HARDIN COUNTY WATER DISTRICT NO. 2

INDEPENDENT AUDITOR'S REPORT
ON FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

YEARS ENDED DECEMBER 31, 2016 AND 2015

HARDIN COUNTY WATER DISTRICT NO. 2

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YEARS ENDED DECEMBER 31, 2016 AND 2015

LETTER OF TRANSMITTAL

A Message from the General Manager

I am pleased to submit the Transmittal Letter for Hardin County Water District No. 2 for the year ending December 31, 2016. Years of long range planning have come to fruition and 2016 was the year of successful completions.

At our water treatment plants, the secondary disinfectant conversion was put to the test and the District celebrated one full year of chloramine treatment on November 30. The year was marked by fewer taste and odor complaints and disinfectant by-product levels that were half of historic levels.

The successful chloramine conversion paves the way for a connection with Louisville Water Company and the purchase of supplemental water supplies beginning in 2017. The pipeline project progressed through the year and saw the completion of pipe installation. Flushing and testing will being in early 2017. This completes the supplemental water supply project that began in 2008.

Another project of note is the Elizabethtown Customer Connection Upgrade Project. After the acquisition of the Elizabethtown customer base in 2014, the District commissioned the upgrade and automation of approximately 9800 domestic services. This project was completed two months early. With these automatic meters in place, the District can quickly gather customer usage information monthly. This information is also used for the City's sewer billing. The District assumed billing and collection services for the City's sewer utility as per their request.

After 20 years, the District reviewed the tap fees for new services. The $600 residential tap fee was found to be grossly under the actual cost of $850 for the materials and labor for new meter installations. A 2015 change in regulations requiring the use of lead-free components was one of the driving factors. The District staff successfully navigated the PSC application process and was approved to update the meter tap fees for all sizes.

As the company continues to grow and expand services, the 360 Ring Road site has reached its full potential to contain the District's base of operations. During the year, the property at 315 Ring Road became available. The District acquired the property in order to sustain continued growth. GRW Architects were retained to develop a site plan for the eventual relocation of the customer service center and central operating headquarters. The proposed site plan was approved by the Board of Commissioners and the objective of relocation was formally adopted.

On the financial side of the business, the District had 3 outstanding bonds that were eligible for refinancing. The activity required a renewed Moody's bond rating analysis. A case was made to the Moody's auditors regarding the strength of the company in the areas of water quality, asset management, capital planning, and financial management. The audit resulted in a bond rating upgrade from Aa3 to Aa2. No other PSC regulated water company in the State of Kentucky currently equals or surpasses this rating.

The upgrade in bond rating and precision market timing contributed to the District successfully refinancing the 3 eligible outstanding bonds. Two new revenue bonds, which combined for a true interest cost of 1.49%, were issued on 10 year terms. The net present value of the refund savings topped $1.17 million, making the exchange the most successful bond refinancing in District history.

Each year at this time, I reflect on the accomplishments of the company and wonder if it is possible for Hardin County Water District No. 2 to experience any higher levels of success. And each year, the news seems to top the year before. I contribute the success of 2016 to the unwavering spirit and zeal of the professionals who run the company each and every day. Hardin County Water District No. 2 has the best employees.

The future still looks bright.

James R. Jeffries
General Manager

INDEPENDENT AUDITOR'S REPORT

CHRIS R. CARTER, CPA
ANN M. FISHER, CPA
SCOTT KISSELBAUGH, CPA
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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Hardin County Water District No. 2 as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Hardin County Water District No. 2, as of December 31, 2016 and 2015, and the respective changes in financial position and cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 1 to the financial statements, during the year ended December 31, 2016, the District adopted Governmental Accounting Standards Board Statement 72, *Fair Value Measurement and Application*, Statement 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, Statement 77, *Tax Abatement Disclosures*, Statement 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans* and Statement 79, *Certain External Investment Pools and Pool Participants*. As discussed in Note 1 to the financial statements, during the year ended December 31, 2016, in accordance with GASB Statement No. 62, Paragraphs 476-500, Regulated Operations, which requires that the effects of the rate-making process be recorded in the financial statements, the District elected to record a regulatory asset for the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions. Accordingly, the District recognizes the actuarially determined contribution as the current year pension expense. Our opinion is not modified with respect to these matters.

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 5 to 9, schedule of proportionate share of the net pension liability on page 30 and schedule of contributions on page 31 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 that collectively comprise the Hardin County Water District No. 2's basic financial statements. Schedules I and II are presented for purposes of additional analysis and are not a required part of the basic financial statements.

Schedules I and II are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, Schedules I and II are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The letter of transmittal and Schedule III have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2017, on our consideration of Hardin County Water District No. 2's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 Hardin County Water District No. 2's internal control over financial reporting and compliance.

Stiles, Carter & Associates

Certified Public Accountants
Elizabethtown, Kentucky
May 23, 2017

REQUIRED SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2016

The discussion and analysis of Hardin County Water District No. 2's financial performance provides an overall review of the District's financial activities for the year ended December 31, 2016. The intent of this discussion and analysis is to review the District's financial performance as a whole. Readers should also review the basic financial statements and notes to the basic financial statements to enhance their understanding of the District's financial performance.

FINANCIAL HIGHLIGHTS

- The ending cash and investment balance for the District was $20.4 million. The balance at December 31, 2015, was $21.3 million. This reflects a decrease in cash and investments during the year of $.9 million.

- The District continued capital construction projects to improve the water system and ensure the future water supply.

- The District adopted the GASB Statement No. 62, Paragraphs 476-500, Regulated Operations, which requires that the effects of the rate-making process be recorded in the financial statements, with respect to its participation in the County Employees Retirement System. The District elected to record a regulatory asset for the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions.

- The District invested approximately $11.8 million in capital assets during the year.

USING THIS ANNUAL REPORT

The basic financial statements report information about the District using full accrual accounting methods as utilized by similar business activities in the private sector. The basic financial statements include a statement of net position; a statement of revenues, expenses, and changes in fund net position; a statement of cash flows; and notes to the basic financial statements.

The ***statement of net position*** presents the financial position of the District on a full accrual historical cost basis. The statement presents information on all of the District's assets, deferred outflows of resources and liabilities and deferred inflows of resources, with the difference reported as net position. Over time, increases and decreases in net position are one indicator of whether the financial position of the District is improving or deteriorating.

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the ***statement of revenues, expenses, and changes in fund net position*** presents the results of the District's activities over the course of the fiscal year and information as to how the net position changed during the 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 related cash flows. This statement also provides certain information about the District's recovery of its costs. Rate setting policies use different methods of cost recovery not fully provided for by generally accepted accounting principles. The primary objectives of the rate model are to improve equity among customer classes and to ensure that capital costs are allocated on the basis of long-term capacity needs, ensuring that growth pays for growth.

The ***statement of cash flows*** presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The ***notes to the basic financial statements*** provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the District's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

ENTITY-WIDE FINANCIAL ANAYLSIS

Net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows exceeded liabilities and deferred inflows by $73.1 million and $63.7 million as of December 31, 2016 and 2015.

The largest portion of the District's net position reflects its investment in infrastructure and capital assets (e.g., land, buildings, vehicles, equipment, transmission and distribution systems and construction in progress), less any related debt used to acquire those assets that is outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets.

(Table 1)
Summary of Net Position
as of December 31, 2016 and 2015

	2016	2015
Assets		
Current and Other Assets	$ 27,192,922	$ 26,104,580
Capital Assets	71,638,003	62,638,515
Total Assets	98,830,925	88,743,095
Deferred Outflows of Resources	1,947,965	1,810,291
Liabilities		
Long-term liabilities	25,241,978	25,079,834
Other Liabilities	2,437,404	1,745,936
Total Liabilities	27,679,382	26,825,770
Deferred Inflows of Resources	-	-
Net Position		
Net investment in capital assets	51,753,510	41,515,184
Restricted for debt service	1,276,639	2,088,360
Unrestricted	20,069,359	20,124,072
Total Net Position	$ 73,099,508	$ 63,727,616

Unrestricted net position, the portion of net position that can be used to finance day-to-day operations (without constraints established by debt covenants, enabling legislation or other legal requirements), decreased $55 thousand (.27%) at December 31, 2016. Restricted net position decreased $811 thousand (38.9%). Net investment in capital assets increased by $10.2 million (24.7%).

(Table 2)
Changes in Net Position
Years Ended December 31, 2016 and 2015

	2016	2015
OPERATING REVENUES:		
Water sales	$ 12,512,174	$ 11,955,417
Other operating income	820,005	623,142
Total operating revenues	13,332,179	12,578,559
OPERATING EXPENSES:		
Power purchased	822,983	687,301
Pumping and treatment labor	1,007,379	983,616
Purification supplies and expense	556,493	539,324
Transmission and distribution labor	1,525,723	1,459,524
Transmission and distribution supplies and expense	242,028	272,431
Transmission and distribution maintenance and repairs	54,476	48,499
Equipment rental	5,131	9,401
Transportation expense	154,429	141,980
Water treatment maintenance and expense	152,360	169,791
General and administrative expenses	2,711,567	2,441,559
Depreciation	2,768,074	2,572,838
Total operating expenses	10,000,643	9,326,264
OPERATING INCOME	3,331,536	3,252,295
NON-OPERATING REVENUES (EXPENSES):		
Investment income	384,592	306,412
Other income	179,376	123,780
Gain (loss) on disposal of capital assets	8,607	3,636
Bond issuance costs	(120,614)	-
Interest expense on long-term debt	(706,250)	(705,596)
Interest expense on customer deposits	(295)	(568)
Amortization of bond discount and utility acquisition	(31,855)	(68,514)
TOTAL NON-OPERATING REVENUES (EXPENSES)	(286,439)	(340,850)
Capital contributions	6,326,795	412,995
Increase in net position	9,371,892	3,324,440
Net position, beginning	63,727,616	60,403,176
Net position, ending	$ 73,099,508	$ 63,727,616

Operating revenue increased 6% as compared to the prior year as new customers were added. Total operating expenses increased 7.2%, which was due to increased depreciation expense and operating costs for personnel. Interest expense on long-term debt was stable. The District continues to receive capital contributions through the State of Kentucky, the Federal government, other governments and individual developers.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2016 and 201, the District had $71.6 million and $62.6 million invested in a variety of capital assets, as reflected in the following table:

(Table 3)
Capital Assets (Net of Depreciation)
as of December 31, 2016 and 2015

	2016	2015
Non-Depreciable Assets:		
Land and land rights	$ 2,137,633	$ 687,483
Depreciable Assets:		
Structures and improvements	7,574,490	7,834,477
Property held for future use	1,173,044	-
Supply mains	706,168	750,267
Water treatment plant	7,082,438	6,826,493
Standpipes, tanks and foundations	7,755,219	7,696,650
Transmission and distribution mains	28,565,090	29,469,797
Services and meters	6,200,302	5,266,191
Hydrants	44,972	30,918
Office furniture and fixtures	133,532	158,953
Transportation equipment	618,310	612,062
Other property and equipment	202,798	251,132
Capital assets in service	62,193,996	59,584,423
Construction in progress	9,444,007	3,054,092
Total capital assets, net of depreciation	$ 71,638,003	$ 62,638,515

(Table 4)
Changes in Capital Assets
Years Ended December 31, 2016 and 2015

	2016	2015
Beginning balance	$ 62,638,515	$ 61,485,222
Additions	12,678,743	3,726,131
Retirements	(911,181)	-
Depreciation	(2,768,074)	(2,572,838)
Ending balance	$ 71,638,003	$ 62,638,515

Debt

At December 31, 2016 and 2015, the District had $14.3 million and $15.3 million, in revenue bonds outstanding and $5.6 million and $5.9 million of notes payable. A total of $1.1 million is due within the 2017 calendar year. The District refunded the 2004A, 2005A and 2007 bonds with the 2016B and 2016C bonds.

(Table 5)
Outstanding Debt
as of December 31, 2016 and 2015

	2016	2015
Revenue bonds	$ 14,320,000	$ 15,343,000
Notes payable	5,621,906	5,861,021
Unamortized discount/premium	146,786	(158,455)
	$ 20,088,692	$ 21,045,566

District Challenges for the Future

The District continues to be financially sound. However, the current state and national financial climate requires the District to remain prudent.

The District will continue to use careful planning and monitoring of finances to provide quality services to its customers.

Contacting the District's Financial Management

This financial report is designed to provide our customers, investors and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives and spends. If you have questions about this report or need additional financial information, contact James Jeffries, General Manager, 360 Ring Road, Elizabethtown, Kentucky 42701, (270) 737-1056.

BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF NET POSITION

DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 3,320,204	$ 2,649,105
Investments	12,805,317	15,126,155
Accounts receivable, net	1,433,412	1,139,535
Prepaid insurance	-	50,000
State grants receivable	476,002	-
Materials and supplies	511,382	518,605
TOTAL CURRENT ASSETS	18,546,317	19,483,400
NONCURRENT ASSETS:		
Restricted cash and cash equivalents	3,089,426	2,521,149
Restricted investments	1,207,394	978,338
Regulatory asset on CERS pension	4,349,785	3,121,693
Non-depreciable capital assets	11,581,639	3,741,575
Depreciable capital assets, net of accumulated depreciation	60,056,364	58,896,940
TOTAL NONCURRENT ASSETS	80,284,608	69,259,695
TOTAL ASSETS	98,830,925	88,743,095
DEFERRED OUTFLOWS OF RESOURCES		
Deferred amount on debt refundings	218,350	251,764
Deferred amount on CERS pension	1,554,468	1,373,650
Utility acquisition adjustments	175,147	184,877
TOTAL DEFERRED OUTFLOWS OF RESOURCES	1,947,965	1,810,291
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	158,753	160,885
Construction projects payable	14,149	329,529
Elizabethtown sewer payable	720,357	-
Accrued taxes	54,703	73,367
Accrued liabilities	75,898	66,851
Accrued vacation	155,245	123,268
Customer deposits	43,008	49,671
Customer advances for construction	77,250	34,250
Bonds payable	855,000	669,000
Notes payable	283,041	239,115
TOTAL CURRENT LIABILITIES	2,437,404	1,745,936
NONCURRENT LIABILITIES:		
Customer deposits	387,072	447,040
Net pension liability - CERS	5,904,253	4,495,343
Bonds payable	13,611,788	14,515,545
Notes payable	5,338,865	5,621,906
TOTAL NONCURRENT LIABILITIES	25,241,978	25,079,834
TOTAL LIABILITIES	27,679,382	26,825,770
NET POSITION		
Net investment in capital assets	51,753,510	41,515,184
Restricted for debt service	1,276,639	2,088,360
Unrestricted	20,069,359	20,124,072
TOTAL NET POSITION	$ 73,099,508	$ 63,727,616

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

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
OPERATING REVENUES:		
Water sales	12,512,174	11,955,417
Other operating income	820,005	623,142
TOTAL OPERATING REVENUES	13,332,179	12,578,559
OPERATING EXPENSES:		
Power purchased	822,983	687,301
Pumping and treatment labor	1,007,379	983,616
Purification supplies and expense	556,493	539,324
Transmission and distribution labor	1,525,723	1,459,524
Transmission and distribution supplies and expense	242,028	272,431
Transmission and distribution maintenance and repairs	54,476	48,499
Equipment rental	5,131	9,401
Transportation expense	154,429	141,980
Water treatment maintenance and expense	152,360	169,789
General and administrative expenses	2,711,567	2,441,561
Depreciation	2,768,074	2,572,838
TOTAL OPERATING EXPENSES	10,000,643	9,326,264
OPERATING INCOME	3,331,536	3,252,295
NON-OPERATING REVENUES (EXPENSES):		
Investment income	384,592	306,412
Other income	179,376	123,780
Gain/(Loss) on disposal of capital assets	8,607	3,636
Bond issuance costs	(120,614)	-
Interest expense on long-term debt	(706,250)	(705,596)
Interest expense on customer deposits	(295)	(568)
Amortization of bond discount and utility acquisition	(31,855)	(68,514)
TOTAL NON-OPERATING REVENUES (EXPENSES)	(286,439)	(340,850)
CAPITAL CONTRIBUTIONS	6,326,795	412,995
CHANGE IN NET POSITION	9,371,892	3,324,440
NET POSITION, beginning of year, as restated	63,727,616	60,403,176
NET POSITION, end of year	$ 73,099,508	$ 63,727,616

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

HARDIN COUNTY WATER DISTRICT NO. 2

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$ 13,038,302	$ 12,394,868
Payments to suppliers	(3,288,324)	(3,605,793)
Payments to employees	(3,182,601)	(2,943,149)
NET CASH PROVIDED BY OPERATING ACTIVITIES	6,567,377	5,845,926
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Principal payments on bonds	(5,633,000)	(648,000)
Proceeds from bonds	4,805,917	-
Principal payments on notes	(239,115)	(232,727)
Acquisition of capital assets	(12,082,942)	(4,542,596)
Contributions in aid of construction	5,850,793	412,995
Interest on long-term debt	(706,250)	(705,596)
Sale of capital assets	8,607	3,636
Customer deposit interest	(295)	(568)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(7,996,285)	(5,712,856)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sale (purchase) of investments	1,931,397	(261,766)
Other income	179,376	123,778
Investment income	557,511	542,433
NET CASH PROVIDED BY INVESTING ACTIVITIES	2,668,284	404,445
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,239,376	537,515
CASH AND CASH EQUIVALENTS, beginning of year	5,170,254	4,632,739
CASH AND CASH EQUIVALENTS, end of year	$ 6,409,630	$ 5,170,254
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 3,331,536	$ 3,252,295
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation	2,768,074	2,572,838
Provision for bad debts	37,690	53,491
(Increase) in accounts receivable	(293,877)	(183,691)
(Increase) decrease in prepaids	50,000	(50,000)
Increase (decrease) in accounts payable	(2,132)	17,633
Increase in Elizabethtown sewer payable	720,357	-
Increase (decrease) in customer deposits	(66,631)	110,454
Increase (decrease) in accrued taxes payable	(18,664)	47,629
Increase in accrued liabilities	9,047	13,399
Increase in accrued vacation	31,977	11,878
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 6,567,377	$ 5,845,926

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

NOTES TO BASIC FINANCIAL STATEMENTS

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Brief history - The Hardin County Water District No. 2 was organized pursuant to the provisions of Kentucky Revised Statutes KRS 74.010 and KRS 44.020 in order to provide a water supply for the residents of Hardin County, Kentucky.

The District's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The District follows the accounting policies and procedures set forth by the National Association of Regulatory Utility Commissioners and the guidance provided by the American Water Works Association in *Water Utility Accounting* and is regulated by the Kentucky Public Service Commission. The more significant accounting policies established in GAAP and used by the District are discussed below.

A. REPORTING ENTITY

These financial statements present the District's financial activities. As defined by GASB No. 14, *The Financial Reporting Entity,* as amended by GASB No. 39, *Determining Whether Certain Organizations Are Component Units* the criteria for inclusion in the reporting entity involve those cases where the District or its officials appoint a voting majority of an organization's governing body, and is either able to impose its will on the organization or there is a potential for the organization to provide specific financial benefits to or to impose specific financial burdens on the District or the nature and significance of the relationship between the District and the organization is such that exclusion would cause the District's financial statements to be incomplete. Applying this definition, the District does not include any component units in its reporting entity.

B. BASIC FINANCIAL STATEMENTS

All activities of the District are accounted for within a single proprietary (enterprise) fund. The focus of proprietary fund measurement is upon determination of operating income, changes in net position, financial position, and cash flows. The GAAP applicable are those similar to businesses in the private sector. Enterprise funds are required to be used to account for operations for which a fee is charged to external users for goods or services and the activity is financed with debt that is solely secured by a pledge of the net revenues.

C. BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues or expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied. The proprietary fund financial statements are presented on the accrual basis of accounting. Nonexchange revenues, including intergovernmental revenues and grants, are reported when all eligibility requirements have been met. Fees and charges and other exchange revenues are recognized when earned and expenses are recognized when incurred. Because the District's rates are regulated by the Kentucky Public Service Commission the District accounts for the financial effects of regulation in accordance with Governmental Accounting Standards Board (GASB) Statement No. 62, Paragraphs 476-500, Regulated Operations. Accordingly, certain costs and income may be capitalized as a regulatory asset or liability that would otherwise be charged to expense or revenues. Regulatory assets and liabilities are recorded when it is probable that future rates will permit recovery.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

D. FINANCIAL STATEMENT AMOUNTS

1. Cash and investments – The District's cash balances are held at multiple financial institutions. Investments are stated at fair value based on quoted market prices.

2. Cash and cash equivalents – The District has defined cash and cash equivalents to include cash on hand and demand deposits. The District considers all highly liquid debt instruments (including restricted assets) purchased with a maturity of three months or less to be cash equivalents.

3. Restricted Assets – Restricted assets consist of demand deposit savings accounts and certificates of deposit. The cost basis approximates market value.

4. Materials and supplies – Materials and supplies is composed of items used in the capital construction process.

5. Accounts Receivable - The allowance method is used to record uncollectible accounts.- At December 31, 2016 and 2015, accounts receivable was stated net of an allowance for uncollectible accounts of $70,000 and $60,000. Bad debt expense for 2016 was $37,690 and 2015 was $53,491. The District does not believe there is any credit risk associated with these receivables due to the large customer base and small individual account balances.

6. Capital Assets – Capital assets in service and construction in progress with an original cost of $5,000 or more are recorded at historical cost, if purchased or constructed. Assets acquired through contributions from developers or other customers are capitalized at their estimated fair market value, if available, or at engineers' estimated fair market value or cost to construct at the date of the contribution. Maintenance and repairs, which do not significantly extend the value or life of property, plant and equipment, are expensed as incurred. Assets are depreciated on the straight-line method. Depreciation is calculated using the following estimated useful lives:

	Years
Source of supply equipment	15-50
Water treatment plant	10-40
Transmission and distribution systems	10-50
Equipment	3-20
Structures and improvements, including buildings	10-50
Office furniture, equipment and vehicles	3-20
Meters	10-20

7. Compensated absences – The District accrues unpaid vacation when earned by the employee.

8. Defining Operating Revenues and Expenses – The District distinguishes between operating and non-operating revenue and expenses. Operating revenues and expenses consist of charges for services and the costs of providing those services, including depreciation and excluding interest cost. All other revenues and expenses are reported as non-operating.

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9. Net Position – Net position is divided into three components:

    a. Net investment in capital assets – consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
    b. Restricted net position – consist of net position that is restricted by the District's creditors (for example, through debt covenants), by grantors (federal, state and local) and by other contributors.
    c. Unrestricted – all other net position is reported in this category.

10. Use of Restricted Resources – When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the District's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.

11. Amortization – Bond discounts/premiums and deferred amounts on refundings are being amortized using the interest method over the life of each respective bond issue.

12. Capital Contributions – Contributions are recognized in the Statement of Revenues, Expenses and Changes in Fund Net Position when earned. Contributions include capacity fees, capital grants, and other supplemental support by other utilities and industrial customers and federal, state and local grants in support of system improvements.

13. Long-term Obligations – Long-term obligations are reported at face value, net of applicable premiums and discounts.

14. Use of Estimates - 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 the reported amounts of assets and 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.

15. Restatement – Change in Accounting Principle – During the year ended December 31, 2016, the District adopted the provisions of GASB Statement No. 62, Paragraphs 476-500, Regulated Operations with respect to its participation in the County Employees Retirement System. The District presents comparative financial statements so the restatement was made through the December 31, 2015 amounts. The effect of the restatement was to record a regulatory asset of $3,121,693, a change to beginning net position of $3,050,465 and an increase in pension expense of $107,955 which was reflected through the change in net position.

16. Pensions – For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the County Employees Retirement System (CERS) and additions to/deductions from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS except that CERS's fiscal year end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

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The District's rates are regulated by the Kentucky Public Service Commission. In accordance with GASB Statement No. 62, Paragraphs 476-500, Regulated Operations, which requires that the effects of the rate-making process be recorded in the financial statements, the District has elected to record a regulatory asset for the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions. Accordingly, the District recognizes the actuarially determined contribution as the current year pension expense.

17. Impact Of Recently Issued Accounting Principles

Recently Issued And Adopted Accounting Principles

In February 2015, the GASB issued Statement 72, *Fair Value Measurement and Application*. GASB 69 establishes accounting and financial reporting standards related to fair value measurements. This statement is effective for periods beginning after June 15, 2015. This statement was adopted during the year ended December 31, 2016 and did not have an impact on the District's financial statements.

In June 2015, the GASB issued Statement 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This statement is effective for periods beginning after June 15, 2015. This statement was adopted during the year ended December 31, 2016 and did not have an impact on the District's financial statements.

In August 2015, the GASB issued Statement 77, *Tax Abatement Disclosures*. This statement is effective for periods beginning after December 15, 2015. This statement was adopted during the year ended December 31, 2016 and did not have an impact on the District's financial statements.

In December 2015, the GASB issued Statement 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*. This statement is effective for periods beginning after December 15, 2015. This statement was adopted during the year ended December 31, 2016 and did not have an impact on the District's financial statements.

In December 2015, the GASB issued Statement 79, *Certain External Investment Pools and Pool Participants*. This statement is effective for periods beginning after June 15, 2015. This statement was adopted during the year ended December 31, 2016 and did not have an impact on the District's financial statements.

Recently Issued Accounting Pronouncements

In June 2015, the GASB issued Statement 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This statement is effective for periods beginning after June 15, 2016. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

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In June 2015, the GASB issued Statement 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.* This statement is effective for periods beginning after June 15, 2017. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In January 2016, the GASB issued Statement 80, *Blending Requirements for Certain Component Units – An Amendment of GASB Statement 14.* This statement is effective for periods beginning after June 15, 2016. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In March 2016, the GASB issued Statement 81, *Irrevocable Split-Interest Agreements.* This statement is effective for periods beginning after December 15, 2016. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In March 2016, the GASB issued Statement 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68 and No. 72.* This statement is effective for periods beginning after June 15, 2016 except for the requirements of the Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In November 2016, the GASB issued Statement 83, *Certain Asset Retirement Obligatons.* This statement is effective for periods beginning after June 15, 2018. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In January 2017, the GASB issued Statement 84, *Fiduciary Activities.* This statement is effective for periods beginning after December 15, 2018. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In March 2017, the GASB issued Statement 85, *Omnibus 2017.* This statement is effective for periods beginning after June 15, 2017. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

In May 2017, the GASB issued Statement 86, *Certain Debt Extinguishment Issues.* This statement is effective for periods beginning after June 15, 2017. Management is currently evaluating the impact of the adoption of this statement on the District's financial statements.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE 2 – ELIZABETHTOWN WATER SYSTEM ACQUISITION

On October 23, 2014, the Kentucky Public Service Commission approved an asset purchase agreement between the District and the City of Elizabethtown, Kentucky, for the District's purchase of certain water system assets of the City. The transaction closed on October 31, 2014. The agreement requires the District to pay a note to the City of $8,000,000 in twenty annual installments of $400,000 beginning in 2015. The note carries no specified interest rate, but interest was imputed at a rate of 2.745 percent resulting in a net principal amount of $6,093,748 and a resulting interest amount of $1,906,252 over the life of the note (See note 5). The assets acquired were recorded at cost as well as the corresponding accumulated depreciation (See note 4). The transaction resulted in a $1,000,000 capital contribution from the City and a utility acquisition adjustment of $194,608 which is presented as a deferred outflow of resources in the Statement of Net Position. This amount is being amortized over 20 years at $9,730 per year. The unamortized amount at December 31, 2016 and 2015 was $175,147 and $184,877.

NOTE 3 – DEPOSITS AND INVESTMENTS

DEPOSITS

Custodial Credit Risk—Deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned or that the District will not be able to recover collateral securities in the possession of an outside party. As of December 31, 2016 and 2015, $7,930,584 and $4,921,205 of the District's bank balance of $8,430,584 and $5,563,590 was exposed to custodial credit risk. For 2016 and 2015, of the amount exposed to custodial credit risk, the entire amount was collateralized by securities held by the pledging financial institution.

INVESTMENTS

At December 31, 2016 and 2015, the District had the following investments and maturities:

	12/31/2016 Fair Value	Average Credit Quality/Ratings	Maturities
Bond Mutual Funds	$ 4,826,954	Unrated	7.5 years average
Bond Mutual Funds	4,524,211	Unrated	5.1 years average
Bond Mutual Funds	3,454,152	Unrated	7.6 years average
Total Investments	$ 12,805,317		

	12/31/2015 Fair Value	Average Credit Quality/Ratings	Maturities
Bond Mutual Funds	$ 4,734,748	Unrated	6.5 years average
Bond Mutual Funds	1,093,947	Unrated	8.5 years average
Bond Mutual Funds	5,977,924	Unrated	4.9 years average
Bond Mutual Funds	3,319,536	Unrated	11 years average
Treasury Money Market Fund	853,282	Unrated	Less than 1 year
Total Investments	$ 15,979,437		

The funds listed above are not rated. The individual investments within the funds are rated no lower than BBB.

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Investment Policies

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Generally, the District's investing activities are under the custody of the District Commissioners. Investing policies comply with the State Statutes. Kentucky Revised Statute 66.480 defines the following items as permissible investments:

- Obligations of the United States and of its agencies and instrumentalities;
- Obligations of any corporation of the United States Government;
- Obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or a United States government agency;
- Uncollateralized certificates of deposit issued by any bank or savings and loan institution rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- Certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation or similar entity or which are collateralized, to the extent uninsured, by any obligations, including surety bonds, permitted by KRS 41.240(4)
- Bankers' acceptances for banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- Commercial paper rated in the highest category by a nationally recognized rating agency;
- Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities;
- Securities issued by a state or local government, or any instrumentality of agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a nationally recognized rating agency; and
- Shares of mutual funds, each of which shall have the following characteristics:
    1. The mutual fund shall be an open-end diversified investment company registered under the Federal Investment Company Act of 1940, as amended;
    2. The management company of the investment company shall have been in operation for at least five (5) years; and
    3. All of the securities in the mutual fund shall be eligible investments pursuant to this section.

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. The District policy provides that, to the extent practicable, investments are matched with anticipated cash flows. Investments are diversified to minimize the risk of loss resulting from over-concentration of assets in a specific maturity period, a single issuer, or an individual class of securities. **Concentration of Credit Risk** is the risk of loss attributed to the magnitude of the District's investment in a single issuer. U.S. Government securities and investments in mutual funds are excluded from this risk. The District does not have more than 5% or more of investments subject to the concentration of credit risk disclosure in any one issuer. **Custodial Credit Risk** is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. No investments are reported at amortized cost. The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. 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 District's investments are level 1 inputs.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE 3 - RESTRICTED CASH

The District has restricted cash for various purposes at December 31, 2016 and 2015 as follows:

Restricted For	December 31, 2016	December 31, 2015
Debt service	$ 2,397,777	$ 1,235,078
Depreciation fund	831,166	465,068
Escrow	65,306	21,850
Construction	474,077	500,484
Health plan	40,000	-
Customer deposits	488,495	423,724
	$ 4,296,821	$ 2,646,204

NOTE 4 – CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2016 follows.

	Balance at December 31, 2015	Additions	Retirements	Balance at December 31, 2016
Non-Depreciable Assets:				
Land and land rights	$ 687,483	$1,450,150	$ -	$ 2,137,633
Construction in progress	3,054,092	7,301,096	(911,181)	9,444,007
Total Capital Assets Not Being Depreciated	3,741,575	8,751,246	(911,181)	11,581,640
Capital Assets Being Depreciated:				
Structures and improvements	10,834,554	49,700	-	10,884,254
Property held for future use	-	1,190,404	-	1,190,404
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	11,113,289	490,312	-	11,603,601
Standpipes, tanks and foundations	10,900,431	338,196	-	11,238,627
Transmission and distribution mains	43,672,916	58,977	-	43,731,893
Services and meters	8,663,459	1,562,688	(116,624)	10,109,523
Hydrants	261,775	23,145	-	284,920
Office furniture and fixtures	479,702	27,115	-	506,817
Transportation equipment	1,667,751	186,960	(69,605)	1,785,106
Other property and equipment	606,185	-	-	606,185
Total Capital Assets Being Depreciated at historical cost	89,964,027	3,927,497	(186,229)	93,705,295
Less accumulated depreciation:				
Structures and improvements	3,000,077	309,687	-	3,309,764
Property held for future use	-	17,360	-	17,360
Supply mains	1,013,698	44,099	-	1,057,797
Water treatment plant	4,286,796	234,367	-	4,521,163
Standpipes, tanks and foundations	3,203,781	279,627	-	3,483,408
Transmission and distribution mains	14,203,119	963,684	-	15,166,803
Services and meters	3,397,268	628,577	(116,624)	3,909,221
Hydrants	230,857	9,091	-	239,948
Office furniture and fixtures	320,749	52,536	-	373,285
Transportation equipment	1,055,689	180,712	(69,605)	1,166,796
Other property and equipment	355,053	48,334	-	403,387
Total accumulated depreciation	31,067,087	2,768,074	(186,229)	33,648,932
Total other capital assets, net	58,896,940	1,159,423	-	60,056,363
Capital assets, net	$ 62,638,515	$9,910,669	$ (911,181)	$ 71,638,003

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

Capital asset activity for the year ended December 31, 2015 follows.

	Balance at December 31, 2014	Additions	Retirements	Balance at December 31, 2015
Non-Depreciable Assets:				
Land and land rights	$ 687,483	$ -	$ -	$ 687,483
Construction in progress	4,434,176	1,737,642	(3,117,726)	3,054,092
Total Capital Assets Not Being Depreciated	5,121,659	1,737,642	(3,117,726)	3,741,575
Capital Assets Being Depreciated:				
Structures and improvements	8,784,688	2,049,866	-	10,834,554
Supply mains	1,763,965	-	-	1,763,965
Water treatment plant	11,113,289	-	-	11,113,289
Standpipes, tanks and foundations	9,949,534	950,897	-	10,900,431
Transmission and distribution mains	43,555,967	116,949	-	43,672,916
Services and meters	7,066,108	1,814,719	(217,368)	8,663,459
Hydrants	261,775	-	-	261,775
Office furniture and fixtures	479,702	-	-	479,702
Transportation equipment	1,580,835	136,229	(49,313)	1,667,751
Other property and equipment	568,630	37,555	-	606,185
Total Capital Assets Being Depreciated at historical cost	85,124,493	5,106,215	(266,681)	89,964,027
Less accumulated depreciation:				
Structures and improvements	2,725,469	274,608	-	3,000,077
Supply mains	969,599	44,099	-	1,013,698
Water treatment plant	4,054,329	232,467	-	4,286,796
Standpipes, tanks and foundations	2,940,933	262,848	-	3,203,781
Transmission and distribution mains	13,241,000	962,119	-	14,203,119
Services and meters	3,103,300	511,336	(217,368)	3,397,268
Hydrants	223,312	7,545	-	230,857
Office furniture and fixtures	266,659	54,090	-	320,749
Transportation equipment	928,588	176,414	(49,313)	1,055,689
Other property and equipment	307,741	47,312	-	355,053
Total accumulated depreciation	28,760,930	2,572,838	(266,681)	31,067,087
Total other capital assets, net	56,363,563	2,533,377	-	58,896,940
Capital assets, net	$ 61,485,222	$ 4,271,019	$ (3,117,726)	$ 62,638,515

During the years ended December 31, 2016 and 2015, the District capitalized no interest in either year and expensed $706,545 and $706,164 of interest.

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

NOTE 5 – LONG-TERM OBLIGATIONS

The construction costs of the District's water facilities have been financed by issuance of revenue bonds authorized under Kentucky Revised. All assets of the District are pledged as collateral for these bonds. Information relating to the outstanding bond issues is summarized below:

Issue	Interest Rate	Face Amount	Bonds Due 12/31/2016	Bonds Due 12/31/2015
2004 Series A	2.0% - 4.0%	$ 2,940,000	$ -	$ 1,765,000
2005 Series B	4.1%	1,775,000	-	1,125,000
2007 Series A	4.00%	2,480,000	-	2,328,000
2010 Series A	2.0% - 4.125%	5,625,000	4,410,000	4,635,000
2012 Series	1.0% - 3.75%	6,070,000	5,300,000	5,490,000
2016 Series B	2.0% - 3.0%	2,180,000	2,180,000	-
2016 Series C	2.0% - 3.0%	2,430,000	2,430,000	-
			$ 14,320,000	$ 15,343,000

On July 7, 2016, the District issued $2,180,000 in Series 2016B Water System Refunding Revenue Bonds with an average interest rate of 2.8 percent and $2,430,000 in Series 2016C Water System Refunding Revenue Bonds with an average interest rate of 2.8 percent to advance refund $4,964,000 of outstanding 2004A, 2005A and 2007 Series Bonds. The refunding was an advance refunding. The net proceeds of $4,814,439 (after $120,614 in cost of issuance, $316,530 in bond premium, and $8,523 in accrued interest) in combination with $174,600 from the District were used to call the bonds ($4,964,000 of principal and $25,039 of interest).

The District completed the refunding to reduce its total debt service payments over the next 10 years by $1,984,658 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $1,172,766.

The District requires new customers to provide a $60 deposit for initial water service. Current customers in good standing who add additional service locations are not required to pay an additional deposit.

Long-term liability activity for the year ended December 31, 2016, was as follows:

	Balance at December 31, 2015	Additions	Reductions	Balance at December 31, 2016	Amount Due Within One Year
Bonds and notes payable:					
Revenue bonds	$ 15,343,000	$ 4,610,000	$ (5,633,000)	$ 14,320,000	$ 855,000
Notes	5,861,021	-	(239,115)	5,621,906	283,041
Unamortized bond premium/discount	(158,455)	316,530	(11,289)	146,786	
Total bonds and notes payable	21,045,566	4,926,530	(5,883,404)	20,088,692	1,138,041
Other liabilities:					
Customer deposits	496,711	176,520	(243,151)	430,080	43,008
Accrued vacation	123,268	155,245	(123,268)	155,245	155,245
Customer advances for construction	34,250	47,000	(4,000)	77,250	77,250
Total other liabilities	654,229	378,765	(370,419)	662,575	275,503
Long-term liabilities	$ 21,699,795	$ 5,305,295	$ (6,253,823)	$ 20,751,267	$ 1,413,544

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HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

Long-term liability activity for the year ended December 31, 2015, was as follows:

	Balance at December 31, 2014	Additions	Reductions	Balance at December 31, 2015	Amount Due Within One Year
Bonds and notes payable:					
Revenue bonds	$ 15,991,000	$ -	$ (648,000)	$ 15,343,000	$ 669,000
Notes	6,093,748	-	(232,727)	5,861,021	239,115
Unamortized bond premium/discount	(181,574)	-	23,119	(158,455)	-
Total bonds and notes payable	21,903,174	-	(857,608)	21,045,566	908,115
Other liabilities:					
Customer deposits	386,257	215,501	(105,047)	496,711	49,671
Accrued vacation	111,390	123,268	(111,390)	123,268	123,268
Customer advances for construction	23,250	27,000	(16,000)	34,250	34,250
Total other liabilities	520,897	365,769	(232,437)	654,229	207,189
Long-term liabilities	$ 22,424,071	$ 365,769	$ (1,090,045)	$ 21,699,795	$ 1,115,304

Bond and note maturities and Sinking Fund requirements in each of the next five years and in five year increments thereafter are as follows at December 31, 2016:

	Revenue Bonds			Notes		
Year	Principal	Interest	Totals	Principal	Interest	Totals
2017	$ 855,000	$ 419,373	$ 1,274,373	$ 245,679	$ 154,321	$ 400,000
2018	860,000	414,169	1,274,169	252,423	147,577	400,000
2019	890,000	392,337	1,282,337	259,352	140,648	400,000
2020	910,000	366,922	1,276,922	266,471	133,529	400,000
2021	950,000	339,906	1,289,906	273,785	126,215	400,000
2022-2026	4,955,000	1,247,014	6,202,014	1,485,870	514,130	2,000,000
2027-2031	3,065,000	611,102	3,676,102	1,701,313	298,687	2,000,000
2032-2036	1,255,000	213,432	1,468,432	1,137,013	62,987	1,200,000
2037-2041	580,000	27,751	607,751	-	-	-
Total	$ 14,320,000	$ 4,032,006	$ 18,352,006	$ 5,621,906	$ 1,578,094	$ 7,200,000

Year	Sinking Fund Requirements
2017	$ 1,674,373
2018	1,674,169
2019	1,682,337
2020	1,676,922
2021	1,689,906
2022-2026	8,202,014
2027-2031	5,676,102
2032-2036	2,668,432
2037-2041	607,751
Total	$ 25,552,006

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Under covenants of the bond ordinances, certain funds have been established. These funds and their current financial requirements are presented as follows:

Revenue Fund
All receipts for services are deposited into this fund and, subsequently, disbursed into the following required funds:

Bond and Interest Redemption Funds
There is to be a monthly deposit of an amount equal to 1/12 of the next ensuing principal payment due and 1/6 of the next ensuing interest payment due for the 2010 Series A, 2012 Series, 2016 Series B and 2016 Series C and 1/12 of the next ensuing principal and interest payment on the note payable.

Depreciation Fund
This fund receives, on a monthly basis, $150,000. This fund also receives the proceeds from the sale of any property or equipment. This fund may be used to purchase new or replacement property and equipment.

Operation and Maintenance Fund
This fund receives, on a monthly basis, sufficient amounts to pay current expenses from the Revenue Fund after the above transfers have been made. This fund is used to pay operating expenditures. This account is funded until it reaches 2 months of forecasted operating expenses. Any surplus left may be added to the Bond and Interest Redemption Fund.

NOTE 6 - RETIREMENT PLAN

Plan Description
The District participates in the County Employees' Retirement System (CERS), a component unit of the Commonwealth of Kentucky which is a cost-sharing multiple-employer defined benefit plan. CERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Under the provisions of KRS Section 61.645, the Board of Trustees of Kentucky Retirement Systems (KERS) administers the CERS. The CERS issues a publicly available financial reports that include financial statements and required supplementary information. CERS' report may be obtained at www.kyret.ky.gov.

Benefits Provided
The system provides for retirement, disability, and death benefits to system members. Retirement benefits may be extended to beneficiaries of members under certain circumstances. Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. On July 1, 2013, the COLA was not granted. Effective July 1, 2009, and on July 1 of each year thereafter through June 30, 2014, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the 12 months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce the COLA if, in its judgment, the welfare of the Commonwealth so demands. No COLA has been granted since July 1, 2011.

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

Contributions

For the calendar year ended December 31, 2016, plan members who began participating prior to September 1, 2008, were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.545(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. The District's contractually required contribution rate for the calendar year ended December 31, 2016, was 12.42 percent of creditable compensation from January 1 to June 30 and 13.95 percent of creditable compensation from July 1 to December 31. The District's contractually required contribution rate for the calendar year ended December 31, 2015, was 12.75 percent of creditable compensation from January 1 to June 30 and 12.42 percent of creditable compensation from July 1 to December 31.Contributions to the pension plan for the years ended December 31, 2016 and 2015, from the District were $542,052 and $491,530. At December 31, 2016 and 2015, the District owed $75,898 and $66,851 to the plan for employer and member contributions for December.

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

At December 31, 2016, the District reported a liability of $5,904,253 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015 using standard roll-forward techniques. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all, actuarially determined. At June 30, 2016, the District's proportion was 0.11992 percent, which was an increase of .01536 percent from its proportion measured as of June 30, 2015.

For the years ended December 31, 2016 and 2015, the District recognized pension expense of $542,052 and $491,530. At December 31, 2016, the District reported its proportionate share of the CERS deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	$ 25,776	$ -
Changes in actuarial assumptions	312,776	-
Difference between projected and actual investment earnings	555,060	-
Changes in proportion and proportionate share of contributions	660,856	-
	$ 1,554,468	$ -

(Continued next page)

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

Amounts reported as deferred outflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31	Amortization Amount
2017	$ 404,955
2018	404,955
2019	404,955
2020	228,591
2021	111,012
	$ 1,554,468

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

Inflation	3.25 percent
Salary increases	4.0 percent, average, including inflation
Investment rate of return	7.50 percent, net of pension plan investment expense, including inflation

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

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

(Continued next page)

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for the Systems. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

Asset Class		Target Allocation	Long-Term Expected Real Rate of Return
Combined Equity		44%	5.40%
Combined Fixed Income		19%	1.50%
Real Return (Diversified Inflation Strategies)		10%	3.50%
Real Estate		5%	4.50%
Absolute Return (Diversified Hedge Funds)		10%	4.25%
Private Equity		10%	8.50%
Cash		2%	-0.25%
	Total	100%	

Discount Rate

The discount rate used to measure the total pension liability as of the Measurement Date was 7.5%. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27 year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period. Projected inflows from investment earnings were calculated using the long-term assumed investment return of 7.5%. The long-term assumed investment rate of return was applied to all periods of projected of benefit payments to determine the total pension liability.

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Sensitivity Of The District's Proportionate Share Of The Net Pension Liability To Changes In The Discount Rate

The following presents the District's proportionate share of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5 percent) or 1-percentage-point higher (8.5 percent) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
District's proportionate share of the net pension liability	7,357,842	5,904,253	4,658,516

Pension Plan Fiduciary Net Position

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

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

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

Years of Service	% paid by Insurance Fund	% Paid by Member through
20 or more	10	0%
15-19	7	25%
10-14	5	50%
4-9	2	75%
Less than 4	0	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount.

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NOTE 8 – CAPITAL CONTRIBUTIONS

The following schedule details the sources of capital contributions for the years ended December 31, 2016 and 2015:

Source	2016	2015
State of Kentucky	$ 5,952,907	$ 270,273
City of Elizabethtown, Kentucky	150,748	-
Tap Fees	219,518	141,533
Developers	3,622	1,189
	$ 6,326,795	$ 412,995

NOTE 9 – RENTAL AGREEMENTS

The District has entered into agreements to lease space on its water towers to various customers. Rental income during the years ended December 31, 2016 and 2015 was $81,940 and $82,507. The following schedule represents future payments to be received. Each agreement provides for optional renewals. The schedule below reflects payments to be received under current agreements and does not include renewals after the current term.

2017	$ 82,577
2018	28,566
Total	$ 111,143

NOTE 10 – COMMITMENTS

The District has entered into construction commitments toward its construction projects. Also, the District has received certain funding commitments from governmental agencies for current and planned construction projects.

NOTE 11 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The District was insured for workers' compensation, general liability and automobile liability coverage under a retrospectively rated commercial policy.

NOTE 12 – SUBSEQUENT EVENTS

In January 2017, the District implemented a self-insured health insurance plan.

REQUIRED SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE CERS NET PENSION LIABILITY

December 31, 2016

Last 10 Years *

		2016	2015
Proportion of the net pension liability		0.119920%	0.104554%
Proportionate share of the net pension liability	$	5,904,253	$ 4,495,343
Covered - employee payroll	$	3,117,060	$ 2,939,133
Proportionate share of the net pension liability as percentage of covered payroll		189.4%	152.9%
Plan fiduciary net position as a percentage of the total pension liability		55.50%	59.97%

* Calendar year 2015 was the first year of implementation, therefore, only two years are shown.

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE OF CONTRIBUTIONS TO CERS

December 31, 2016

Last 10 Years *

	2016	2015
Contractually required contribution (actuarially determined)	$ 412,832	$ 312,163
Contribution in relation to the actuarially determined contributions	412,832	312,163
Contribution deficiency (excess)	$ -	$ -
Covered employee payroll	$ 3,117,060	$ 2,939,133
Contributions as a percentage of covered employee payroll	13.24%	10.62%

* Calendar year 2015 was the first year of implementation, therefore, only two years are shown.

HARDIN COUNTY WATER DISTRICT NO. 2

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

FOR THE YEAR ENDED DECEMBER 31, 2016

Changes of benefit terms. There were no changes in benefit terms.

Changes of assumptions. There were no changes in assumptions.

OTHER SUPPLEMENTARY INFORMATION

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2016

	$ 5,625,000 2010 SERIES A		$ 6,070,000 2012 SERIES	
	BOND	INTEREST	BOND	INTEREST
2017	$ 230,000	$ 156,288	$ 195,000	$ 151,375
2018	235,000	149,894	195,000	147,475
2019	245,000	142,987	200,000	143,525
2020	250,000	135,250	205,000	139,347
2021	260,000	126,800	210,000	134,806
2022	265,000	117,940	215,000	129,891
2023	275,000	108,656	220,000	124,725
2024	290,000	98,588	230,000	119,238
2025	300,000	87,707	235,000	113,425
2026	310,000	76,075	245,000	107,119
2027	325,000	63,772	245,000	100,381
2028	340,000	50,676	255,000	93,506
2029	345,000	36,976	265,000	86,356
2030	360,000	22,876	270,000	78,663
2031	380,000	7,833	280,000	70,063
2032			295,000	60,719
2033			300,000	50,675
2034			210,000	41,750
2035			220,000	34,225
2036			230,000	26,063
2037			235,000	17,344
2038			250,000	8,250
2039			85,000	1,969
2040			10,000	188
	$ 4,410,000	$ 1,382,318	$ 5,300,000	$ 1,981,078

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HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2016

(CONTINUED)

	$ 2,180,000 2016 SERIES B		$ 2,430,000 2016 SERIES C	
	BOND	INTEREST	BOND	INTEREST
2017	200,000	52,964	$ 230,000	$ 58,746
2018	195,000	55,500	235,000	61,300
2019	200,000	50,550	245,000	55,275
2020	205,000	44,475	250,000	47,850
2021	215,000	38,175	265,000	40,125
2022	220,000	31,650	280,000	31,950
2023	225,000	24,975	295,000	23,325
2024	235,000	18,075	310,000	14,250
2025	240,000	10,950	320,000	4,800
2026	245,000	3,675		
2027				
2028				
2029				
2030				
2031				
2032				
2033				
2034				
2035				
2036				
2037				
2038				
2039				
2040				
	$ 2,180,000	$ 330,989	$ 2,430,000	$ 337,621

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HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE I - BOND AND INTEREST REQUIREMENTS

DECEMBER 31, 2016

(CONTINUED)

TOTAL ALL ISSUES BOND	INTEREST
$ 855,000	$ 419,373
860,000	414,169
890,000	392,337
910,000	366,922
950,000	339,906
980,000	311,431
1,015,000	281,681
1,065,000	250,151
1,095,000	216,882
800,000	186,869
570,000	164,153
595,000	144,182
610,000	123,332
630,000	101,539
660,000	77,896
295,000	60,719
300,000	50,675
210,000	41,750
220,000	34,225
230,000	26,063
235,000	17,344
250,000	8,250
85,000	1,969
10,000	188
$ 14,320,000	$ 4,032,006

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE II - GENERAL AND ADMINISTRATIVE EXPENSES

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Salaries	$ 1,203,525	$ 1,067,634
Commissioner's salaries	30,314	30,276
Employee benefits	542,871	494,661
Materials and supplies	90,687	87,904
Professional fees and contractual services	221,428	281,434
Insurance	138,909	136,110
Advertising	7,853	3,738
Provision for bad debts	37,690	53,491
Other general and administrative	438,290	286,313
	$ 2,711,567	$ 2,441,561

HARDIN COUNTY WATER DISTRICT NO. 2

SCHEDULE III - ORGANIZATION DATA

DECEMBER 31, 2016

WATER COMMISSIONERS

Michael Bell - Chairman
Morris Miller - Secretary/Treasurer
Cordell Tabb - Member
John Effinger - Member
Tim Davis - Member

ATTORNEY

Stoll, Keenon, Ogden, PLLC

GENERAL MANAGER

James Jeffries

CALENDAR YEAR

January 1 to December 31

INTERNAL CONTROL AND FISCAL COMPLIANCE

CHRIS R. CARTER, CPA
ANN M. FISHER, CPA
SCOTT KISSELBAUGH, CPA
PHILIP A. LOGSDON, CPA
BRIAN S. WOOSLEY, CPA

STILES, CARTER & ASSOCIATES
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AMERICAN INSTITUTE OF CPAS
KENTUCKY SOCIETY OF CPAS

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

Board of Commissioners
Hardin County Water District No. 2
Elizabethtown, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Hardin County Water District No. 2, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise Hardin County Water District No. 2's basic financial statements and have issued our report thereon dated May 23, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Hardin County Water District No. 2's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Hardin County Water District No. 2's internal control. Accordingly, we do not express an opinion on the effectiveness of Hardin County Water District No. 2'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 combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as item 2016-001 that we consider to be a material weakness.

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120 WEST STEPHEN FOSTER AVENUE, #113 · BARDSTOWN, KY 40004 / PHONE 502-348-1433 · FAX 502-349-6365

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hardin County Water District No. 2's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Hardin County Water District's Response to Findings

Hardin County Water District No. 2's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Hardin County Water District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District'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.

Stiles, Carter & Associates

Certified Public Accountants
Elizabethtown, Kentucky
May 23, 2017

SCHEDULE OF FINDINGS AND RESPONSES

HARDIN COUNTY WATER DISTRICT NO. 2
SCHEDULE OF FINDINGS AND RESPONSES
FOR THE YEAR ENDED DECEMBER 31, 2016

MATERIAL WEAKNESSES

REFERENCE NUMBER 2016-001 FINANCIAL STATEMENT ADJUSTMENTS

Criteria: The District's management is responsible for establishing and maintaining internal controls over the application of transactions and the preparation of financial statements.

Condition: As part of the audit, we noted that material adjustments were required in order to prevent the financial statements from being materially misstated.

Cause: The District did not make all necessary adjustments when closing the year.

Effect: The financial statements required adjustment of significant items.

Recommendation: We recommend District management and financial personnel continue to increase their awareness and knowledge of all procedures and processes involved in preparing financial statements and develop internal control policies to ensure proper financial statement presentation.

Management Response: Management will improve operations to ensure that necessary adjustments are made in accordance with the normal closing process.