

UNION COUNTY WATER DISTRICT
FINANCIAL STATEMENTS
Years Ended December 31, 2017 and 2016

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INDEPENDENT AUDITORS' REPORT

Board of Commissioners
Union County Water District
Morganfield, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Union County Water District (District) as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express

no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Union County Water District as of December 31, 2017 and 2016 and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Accounting principles generally accepted in the United States of America require that the Pension Schedules on pages 26-27, 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 24, 2018, on our consideration of Union County Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Union County Water District's internal control over financial reporting and compliance.

Kemper CPA Group LLP

Kemper CPA Group LLP
Certified Public Accountants and Consultants

Morganfield, Kentucky
May 24, 2018

UNION COUNTY WATER DISTRICT
Statement of Net Position
December 31, 2017 and 2016

ASSETS

	<u>2017</u>	<u>2016</u>
Current assets:		
Cash and cash equivalents	\$ 160,191	\$ 205,127
Accounts receivable, consumers	147,116	144,318
Other receivables	143	-
Other assets	99,247	91,452
	<u>406,697</u>	<u>440,897</u>
Total current assets		
Restricted assets:		
Cash and cash equivalents	<u>136,006</u>	<u>196,572</u>
Capital assets:		
Non-depreciable	10,175	46,525
Depreciable	13,932,884	13,713,192
Less: accumulated depreciation	<u>(6,497,639)</u>	<u>(6,183,275)</u>
	<u>7,445,420</u>	<u>7,576,442</u>
Total capital assets		
	<u>7,988,123</u>	<u>8,213,911</u>
Total assets		
DEFERRED OUTFLOW OF RESOURCES		
Deferred outflow related to pension	<u>159,348</u>	<u>84,484</u>

LIABILITIES

	<u>2017</u>	<u>2016</u>
Current liabilities:		
Accounts payable	\$ 8,465	\$ 24,540
Other accrued liabilities	<u>91,564</u>	<u>81,626</u>
	<u>100,029</u>	<u>106,166</u>
Current liabilities payable from restricted assets:		
Accrued interest payable	923	1,488
Current portion of long-term debt	<u>23,000</u>	<u>22,000</u>
	<u>23,923</u>	<u>23,488</u>
Total current liabilities	<u>123,952</u>	<u>129,654</u>
Non-current liabilities:		
Long-term debt, net of current portion	13,000	36,000
Net pension liability	537,802	457,239
Customer advances in aid of construction	<u>-</u>	<u>1,094</u>
Total non-current liabilities	<u>550,802</u>	<u>494,333</u>
Total liabilities	<u>674,754</u>	<u>623,987</u>

DEFERRED INFLOW OF RESOURCES

Deferred inflows related to pension	<u>52,138</u>	<u>-</u>
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NET POSITION

Net invested in capital assets	7,432,420	7,540,442
Restricted for debt service	38,375	31,649
Restricted for capital projects	73,708	141,435
Unrestricted	<u>(123,924)</u>	<u>(39,118)</u>
Total net position	<u>\$ 7,420,579</u>	<u>\$ 7,674,408</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT

**Statement of Revenues, Expenses, and Changes in Net Position
For the years ended December 31, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
Operating revenues:		
Water sales	\$ 1,639,488	\$ 1,391,465
Other revenues	79,197	78,181
	<u>1,718,685</u>	<u>1,469,646</u>
Operating expenses:		
Water purchased	950,496	663,851
Fuel and power purchased for pumping	75,112	75,335
Water transmission and distribution	56,036	85,249
Customer account expense	23,924	27,607
General and administrative	562,701	545,980
Depreciation and amortization	314,364	311,362
	<u>1,982,633</u>	<u>1,709,384</u>
Total operating expenses		
	<u>(263,948)</u>	<u>(239,738)</u>
Operating loss		
Non-operating revenues (expenses):		
Interest income	5	4
Interest expense	(1,844)	(2,974)
	<u>(1,839)</u>	<u>(2,970)</u>
Total non-operating expenses		
	<u>(265,787)</u>	<u>(242,708)</u>
Loss before contributions		
Capital contributions	11,958	28,364
	<u>(253,829)</u>	<u>(214,344)</u>
Change in net position		
Net Position:		
Total net position- beginning of year	<u>7,674,408</u>	<u>7,888,752</u>
Total net position- end of year	<u>\$ 7,420,579</u>	<u>\$ 7,674,408</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT
Statement of Cash Flows
For the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Receipts from customers	\$ 1,715,887	\$ 1,448,451
Payments to suppliers	(1,216,450)	(938,700)
Payments to employees	(408,622)	(415,990)
	<u>90,815</u>	<u>93,761</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(182,777)	(105,453)
Principal payments on bond indebtedness	(22,000)	(20,000)
Interest payments on bond indebtedness	(2,409)	(3,485)
Proceeds from contributed capital	11,958	28,364
Proceeds (payments) on customer advances	(1,094)	(193)
	<u>(196,322)</u>	<u>(100,767)</u>
Cash flows from investing activities:		
Investment income	<u>5</u>	<u>4</u>
	<u>5</u>	<u>4</u>
Net increase in cash and cash equivalents	(105,502)	(7,002)
Cash and cash equivalents, beginning of year	<u>401,699</u>	<u>408,701</u>
Cash and cash equivalents, end of year	<u>\$ 296,197</u>	<u>\$ 401,699</u>

The accompanying notes are an integral part of the financial statements

UNION COUNTY WATER DISTRICT
Statement of Cash Flows, Continued
For the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating loss	\$ (263,948)	\$ (239,738)
Items to reconcile net operating income to net cash provided by operations:		
Depreciation and amortization	314,364	311,362
Changes in operation assets and liabilities:		
Accounts receivable- consumers	(2,798)	(21,195)
Other assets	(7,938)	(2,608)
Deferred outflow	(74,864)	(12,722)
Accounts payable	(16,075)	3,818
Accrued interest payable	(565)	(511)
Deferred revenue	-	(15,000)
Other accrued liabilities	9,938	20,089
Net pension liability	80,563	50,266
Deferred inflow	52,138	-
Net cash provided by operating activities	<u>\$ 90,815</u>	<u>\$ 93,761</u>
 Reconciliation of cash and cash equivalents:		
Unrestricted cash and cash equivalents	\$ 160,191	\$ 205,127
Restricted cash and cash equivalents	136,006	196,572
Total cash and cash equivalents	<u>\$ 296,197</u>	<u>\$ 401,699</u>

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

1. **Summary of Significant Accounting Policies**

The Union County Water District's ("District") financial statements are prepared in accordance to generally accepted accounting principles (GAAP) applicable to governmental units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements. The following summary of the more significant accounting policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

a. **Reporting Entity**

In evaluating how to define the entity for financial reporting purposes, management considered whether the District is a component unit of another primary government and all potential component units of the District. The District is a special-purpose district organized to construct, operate, and maintain water service facilities and supply water to customers in Union County, Kentucky. The District is governed by three appointed Commissioners who are nominated and approved by the Union County Fiscal Court. The District purchases its water supply from the City of Morganfield, Kentucky. All of the water purchased by the District has been filtered and treated. The District operates and maintains the distribution system that supplies its end users. The District's basic financial statements include the financial position and the results of operations of the District. A review of other units of local government, using the criteria set forth in generally accepted accounting principles, indicates there are no additional entities or funds for which the District has reporting responsibilities. Management has determined the District should not be considered a part of any unit of local government for reporting purposes for the following reasons:

1. The District has separate legal standing from all other units of government.
2. A primary government appoints the voting majority of the District's Board of Commissioners. However, the primary government is not able to impose its will on the District and there is no potential for the District to provide benefits to or burdens on the primary government.
3. The District is fiscally independent of all other units of local government. The District's Board of Commissioners has the sole authority to determine financial programs, establish rates (subject to Public Service Commission approval) and issue bonded debt.
4. The financial statements of other units of local government would not be misleading or incomplete without the inclusion of the District's financial statements.

b. **Basis of Accounting and Presentation**

The District is a single-enterprise proprietary fund and uses the accrual basis of accounting. Proprietary funds are used to account for activities that are operated and financed in a manner similar to private business enterprise and that a periodic determination of revenues earned, expenses incurred and/or change in position is appropriate for capital maintenance, public policy, management control, accountability or other purposes. Under the accrual method, revenues are recognized when earned, and expenses are recognized as soon as they result in liabilities for the benefits provided.

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

b. Basis of Accounting and Presentation, Continued

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the proprietary funds principle ongoing operations. The principle operating revenues of the District are charges to customers for water usage. Operating expenses include the cost of providing water service, administrative expenses and depreciation on capital assets. Other revenues and expenses are reported as non-operating in the financial statements.

Charges for services include revenues based on exchange or exchange-like transactions, namely water and sewer use. Program-specific grants and contributions (operating and capital), include revenues arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program, are accrued when all related eligibility requirements have been met.

c. Measurement Focus

The District's enterprise fund is accounted for on an "economic resources" measurement focus. Accordingly, determination of operating income, changes in net position, financial position and cash flows are the primary focus of fund measurement.

d. Cash and Cash Equivalents

The District considers all highly liquid investments with an original maturity of ninety days or less to be cash equivalents.

e. Investments

KRS 66.480 permits the District to invest in U.S. Treasury obligations, U.S. Agency obligations, certain Federal instruments, repurchase agreements, commercial bank certificates of deposit, savings and loan deposits, and the Commonwealth of Kentucky investment pool. Investments are recorded at fair market value. Certificates of deposit are reported at cost since the redemption terms do not consider market rates. These investments are required to be fully collateralized in accordance with provisions of KRS 66.480.

f. Accounts Receivable

The District's receivable balances are expected to be fully collectible; therefore an allowance for uncollectible accounts has not been recorded.

g. Restricted Assets

Restricted assets are cash and cash equivalents whose use is limited by legal requirements. Restricted cash and cash equivalents represent amounts required by debt covenants to be segregated for future debt payments and accrued interest on long-term debt obligations.

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

h. Capital Assets

Capital assets represent the cumulative amount of capital assets owned by the District. Capital assets purchased or acquired are reported at historical cost. Contributed assets are reported at fair value as of the date received. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. All capital assets except land and construction in progress are depreciated. Depreciation is provided for by using the straight-line method over the following estimated useful lives of the assets:

Structures, lines, mains and accessories, and system improvements	50 years
Equipment, including hydrants, pumps and meters	5-30 years
Transportation equipment	5 years

i. Unearned Revenues

The District reports unearned revenue on its statement of net position. Unearned revenues arise when potential revenue does not meet both the “measurable” and “available” criteria for recognition in the current period. In subsequent periods, when both revenue recognition criteria are met the liability for the unearned revenue is removed from the statement of net position and revenue is recognized.

j. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. A liability for compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the District and its employees is accrued as employees earn the rights to the benefits. The District’s policy is to accrue up to 30 days of unused vacation, which is payable upon termination of employment. Employees can accrue up to 60 days of sick leave, which upon termination of employment has no monetary value. Compensated absence activity for the year ended December 31, 2016 was as follows:

	Balance Jan. 1, 2017	Additions	Deductions	Balance Dec. 31, 2017
Compensated absences	\$ 5,029	9,022	(11,108)	\$ 2,943

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

k. Net Position

Net position presents the difference between assets and liabilities in the statement of net position. Proprietary fund net position is divided into three components:

- 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 plus deferred outflows of resources less deferred inflows of resources related to those assets.
- Restricted- consist of net position that is restricted by the District's creditors (for example, through debt covenants), by state enabling legislation (through restrictions on shared revenues), by grantors (both federal and state), and by other contributors less related liabilities and deferred inflows of resources.
- Unrestricted- all other net position is reported in this category.

l. Use of Restricted Resources

When an expense is incurred for purposes for which both restricted and unrestricted resources (net position) are available, the District's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.

m. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employees Retirement System (CERS) and additions to / deductions from CERS's 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 benefit terms. Investments are reported at fair value.

n. Deferred Outflows / Deferred Inflows

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. The District has only one item that qualifies for reporting in this category: the pension-related deferred outflows reported in the statement of net position totaling \$159,348 and \$84,484 for the years ended December 31, 2017 and 2016, respectively, as described in Note 8 to financial statements.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period and so will not be recognized as revenue until then. The District only has one item that meets this criteria: the pension deferred inflows reported in the statement of net position totaling \$52,138 and \$0 for the years ended December 31, 2017 and 2016, respectively, as described in Note 8 to financial statements.

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

2. Deposits

At December 31, 2017, the Union County Water District maintained deposits of \$295,456 at two financial institutions. Of these bank balances \$295,456 was covered by federal depository insurance and the balance of \$0 was fully collateralized by pledged securities.

3. Restricted Assets

The Union County Water District had certain assets restricted for debt service by third parties and for capital improvements and maintenance by Board designation as December 31, 2017 and 2016:

<u>Assets Restricted for:</u>	<u>2017</u>	<u>2016</u>
Debt service	\$ 38,375	\$ 31,649
Capital improvements and maintenance	73,708	141,435
Total restricted assets	<u>\$ 112,083</u>	<u>\$ 173,084</u>

The District had certain assets and corresponding net position reserved for debt service which were restricted due to its outstanding debt. These consisted of a cash reserve and sinking fund for the United States Department of Agriculture note.

<u>Restricted Assets for Debt Service:</u>	<u>2017</u>	<u>2016</u>
Sinking Fund	\$ 23,990	\$ 23,553
Reserve Fund	38,308	31,584
Total restricted assets	<u>62,298</u>	<u>55,137</u>
Less: Current liabilities payable from restricted assets:		
Principal	23,000	22,000
Interest	923	1,488
	<u>23,923</u>	<u>23,488</u>
Net position restricted for debt service	<u>\$ 38,375</u>	<u>\$ 31,649</u>

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

4. Capital Assets

Capital asset activity consisted of the following for the year ended December 31, 2017:

	December 31, 2016	Additions	Disposals	December 31, 2017
Capital assets not depreciated:				
Land and land rights	\$ 10,175	\$ -	\$ -	\$ 10,175
Construction in progress	36,350	119,163	(155,513)	-
	<u>46,525</u>	<u>119,163</u>	<u>(155,513)</u>	<u>10,175</u>
Capital assets depreciated:				
Transport and distribution mains	4,250,422	8,248	-	4,258,670
Other transport and distribution plant	25,354	-	-	25,354
Distribution reservoirs and standpipe	6,918,359	35,759	-	6,954,118
Meters	1,195,297	20,172	-	1,215,469
Hydrants	34,523	-	-	34,523
Electric pumping equipment	1,012,748	155,513	-	1,168,261
Structures and improvements	20,202	-	-	20,202
Equipment	123,770	-	-	123,770
Transportation equipment	94,797	-	-	94,797
Office equipment and software	26,820	-	-	26,820
Other tangible property	10,900	-	-	10,900
	<u>13,713,192</u>	<u>219,692</u>	<u>-</u>	<u>13,932,884</u>
Total assets at historical cost	13,759,717	219,692	-	13,943,059
Less accumulated depreciation	<u>(6,183,275)</u>	<u>(314,364)</u>	<u>-</u>	<u>(6,497,639)</u>
Total capital assets, net	<u>\$ 7,576,442</u>	<u>\$ (94,672)</u>	<u>\$ -</u>	<u>\$ 7,445,420</u>

Depreciation expense amounted to \$314,364 and \$311,362 for the years ended December 31, 2017 and 2016, respectively. Amortization expense amounted to \$0 and \$0 for the years ended December 31, 2017 and 2016, respectively.

5. Long-Term Debt

Long-term debt of the District consisted of the following as of December 31, 2017 and 2016:

	December 31, 2017				
	Balance Dec. 31, 2016	Additions	Deductions	Balance Dec. 31, 2017	Balance Due Within One Year
USDA Loan	\$ 58,000	\$ -	\$ (22,000)	\$ 36,000	\$ 23,000
Net Pension Liability	457,239	80,563	-	537,802	-
Total long-term debt	<u>\$ 515,239</u>	<u>\$ 80,563</u>	<u>\$ (22,000)</u>	<u>\$ 573,802</u>	<u>\$ 23,000</u>

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

5. Long-Term Debt, Continued

Presented on the balance sheet under the following captions:

Current portion long-term debt payable from restricted assets	\$ 23,000
Long-term debt, net of current portion	13,000
	<u>\$ 36,000</u>

Principal and interest requirements to retire the District's long-term obligations at December 31, 2017 were as follows:

	Principal	Interest	Total
2018	23,000	923	23,923
2019	13,000	333	13,333
	<u>\$ 36,000</u>	<u>\$ 1,256</u>	<u>\$ 37,256</u>

Other information on the District's long-term indebtedness is summarized below:

	Interest Rate	Final Maturity	Principal Balance	Security
USDA Loan	5.125%	1/1/2019	\$ 36,000	Utility Revenues

December 31, 2016

	Balance Dec. 31, 2015	Additions	Deductions	Balance Dec. 31, 2016	Due Within One Year
USDA Loan	\$ 78,000	\$ -	\$ (20,000)	\$ 58,000	\$ 22,000
Net Pension Liability	\$ 406,973	\$ 50,266	\$ -	\$ 457,239	\$ -
Total long-term debt	<u>484,973</u>	<u>50,266</u>	<u>(20,000)</u>	<u>515,239</u>	<u>\$ 22,000</u>

6. Operating Lease

The Union County Water District entered into a lease agreement with the Union County Fiscal Court to lease office space. The original lease was for a term of twenty-four months expiring December 31, 2015 with an option for three annual renewals. The District is now paying a monthly rent payment of \$500, and is currently in its third annual renewal. Rent expense amounted to \$6,000 and \$6,000 for the years ended December 31, 2017 and 2016, respectively.

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

7. **Pension Plan**

Plan Description

The District participates in the County Employees Retirement System (CERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems (KRS), an agency of the Commonwealth of Kentucky. CERS covers all full-time and eligible part-time employees employed in nonhazardous positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of Kentucky Retirement Systems (Board). KRS issues a publicly available financial report that includes audited financial statements and audited required supplementary information for CERS. The report may be obtained by writing to Kentucky Retirement System, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601, or it may be found at the KRS website at www.kyret.ky.gov.

Benefits Provided

CERS provides for retirement, disability, and death benefits to system members. Retirement benefits may be extended to beneficiaries of members under certain circumstances. Retirement benefits are determined using a formula which considers the member's final compensation; benefit factors set by statute which vary depending upon the type/amount of service, participation date, and retirement date; and years of service. The information below summarizes the major retirement benefit provisions of CERS. For retirement and benefit purposes, employees are grouped into three tiers. The following summaries are not intended to be, nor should it be interpreted as, a complete statement of all benefit provisions:

Tier 1:

For members whose participation began before September 1, 2008, the following provisions are in force:

Age and service requirement:

Unreduced Benefit: Age 65, with at least 48 months of service credit.
Age 65, with at least one month of non-hazardous duty service credit.
Any age with 27 or more years of service credit.

Reduced Benefit: Age 55, with at least five (5) years of service credit.
Any age with at least 25 and up to 27 years of service credit.

Benefit Amount:

For members whose participation began before August 1, 2004, if a member has at least 48 months of service, the monthly benefit is 2.2% times final average compensation times years of service. For members whose participation began on or after August 1, 2004, the benefit factor is 2.0%. Benefits are reduced by varying percentage based on years of age or service from full retirement criteria.

If a member has at least one month but less than 48 months of service, the monthly benefit is the actuarial equivalent of two times the member's contributions with interest.

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

7. Pension Plan, Continued

Benefits Provided, Continued

Compensation:

Final compensation is calculated by taking the average of the highest five (5) fiscal years of salary. If the number of months of service credit during the five (5) year period is less than forty-eight (48), one (1) or more additional fiscal years shall be used.

Tier 2:

For members whose participation began on or after September 1, 2008, but before January 1, 2014, the following provisions are in force:

Age and service requirement:

Unreduced Benefit: Age 65, with at least 60 months of service credit.
 Age 57, if members age and years of service equal 87 (Rule of 87)

Reduced Benefit: Age 60, with at least 120 months of service credit

Benefit Amount:

The monthly benefit is the following benefit factor based on service credit at retirement multiplied by final average compensation, multiplied by years of service.

<u>Service Credit</u>	<u>Benefit Factor</u>
120 months or less	1.10%
121 - 240 months	1.30%
241 - 312 months	1.50%
313 - 360 months	1.75%
Over 360 months	2.00%

Benefits are reduced by varying percentage based on years of age or service from full retirement criteria.

Compensation:

Final compensation is calculated by taking the average of the last (not highest) five (5) complete fiscal years of salary. Each fiscal year used to determine final compensation must contain twelve (12) months of service credit.

Tier 3:

For members whose participation began on or after January 1, 2014, the following provisions are in force:

Age and service requirement:

Unreduced Benefit: Age 65, with at least 60 months of service credit.
 Age 57, if members age and years of service equal 87 (Rule of 87)

Reduced Benefit: Not available

**UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016**

7. Pension Plan, Continued

Benefits Provided, Continued

Benefit Amount:

Plan members in Tier 3 participate in and contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a Defined Benefit Plan and a Defined Contribution Plan. Each year that a member is an active contributing member to the System, the member and the member's employer will contribute 5.00% and 4.00%, respectively, of creditable compensation into a hypothetical account. The hypothetical account will earn interest annually on both the member's and employer's contribution at a minimum rate of 4%. If the System's geometric average net investment return for the previous five years exceeds 4%, then the hypothetical account will be credited with an additional amount of interest equal to 75% of the amount of the return which exceeds 4%. All interest credits will be applied to the hypothetical account balance on June 30 based on the account balance as of June 30 of the previous year. Upon retirement the hypothetical account which includes member contributions, employer contributions and interest credits can be withdrawn from the System as a lump sum or annuitized into a single life annuity option.

For all tiers, cost of living adjustments (COLA) are provided only if authorized by the Legislature and are at the discretion of the General Assembly. Please refer to the Summary Plan Description, available from KRS, for a complete description of all Plan benefits and provisions.

Contributions

Per Kentucky Revised Statutes Sections 78.545 (33), contribution requirements of the active employees and the participating employers are established and may be amended by the KRS Board. Plan members, are required to contribute a percentage of their annual creditable compensation based on their benefit tier as follows:

	<u>Required Contribution</u>
Tier 1	5%
Tier 2	5% + 1% for health insurance fund
Tier 3	5% + 1% for health insurance fund

The District's actuarially determined contribution rate for the year ended December 31, 2017, was 18.68% (for the months of January through June) and 19.18% (for the months of July through December) of annual creditable compensation. Of these determined contribution rates, 13.95% and 4.73%, which makes up the 18.68%, was contributed to the Pension and Insurance Funds within CERS respectively, and 14.48% and 4.70%, which makes up the 19.18% was contributed to the Pension and Insurance Funds within CERS, respectively. Contributions to CERS Pension Fund by the District were \$32,503 for the year ended December 31, 2017.

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

7. Pension Plan, Continued

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

At December 31, 2017, the District reported a liability of \$537,802 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The District's proportion of the net pension liability was based on a projection of the District's long term share contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2017, the District's proportion was 0.00919%, a decrease of 0.0001% from its proportion measured as of June 30, 2016 of 0.00929%.

For the years ended December 31, 2017 and 2016, the District recognized pension expenses of \$100,844 and \$77,164, respectively. At December 31, 2017, the 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
Difference between expected & actual experience	\$ 667	\$ 13,652
Net difference between projected & actual investment earnings on pension plan investments.	42,593	35,941
Changes of assumptions	99,239	-
Changes in proportion & differences between employer contributions & proportionate share of contributions.	144	2,545
District contributions subsequent to the measurement date.	16,705	-
Total	<u>\$ 159,348</u>	<u>\$ 52,138</u>

The \$16,705 of deferred outflows of resources resulting from the District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year ending December 31,	
2018	\$ 40,194
2019	39,685
2020	17,532
2021	(6,906)
2022	-
Thereafter	-
	<u>\$ 90,505</u>

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

7. Pension Plan, Continued

Actuarial Assumptions

The total pension liability in the June 30, 2017, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.30%
Salary increases	3.05%, average
Investment rate of return	6.25%

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for the 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 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2017, valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

Discount rate: The projection of cash flows used to determine the discount rate of 6.25% assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26 years (closed) amortization period of the unfunded actuarial accrued liability.

Projected cash flows: The projection of cash flows used to determine the discount rate assumed the local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 28 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.

Long term rate of return: The long term rate of return assumption on plan assets is reviewed as part of the regular experience studies prepared every five years for the System. 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 determining the long-term rate of return assumption including long term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce 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.

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

7. Pension Plan, Continued

Actuarial Assumptions, Continued

Municipal bond rate: The discount rate determination does not use a municipal bond rate.

Periods of projected benefit payments: Projected future benefit payments for all current plan members were projected through 2117.

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

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 Equivalent	2%	-0.25%
Total	<u>100%</u>	

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 7.50%, 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 (6.50%) or 1-percentage-point higher (8.50%) than the current rate:

	Discount Rate	District's Proportionate Share of Net Pension Liability
1% decrease	5.25%	\$678,284
Current discount rate	6.25%	\$537,802
1% increase	7.25%	\$420,289

UNION COUNTY WATER DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2017 and 2016

7. Pension Plan, Continued

Method and Assumptions Used in Calculations of Actuarially Determined Contributions

The actuarially determined contribution rates are determined on a biennial basis beginning with the fiscal years ended 2017 and 2018, determined as of July 1, 2017. The amortization period of the unfunded liability has been reset as of July 1, 2015 to a closed 28-year period. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

Actuarial cost method	Entry age normal
Amortization method	Level percentage of pay
Remaining amortization period	28 years, closed
Asset valuation method	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized
Inflation	3.25 percent
Salary increase	4.00 percent, average
Investment rate of return	7.50 percent

Changes in Assumptions and Benefit Terms

There were no changes in benefit terms since the prior measurement date. The following changes of assumptions were made by the Kentucky Legislature and reflected in the valuation performed as of June 30, 2016 as follows:

- The assumed investment rate of return was decreased from 7.50% to 6.25%
- The assumed rate of inflation was reduced from 3.25% to 2.30%
- Payroll growth assumption was reduced from 4.00% to 2.00%

Changes Since Measurement Date

There were no changes between the measurement date of the collective net pension liability and the employer's reporting date.

Plan Fiduciary Net Position

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

Payables to the Pension Plan

At December 31, 2017 and 2016, the District reported a legally required payable of \$3,190 and \$2,384, respectively, for the outstanding amount of contributions due to CERS Pension Fund for the year.

**UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016**

8. Other Post-Employment Benefits

In addition to the pension benefits described above, the Kentucky Retirement Systems (KRS) provides post-retirement healthcare benefits, in accordance with Kentucky Revised Statutes. The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from KRS, including those in the County Employees Retirement System (CERS), which the District participates. The fund and members receiving benefits pay prescribed portions of the aggregate premiums paid by the Fund. The allocation of insurance premiums paid by the Fund and amounts withheld from member benefits is based on years of service with the Systems. For member participating prior to July 1, 2003, years of service and respective percentage of the maximum contribution are as follows:

<u>Service Period</u>	<u>% Paid by Insurance Fund</u>
20 or more years	100%
15-19 years	75%
10-14 years	50%
4-9 years	25%
Less than 4 years	0%

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for members who began participating on, or after, July 1, 2003. Once members reach a minimum vesting period of ten years, nonhazardous employees whose participation began on, or after, July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is at the discretion of the Kentucky General Assembly who reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

In prior years, the employers' required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20 year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

On August 6, 2012, the Retirement System Board voted to cease self-funding of healthcare benefits for most KRS Medicare eligible retirees. The Board elected to contract with Humana Insurance Company to provide healthcare benefits to KRS' retirees through a fully-insured Medicare Advantage Plan. The Humana Medicare Advantage Plan became effective January 1, 2013.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502-564-4646).

UNION COUNTY WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
December 31, 2017 and 2016

9. Deferred Compensation

The District allows all eligible employees to participate in deferred compensation plans administered by the Kentucky Public Employees' Deferred Compensation Authority. The Kentucky Public Employees' Deferred Compensation Authority is authorized under KRS 18A.230 to 18A.275 to provide administration of tax sheltered supplemental retirement plans for all state, public school and university employees and employees of local political subdivisions that have elected to participate. These deferred compensation plans permit all full-time employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Participation by eligible employees in the deferred compensation plans is voluntary.

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

10. Concentrations of Sales

For the year ended December 31, 2017, two customers accounted for \$619,416 in sales and surcharges for approximately 36% of the District's total operating revenues. For the year ended December 31, 2016, sales attributable to these companies were \$511,471 or approximately 37% of total operating revenues.

11. Commitments

The District entered into an agreement dated December 19, 1986 with the City of Morganfield, Kentucky whereby the City agrees to sell and deliver to the District and the District agrees to purchase and receive from the City all of the water required by the District up to a maximum of 1,000,000 gallons per day. The District can purchase water from other suppliers only in the event of an emergency. The agreement outlines a specific method of determining the City's cost of water produced during the previous fiscal year which is the rate charged to the District for the next year. The agreement covers a period of 42 years which expires December 19, 2028.

On July 3, 2013, the District and the City of Morganfield amended the contract to increase the maximum amount of water which the City must furnish to the District during any twenty-four (24) hour period by 1,000,000 gallons to a maximum of 2,000,000 gallons per day.

12. 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; injuries to employees, and natural disasters. The District carries commercial insurance for these types of risk of loss, including workers compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

13. Subsequent Events

In preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through May 24, 2018, the date the financial statements were available to be issued.

UNION COUNTY WATER DISTRICT
Schedule of Proportionate Share of the Net Pension Liability
County Employees Retirement System

Last 10 Fiscal Years *

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
District's proportion of the net pension liability	0.00919%	0.00929%	0.00928%	0.00928%
District's proportionate share of the net pension liability	\$ 537,802	\$ 457,239	\$ 406,973	\$ 300,948
District's covered-employee payroll	\$ 228,611	\$ 221,751	\$ 221,057	\$ 211,227
District's proportionate share of the net pension liability as a percentage of its covered employee payroll	235.25%	206.19%	184.10%	142.48%
Plan fiduciary net position as a percentage of the total pension liability.	53.30%	55.50%	59.97%	66.80%

* The amounts presented for each fiscal year were determined as of one half-year prior to the fiscal year end. Fiscal year 2015 was the first year of implementation.

UNION COUNTY WATER DISTRICT
Schedule of Contributions
County Employees Retirement System

Last 10 Fiscal Years *

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Contractually required contributions	\$ 32,503	\$ 29,231	\$ 27,828	\$ 28,644
Contributions in relation to the contractually required contributions	<u>(32,503)</u>	<u>(29,231)</u>	<u>(27,828)</u>	<u>(28,644)</u>
Contribution (excess) deficiency	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
District's covered-employee payroll	\$ 228,611	\$ 221,751	\$ 221,057	\$ 211,227
Contributions as a percentage of covered-employee payroll	14.22%	13.18%	12.59%	13.56%

* The amounts presented for each fiscal year were determined as of one half-year prior to the fiscal year end. Fiscal year 2015 was the first year of implementation.

UNION COUNTY WATER DISTRICT
Notes to Required Supplementary Information
December 31, 2017

Changes of benefit terms: The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2014:

- A cash balance plan was introduced for members whose participation date is on or after January 1, 2014.

Changes of assumptions: The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2015:

- The assumed investment rate of return was decreased from 7.75% to 7.50%.
- The assumed rate of inflation was reduced from 3.50% to 3.25%.
- The assumed rate of wage inflation was reduced from 1.00% to 0.75%.
- Payroll growth assumption was reduced from 4.50% to 4.00%.
- 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 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 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 assumed rates of retirement, Withdrawal and Disability were updated to more accurately reflect experience.

2016:

- The assumed investment rate of return was decreased from 7.50% to 6.25%
- The assumed rate of inflation was reduced from 3.25% to 2.30%
- Payroll growth assumption was reduced from 4.00% to 2.00%



**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit
of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Commissioners
Union County Water District
Morganfield, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Union County Water District, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued our report thereon dated May 24, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Union County Water District's internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses that we consider to be material weaknesses. [A-1 and A-2]

Compliance and Other Matters

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

Union County Water District's Response to Findings

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

Purpose of the Report

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

Kemper CPA Group LLP

Kemper CPA Group LLP
Certified Public Accountants and Consultants

Morganfield, Kentucky
May 24, 2018

Schedule of Findings & Responses

A-1 Control Risk Related To Lack Of Segregation Of Duties:

Due to a limited number of personnel employed at the District, incompatible work functions are often performed by the same individual and a high degree of trust is necessitated.

Criteria: Each key step of an accounting system should be segregated among employees. Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition.

Effect: The staff size of the District limits the ability to rotate duties and implement some checking procedures. This limitation may affect the ability to record, process, summarize and report financial data.

Recommendation: We recommend that management always be mindful of key functions assigned to employees and provide oversight in all steps of the accounting system.

Response: Management concurs with the recommendation and has taken steps to separate functions and provide oversight where needed.

A-2 Failure to Prepare Complete Set of Financial Statements Including Required Note Disclosures

The auditor, from the District's books of original entry, prepares the financial statements and notes for the Union County Water District.

Criteria: Internal controls should be put in place for the District to review and approve generally accepted accounting principles (GAAP) financial statements and notes. The District is to accept full responsibility for the accuracy of the GAAP financial statements and notes.

Effect: Based upon the entity's present financial statements, the client's auditor is currently preparing the audit financial statements and disclosures.

Recommendation: Procedures should be implemented to allow the District to prepare their own GAAP financial statements and notes.

Response: Management is aware of the situation regarding the preparation of GAAP financial statements and is continuing to determine the best way to handle the situation.