

MOUNTAIN WATER DISTRICT

REPORT OF AUDIT

DECEMBER 31, 2016

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Mountain Water District
Pikeville, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of the Mountain Water District as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Mountain Water 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

My responsibility is to express opinions on these financial statements based on our audit. I conducted my 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 I 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, I 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.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

Opinions

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of business-type activities, the major fund, and the aggregate remaining fund information of the Mountain Water District, as of December 31, 2016, and the respective changes in financial position, and, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3–5 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. I 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 my inquiries, the basic financial statements, and other knowledge we obtained during my

audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

Other Information

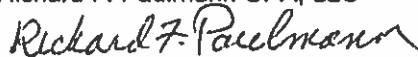
My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Mountain Water District's basic financial statements. The introductory section, combining and individual nonmajor fund financial statements, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements.

My audit was conducted for the purpose of forming opinion on the financial statements that collectively comprise the Mountain Water District's basis financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by Title 2 U.S. Code of Federal Regulations part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, and is not a required part of 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 my opinion, the combining and individual nonmajor fund financial statements and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated September 27, 2017, on my consideration of the Mountain Water District's internal control over financial reporting and on my 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 my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Mountain Water District's internal control over financial reporting and compliance.

Richard F. Paulmann CPA, LLC



Pewee Valley, Kentucky
September 27, 2017

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2016

Our discussion and analysis of the Mountain Water (the District) financial performance provides an overview of the District's financial activities for the fiscal year ended December 31, 2016. Please read it in conjunction with the accompanying basic financial statements. It is our intent that this discussion provide all parties interested in the District's financial condition, especially the users of the facilities, a better understanding of the District's operations and financial status.

The District reports its financial statements in a required model format issued by the Governmental Accounting Standards Board.

Financial Highlights

- Net assets decreased this year by \$1,021,644 from operating activities and before capital contributions.
- The District's total long-term debt decreased by \$516,965 from the prior year.
- The District acquired several vehicles through financing.
- The District was able to make the following purchases:
 1. Significant water and sewer line extensions to the outlying areas of Pike County.
 2. Assorted new equipment for treatment plant and distribution system to facilitate daily operations.

Overview of the Financial Statements

The District's basic financial statements include: (1) fund financial statements, and (2) notes to the financial statements. These financial statements present information about business-type activities, which consists principally of the fees the District charges its users to cover all or most of the cost of the services it provides.

Fund Financial Statements

The fund financial statements provide detailed information about the proprietary fund. When the District charges customers for services it provides, these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the District's enterprise funds (a component of proprietary funds) are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows for proprietary funds.

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2016
(CONTINUED)

Notes to the financial statements

The accompanying notes to the financial statements provide information essential to a full understanding of the fund financial statements. The notes to the financial statements begin immediately following the basic financial statements.

Reporting on the District as a Whole

One of the most important questions asked about the District's finances is, "Is the District as a whole better off or worse off as a result of this year's activities?" The Statements of Financial Position and the Statement of Revenue, Expenses and Changes in Fund Net Assets report information about the District as a whole and about its activities in a way that helps answer this question.

Our discussion begins with an analysis of overall revenues and expenses and their treatment. A majority of the District's revenue is received from charges for services.

The District's total revenues increased from a year ago by \$1,916,284 (21%). The increase was the result of a rate increase late in the year. Total cost of all programs and services (including depreciation) decreased by \$559,041 (5%). Interest expense increased by \$1,572, due in large part to the refinancing of bonds in 2012 at lower interest rates. This trend is expected to remain approximately the same through the next fiscal year end.

Financial Analysis of the District's Proprietary Fund

At year-end, the District's proprietary fund reported total net assets of \$73,802,452, which is a decrease of \$273,944 or (.369%) from last year.

Capital Assets

As noted above, the District was able to make several capital asset purchases without additional debt.

Debt/Advances in Construction

At year-end, the District had various bond/notes payables to various lenders with a combined remaining principal balance of \$11,817,233 to be paid from utility revenues.

As of December 31, 2016, the District received advances for construction towards projects not completed in the amount of \$5,771,746. During 2016, various construction projects were completed allowing the advances for construction from the prior year in the amount of \$989,473 to be transferred to capital contributions from government grants.

MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2016
(CONTINUED)

Contacting the District's Financial Management

This financial report is designed to provide our customers, creditors, and other users with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Treasurer, at the Mountain Water District, P. O. Box 3157, Pikeville, KY 41502, telephone number (606) 631-9162.

MOUNTAIN WATER DISTRICT
STATEMENT OF FINANCIAL POSITION
December 31, 2016
(with prior year data for comparison purposes only)

	<u>2016</u>	<u>2015</u>
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash and Cash Equivalents	\$ 570,549	\$ 135,844
Accounts Receivable (Net of Allowance for Delinquencies of \$43,000 in 2016 and \$40,000 in 2015)	1,413,077	1,749,423
Prepaid Expenses	14,322	
Inventory	185,656	
TOTAL CURENT ASSETS	2,183,604	1,885,267
<u>NONCURRENT ASSETS</u>		
Restricted Cash		
Cash-Depreciation Reserve	881,412	803,625
Cash-Construction	350,548	399,626
Cash-Customer Deposits	338,760	331,128
Cash-Recycling Account	2,096	2,893
Cash-Operation and Maintenance Reserve	16,583	16,567
Cash-Wastewater Operation and Maintenance Reserve	866,399	827,723
Cash-Sinking Fund	571,601	461,566
TOTAL RESTRICTED CASH	3,027,399	2,843,128
Capital Assets		
Supply & Pumping	3,566,550	3,547,281
Water Treatment Equipment	11,278,705	11,261,985
Transmission & Distribution	87,012,032	85,807,060
General Plant	4,176,767	4,176,916
Land and Land Rights	553,267	549,443
Sewer Utility Plant	29,368,099	29,345,539
Sewer General Plant	725,012	707,650
Total Capital Assets	136,680,432	135,395,874
Less: Accumulated Depreciation	(54,433,806)	(50,590,049)
Net Capital Assets	82,246,626	84,805,825
Construction in Progress	5,771,746	3,970,941
OTHER ASSETS		
Deposit on Leased Vehicles	625	625
FEMA receivable	92,798	67,757
Rate Case Cost-Net of Amortization	105,098	162,439
TOTAL OTHER ASSETS	198,521	230,821
<u>TOTAL NONCURRENT ASSETS</u>	<u>91,244,292</u>	<u>91,850,715</u>
<u>TOTAL ASSETS</u>	<u>\$ 93,427,896</u>	<u>\$ 93,735,982</u>
<u>DEFERRED OUT FLOW OF RESOURCES</u>		
Deferred Pension Contributions	\$ 190,569	\$ 20,207

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF FINANCIAL POSITION (CONTINUED)
,December 31, 2016
(with prior year data for comparison purposes only)

	2016	2015
<u>LIABILITIES</u>		
<u>CURRENT LIABILITIES</u>		
Accounts Payable Trade	\$ 184,500	\$ 154,898
Accounts Payable UMG, Current	1,246,932	1,050,000
Other Accrued Liabilities	64,724	28,835
Accrued Interest	156,481	162,005
Customer Deposits	321,041	311,320
Line of Credit	225,613	93,790
Bonds Payable, Current	69,000	66,500
Notes Payable and Capital Leases, Current	1,092,233	820,758
TOTAL CURRENT LIABILITIES	3,360,524	2,688,106
<u>LONG-TERM LIABILITIES</u>		
Bonds Payable, Long-Term	3,651,500	3,721,500
Notes Payable and Capital		
Net Pension Liability	242,159	162,933
Accounts Payable UMG, Long Term	-	1,423,265
Leases, Long-Term	7,004,500	7,750,561
Advances For Construction	5,632,615	3,996,360
Less - Deferred Financing Cost	(77,681)	(84,561)
TOTAL LONG-TERM LIABILITIES	16,453,093	16,970,058
<u>TOTAL LIABILITIES</u>	19,813,617	19,658,164
<u>DEFERRED INFLOWS OF RESOURCES</u>		
Deferred Pension Investment Earnings	2,396	18,189
NET POSITION		
Invested in Capital Assets, Net of Related Debt	70,429,393	72,446,506
Restricted for:		
Construction	350,548	399,626
Depreciation, Maintenance and Replacement- Capital Assets	2,051,461	1,824,054
Customer Deposits	17,719	19,808
Unrestricted (Deficit)	953,331	(613,598)
<u>TOTAL NET POSITION</u>	73,802,452	74,076,396

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
 FOR THE YEAR ENDED DECEMBER 31, 2016
 (With prior year data for comparison purposes only)

	<u>2016</u>	<u>2015</u>
<u>OPERATING REVENUE</u>		
Metered Sales-Residential	\$7,672,034	\$6,482,561
Metered Sales-Commercial	625,572	597,841
Sewage Revenue	1,331,787	875,890
Metered Sales-Multi-Family	356,014	278,344
Metered Sales-Public Authorities	297,278	228,853
Customer Late Payment Charges	254,949	190,417
Other Water Service Revenue	170,411	188,093
Service Connection Fees	145,876	119,535
Metered Sales-Industrial	82,157	58,060
Fire Protection Revenue	<u>1,000</u>	<u>1,200</u>
<u>TOTAL OPERATING REVENUE</u>	10,937,078	9,020,794
<u>OPERATING EXPENSES</u>		
Contract Service-Management	4,105,790	7,592,331
Depreciation	3,843,906	3,815,934
Water Purchased	498,554	-
Material and Supplies	441,179	350,163
Wages	888,058	149,961
Contract Service-Accounting	82,459	61,877
Education, Dues and Meetings	63,977	14,542
Employee Benefits	274,958	14,857
Contract Service-Legal Engineering	168,028	52,352
Taxes & Licenses	17,541	16,951
Payroll Taxes	68,708	11,211
Retirement Expense	46,989	18,544
Settlement Fees	4,500	2,000
Sewage fees	37,415	-
Rate Study Expense	33,267	-
Repairs and Maintenance	339,591	-
Rent Expense	-	1,200
Utilities	561,049	-
Telephone Expense	18,333	4,200
Advertising	6,243	1,221
Amortization Expense	<u>60,781</u>	<u>13,023</u>
<u>TOTAL OPERATING EXPENSE</u>	<u>11,561,326</u>	<u>12,120,367</u>
<u>OPERATING LOSS</u>	<u>(624,248)</u>	<u>(3,099,573)</u>
<u>NON-OPERATING REVENUE (EXPENSES)</u>		
Gain On Sale of Assets	-	(12,661)
Interest Income	3,161	2,774
Interest Expense	<u>(400,557)</u>	<u>(398,985)</u>
<u>TOTAL NON-OPERATING REVENUE (EXPENSES)</u>	<u>(397,396)</u>	<u>(408,872)</u>
<u>LOSS BEFORE CAPITAL CONTRIBUTIONS AND OTHER CHANGES IN NET POSITION</u>	<u>(\$1,021,644)</u>	<u>(\$3,508,445)</u>

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION (CONTINUED)
 FOR THE YEAR ENDED DECEMBER 31, 2016
 (With prior year data for comparison purposes only)

	2016	2015
<u>CAPITAL CONTRIBUTIONS AND OTHER CHANGES</u>		
<u>IN NET ASSETS</u>		
Capital Contributions from:		
Government Grants	\$669,102	\$2,095,459
Customers through Tap-on Fees	78,598	91,409
<u>TOTAL CAPITAL CONTRIBUTIONS AND</u>		
<u>OTHER CHANGES IN NET POSITION</u>	747,700	2,186,868
<u>CHANGE IN NET POSITION</u>	(273,944)	(1,321,577)
<u>NET POSITION, BEGINNING OF YEAR</u>	74,076,396	75,397,973
<u>NET POSITION, END OF YEAR</u>	\$ 73,802,452	\$ 74,076,396

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016
(with prior year data for comparison purposes only)

	<u>2016</u>	<u>2015</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Receipts from Customers	\$10,824,090	\$8,462,798
Payment to Suppliers	(5,861,950)	(8,123,739)
Payment to Employees	(1,278,633)	(164,818)
<u>NET CASH PROVIDED BY OPERATING ACTIVITIES</u>	<u>3,683,507</u>	<u>174,241</u>
<u>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</u>		
(Decrease) In Customer Deposits	<u>(7,632)</u>	<u>(10,280)</u>
<u>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</u>		
Proceeds From Tap-On Fees	78,598	91,409
Payments for rate increase		(134,728)
Government Grants	669,102	2,095,459
Advances for Construction	1,636,255	318,226
Purchases of Equipment	(1,284,707)	(2,570,404)
Construction in Progress	(1,800,805)	(308,827)
Principal Payments	(737,137)	(772,464)
Interest Payments	(395,033)	(393,533)
Notes Payable Bonds & UMG	(1,226,333)	1,609,292
Proceeds from Sale of Vehicles	<u>-</u>	<u>1,350</u>
<u>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</u>	<u>(3,060,060)</u>	<u>(64,220)</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Interest Income	<u>3,161</u>	<u>2,774</u>
<u>NET INCREASE IN CASH AND EQUIVALENTS AND RESTRICTED CASH</u>	<u>618,976</u>	<u>102,515</u>
<u>CASH AND CASH EQUIVALENTS AND RESTRICTED CASH, BEGINNING OF YEAR</u>	2,978,972	2,876,457
<u>CASH AND CASH EQUIVALENTS AND RESTRICTED CASH, END OF YEAR</u>	<u>\$ 3,597,948</u>	<u>\$ 2,978,972</u>

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016
(with prior year date for comparison purposes only)
"Continued"

	2016	2015
<u>RECONCILIATION OF OPERATING LOSS</u>		
<u>TO NET CASH PROVIDED BY</u>		
<u>OPERATING ACTIVITIES</u>		
Operating Loss	\$ (624,248)	\$ (3,099,523)
Adjustments to Reconcile Operating Loss to Net Cash Provided by Operating Activities		
Depreciation	3,843,906	3,815,934
Amortization	60,781	13,023
Increase (Decrease) in Provision for Uncollectible Accounts	3,000	(6,000)
Decrease (Increase) In:		
Customer Accounts Receivable	(112,988)	(206,535)
Other Accounts Receivable	446,334	(426,331)
Prepaid Expenses	(14,322)	31,294
Inventory	(185,656)	-
Increase (Decrease) In:		
Accounts Payable Trade	65,491	32,893
Other Accrued Liabilities	201,209	19,486
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 3,683,507	\$ 174,241
 NON-CASH CAPITAL AND RELATED FINANCINGS ACTIVITIES		
During the period the District purchased Vehicles in exchange for long term debt.	\$ 129,266	\$ 29,119
During the period the District completed certain construction projects that were transferred to capital assets.	\$ 989,473	\$ 2,323,091
Gain on Sale of Assets	\$ -	\$ (12,661)

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Mountain Water District ("the District") conform to generally accepted accounting principles as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The following is a summary of the more significant policies:

A. Organization

Mountain Water District is a political subdivision of the Pike County Fiscal Court, organized under chapter 74 of the Kentucky Revised Statutes. It was formed from a merger of four existing water districts-Marrowbone Water District, Shelby Valley Water District, Pond Creek Water District, and John's Creek Water District- on June 30, 1986 and at that time assumed all assets and liabilities of the existing water districts.

The territorial limits of Mountain Water District, set by the Pike County Judge/Executive on January 20, 1987, are all of Pike County except; (1) the territory of that portion of the Sandy Valley Water District located in Pike County (2) the water services area of the City of Pikeville, and (3) special financing relationships.

B. Reporting Entity

The District is the basic level of government which has financial accountability and control over all activities related to the District. The District is not included in any other governmental "reporting entity" as defined by GASB pronouncement. The Board of Commissioners have decision making authority, the power to designate management, the ability to influence operations, and the primary accountability for fiscal matters. There are no component units as defined in GASB Statement 14 and 61 which are included in the District's reporting entity.

C. Basis of Presentation-Funds Accounting

The accounts of the District are organized on the basis of funds each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures, or expenses, as appropriate.

Proprietary Funds/Enterprises Funds

Proprietary funds and Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises-where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for accountability, capital maintenance, public policy, management control, or other purposes.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Basis of Accounting

All proprietary funds are accounted for using the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when obligations are incurred.

E. Encumbrance Accounting

The District does not use encumbrance accounting. Since effective budgetary control and accountability and cash planning and control can be facilitated without encumbrance accounting, this is not considered departure from generally accepted accounting principles. There were no unperformed contracts in process at year end which otherwise might have resulted in the need to encumber estimated expenditures.

F. Customer Accounts Receivable

Customer accounts receivable are stated at face value, less allowance for uncollectible accounts. Changes in the allowance are charged to operating expenses.

G. Capital Assets

Capital Assets, which included property, plant and equipment, are reported in the fund financial statements at historical cost.

Depreciation is recorded as an allocated expense in the Statement of Revenues, Expenses and Changes in Fund Net Assets with accumulated depreciation reflected in the Statement of Financial Position. Depreciation is computed using straight-line method over the estimated useful lives of the related assets. Estimated useful lives range from 3 to 40 years.

Capital additions improvements and major renewals are capitalized, whereas maintenance, repairs and minor renewals are charged to expenses when they are incurred. In the case of disposals, the assets and related reserves are removed from the accounts and the net amount less any proceeds from disposals, is charged or credited to revenues. Most construction in progress is not capitalized until water runs through the lines.

H. Cash and Cash Equivalents

For purpose of the statement of cash flows, the District considered all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

As of December 31, 2016, cash and cash equivalents restricted cash consisted of the following:

Petty Cash	\$ 320
Cash in Bank	570,229
Restricted Cash	<u>3,207,399</u>
Total	<u>\$ 3,597,948</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

I. Bad Debts

Bad debts are recognized using the reserve method of accounting for uncollectible accounts.

J. Inventory

Inventory is valued at lower of cost or market on a First-In, First-Out Basis. The management service company took over ownership of the inventory and its maintenance until the contract with them is completed July 2016. December 31, 2016 inventory balance was \$185,656.

K. Investment Policy

The District's policy is to invest available funds in the following:

1. Obligations of the U.S. and its agencies and Instrumentalities.
2. Obligations and contract for future delivery of purchases of obligations backed by the full faith and credit of the U.S. or a U.S. Government agency, including but not limited to"
 - a) United States Treasury
 - b) Export-Import Bank of the United States.
 - c) USDA-Rural Development
 - d) Government National Mortgage Corporation, and
 - e) Merchant Marine Bonds
3. Obligations of any corporation of the U.S. Government.
4. Certificate of Deposit issued by other interest bearing accounts of any bank or savings and loan institutions which are issued by the Federal Deposit Insurance Corporation or similar entity of which are collateralized, to the extent uninsured, by any obligation permitted by section 41.240(4) of the Kentucky revised statutes.
5. Uncollateralized certificates of deposits issued by any bank or savings and loans institution rated in one of the three highest categories by a national recognized rating agency.
6. Bankers' Acceptance for banks rated in one of three highest categories by a nationally recognized rating agency.
7. Commercial paper rated in the highest categories by a nationally recognized rated agency.
8. Bonds or certified of indebtedness of the Commonwealth of Kentucky and of its agencies or instrumentalities.
9. Securities issued by a state or local government, or any instrumentality or agency thereof, in the U.S. , and rated in one the three highest categories by a nationally recognized rating agency.
10. Shares of mutual funds, which contain certain characteristics.

Limits on investments transactions are limited in amount in one category to 20% of the total funds invested and no investment shall be purchased on a margin basis.

The District is currently invested only in interest bearing accounts of local federal insured financial institutions, including interest bearing checking accounts and certificates.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

L. Leave Policy-Vacation/Leave Policy-Sick Leave

The District allows full-time employees to accrue vacation leave as follows: (a) ten (10) days during the first year of employment. Employees can accrue vacation time up to a maximum of twice the annual entitlement. If an accrual of twice the annual vacation entitlement is attained, additional vacation days do not accrue. Upon termination of employment, an employee shall be paid for all accrued vacation leave.

Employees shall accrue sick leave at the rate of ten (10) days per year. Employees can accrue sick leave up to a maximum of 160 hours, after the maximum is obtained no additional sick leave is accrued. Upon termination, resignation, retirement or voluntary leave, the employee shall not be reimbursed for the accrued leave hours.

As of December 31, 2016 and 2015, the accrued liability for vacation leave was -0- and -0-, respectively.

M. Advertising

The District expenses advertising costs as incurred. Total advertising costs charged to expense for the years ended December 31, 2016 and 2015 are \$6,243 and \$1,221, respectively.

N. Net Position Classifications

In the fund financial statements, Net Position is classified as net assets and displayed in three components.

- Invested in capital assets, net of related debt-Consist of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowing that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted net assets-Consist of net assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- Unrestricted net assets-All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

N. Accounting Policy for Loan Cost

Comparative loan costs are amortized on the straight line method over the remaining life of the loan and A direct deduction from the carrying amount of the debt liability. Amortization for 2016 and 2015 was \$3,441 and charged to amortization expense. Original Deferred Financial Cost \$92,316 both years. Amortization was \$14,636 for 2016 and \$11,195 for 2015.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

2. EMPLOYEE RETIREMENT SYSTEMS

The District has elected to participate in the County Employee Retirement System (CERS) pursuant to KRS 78.530, administered by the Board of Trustees of the Kentucky Retirement System. This is a multiple employer public retirement system which covers all eligible full-time-employees. Benefit contributions and provisions are established by statute. Non-hazardous covered employees are required to contribute 5 percent of their salary to the Plan. The District's contribution rate for non-hazardous employees was 17.67 percent.

(CERS) is a defined benefit plan created by the Kentucky General Assembly. (CERS) provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries.

The Board of Trustees of the County Employee Retirement System (A division of Kentucky Retirement System), in consultation with the actuary, set the actuarial assumptions and methods used in the valuation. Once every five years the actuary conducts a thorough review of plan experience for the preceding five years, and then makes recommendations to the board.

CERS also provides postretirement health care coverage to age and service retirees with 20 or more years of qualifying CERS service credit. A portion of each employer's and employee's contribution to CERS is set aside for funding postretirement health care. The health care coverage provided by the retirement is considered another Post Employment Benefit as described in Governmental Accounting Board Statement 45. KRS provides statutory authority requiring public employers to fund post health care through contributions to (CERS).

The Schedule of Funding Progress for Pension Fund and the Schedule of Funding Progress for Health Fund, show the latest information for the past four fiscal years ending June 30, 2015 reported in Kentucky Retirement Systems audited financial statements for the fiscal year ended June 30, 2015 as follows:

Benefits fully vest on reaching five years of service for non-hazardous employees. Aspects of benefits for non-hazardous employees included retirement after 27 years of service or age 65.

The District's payroll for the year ended December 31, 2016 was \$857,021. The payroll for employees covered under CERS was \$781,873. The contributions required for CERS for the year was \$193,845 which consisted of \$153,918 of District contributions and \$39,927 of employee contributions.

The District's payroll for the year ended December 31, 2015 was \$149,961. The payroll for employees covered under CERS was \$116,364. The contributions required for CERS for the year was \$26,380 which consisted of \$20,562 of District contributions and \$5,818 of employee contributions.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

2. EMPLOYEE RETIREMENT SYSTEM (Continued)

CERS issues a standalone financial report, which may be obtained from Kentucky Retirements Systems, 120 Louisville Road, Frankfort Kentucky, 40601.

FISCAL YEAR <u>FUNDING</u>	ANNUAL PENSION COST <u>(APC)</u>
12/31/15	\$20,562
12/31/16	\$20,562
12/31/17	\$31,865

Schedule of Nonhazardous Funding Progress – Pension Fund (CERS)

Actuarial Valuation <u>Date</u>	Actuarial Value <u>of Assets</u>	Actuarial Accrued Liability (AAL) Target <u>Rate</u>	Unfunded AAL <u>(UAAL)</u>	percent <u>Funded</u>	Covered <u>Payroll</u>	UAAL as a % of Cover <u>Payroll</u>
June 30, 2012	5,547,235,599	9,139,567,695	3,592,332,096	60.7	2,236,546,345	160.6
June 30, 2013	5,637,094,483	9,387,867,114	3,471,781,631	60.1	2,236,277,489	167.3
June 30, 2014	6,528,147,000	9,772,523,000	3,244,376,000	66.8	2,272,270,000	142.78
June 30, 2015	6,474,848,513	10,740,325,421	4,265,476,908	60.3	2,296,715,957	185.7
June 30, 2016	6,535,372,347	11,076,456,794	4,451,084,447	59.0	2,352,761,794	193.0

Schedule of Non hazardous Funding Progress – Health Insurance Fund (CERS)

Actuarial Valuation <u>Date</u>	Actuarial Value <u>of Assets</u>	Actuarial Accrued Liability (AAL) Target <u>Rate</u>	Unfunded AAL <u>(UAAL)</u>	percent <u>Funded</u>	Covered <u>Payroll</u>	UAAL as a % of Cover <u>Payroll</u>
June 30, 2012	1,512,853,851	3,370,771,228	857,917,437	63.8	2,236,546,345	38.4
June 30, 2013	1,628,244,197	2,443,894,100	815,649,903	66.6	2,236,277,489	36.5
June 30, 2014	1,831,199,465	2,616,914,600	785,715,135	70.0	2,272,270,000	34.6
June 30, 2015	1,997,456,463	2,907,817,440	910,370,977	68.7	2,296,715,957	39.6
June 30, 2016	2,097,811,055	2,988,121,117	908,310,062	69.6	2,352,761,794	38.6

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

2. EMPLOYEE RETIREMENT SYSTEM (Continued)

In accordance with Statement 68, cost sharing governmental employers, such as Mountain Water District are required to report a net pension liability, pension expense and pension related assets and liabilities based on their proportionate share of the collective amounts for all governments in the plan. For purpose of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension, and pension expense, information about the fiduciary net position have been determined on the same basis as they are reported by CERS.

For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefits terms. Investments are reported at fair value.

As of December 31, 2016 Mountain Water District reported a liability of \$242,159 for its proportionate share of the net pension liability. The net pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

Mountain Water District proportion of the net pension liability was based on a projection of Mountain Water District's long term share of contributions of all to the pension relative to the projected contributions of all participating organizations, actuarially determined. At December 31, 2016, Mountain Water District proportion was 0.00492%.

At December 31, 2016 Mountain Water District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
<u>Nonhazardous</u>		
Difference between Expected and Actual experience	\$ 1,057	\$
Change in Assumption	12,828	
Net difference between projected and Actual earnings on investment	22,765	
Deferred pension investment earnings District contributions subsequent to The measurement date	<u>153,919</u>	2,396
Total	<u>\$ 190,569</u>	<u>\$ 2,396</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

2. EMPLOYEE RETIREMENT SYSTEM (Continued)

The deferred outflows of resources relate to Mountain Water District Contributions to the CERS plan subsequent to the measurement date and will be recognized as a reduction of net pension liability in the year ending December 31, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension will be recognized in pension expense as follows:

Year ending December 31:

2017	\$ 599
2018	599
2019	599
2020	<u>599</u>
Total	<u>\$ 2,396</u>

Actuarial assumption – The total pension liability in the actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the investments:

Inflation	3.25 percent
Salary increases	4.0 percent, average, including inflation
Investment rate – Of return	6.75 percent, net of pension plan investments Expense, including inflation

The rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006, And the 1194 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward five years used for the period after disability retirement.

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, 2005 to June 2008.

The long term expected rate of return on pension plan investments was determined using a building block method in which best estimate ranges of expected future real rates of return (expressed returns, net of pension plan investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long term expected future real rates of return by weighting the expected future rates of return by the target assets allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

2. **EMPLOYEE RETIREMENT SYSTEM (Continued)**

	Target <u>Allocation</u>	Long Term Nominal Rate <u>of Return</u>
Combined Equity	44%	5.40%
Combined Fixed Income	19%	1.50%
Real Return (Diversified Inflation Strategies)	10%	3.50%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.50%
Real Estate	5%	4.50%
Cash + Equivalent	<u>2%</u>	-0.25%
Total	100%	

Discount rate – The discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed that Contributions from plan members and employers will be made at statutory contribution rates.

Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Mountain Water District’s proportionate share of the net pension liability to changes in the discount rate – The following presents Mountain Water District’s share of the net pension liability calculated using the discount rate of 7.50%, as well as what the Mountain Water District’s proportionate share of the net pension would be if it were calculated using a discount rate that is 1 percentage point lower (6.50%) or 1 percentage point higher (8.50%) than the current rate.

	1% Decrease <u>(6.50%)</u>	Current Discount Rate <u>(7.50%)</u>	1% Increase <u>(8.50%)</u>
Mountain Water District Share Of the net pension liability	<u>\$ 309,162</u>	<u>\$ 242,159</u>	<u>\$ 184,800</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

3. CUSTOMER DEPOSIT FUND

Deposits required from customers when they sign up for the water service are deposited into the customer deposit escrow account. When services are terminated or a customer has paid in a timely fashion, a refund of the deposit plus interest is given after a year of water service. Customer deposits as of December 31, 2016 and December 31, 2015 were \$321,041 and \$311,320, respectively, and are currently held in escrow.

4. COMMITMENTS AND CONTINGENCIES

The District has been committed to several construction projects that have not been either started or completed as of the date of this report.

5. CAPITAL ASSETS

The following is a summary of changes in fixed asset:

Description	Balance January 1, <u>2016</u>	<u>Additions</u>	<u>Dispositions</u>	Balance December 31, <u>2016</u>
Supply & Pumping	\$3,547,281	\$ 19,269	\$ -0-	\$3,566,550
Water Treatment Equipment	11,261,985	16,720	-0-	11,278,705
Transmission & Distribution	85,807,060	1,204,972	-0-	87,012,032
General Plant	4,176,916	-0-	149	4,176,767
Land and Land Rights	549,443	3,824	-0-	553,267
Sewer Utility Plant	29,345,539	22,560	-0-	29,368,099
Sewer General Plant	<u>707,650</u>	<u>17,362</u>	<u>-0-</u>	<u>725,012</u>
Totals	135,385,874	1,284,707	149	136,680,432
Accumulated Depreciation	<u>(50,590,049)</u>	<u>(3,843,906)</u>	<u>149</u>	<u>(54,433,806)</u>
Net Utility Plant	<u>\$84,805,825</u>	<u>\$(2,559,199)</u>	<u>\$ -0-</u>	<u>\$82,246,626</u>
	January 1, <u>2015</u>	<u>Additions</u>	<u>Dispositions</u>	December 31, <u>2015</u>
Supply & Pumping	\$3,668,064	\$277,729	\$ 365,532	\$3,547,281
Water Treatment Equipment	9,658,690	1,603,295	-0-	11,261,985
Transmission & Distribution	85,627,046	637,858	457,844	85,807,060
General Plant	4,327,092	28,400	178,576	4,176,916
Land and Land Rights	540,235	9,208	-0-	549,443
Sewer Utility Plant	29,598,405	-0-	252,866	29,598,539
Sewer General Plant	<u>660,756</u>	<u>46,894</u>	<u>-0-</u>	<u>707,650</u>
Totals	134,080,288	2,570,404	1,254,818	135,385,874
Accumulated Depreciation	<u>(48,016,341)</u>	<u>(3,815,934)</u>	<u>1,242,226</u>	<u>(50,590,049)</u>
Net Utility Plant	<u>\$86,063,947</u>	<u>\$(1,245,500)</u>	<u>\$ 12,592</u>	<u>\$84,805,825</u>

Depreciation expense was \$3,843,906 and \$3,815,934 for the years ended December 31, 2016 and 2015, respectively.

MOUNTAIN WATER DISTRICT
NOTES TO
THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

6. SUBSEQUENT EVENTS

In preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through September 26, 2017 the date the financial statements were available to be issued.

7. RECLASSIFICATIONS

Certain amounts in prior year financial statements have been reclassified for comparative purposes to conform with presentation in the current year financial statements.

8. CONSTRUCTION IN PROGRESS

Mountain Water District has overseen several construction projects. As of December 31, 2016 and 2015, the following projects were in progress.

	<u>2016</u>	<u>2015</u>
<u>Water Projects</u>		
FEMA Mitigation Project	\$ 958,438	\$ 254,088
Tank Rehab Southern Corrosion	57,582	57,582
Jonican	908,105	901,889
Bad Fork	-0-	445,751
Pompey	824,140	47,488
Majesterial District 2	8,298	5,801
Phelps High School	-0-	52,000
Big Creek Relocation	-0-	27,158
BPS Upgrade	-0-	16,960
Various In House Projects	1,950,453	-0-
<u>Sewer Projects</u>		
Phelps/Buskirk	67,038	67,038
Henry Clay	138,708	138,708
Belfry Pond Sewer	690,454	582,981
Douglas	<u>168,530</u>	<u>109,842</u>
<u>Total Construction in Progress</u>	<u>\$ 5,771,746</u>	<u>\$ 3,970,914</u>

9. RESTRICTED ASSETS AND RESERVE NET ASSETS

Each of the proprietary funds has a portion of its net assets restricted in connection with assets restricted in uses, such as bond interest and redemption, depreciation, and customer deposits. Restricted net assets includes excess of restricted cash over liabilities payable from restricted cash.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

10. DEPOSITS WITH FINANCIAL INSTITUTIONS

At December 31, 2016, the carrying amount of the District's deposits with financial institutions was \$3,597,948 and the bank balance, per statements was \$5,165,396. The Bank balance is categorized as follows:

Amount insured by FDIC	\$ 750,000
Amount collateralized by securities held by third party trust company in the District's name	<u>3,293,470</u>
<u>Total Bank Balance</u>	<u>\$ 4,043,470</u>

Pledged collateral was obtained for amounts up to \$2,445,766 for money on deposit at Community Trust Bank in the name of the District. Pledged collateral was obtained for accounts up to \$847,704 for money on deposit with BB&T and Community Trust Bank in the name of the District.

11. CONSTRUCTION FUNDS

The District has several construction accounts used for the water projects. These are as follows:

	<u>2016</u>	<u>2015</u>
Big Creek Sewer Coal Settlement	\$5,401	\$ 5,401
District Wide Tap Fees	33,473	126,462
Misc. Line Extensions	118,391	4,968
MWD Special Projects	940	1,140
Penny Road Water and Sewer	3,158	29,973
Cowpen Waste Water Project	1,860	1,860
Elk Creek Project	2,272	2,272
Water Treatment Plant Upgrade	1	1
Water Treatment Raw Water Intake	25	25
LMI Service Contract	656	656
Various Short Line Extensions	191	191
Telemetry Project	100	100
Watson Hill Water Line	85	85
Long Fork Virgie Sewer Project	100	100
Belfry Pond Sewer Project	100	100
Smith Fork Waste Water Phase II	100	100
Pike County Fiscal Court Projects	158,566	173,606
Repair and Maintenance Reimbursement	435	2,200
MWD Rehabilitation Project	5,160	21,880
Sewer Customer Deposit	<u>19,534</u>	<u>28,506</u>
<u>Total Construction Funds</u>	<u>\$ 350,548</u>	<u>\$ 399,626</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

11 RESTRICTED ASSETS AND RESERVE NET ASSETS Continued)

As of December 31, 2016 and 2015 restricted cash were as follows:

	<u>2016</u>	<u>2015</u>
Depreciation Reserve	\$ 881,412	\$ 803,625
Sinking Fund	571,601	461,566
Customer Deposit Escrow Account	338,760	331,128
Operation & Maintenance reserve	16,583	16,567
Waste Water O & M Reserve	866,399	827,723
Recycling Account	2,096	2,893
Construction Account	<u>350,548</u>	<u>399,626</u>
Total Restricted Cash	<u>\$3,027,399</u>	<u>\$2,843,128</u>

The District is required by debt covenants to pay into and maintain a Depreciation Reserve Fund, a Repair and Maintenance Fund and Operation and Maintenance Fund. These Amounts may be used for extraordinary maintenance expenses related to the project or for costs of replacing worn obsolete portions of the project. If Amounts are withdrawn from said funds, the District must make required periodic deposits until the required balance is reinstated.

	Maximum Required Balance	Required Balance at <u>12/31/16</u>	Actual Balance At <u>12/31/16</u>
Depreciation Reserve Funds	\$851,400	\$ 831,780	\$ 881,412
Repairs and Maintenance Funds	866,168	<u>858,668</u>	<u>882,982</u>
Total		<u>\$1,690,448</u>	<u>\$1,764,394</u>

The Repair and Maintenance Funds required by Kentucky Infrastructure Authority (KIA) loan agreements are fully funded.

The Depreciation Reserve Funds Required by USDA-Rural Development (RD) loan requirements are fully funded.

Mountain Water's management stated during the field work that there is verbal agreement to transfer \$11,000 to Kentucky Infrastructure Authority reserves and \$9,000 monthly to Rural Development Reserves until the deficit is made up. These payments were transferred during 2016.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

11 RESTRICTED ASSETS AND RESERVE NET ASSETS Continued)

The USDA-Rural Development (RD) loan agreements also include a requirement for an Operation and Maintenance Fund. The funding of this reserve is secondary to the Depreciation Reserve Funds.

12. BONDS PAYABLE

	<u>2016</u>	<u>2015</u>
Shelby Waste Water Project Fund The 4.125% sewer system revenue bonds issued July 22, 2005 in the original amount of \$740,000 are payable to USDA-Rural Development to the year 2045. The bonds are secured by a statutory mortgage lien on the utility plant service and a pledge of all water revenues from the system	\$645,500	\$657,000
Phelps Waste Water Project Bond The 4.5% sewer system revenue bonds issued October 23, 2003 in the original amount of \$426,000 are payable to USDA-Rural Development to the year 2043. The bonds are secured by a statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system.	\$ 364,000	\$371,000
Fedscreek Project The 3.5% revenue bonds issued July 2002 in the original amount of \$800,000 are payable to USDA-Rural Development to the year 2035. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system.	\$642,000	\$658,000
Johns Creek The 4.125% revenue bonds issued November 2005 in the original amount of \$1,650,000 are payable to USDA-Rural Development to the year 2027. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system.	\$1,465,000	\$1,489,000

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

12 BONDS PAYABLE (Continued)

	<u>2016</u>	<u>2015</u>
Russell Fork Water Plant Project		
The 4.5% revenue bonds issued April 2009 in the original amount of \$650,000 are payable to USDA-Rural Development to the year 2047. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and pledge of all water revenue from the system.	\$ 604,000	\$ 613,000
Total bonds	\$3,720,500	\$ 3,788,000
Less current portion	(69,000)	(66,500)
Long Term Bonds Payable	<u>\$3,651,500</u>	<u>\$3,721,500</u>

Maturities of these long-term bonds are as follows:

	<u>Principal</u>	<u>Interest</u>
December 31		
2017	69,000	150,327
2018	73,000	147,461
2019	76,000	144,494
2020	78,500	141,293
2021-2025	447,000	657,076
2026-2030	548,500	562,686
2031-2035	676,000	430,810
2036-2040	832,000	282,536
2041-2045	821,500	103,548
2046-2050	99,000	9,000
	<u>\$3,720,500</u>	<u>\$2,629,231</u>

13. NOTES PAYABLE AND CAPITAL LEASES

	<u>2016</u>	<u>2015</u>
Kentucky Rural Water Finance Corporation		
The 3.14% note issued August 2012 in the original amount of \$6,270,000, payable in monthly installments, with payments through August 2039, secured by water revenues from the system.	\$ 5,040,000	\$ 5,400,000
Kentucky Infrastructure Authority-Multi-Area		
The 2.9% note issued June 1994 in the original amount of \$5,165,093, payable in semi-annual installments of \$129,479, with payments through the year 2023, secured by water revenues from the system.	1,629,931	1,837,105

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENT
DECEMBER 31, 2016 AND 2015

13 NOTES PAYABLE AND CAPITAL LEASES (Continued)

	<u>2016</u>	<u>2015</u>
<p>Kentucky Infrastructure Authority-Indian Creek The 3% note issued June 1994 in the original amount of \$377,760, payable in semi-annual installments of \$8,577, with payments through the year 2023, secured by water revenue from the system.</p>	\$ 107,583	\$ 121,202
<p>Kentucky Infrastructure Authority-F01-07 The 1.8% note issued January 2002 in the original amount of \$1,197,072 payable in semi-annual of \$35,769, with payments through the year 20024 secured by water revenues from the system.</p>	499,800	561,508
<p>Kentucky Infrastructure Authority A03-06 The 1% note issued June 2004 in the original Amount of \$226,776, payable in semi-annual installments of \$6,846 with payments through the year 2023, secured by water revenues from the system.</p>	78,325	87,684
<p>Kentucky Infrastructure Authority A209-32 The 1% note issued January 2010 in the original amount of \$750,000 with \$390,750 in principle forgiveness, payable in semi-annual installments of \$5,212, with payments through the year 2031, secured by water revenues from the system.</p>	273,393	290,830
<u>US Bank</u>		
<p>Loan to finance rate study, original balance \$149,956 at 2.9% interest; payments are \$6,441 for 24 months, maturing December 2017.</p>	82,321	149,956
<u>Community Trust Bank</u>		
<p>A purchase agreement, original balance \$29,128 at 4.0% interest, secured by vehicle; payments are \$660 for 48 months, maturing April 2020.</p>	24,078	-0-
<u>US Bank</u>		
<p>A purchase agreement, original balance \$26,853 at 3.0% interest, secured by vehicle; payments are \$568 for 25 months, maturing July 2018.</p>	23,119	-0-

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

13 NOTES PAYABLE AND CAPITAL LEASES (Continued)

	<u>2016</u>	<u>2015</u>
<u>Community Trust Bank</u>		
A purchase agreement, original balance \$22,111 at 4.0% interest, secured by vehicle; payments are \$500 for 48 months, maturing September 2020	\$ 20,830	\$ -0-
<u>Community Trust Bank</u>		
A purchase agreement, original balance \$22,111 at 4.0% interest, secured by vehicle; payments are \$500 for 48 months, maturing September 2020	20,830	-0-
<u>US Bank</u>		
Loan to finance Big Fork Project, original balance \$272,145 at 3.1% interest; payments are \$4,153 beginning June 26, 2016 for 24 months, maturing December 2017	219,191	27,428
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$34,625; at 3.99% interest; secured by a vehicle; payments are \$638 for 23 months and a final Balloon payment of \$22,246, maturing April 2017.	2,472	9,873
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$29,119; at 2.01% interest; secured by a vehicle; payments are \$658 for 48 months and a final maturing June 2020.	18,145	25,163
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,772; at 3.035% interest; secured by a vehicle; payments are \$460 for 48 months and a final Balloon payment of \$22,246, maturing June 2018.	8,085	13,276
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$27,256; at 3.99% interest; secured by vehicle; payments are \$503 for 23 months with a final balloon payment of \$17,511, maturing May 2017.	2,468	8,269

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENT
DECEMBER 31, 2016 AND 2015

<u>13 NOTES PAYABLE AND CAPITAL LEASES (Continued)</u>	<u>2016</u>	<u>2015</u>
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,772; at 3.035% interest; secured by a vehicle; payments are \$460 for 48 months and a final balloon payment of \$22,246, maturing June 2018.	\$ 8,085	\$ 13,276
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,772; at 3.035% interest; secured by a vehicle; payments are \$460 for 18 months and a final balloon payment of \$22,246, maturing June 2018.	8,085	13,276
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$27,580; at 3.99% interest; secured by a vehicle; payments are \$623 for 23 months with a final balloon payment of \$14,970, paid off in 2016.	-0-	4,998
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$30,198; at 4.051% interest; secured by a vehicle; payments are \$683 for 48 months with a final balloon payment of \$14,970, paid off in 2016.	-0-	4,998
<u>Community Trust Bank</u>		
A purchase agreement, original balance \$30,198 at 4.051% interest, secured by vehicle; payments are \$683 for 48 months, maturing March 2020.	24,902	-0-
<u>Community Trust Bank</u>		
Line of credit AEP currently at 3.5% Index rate maximum rate of 3.75% renews every August	2,750	- 0-

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

14 NOTES PAYABLE AND CAPITAL LEASES (Continued)

Community Trust Bank

A lease purchase agreement, original balance \$20,039; at 3.99% interest; secured by a vehicle; Payments are \$453 for 23 months with a final balloon payment of \$13,294, maturing May 2017.

	<u>2,340</u>	<u>7,475</u>
Total Notes Payable and Capital Leases	8,096,733	8,571,319
Less current portion	<u>(1,092,233)</u>	<u>(820,758)</u>
Total Long-term Portion	<u>\$7,004,500</u>	<u>\$7,750,561</u>

Maturity of the notes payable and capital leases are as follows:

	<u>Principal</u>	<u>Interest</u>
2017	864,339	92,610
2018	819,679	80,681
2019	795,429	69,311
2020	731,648	57,838
2021	734,453	48,198
2022-2026	1,994,537	139,408
2027-2031	1,298,282	55,146
2032-2036	749,583	24,183
2037-2041	<u>108,783</u>	<u>5,701</u>
	<u>\$8,096,733</u>	<u>\$573,076</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

14. ADVANCES FOR CONSTRUCTION

	<u>2016</u>	<u>2015</u>
<u>Water Projects</u>		
In House Projects	\$ 2,021,424	\$ 1,359,078
Bad Fork Abandoned Mine	-0-	445,751
Pompey	824,140	47,488
PW220	-0-	18,315
Booster Pump	829,820	193,900
Phelps High	-0-	119,815
Big Creek	-0-	27,158
Tank Rehabilitation		
Coal Severance	908,105	901,889
<u>Sewer Projects</u>		
Phelps Waste Water		
Kentucky Infrastructure Authority	57,110	57,110
Douglas WTP		
LGEDF Funds	163,530	104,842
Henry Clay Sewer Projects:		
COE Section 531	45,391	45,391
LGEDF Funds	92,640	92,641
Belfry Pond		
Coal Severance	<u>690,455</u>	<u>582,982</u>
<u>Total Advances for Construction</u>	<u>\$5,632,615</u>	<u>\$ 3,996,360</u>

15. MANAGEMENT SERVICE AGREEMENT

In January, 2011 the District entered into another five (5) year agreement with a management service company to manage the daily operations, water facilities and waste water facilities for the District. Each period during the term commencing January 1, and ending the following December 31, shall be referred to as an "Agreement Year". Either party shall have the right, without cause, to terminate the agreement at the end of the third agreement year. Notice of termination shall be given in writing no less than 120 days in advance of the effective date of termination. The management service company compensation under the agreement shall consist of an annual fee. The annual fee for the first year, which shall be the period January 1, 2011 through December 31, 2011, shall be \$7,632,000. The annual fee shall be adjusted annually to provide that management service company will be paid 70% of the increase in total operating revenue based on the District's two most recent prior year's audits. If the annual revenue decreases, there will likewise be a downward adjustment in the fee based on the same ratio. Included in the annual fee is the allowance for maintenance and repair, which shall initially be \$564,000. The maintenance and repair budget shall adjust annually in direct proportion with any adjustment in the annual fee.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

15. MANAGEMENT SERVICE AGREEMENT (Continued)

On March 27, 2014 the District renewed another three (3) year agreement with a management service company to manage the daily operations, water facilities and waste water facilities for the District. Each period during the term commencing January 1, and ending the following December 31, shall be referred to as an "Agreement Year". Either party shall have the right, without cause, to terminate the agreement at the end of the third agreement year. Notice of termination shall be given in writing no less than 120 days in advance of the effective date of termination. The management service company compensation under the agreement shall consist of an annual fee. The annual fee for the first year, which shall be the period January 1, 2014 through December 31, 2014, shall be \$7,680,850. The annual fee for 2015 and 2016, shall be \$7,757,660.

Total management fees paid for this service for the year ended December 31, 2016 were \$4,243,659 less certain expenses assumed by the management service company totaling \$137,689, resulting in net payment of \$4,105,790.

In July 2016 Mountain Water District Board effectively terminated the contracts with the management service company. An agreement was made for Mountain Water to pay the management service Company \$50,000 per month through March 2016 then \$100,000 monthly until the balance is paid off. In these financial statements \$1,236,942 has been reflected as a current liability with \$757,433 was paid during 2016 per agreement on the \$2,473,265 originally incurred.

MOUNTAIN WATER DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2016

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>TOTAL Federal Expenditures</u>
U.S. Department of Agriculture Water and Waste Disposal Systems For Rural Communities	10-760-1	\$ 127,372
U.S. Department of Interior Passed through Commonwealth of Kentucky Energy and Environmental Cabinet: Abandoned Mine Land Reclamation (AMLR) Program	15.225	378,433
U.S. Department of Homeland Security Hazard Mitigation Grant (HMGP)	97.039	<u>524,796</u>
Total		<u>\$ 1,030,601</u>

Reconciling items to the Financial statements

(See Construction in Progress)

a) Pompey Water Project	\$ 505,805
Booster Pump Fema Mitigation Project	<u>524,796</u>
Total Federal Revenue per Financial Statements:	<u>\$ 1,030,601</u>

See accompanying note

**MOUNTAIN WATER DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2016**

NOTE A - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Mountain Water District, under programs of the federal government for the year ended December 31, 2016. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B – INDIRECT COST RATIO

Mountain Water District elected not to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.

See accompanying schedule

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INDEPENDENT AUDITORS'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 GAS

To the Board of Commissioners
Mountain Water District
Pikeville, KY

I 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 GAS issued by the Comptroller General of the United States, the financial statements of the business type activities of Mountain Water District as of and for the year December 31, 2016, and the related notes to the financial statements, which collectively comprise Mountain Water District's basic financial statements, and have issued my report thereon dated September 27, 2017.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered Mountain Water District's internal control over financial reporting (internal control), to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Mountain Water District's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or 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.

My consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Mountain Water District's financial statements are free from material misstatement, I performed test 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under GAS.

Purpose of this Report

The purpose of this report is solely to describe the scope of my testing of internal control and compliance and the results to that testing; and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with GAS in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Richard F. Paulmann, CPA, LLC.
Pewee Valley, KY
September 27, 2017

RICHARD F. PAULMANN, LLC
CERTIFIED PUBLIC ACCOUNTANT
301 MOUNT MERCY ROAD
PEWEE VALLEY, KY 40056
(502) 550-1568

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

To the Board of Commissioners
Mountain Water District
Pikeville, KY

Report on Compliance for Each Major Program

I have audited the Mountain Water District's compliance, with the types of compliance requirements described in the *(OMB) Compliance Supplement* that could have a direct and material effect on each of Mountain Water District's major federal programs for the year ended December 31, 2016. Mountain Water District's 's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned cost.

Management's Responsibilities

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

My responsibility is to express an opinion on compliance for each of Mountain Water District 's major federal programs based on my audit of the types of compliance requirements referred to above. I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, Uniform Administrative requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Those standards and the Uniform Guidance require that I plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Mountain Water District 's compliance with those requirements and performing such other procedures as I consider necessary in the circumstances.

I believe that my audit provides a reasonable basis for my opinion on compliance for each major federal program. However, my audit does not provide a legal determination of Mountain Water District 's compliance.

Opinion on Each Major Federal Program

In my opinion, Mountain Water District's complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2016.

Report on Internal Control Over Compliance

The management of Mountain Water District's is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing my audit of compliance, I considered Mountain Water District 's internal control over compliance with the types of compliance requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstance for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of Mountain Water District 's internal control over compliance.

A deficiency in internal control over compliance exists when the design of operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

My consideration of the internal control over compliance was for the limited purpose described in the preceding paragraph of the section and was not designed to identify all deficiencies in the internal control over compliance that might be material weaknesses or significant deficiencies. I did not identify any deficiencies we consider to be significant deficiencies. However material weaknesses or significant deficiencies may exist that were not identified.

The purpose of this report on internal control over compliance is solely to describe the scope of my testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Richard F. Paulmann, LLC
September 27, 2017

**MOUNTAIN WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2016**

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unmodified opinion on whether the financial statements of Mountain Water District were prepared in accordance with GAAP..
2. No material weakness was identified on internal control over financial reporting. No significant deficiencies were reported
3. No instances of noncompliance material to the financial statements of Mountain Water District which would be required to be reported in accordance with Government Auditing Standards were disclosed during the audit.
4. No material weakness over in internal control over major program were identified during the audit of the major federal award programs. No significant deficiencies were reported
5. The auditor's report on compliance for the major federal award programs for Mountain Water District expresses an unmodified opinion on all major federal programs.
6. Audit findings, if any, relative to the major federal award programs for Mountain Water District are reported on Part C of this Schedule.
7. The programs tested as major programs included:
 - a. 97.039 U.S. Department of Homeland Security Hazard Mitigation Grant.
 - b. 10-760 U.S. Department of Agriculture Water and Waste Systems For Rural Communities.
 - c. 15.225 U.S. Department of Interior Not Major program.
8. The threshold for distinguishing Types A and B programs was \$750,000.
9. Mountain Water District was determined to be a high-risk auditee.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

No Findings

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

No Findings

See accompanying notes

**MOUNTAIN WATER DISTRICT
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2016**

DEPARTMENT OF AGRICULTURE

DEPARTMENT OF INTERIOR

DEPARTMENT OF HOMELAND SECURITY

There were no prior audit findings noted.

MOUNTAIN WATER DISTRICT
CORRECTIVE ACTION PLAN
FOR THE YEAR ENDED DECEMBER 31, 2016

A. Comments on Findings and Recommendations

All findings have been addressed and cleared.

B. Action Taken or Planned

All findings have been addressed as recommended by reviewer.

C. Status of Corrective Actions on Prior Findings

There were no findings noted in prior year's audit report.

**MOUNTAIN WATER DISTRICT
SCHEDULE OF LONG TERM DEBT**

ATTACHMENT - GOLD BUDGET

DESCRIPTION	ORIGINAL ISSUE AMOUNT	1/1/2017 PROJECTED BEGINNING BALANCE	PROJECTED PRINCIPAL PAYMENTS	12/31/2017 PROJECTED ENDING BALANCE
BONDS				
Rural Development (Feds creek)	800,000	626,000	16,000	610,000
Rural Development (Phelps Sewer)	426,000	357,000	7,000	350,000
Rural Development (Shelby Sewer)	740,000	634,000	12,000	622,000
Rural Development (Water Treatment Plant)	650,000	597,000	8,000	589,000
Rural Development (New Bond)	1,650,000	1,441,000	26,000	1,415,000
		3,655,000	69,000	3,586,000
KIA NOTES				
KIA Shelby Phase III	375,000	273,393	17,612	255,781
KIA (Multi-Area)	5,165,099	1,629,931	207,174	1,422,757
KIA (Indian Creek)	337,760	107,583	14,031	93,552
KIA (South Williamson)	184,695	78,326	9,452	68,874
KIA (Water Plant)	1,197,072	499,801	62,823	436,978
		2,589,034	311,092	2,277,942
OTHER NOTES				
US Bank Big Creek	225,000	202,026	35,382	166,644
US Bank Rate Study	150,000	85,655	48,000	37,655
CTB Line Of Credit FEMA BPS Study	250,000	226,014	-	226,014
Community Trust - Vehicle 138	30,400	2,478	2,478	-
Community Trust - Vehicle 140	27,256	2,467	2,467	-
Community Trust - Vehicle 142	20,039	2,246	2,246	-
Community Trust - Vehicle 143	20,772	8,086	5,350	2,736
Community Trust - Vehicle 144	20,772	8,086	5,350	2,736
Community Trust - Vehicle 145	20,772	8,086	5,350	2,736
Community Trust - Vehicle 146	29,119	18,179	7,272	10,907
Community Trust - Vehicle 147		30,198	5,297	24,901
Community Trust - Vehicle 148		29,198	5,122	24,076
Community Trust - Vehicle 149		25,648	2,529	23,119
Community Trust - Vehicle 150		22,111	1,280	20,831
Community Trust - Vehicle 151		22,111	1,280	20,831
Kentucky Rural Water (Bond Refinancing)	6,270,000	5,037,917	369,167	4,668,750
		5,730,506	498,570	5,231,936
TOTAL LONG TERM DEBT	11,900,626	11,974,540	878,662	11,095,878