financed in a manner similar to private business enterprise where the intent of the governing body is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges and (b) that a periodic determination of revenues earned, expenses incurred and/or change in net assets is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Charges for services include revenues based on exchange or exchange-like transactions, namely water and sewer use. Program-specific grants and contributions (operating and capital) include revenues arising from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program.

Allocation of overhead expenses from one function to another, and within one function, are eliminated in the statement of revenues, expenses, and changes in net position so that allocated expenses are reported only by the function to which they were allocated.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. Organization and Summary of Significant Accounting Policies, Continued

Basis of Accounting, 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 the proprietary funds principle ongoing operations. The principle operating revenues of the Utility are charges to customers for water and sewer usage. Operating expenses include the cost of providing water and sewer services, administrative expenses and depreciation on capital assets. Other revenues and expenses are reported as nonoperating in the financial statements.

Measurement Focus

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The financial statements for proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the statement of net position and the statement of revenues, expenses and changes in net position present increases (revenues) and decreases (expenses) in total net assets. Under the accrual basis of accounting revenues are recognized when earned, including unbilled utility services which are accrued. Expenses are recognized at the time the liability is incurred. Property tax revenues are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Revenue Recognition

The Utility recognizes revenues as services are rendered to customers. The determination of water sales and wastewater services to individual customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of the fiscal year, amounts for services delivered to customers since the date of the last meter reading are estimated and the corresponding unbilled revenue is estimated.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Utility considers all cash on hand and demand deposits to be cash and cash equivalents.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. Organization and Summary of Significant Accounting Policies, Continued

Investments

KRS 66.480 permits the Utility to invest in U.S. Treasury obligations, U.S. Agency obligations, certain Federal instruments, repurchase agreements, commercial bank certificates of deposit, savings and loan deposits, and the Commonwealth of Kentucky investment pool. Investments are recorded at fair market value based on quoted market prices. Any gains or losses are reflected in the statement of income, in accordance with GASBS No. 31 *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

Accounts Receivable

Accounts receivable on the statement of net position is stated at face value, less an allowance for uncollectible accounts of \$80,290.

Inventories

Inventories of chemicals, parts and supplies are recorded at cost, which approximates market, using the FIFO method (first in, first out). The cost is recorded on an asset when purchased and as an expense when used (consumption method).

Capital Assets

Capital assets are stated at cost. All materials for capital improvements are capitalized when purchased. Construction in progress is not depreciated until completed and placed into service. Interest is capitalized on assets constructed and acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of borrowing until the completion of the project with interest earned on the invested proceeds from debt issuance over the same period.

Depreciation rates are based upon estimated useful lives and have been applied on the straight-line method. The estimated useful lives are as follows:

	<u>Years</u>
Structures, lines, mains and accessories, and system improvements	5-50
Equipment, tools and accessories, office equipment, shop and lab equipment	7-10
Transportation equipment	5
Rental property	20

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. Organization and Summary of Significant Accounting Policies, Continued

Bonds and Related Premiums, Discounts, and Issuance Costs

Bond premiums and discounts are deferred and amortized over the life of the bonds using the interest rate method, as are deferred charges on refunding.

The Utility's current rate methodology as it relates to contracts with certain large industrial concerns provides for recovery of debt issuance costs through its rate structure; therefore, the Utility elected to follow the guidance under GASBS No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, rather than GASBS No. 65, *Items Previously Reported as Assets and Liabilities*. Under the guidance of GASBS No. 62, the debt issuance costs are considered by management to be a regulatory asset and are amortized over the life of the related debt using the interest rate method.

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. A liability for compensated absences attributable to services already rendered and that are not contingent on a specific event that is outside the control of the Utility and its employees is accrued as employees earn the rights to the benefits. Employees of the Utility are entitled to paid vacations and paid sick days, depending on job classification, length of service and other factors. The Utility's policy is to recognize the costs of accumulated earned, but unused, vacation and sick pay benefits under the accrual method of accounting in accordance with GASBS No. 16, *Accounting for Compensated Absences*.

Compensated absence activity for the year ended June 30, 2018, was as follows:

	Balance June 30, 2017	Additions	Deductions	Balance June 30, 2018
Compensated absences	\$ 695,072	\$ 488,564	\$ (551,755)	\$ 631,881

Presented on the statement of net position under the following captions:

Current liabilities – compensated absences	\$ 389,240
Noncurrent liabilities – compensated absences	242,641
	<u>\$ 631,881</u>

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. Organization and Summary of Significant Accounting Policies, Continued

Pension and Other Postemployment Benefits

For purposes of measuring the net liabilities, the deferred outflows of resources and deferred inflows of resources and expense related to pensions and other postemployment benefits (OPEB), information about the fiduciary net position of the pension/OPEB plans, and additions to/deductions from the pension/OPEB plans' fiduciary net position have been determined on the same basis as they are reported by the pension/OPEB plans. For this purpose, revenues are recognized when earned. Contributions are recognized when due, pursuant to legal (or statutory) requirements. Benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Plan investments are reported at fair value.

Deferred Outflows and Inflows of Resources

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

Net Position

Net position presents the difference between assets plus deferred outflows of resources, and liabilities plus deferred inflows of resources in the statement of net position. Proprietary fund net position is divided into three components:

- Net investment in capital assets consists of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
- Restricted consists of net position that is restricted by the Utility's creditors (for example, through debt covenants), by state enabling legislation (through restrictions on shared revenues), by grantors (both federal and state), and by other contributors.
- Unrestricted consists of net position that typically includes unrestricted liquid assets.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, restricted resources are applied first.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. Organization and Summary of Significant Accounting Policies, Continued

Accounting and Related Services

The Utility has an agreement with the City of Henderson to perform its billing and collection services. All monies collected and due to the Utility are maintained in the City of Henderson's Utility Clearing Fund and are paid to the Utility on a weekly basis. The City of Henderson also processes the recording and payment of vendor invoices and the bi-weekly payroll processing for the Utility. In addition, the City manages the human resource functions administration for the Utility.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Standards

The following recently issued accounting standard was implemented by the Utility at June 30, 2018:

In fiscal year 2018, the Henderson Water Utility implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* (GASBS No. 75), which amends or supersedes the accounting and financial reporting guidance for postemployment benefits other than pensions (other postemployment benefits or OPEB) provided to the employees of state and local governmental employers. The objective is to improve accounting and financial reporting for OPEB by state and local governments.

Under GASBS No. 75, the liability to be recognized by participating employers is measured as the portion of the present value of projected benefit payments to be provided through the OPEB plan to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. The OPEB expense and deferred outflows of resources and deferred inflows of resources related to OPEB that are required to be recognized by an employer result primarily from changes in the components of the net OPEB liability, as detailed in Note 6 to financial statements.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

1. Organization and Summary of Significant Accounting Policies, Continued

Recently Issued Accounting Standards, Continued

The cumulative effect of this change in accounting principle is disclosed in Note 13. The net OPEB liability and the deferred outflows and inflows related to GASBS No. 75 are disclosed in Note 6 to the financial statements.

The following recently issued accounting standards are expected to impact the financial statements of the Utility in future periods:

GASBS No. 88 Certain Disclosures Related to Debt, including Direct Borrowing and Direct Placements

In March of 2018, the GASBS issued Statement No. 88 to improve the information that is disclosed in notes to government financial statements related to debt. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. The statement is effective for fiscal years beginning after June 15, 2018. The Utility is currently evaluating the impact that the standard will have on its financial statements.

GASBS No. 89 Accounting for Interest Cost Incurred before the End of a Construction Period

In June of 2018, the GASBS issued Statement No. 89 to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period, and to simplify accounting for interest cost incurred before the end of a construction period. This Statement establishes accounting requirements for interest cost incurred before the end of a construction period and requires that such interest be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in an enterprise fund. The statement is effective for fiscal years beginning after December 15, 2019. The Utility is currently evaluating the impact that the standard will have on its financial statements.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

2. Cash and Cash Equivalents

At June 30, 2018, the Utility maintained deposits in the amount of \$6,456,831 with one local financial institution. Of the bank balances, \$250,000 was insured by federal deposit insurance and the remaining balance was fully collateralized by pledged securities.

3. Investments

At June 30, 2018, the carrying amount of investments was \$46,067 and consisted of marketable securities.

Investments are measured at fair value on a recurring basis. Recurring fair value measurements are those that GASBS Statements require or permit in the statement of net position at the end of each reporting period. Fair value measurements are categorized based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The investments consist of marketable securities, which utilize Level 1 inputs for fair value measurements.

Interest Rate Risk

As a means of limiting exposures to fair value losses arising from interest rates, the Utility manages the maturities of its investment portfolio. The Utility had no investments at June 30, 2018, subject to interest rate risk.

Credit Risk

The Utility is authorized to invest in U.S. government-backed securities, any corporation of the U.S. Government, certificates of deposit and bankers acceptances issued by highly rated banks, commercial paper in the highest rating category, and securities issued by a state or local government rated in one of the three highest categories by a nationally recognized rating agency, and any other investment permitted by KRS 66.480.

The only exception is the marketable securities owned by the Utility. These securities were obtained by the Utility at no cost when the Utility's life insurance provider converted to a publicly-traded company from a mutual company in 2002.

Custodial Credit Risk

For an investment, the custodial credit risk is the risk that in the event of the failure of the counterparty, the Utility will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of the Utility's investments are held in the name of the Utility.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

3. Investments, Continued

Concentration of Credit Risk

The amount of money invested at any time by the Utility in one or more of the categories of investments authorized by KRS 66.480 shall not exceed 20%.

All of the investments held by the Utility at June 30, 2018, are in marketable securities. These securities were obtained by the Utility at no cost when the Utility's life insurance provider converted to a publicly-traded company from a mutual company in 2002.

Investment Earnings

Investment earnings for the Utility consisted of the following for the year ended June 30, 2018:

	<u>Marketable Securities</u>	<u>Bank Deposits</u>	<u>Total</u>
Dividends and interest	\$ 1,731	\$ 105,148	\$ 106,879
Unrealized gain (loss)	(9,674)	-	(9,674)
	<u>\$ (7,943)</u>	<u>\$ 105,148</u>	<u>\$ 97,205</u>

4. Capital Assets

Capital asset activity for the year ended June 30, 2018, was as follows:

	<u>Balance June 30, 2017</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance June 30, 2018</u>
North:				
Water pumps and tanks	\$ 7,242,228	\$ 447,149	\$ -	\$ 7,689,377
Water treatment plant	6,543,466	88,109	-	6,631,575
Water transmission and distribution	21,628,205	198,008	-	21,826,213
Wastewater lines and collections	27,135,070	178,401	(117,000)	27,196,471
Wastewater pumping stations	6,935,112	21,050	-	6,956,162
Wastewater treatment plant	28,285,163	10,200	-	28,295,363
Stormwater system	14,115,541	188,637	-	14,304,178
South:				
Water pumps and tanks	1,645,225	-	-	1,645,225
Water treatment plant	3,397,690	12,820	-	3,410,510
Water transmission and distribution	1,200,899	-	-	1,200,899
Wastewater lines and collections	2,923,221	-	-	2,923,221
Wastewater pumping stations	1,035,100	-	-	1,035,100
Wastewater treatment plant	8,902,346	7,656	-	8,910,002
Administration	1,217,061	37,497	(59,190)	1,195,368
Systems operations center	4,673,928	6,488	(6,999)	4,673,417
Total, at original cost	<u>136,880,255</u>	<u>1,196,015</u>	<u>(183,189)</u>	<u>137,893,081</u>
Accumulated depreciation	<u>(56,418,558)</u>	<u>(3,678,036)</u>	<u>177,882</u>	<u>(59,918,712)</u>
	80,461,697	(2,482,021)	(5,307)	77,974,369
Construction in progress	<u>1,882,491</u>	<u>4,071,154</u>	<u>(1,036,213)</u>	<u>4,917,432</u>
Capital assets, net	<u>\$ 82,344,188</u>	<u>\$ 1,589,133</u>	<u>\$ (1,041,520)</u>	<u>\$ 82,891,801</u>

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

5. Long-Term Debt

Long-term debt activity for the year ended June 30, 2018, was as follows:

	Balance June 30,2017	Additions	Reductions	Balance June 30, 2018	Due Within One Year
Notes to City of Henderson:					
Series 2010B	\$ 911,093	\$ -	\$ (118,613)	\$ 792,480	\$ 121,297
Series 2012A	7,885,000	-	(440,000)	7,445,000	450,000
Series 2013A	8,085,000	-	(430,000)	7,655,000	440,000
Series 2014A	7,355,000	-	(330,000)	7,025,000	340,000
Series 2015B	1,555,000	-	(155,000)	1,400,000	155,000
Series 2015C	1,590,000	-	(105,000)	1,485,000	110,000
Series 2016B	7,515,000	-	(475,000)	7,040,000	480,000
Series 2017B	2,390,000	-	(200,000)	2,190,000	210,000
	37,286,093	-	(2,253,613)	35,032,480	\$ 2,306,297
Add unamortized debt premium	397,467	-	(52,469)	344,998	
Total long-term debt	\$ 37,683,560	\$ -	\$ (2,306,082)	\$ 35,377,478	

Long-term debt at June 30, 2018, consists of the following:

Note payable to City of Henderson 2010B, 2.00% to 3.50%, due serially thru 2023	\$ 792,480
Note payable to City of Henderson 2012A, 1.00%, due serially thru 2031	7,445,000
Note payable to City of Henderson 2013A, 2.00% to 2.75%, due serially thru 2032	7,655,000
Note payable to City of Henderson 2014A, 2.00% to 2.50%, due serially thru 2034	7,025,000
Note payable to City of Henderson 2015B, 1.00% to 2.50%, due serially thru 2026	1,400,000
Note payable to City of Henderson 2015C, 2.00% to 2.75%, due serially thru 2029	1,485,000
Note payable to City of Henderson 2016B, 2.00% to 2.50%, due serially thru 2030	7,040,000
Note payable to City of Henderson 2017B, 2.00% to 3.00%, due serially thru 2025	2,190,000
	\$ 35,032,480

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

5. Long-Term Debt, Continued

Scheduled aggregate maturities of long-term debt are as follows:

<u>Year Ending June 30:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 2,306,297	\$ 848,167	\$ 3,154,464
2020	2,354,090	799,791	3,153,881
2021	2,411,671	749,785	3,161,456
2022	2,464,202	697,329	3,161,531
2023	2,511,817	642,195	3,154,012
2024 – 2028	12,349,403	2,317,344	14,666,747
2029 – 2033	9,610,000	806,220	10,416,220
2034	1,025,000	36,137	1,061,137
	<u>\$ 35,032,480</u>	<u>\$ 6,896,968</u>	<u>\$ 41,929,448</u>

In 2010, the City of Henderson issued General Obligation Bonds Series 2010B. The City's General Obligation Bonds, Tax-Exempt Series 2010B, were issued to refund various debt issues of the City of Henderson and the Utility. The City of Henderson designated in the bond ordinance that \$1,591,251 of the 2010B issue, which totaled \$3,605,000, be used to refund the Utility's Kentucky Council of Area Development District 2002 Series 065 debt. The Utility is to fully reimburse the City for its pro-rata share of the debt service payments on the 2010B issue.

In 2012, the City of Henderson issued General Obligation Bond Series 2012A. The City's General Obligation Bonds, Tax-Exempt Series 2012A, were issued to continue construction of the Canoe Creek Phase Two Project and begin construction on the new North Wastewater Plant Head Works Project. The City of Henderson designated in the bond ordinance that the proceeds of \$9,995,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired.

In 2013, the City of Henderson issued General Obligation Bond Series 2013A. The City's General Obligation Bonds, Tax-Exempt Series 2013A, were used to complete construction of the Canoe Creek Phase Two Project and continue construction on the North Wastewater Plant Head Works Project. The City of Henderson designated in the bond ordinance that the proceeds of \$9,730,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired.

In 2014, the City of Henderson issued General Obligation Bond Series 2014A. The City's General Obligation Bonds, Tax-Exempt Series 2014A, were issued to complete projects in the North and South water systems. The City of Henderson designated in the bond ordinance that the proceeds of \$8,000,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

5. Long-Term Debt, Continued

In 2015, the City of Henderson issued General Obligation Bond Series 2015B. The City's General Obligation Bonds, Tax- Exempt Series 2015B, were issued to refund the Utility's Kentucky Infrastructure Authority loan from 1996. The City of Henderson designated in the bond ordinance that the proceeds of \$1,870,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired. The economic gain resulting from this refunding was \$448,239 (based upon NPV from delivery date.) The difference in cash flow requirements to service the old debt of \$2,034,088 and the cash flows to service the new debt of \$1,870,000 is \$507,465.

In 2015 the City of Henderson issued General Obligation Bond Series 2015C. The City's General Obligation Bonds, Tax- Exempt Series 2015C, were issued to refund the Utility's Kentucky Area Development District loan of 2005. The City of Henderson designated in the bond ordinance that the proceeds of \$1,700,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired. The economic gain resulting from this refunding was \$319,945 (based upon NPV from delivery date.) The difference in cash flow requirements to service the old debt of \$1,828,888 and the cash flows to service the new debt of \$1,700,000 is \$376,224.

In 2016, the City of Henderson issued General Obligation Bond Series 2016B. The City's General Obligation Bonds, Tax- Exempt Series 2016B, were issued to refund the City's Series 2010A Build America Bonds that were loaned to the Utility for the Downtown Sewer Separation Project. The City of Henderson designated in the bond ordinance that the proceeds of \$8,015,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired. The economic gain resulting from this refunding was \$880,146 (based upon NPV from delivery date.) The difference in cash flow requirements to service the old debt of \$8,430,000 and the cash flows to service the new debt of \$8,015,000 is \$1,035,529.

In 2017, the City of Henderson issued General Obligation Bond Series 2017B. The City's General Obligation Bonds, Tax- Exempt Series 2017B, were issued to refund the Utility's Water and Sewer Revenue Bonds Series 2006A that were issued to fund the Downtown Sewer Separation Project. The City of Henderson designated in the bond ordinance that the proceeds of \$2,390,000 were solely for the benefit of the Utility. The Utility is to fully reimburse the City annually for all required debt service payments until the bonds are retired. The economic gain resulting from this refunding was \$224,213 (based upon NPV from delivery date and after application of reserve funds of \$450,597.) The difference in cash flow requirements to service the old debt of \$3,110,000 and the cash flows to service the new debt of \$2,390,000 is \$751,566.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

5. Long-Term Debt, Continued

All bonds are secured by a pledge of, and are payable from, the gross revenues derived from the operation of the Utility.

The difference between the reacquisition price and the net carrying amount of defeased bond issues has been deferred and is being amortized using the interest rate method over the lives of the defeased bond issues.

6. Pension and Other Postemployment Benefits

Plan Description

The Utility contributes to the County Employees Retirement System (CERS), which is a cost-sharing multiple-employer defined benefit pension/OPEB plan administered by Kentucky Retirement Systems (KRS) that covers members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of Kentucky Retirement Systems (Board). KRS issues a publicly available financial report that can be obtained at www.kyret.ky.gov.

Benefits Provided

CERS provides for retirement, disability, and death benefits to system members through its Pension Fund, as well as other postemployment benefits (OPEB) for hospital and medical insurance through its Insurance Fund.

Retirement benefits may be extended to beneficiaries of members under certain circumstances. Retirement benefits are determined using a formula which considers the member's final compensation; benefit factors set by statute which vary depending upon the type / amount of service, participation date, and retirement date; and years of service. Plan members with a participation date prior to September 1, 2008, are eligible to retire with full benefits at any time with 27 or more years of service credit, or at age 65 with at least 4 years of service credit. Plan members with a participation date on or after September 1, 2008, are eligible to retire with full benefits at age 57 if the member's age and years of service equal 87, or at age 65 with at least 5 years of service credit.

Other postemployment benefits provided by CERS consist of prescribed contributions for whole or partial payments of required premiums to purchase hospital and medical insurance.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

6. Pension and Other Postemployment Benefits, Continued

Contributions

State statute requires active members to contribute 5% of creditable compensation. For members participating on or after September 1, 2008, an additional 1% of creditable compensation is required. This amount is credited to the Insurance Fund and is non-refundable to the member. Employers contribute at the rate determined by the KRS Board to be necessary for the actuarial soundness of the systems, as required by KRS 61.565 and KRS 61.752.

The Utility's actuarially determined contribution rates and contribution amounts, based on annual creditable compensation, for the year ended June 30, 2018, were as follows:

	<u>Contribution Rates</u>		<u>Contributions</u>
Pension	14.48%	\$	582,705
OPEB	4.70		189,138
Total	<u>19.18%</u>	<u>\$</u>	<u>771,843</u>

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

The net pension and OPEB liabilities reported as of June 30, 2018, were measured as of June 30, 2017, and the total pension and OPEB liabilities used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2016. The Utility's proportion of the liabilities was based on a projection of the Utility's long-term share of contributions to the plan relative to the projected contributions of all participating entities, actuarially determined. At the June 30, 2017, measurement date, the Utility's pension and OPEB proportion was 0.164653%, a decrease of (0.000518%) from its proportion measured as of June 30, 2016, of 0.165171%.

The Utility's pension and OPEB liabilities and expense as of and for the year ended June 30, 2018, were as follows:

	<u>Pension</u>		<u>OPEB</u>
Net Liability	\$ 9,637,646	\$	3,310,089
Expense	<u>1,753,494</u>	<u>\$</u>	<u>356,427</u>

At June 30, 2018, the Utility reported deferred outflows of resources and deferred inflows of resources related to pensions and OPEB from the following sources:

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

6. Pension and Other Postemployment Benefits, Continued

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

	Pension		OPEB	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 11,954	\$ 244,645	\$ -	\$ 9,194
Changes of assumptions	1,778,407	-	720,254	-
Net difference between projected and actual earnings on plan investments	763,290	644,083	-	156,433
Changes in proportion and differences between contributions and proportionate share of contributions	140,179	8,281	-	7,680
Contributions subsequent to the measurement date	582,705	-	189,138	-
Total	\$ 3,276,535	\$ 897,009	\$ 909,392	\$ 173,307

The \$582,705 and \$189,138 of deferred outflows of resources resulting from the Utility's pension and OPEB contributions subsequent to the measurement date will be recognized as a reduction of the net pension and OPEB liabilities in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized as follows:

	Pension	OPEB
Year ending June 30,		
2019	\$ 836,324	\$ 94,107
2020	762,599	94,107
2021	321,651	94,107
2022	(123,753)	94,107
2023	-	133,217
2024	-	37,302
	\$ 1,796,821	\$ 546,947

Actuarial Assumptions

The total pension/OPEB liabilities in the June 30, 2016, actuarial valuation were determined using the following actuarial assumptions, applied to all periods included in the measurement:

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

6. Pension and Other Postemployment Benefits, Continued

Actuarial Assumptions, Continued

Inflation	2.30%
Salary increases	2.00% average
Investment rate of return	6.25%, net of investment expenses
Healthcare cost trend rates (OPEB)	Initial trend starting at 7.50% for Pre-65, or 5.5% for Post-65, and gradually decreasing to an ultimate trend rate of 5% over a period of 5 years for Pre-65, or 2 years for Post-65

Mortality rates were based on the following assumptions and assume a margin for future mortality improvement:

Pre-retirement mortality: RP-2000 Combined Mortality Table projected with Scale BB to 2013. Male mortality rates are multiplied by 50% and female mortality rates are multiplied by 30%.

Post-retirement mortality (non-disabled): RP-2000 Combined Mortality Table projected with Scale BB to 2013. Female mortality rates are set back one year.

Post-retirement mortality (disabled): RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013. Male mortality rates are set back four years.

The actuarial assumptions used in the June 30, 2016, valuation were based on the results of an actuarial experience study for the five-year period ended June 30, 2013.

The long-term expected rate of return was determined by using a building-block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage. The target allocation and best estimates of arithmetic real rate of return for each major asset class are summarized in the tables below.

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

6. Pension and Other Postemployment Benefits, Continued

Actuarial Assumptions, Continued

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
US equity	17.50%	5.97%
International equity	17.50	7.85%
Global bonds	4.00	2.63%
Global credit	2.00	3.63%
High yield	7.00	5.75%
Emerging market debt	5.00	5.50%
Private credit	10.00	8.75%
Real estate	5.00	7.63%
Absolute return	10.00	5.63%
Real returns	10.00	6.13%
Private equity	10.00	8.25%
Cash	2.00	1.88%
Total	100.00%	

Discount Rate

The discount rates used to measure the total pension/OPEB liabilities at the measurement dates and changes since the prior year were as follows:

	Pension	OPEB
Discount rate, June 30, 2016	7.50%	6.89%
Increase (decrease)	(1.25)	(1.05)
Discount rate, June 30, 2017	6.25%	5.84%

The discount rate of 6.25% used to measure the total pension liability was based on the expected rate of return on pension plan investments. The discount rate of 5.84% used to measure the total OPEB liability was based on the expected rate of return on OPEB plan investments of 6.25% and a municipal bond rate of 3.56%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2017.

The projection of cash flows used to determine the discount rates is based on the assumption that each participating employer in CERS will contribute the actuarially determined contribution rates, which are determined using a closed funding period (26 years as of June 30, 2017), as well as the actuarial assumptions and methods adopted by the KRS Board of Trustees. Current assets, future contributions, and investment earnings are projected to be sufficient to pay the projected benefit payments from the system.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

6. Pension and Other Postemployment Benefits, Continued

Sensitivity of the Utility's Proportionate Share of the Liabilities to Changes in the Discount Rate

The following presents the Utility's proportionate share of the net pension/OPEB liabilities, as well as what the Utility's proportionate share of the net pension/OPEB liabilities would be if they were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate:

	Utility's Proportionate Share			
	Discount Rate	Net pension Liability	Discount Rate	Net OPEB Liability
1% decrease	5.25%	\$ 12,155,155	4.84%	\$ 4,211,904
Current discount rate	6.25%	\$ 9,637,646	5.84%	\$ 3,310,089
1% increase	7.25%	\$ 7,531,769	6.84%	\$ 2,559,636

Sensitivity of the Utility's Proportionate Share of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rates

The following presents the Utility's proportionate share of the net OPEB liability, as well as what the Utility's proportionate share of the net OPB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current rate:

	Healthcare Cost Trend Rate	Utility's Proportionate Share of Net OPEB Liability
	1% decrease	6.5% Pre-65 or 5.5% Post-65 decreasing to 4%
Current healthcare cost trend rate	7.5% Pre-65 or 5.5% Post-65 decreasing to 5%	\$ 3,310,089
1% increase	8.5% Pre-65 or 5.5% Post-65 decreasing to 6%	\$ 4,312,448

Plan Fiduciary Net Position

Detailed information about the CERS fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

6. Pension and Other Postemployment Benefits, Continued

Payables to the Pension/OPEB Plans

The Utility remits their portion of pension/OPEB contributions with each payroll transfer to the City of Henderson (City). The outstanding amount of the Utility's pension/OPEB contributions due to CERS from the City for the year ended June 30, 2018 are:

<u>Pension</u>	<u>OPEB</u>
\$ 43,258	\$ 14,038

7. Deferred Compensation

The Utility allows all eligible employees to participate in deferred compensation plans administered by the Kentucky Public Employees' Deferred Compensation Authority (KDC). The KDC is authorized under Kentucky Revised Statutes (18A.230 - 18A.275) to provide administration of tax sheltered supplemental retirement plans for all state, public school and university employees and employees of local political subdivisions that have elected to participate. The KDC offers a plan authorized by Section 457(b) of the Internal Revenue Code and a plan authorized by Section 404(k) of the Internal Revenue Code. Both plans are available to all employees and permit them to defer up to 25% of their compensation (subject to limits) until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Participation by eligible employees in the deferred compensation plans is voluntary. The Utility makes no contributions to these plans.

Historical trend information showing the Kentucky Public Employees' Deferred Compensation Authority's progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Public Employees' Deferred Compensation Authority's annual financial report. This report may be obtained by writing the Kentucky Public Employees' Deferred Compensation Authority at 101 Sea Hero Road, Suite 110, Frankfort, KY 40601-8862, or by telephone at (502) 573-7925.

8. Related Party Transactions

The Water and Sewer Commission's members are appointed by the Mayor and Commissioners of the City of Henderson. The Water and Sewer Commission is organized to operate, manage, and control the City of Henderson's Wastewater and Stormwater Systems and the City of Henderson is contingently liable for the outstanding bonded indebtedness (Note 5) of the system in the event user charges are inadequate to fulfill the system's debt service requirements. Other transactions with the City of Henderson during the year ended June 30, 2018, were as follows:

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

8. Related Party Transactions, Continued

Payment to the City of Henderson of \$640,000 for data processing, meter-reading, customer service and other services relating to water, wastewater and stormwater billings and collections.

Payment to the City of Henderson of \$400,000 in the form of a distribution.

Payment to the City of Henderson of \$1,340,208 for health insurance. The Utility participates in the City of Henderson's self-insurance plan. Risk is minimized by the purchase of re-insurance for amounts in excess of the stop loss limit. Charges are based on amounts determined to fund claims as they become due and payable and are adjusted periodically.

The Utility has recorded payables to the City of Henderson of \$184,703. These payables consisted of electric and gas utility payments, reimbursements of street repairs and other expenses and payroll tax liabilities.

The Utility has recorded receivables from the City of Henderson of \$951,750. These receivables related to billings and collections of water and wastewater services by the City of Henderson and not yet remitted to the Utility.

The Utility reimbursed the City of Henderson for all principal and interest payments required under the bond ordinances as set forth in Footnote 5.

9. Commitments and Contractual Obligations

The Henderson Water Utility operates a secondary water and wastewater treatment facility located in Southeastern Henderson County, Kentucky, capable of producing 4 million gallons of water and treating 8 million gallons of wastewater daily. The Utility has an inter-local agreement with the Counties of Henderson, McLean, and Webster to share equally in the debt service in the event adequate funds are not generated by this facility to cover the amount of the annual debt service. The Utility also has agreements to provide water to the following communities:

City of Sebree

In September 1995, the Henderson Water Utility entered into an agreement with the City of Sebree, Kentucky, whereby the Utility agrees to sell and deliver to the City and the City agrees to purchase and receive from the Utility all of the water and sewer services required by the City. The agreement outlines a specific rate, which will be charged by the Utility to the City for water and sewer service. Sales to the City of Sebree totaled \$261,336 for the year ended June 30, 2018.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

9. Commitments and Contractual Obligations, Continued

City of Beech Grove

In October 2014, the Henderson Water Utility entered into an agreement with the Beech Grove Water System, whereby the Utility agrees to sell and deliver to the System and the System will purchase and receive from the Utility all of the water services required by the System. The agreement outlines a specific rate, which will be charged by the Utility to the system for water service. The term of the contract will be twenty-five years, expiring on September 30, 2039. Sales to the Beech Grove Water System totaled \$215,045 for the year ended June 30, 2018.

City of Corydon

In April 2015, the Henderson Water Utility entered into an agreement with the City of Corydon, Kentucky, whereby the Utility agrees to sell and deliver to the City and the City agrees to purchase and receive from the Utility all of the sewer services required by the City. The agreement outlines a specific flat rate, adjusted annually for inflation, which will be charged by the Utility to the City for sewer service. The term of the contract will be forty years expiring on April 30, 2055. Sales to the City of Corydon totaled \$38,847 for the year ended June 30, 2018.

Henderson County Water District

In June 1989, amended February 1997, the Henderson Water Utility entered into an agreement with the Henderson County Water District, whereby the Utility agrees to sell and deliver to the District and the District will purchase and receive from the Utility all of the water services required by the District. The agreement outlines a specific rate, which will be charged by the Utility to the District for water service. The term of the contract will be forty years, expiring in July 2029. Sales to the Henderson County Water District totaled \$1,174,292 for the year ended June 30, 2018.

Tyson Foods, Inc.

In November 1994, amended February 1998 and October 2000, the Henderson Water Utility entered into an agreement with Tyson Foods, Inc. (formerly Hudson Foods, Inc.) whereby the Utility agrees to sell and deliver to Tyson and Tyson agrees to purchase and receive from the Utility all of the water and sewer service. The terms of the contract expire June 30, 2018, but shall continue until eighteen-month notice by either party in the event Tyson is not in default at the end of original contract term. The agreement outlines a specific rate, which will be charged by the Utility to the Tyson Foods, Inc. for water and sewer service. Sales to Tyson Foods, Inc. totaled \$4,819,016 for the year ended June 30, 2018.

HENDERSON WATER UTILITY
NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

9. Commitments and Contractual Obligations, Continued

International Paper Company (formerly Weyerhaeuser Company)

In January 1996, amended October 1998, and July 1999, the Henderson Water Utility entered into an agreement with the International Paper Company (formerly Weyerhaeuser Company) whereby the Utility agrees to sell and deliver to the International Paper Company and the International Paper Company agrees to purchase and receive from the Utility all of the water and sewer services required by the International Paper Company. The terms of the contract expire December 31, 2018, but shall continue until eighteen-month notice by either party in the event International Paper Company is not in default at the end of original contract term. The agreement outlines a specific rate, which will be charged by the Utility to the International Paper Company for water and sewer service. Sales to the International Paper Company totaled \$2,687,229 for the year ended June 30, 2018.

Big Rivers Electric Corporation

In March 1995, amended October 2000 and September 2015, the Henderson Water Utility entered an agreement with Big Rivers Electric Corporation, whereby the Utility agrees to sell and deliver to Big Rivers Electric Corporation and Big Rivers Electric Corporation will receive from the Utility all the water and sewer services required by Big Rivers Electric Corporation. The agreement outlines that no rate or fee will be charged by the Utility to Big Rivers Electric Company for water service, on up to 75,000 gallons per day, and sewer service. The term of the contract will be twenty-five years expiring in September 2040, with an automatic renewal for successive five year terms until terminated by either party with two-year notice. The Utility has elected to waive any charge due to the fact that Big Rivers Electric Corporation provides power for pumping equipment at the South Water Treatment Plan free of charge to the Utility.

10. Major Customers

For the year ended June 30, 2018, one industrial customer, one commercial customer, and one governmental utility customer accounted for \$8,680,537 in sales and surcharges for approximately 42% of the Utility's total operating revenues.

11. Risk Management

The Utility is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utility carries commercial insurance for these types of risks of loss, including workers' compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

11. Risk Management, Continued

Self-Funded Health Insurance Plan

The Utility participates in the City of Henderson, Kentucky's, self-insured health plan for the purpose of providing health insurance to its employees. The plan limits its losses via the purchase of stop loss insurance. Specific losses to claims are limited to \$125,000.

The City of Henderson estimates the annual amount of the premiums as part of its budgetary process each year. Each department or component unit is billed based on its percentage of employees in the plan. Charges to each department or component unit participating in the plan may increase depending on the dollar volume of claims activity. The Utility's share of the unpaid claims and incurred but not reported liability are immaterial to the financial statements as of June 30, 2018.

12. Contingencies

Consent Judgment

On August 30, 2007, a Consent Judgment between Henderson Water Utility and the Commonwealth of Kentucky was accepted by the Franklin Circuit Court under Civil Action 07-CI-1250. Under the terms of the Consent Judgment, Henderson Water Utility had committed to complete improvements to its sewer system infrastructure in order to comply with certain regulatory requirements of the Federal Clean Water Act.

The Consent Judgment required the development of a Long-Term Control Plan and identified sewer system infrastructure improvements that, when completed, would bring the Utility's combined sewer system into regulatory compliance.

The Long-Term Control Plan (LTCP) was submitted to the Kentucky Environmental & Public Protection Cabinet (EPPC) and the U.S. Environmental Protection Agency (EPA) in March 2009 and that LTCP was approved by both agencies in April 2012. The projects identified in the Utility's LTCP were to have been completed no later than December 2017 under an Administrative Order (AO) issued by the EPA, although that AO has since been rescinded, and some projects in the LTCP were modified or dropped in an Amendment approved in February 2014.

All components of the LTCP have been completed with a final cost of approximately \$42 million. The Division of Water agreed to the Termination of the Consent Judgment and action was entered in Franklin Circuit Court on July 11, 2018, to finalize the termination. Additional reporting requirements will be ongoing as part of the LTCP implementation.

HENDERSON WATER UTILITY

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

13. Restatement of Beginning Net Position

In fiscal year 2018, as a result of implementing GASBS No. 75, the Utility has restated beginning net position for the cumulative effect of this change in accounting principle, as described in Note 1. Additionally, beginning net position has been restated as a result of an error noted in prior years' financial statements relating to the failure to record unbilled revenue.

Total net position, June 30, 2017, as previously reported	\$ 46,092,187
Cumulative effect of change in accounting principle:	
GASBS No. 75, <i>Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions</i>	(2,406,714)
Adjustment to correct prior years' error	<u>1,475,686</u>
Total net position, June 30, 2017, restated	<u>\$ 45,161,159</u>

14. Subsequent Events

On July 11, 2018, at a hearing in Franklin Circuit Court, the final order related to the termination of the Consent Judgment between Henderson Water Utility and the Commonwealth of Kentucky was signed, formally ending the Consent Judgment.

HENDERSON WATER UTILITY

**SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM
PENSION FUND**

Last 10 Fiscal Years *

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Utility's proportion of the net pension liability	0.164653%	0.165171%	0.157013%	0.154670%
Utility's proportionate share of the net pension liability	\$ 9,637,646	\$ 8,132,373	\$ 6,734,694	\$ 5,018,000
Utility's covered payroll	\$ 4,064,860	\$ 3,983,454	\$ 3,707,812	\$ 3,548,282
Utility's proportionate share of the net pension liability as a percentage of its covered payroll	237.10%	204.15%	181.64%	141.42%
Plan fiduciary net position as a percentage of the total pension liability	53.32%	55.50%	59.97%	66.80%

* Presented for those years for which the information is available.

HENDERSON WATER UTILITY

**SCHEDULE OF PENSION CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM
PENSION FUND**

Last 10 Fiscal Years *

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contributions	582,705	\$ 567,048	\$ 494,745	\$ 472,746
Contributions in relation to the contractually required contributions	<u>(582,705)</u>	<u>(567,048)</u>	<u>(494,745)</u>	<u>(472,746)</u>
Contribution deficiency (excess)	<u>-</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>
Utility's covered payroll	4,024,206	\$ 4,064,860	\$ 3,983,454	\$ 3,707,812
Contributions as a percentage of covered payroll	14.48%	13.95%	12.42%	12.75%

* Presented for those years for which the information is available.

HENDERSON WATER UTILITY

**SCHEDULE OF PROPORTIONATE SHARE OF THE NET OPEB LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years *

	<u>2018</u>
Utility's proportion of the net OPEB liability	0.164653%
Utility's proportionate share of the net OPEB liability	\$ 3,310,089
Utility's covered payroll	\$ 4,064,860
Utility's proportionate share of the net OPEB liability as a percentage of its covered payroll	81.43%
Plan fiduciary net position as a percentage of the total OPEB liability	52.39%

* Presented for those years for which the information is available.

HENDERSON WATER UTILITY

**SCHEDULE OF OPEB CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years

	<u>2018</u>
Contractually required contributions	\$ 189,138
Contributions in relation to the contractually required contributions	<u>(189,138)</u>
Contribution deficiency (excess)	<u>\$ -</u>
Utility's covered payroll	\$ 4,024,206
Contributions as a percentage of covered payroll	4.70%

* Presented for those years for which the information is available.

HENDERSON WATER UTILITY

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION COUNTY EMPLOYEES RETIREMENT SYSTEM PENSION FUND

Year Ended June 30, 2018

Changes of Benefit Terms

None

Changes of Assumptions

Pension and OPEB:

The assumed investment return was changed from 7.50% to 6.25%.

The price inflation assumption was changed from 3.25% to 2.30%, which also resulted in a 0.95% decrease in the salary increase assumption at all years of service.

The payroll growth assumption (applicable for the amortization of unfunded actuarial accrued liabilities) was changed from 4.00% to 2.00%.

OPEB:

The single discount rate changed from 6.89% to 5.84%.

HENDERSON WATER UTILITY

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION BY DIVISION

Year ended June 30, 2018

	<u>North Water</u>	<u>North Wastewater</u>	<u>Stormwater</u>	<u>South Water</u>	<u>South Wastewater</u>	<u>Total</u>
Operating revenues:						
Sales	\$ 5,776,454	\$ 8,362,011	\$ 734,921	\$ 2,208,487	\$ 3,058,273	\$ 20,140,146
Penalties, surcharges and fees	73,210	353,986	-	357	119,327	546,880
Total operating revenues	<u>5,849,664</u>	<u>8,715,997</u>	<u>734,921</u>	<u>2,208,844</u>	<u>3,177,600</u>	<u>20,687,026</u>
Operating expenses:						
Water pumps and tanks	146,248	-	-	5,329	-	151,577
Depreciation	284,141	-	-	34,903	-	319,044
Water intake and treatment	1,948,900	-	-	1,549,894	-	3,498,794
Depreciation	212,263	-	-	101,272	-	313,535
Water transmission and distribution	2,553,636	-	-	71,197	-	2,624,833
Depreciation	572,125	-	-	41,613	-	613,738
Wastewater lines and collection	-	1,645,080	-	-	48,527	1,693,607
Depreciation	-	644,120	-	-	41,432	685,552
Wastewater pumping stations	-	1,171,350	-	-	314,477	1,485,827
Depreciation	-	302,381	-	-	29,615	331,996
Wastewater pretreatment and treatment	-	2,853,946	-	-	1,883,047	4,736,993
Depreciation	-	853,461	-	-	176,952	1,030,413
Stormwater	-	-	1,195,485	-	-	1,195,485
Depreciation	-	-	383,758	-	-	383,758
Total operating expenses	<u>5,717,313</u>	<u>7,470,338</u>	<u>1,579,243</u>	<u>1,804,208</u>	<u>2,494,050</u>	<u>19,065,152</u>
Operating income (loss)	<u>132,351</u>	<u>1,245,659</u>	<u>(844,322)</u>	<u>404,636</u>	<u>683,550</u>	<u>1,621,874</u>
Non-operating revenues (expenses):						
Gain on disposal of capital assets	64,238	-	-	-	-	64,238
Investment income	97,205	-	-	-	-	97,205
Miscellaneous revenue	66,473	-	-	-	-	66,473
Interest expense	(111,676)	(609,281)	(104,524)	(51,192)	(20,576)	(897,249)
Total non-operating revenues (expenses)	<u>116,240</u>	<u>(609,281)</u>	<u>(104,524)</u>	<u>(51,192)</u>	<u>(20,576)</u>	<u>(669,333)</u>
Change in net position before distribution and contributions	<u>\$ 248,591</u>	<u>\$ 636,378</u>	<u>\$ (948,846)</u>	<u>\$ 353,444</u>	<u>\$ 662,974</u>	<u>\$ 952,541</u>



**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**

Water and Sewer Commission
Henderson Water Utility

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 Henderson Water Utility as of and for the year ended June 30, 2018, and the related notes to the financial statements, and have issued our report thereon dated November 14, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Henderson Water Utility's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Henderson Water Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of the Henderson Water Utility'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 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 have not been identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as Finding 2018-001 that we consider to be a material weakness.

Compliance and Other Matters

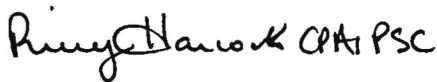
As part of obtaining reasonable assurance about whether the Henderson Water Utility's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct 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*.

Henderson Water Utility's Response to Findings

Henderson Water Utility's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. Henderson Water Utility's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of 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.

 Ringo Hancock CPA, PSC

Owensboro, Kentucky
November 14, 2018

HENDERSON WATER UTILITY

SCHEDULE OF FINDINGS AND RESPONSES

Year Ended June 30, 2018

Material Weakness:

Finding 2018-001:

A misstatement was identified in the June 30, 2017, financial statements on which the predecessor auditor issued an unmodified opinion. This error related to the failure to record unbilled revenue as of June 30, 2017, and years prior thereto. The effect of this error on the Utility's beginning net position was an understatement of \$1,475,686.

Recommendation:

We recommend that management record a prior period adjustment to correct the error.

Management Response:

Net position as of June 30, 2017, was restated in the audited financial statements for the identified prior period adjustment. Management has correctly recorded this transaction in the 2018 audited financial statements.