

**Mount Sterling Water and  
Sewer Commission**

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**Independent Auditor's Report  
and Basic Financial Statements  
June 30, 2017 and 2016**

**Mount Sterling Water and Sewer Commission**  
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**June 30, 2017 and 2016**

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**INDEPENDENT AUDITOR'S REPORT**

Mount Sterling Water and  
Sewer Commission and  
the City Council  
Mount Sterling, Kentucky 40353

**Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

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

***Auditor's Responsibility***

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

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

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

### ***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 Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as June 30, 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*

Accounting principles generally accepted in the United States of America require that the schedules of selected pension information on pages 24 through 26 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.

Management has omitted the Management's Discussion & 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.

#### *Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Mount Sterling Water and Sewer Commission's basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedules of Debt Service Requirements are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedules of Debt Service Requirements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such

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information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedules of Debt Service Requirements 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*, we have also issued our report dated September 7, 2017, on our consideration of the Commission'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 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 Commission's internal control over financial reporting and compliance.

***Faulkner, King & Wenz, PSC***

September 7, 2017

**Mount Sterling Water and Sewer Commission**  
**Statements of Net Position**  
**June 30, 2017 and 2016**

| <b>Assets</b>  | <u>2017</u>          | <u>2016</u>          |
|--|----------------------|----------------------|
| <b>Current assets:</b>   |                      |                      |
| Cash and investments   | \$ 4,992,458         | \$ 3,935,176         |
| Accounts receivable, net   | 792,954              | 745,180              |
| Interest receivable  | 169                  | 199                  |
| Other receivables  | 26,028               | 45,687               |
| Inventory  | 175,347              | 168,318              |
| Prepaid expenses   | 43,525               | 139,410              |
| Total current assets   | <u>6,030,481</u>     | <u>5,033,970</u>     |
| <b>Non-current assets:</b>   |                      |                      |
| Restricted cash and cash equivalents                                 | 1,292,973            | 1,347,460            |
| Capital Assets:  |                      |                      |
| Land and building  | 1,773,582            | 1,762,247            |
| Water and sewer system   | 60,398,806           | 60,118,764           |
| Equipment  | 1,413,901            | 1,293,256            |
| Vehicles   | 378,211              | 358,927              |
| Construction in progress   | 164,079              | 2,325                |
| Less accumulated depreciation  | <u>(33,735,390)</u>  | <u>(31,875,365)</u>  |
| Total non-current assets   | <u>31,686,162</u>    | <u>33,007,614</u>    |
| <b>Deferred Outflows of Resources</b>                                |                      |                      |
| Deferred outflows - pension  | <u>686,141</u>       | <u>461,256</u>       |
| Total assets and deferred outflows of resources                      | <u>\$ 38,402,784</u> | <u>\$ 38,502,840</u> |
| <b>Liabilities</b>   |                      |                      |
| <b>Current liabilities:</b>  |                      |                      |
| Accounts payable   | \$ 123,399           | \$ 163,763           |
| Other accrued liabilities  | 274,085              | 262,771              |
| Accrued interest on bonds  | 4,129                | 5,271                |
| Customer deposits  | 314,794              | 290,495              |
| Notes payable  | 864,798              | 987,655              |
| Total current liabilities  | <u>1,581,205</u>     | <u>1,709,955</u>     |
| <b>Non-current liabilities:</b>                                      |                      |                      |
| Notes payable  | 3,841,282            | 4,706,083            |
| Net pension liability  | 2,834,255            | 2,371,971            |
| Total non-current liabilities  | <u>6,675,537</u>     | <u>7,078,054</u>     |
| Total liabilities  | <u>8,256,742</u>     | <u>8,788,009</u>     |
| <b>Deferred Inflows of Resources</b>                                 |                      |                      |
| Deferred inflows - pension   | <u>0</u>             | <u>0</u>             |
| <b>Net Position</b>  |                      |                      |
| Invested in capital assets, net of related debt                      | 25,687,109           | 25,966,416           |
| Restricted for debt service  | 978,179              | 1,056,965            |
| Unrestricted   | 3,480,754            | 2,691,450            |
| Total net position   | <u>30,146,042</u>    | <u>29,714,831</u>    |
| Total liabilities, deferred inflows of resources<br>and net position | <u>\$ 38,402,784</u> | <u>\$ 38,502,840</u> |

**Mount Sterling Water and Sewer Commission**  
**Statements of Revenues, Expenses And Changes in Net Position**  
**For the Years Ended June 30, 2017 and 2016**

| <b>Operating revenues</b>                  | <u>2017</u>          | <u>2016</u>          |
|--|----------------------|----------------------|
| Water sales                                | \$ 3,367,522         | \$ 3,294,147         |
| Sewer sales                                | 2,392,946            | 2,414,065            |
| Other income                               | 164,042              | 248,018              |
| Total operating revenues                   | <u>5,924,510</u>     | <u>5,956,230</u>     |
| <br>                                       |                      |                      |
| <b>Operating expenses</b>                  |                      |                      |
| Water                                      | 2,417,908            | 2,508,043            |
| Sewer                                      | 1,540,556            | 1,621,920            |
| General and administrative costs:          |                      |                      |
| Water                                      | 1,008,988            | 827,507              |
| Sewer                                      | 471,069              | 397,074              |
| Total operating expenses                   | <u>5,438,521</u>     | <u>5,354,544</u>     |
| Operating income                           | <u>485,989</u>       | <u>601,686</u>       |
| <br>                                       |                      |                      |
| <b>Nonoperating revenues (expenses)</b>    |                      |                      |
| Interest income                            | 11,570               | 12,308               |
| Gain (Loss) on sale of fixed assets        | 12,631               | 7,400                |
| Other expense                              | (17,513)             | (17,193)             |
| Interest expense                           | (61,466)             | (79,567)             |
| Total net nonoperating revenues (expenses) | <u>(54,778)</u>      | <u>(77,052)</u>      |
| Income before contributions                | 431,211              | 524,634              |
| Capital contributions                      | <u>0</u>             | <u>0</u>             |
| Change in net position                     | 431,211              | 524,634              |
| Total net position, beginning of year      | <u>29,714,831</u>    | <u>29,190,197</u>    |
| Total net position, end of year            | <u>\$ 30,146,042</u> | <u>\$ 29,714,831</u> |

**Mount Sterling Water and Sewer Commission**  
**Statements of Cash Flows**  
**For the Years Ended June 30, 2017 and 2016**

| <b>Cash Flows from Operating Activities</b>                      | <u>2017</u>         | <u>2016</u>         |
|--|---------------------|---------------------|
| Cash received from customers                                     | \$ 5,732,353        | \$ 5,664,128        |
| Other cash receipts  | 164,042             | 248,018             |
| Cash payments to vendors for water services and supplies         | (702,755)           | (811,402)           |
| Cash payments to vendors for sewer services and supplies         | (295,591)           | (357,479)           |
| Cash payments to employees for services                          | (1,426,333)         | (1,374,960)         |
| Cash payments for water administrative costs                     | (642,964)           | (634,101)           |
| Cash payments for sewer administrative costs                     | (182,395)           | (268,852)           |
| <b>Net cash provided by operating activities</b>                 | <u>2,646,358</u>    | <u>2,465,352</u>    |
| <br>   |                     |                     |
| <b>Cash Flows from Capital and Related Financing Activities</b>  |                     |                     |
| Acquisition and construction of capital assets                   | (624,314)           | (1,035,131)         |
| Proceeds from sale of assets                                     | 12,631              | 7,400               |
| Interest paid on revenue bonds                                   | (62,608)            | (81,050)            |
| Principal paid on debt   | (987,658)           | (1,134,228)         |
| Increase in customer deposits                                    | 24,299              | 7,150               |
| Other expense  | (17,513)            | (17,193)            |
| <b>Net cash used in capital and related financing activities</b> | <u>(1,655,163)</u>  | <u>(2,253,052)</u>  |
| <br>   |                     |                     |
| <b>Cash Flows from Investing Activities</b>                      |                     |                     |
| Interest income from investments                                 | 11,600              | 12,293              |
| <b>Net cash provided by investing activities</b>                 | <u>11,600</u>       | <u>12,293</u>       |
| <br>   |                     |                     |
| <b>Net change in cash and cash equivalents</b>                   | 1,002,795           | 224,593             |
| <br>   |                     |                     |
| Cash and cash equivalents, beginning of year                     | <u>5,282,636</u>    | <u>5,058,043</u>    |
| <br>   |                     |                     |
| <b>Total cash and cash equivalents, end of year</b>              | <u>\$ 6,285,431</u> | <u>\$ 5,282,636</u> |
| <br>   |                     |                     |
| <b>Restricted cash and cash equivalents</b>                      | \$ 1,292,973        | \$ 1,347,460        |
| <b>Unrestricted cash and cash equivalents</b>                    | <u>4,992,458</u>    | <u>3,935,176</u>    |
| <b>Total cash and cash equivalents, end of year</b>              | <u>\$ 6,285,431</u> | <u>\$ 5,282,636</u> |

**Mount Sterling Water and Sewer Commission**  
**Statements of Cash Flows (continued)**  
**For the Years Ended June 30, 2017 and 2016**

| <b>Reconciliation of operating income to net cash provided by operating activities:</b> | <u>2017</u>                | <u>2016</u>                |
|---|----------------------------|----------------------------|
| Operating income  | <u>\$ 485,989</u>          | <u>\$ 601,686</u>          |
| Adjustments to reconcile operating income to net cash provided by operating activities: |                            |                            |
| Depreciation  | 1,891,279                  | 1,884,170                  |
| Provision for bad debts   | 5,939                      | 3,180                      |
| Change in assets and liabilities:   |                            |                            |
| Increase in accounts receivable   | (34,054)                   | (47,264)                   |
| (Increase) decrease in inventories  | (7,029)                    | 5,931                      |
| Decrease (increase) in prepaids   | 95,885                     | (66,307)                   |
| (Decrease) in accounts payable and accrued expenses                                     | (29,050)                   | (11,041)                   |
| Increase in net pension obligation  | <u>237,399</u>             | <u>94,997</u>              |
| Total adjustments   | <u>2,160,369</u>           | <u>1,863,666</u>           |
| <b>Net cash provided by operating activities</b>  | <u><u>\$ 2,646,358</u></u> | <u><u>\$ 2,465,352</u></u> |

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 1. Summary of Significant Accounting Policies**

The accounting policies of the Mount Sterling Water and Sewer Commission (the Commission) conform to accounting principles generally accepted in the United States of America (GAAP). The Commission applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements, in which case, GASB prevails. The following is a summary of the more significant policies:

**Basis of accounting**

The Commission is an individual fund of the City of Mount Sterling, Kentucky and is accounted for as a governmental enterprise fund. It is financed and operated in a manner similar to a private business enterprise where the intent of the governing body is that costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed primarily through user charges.

Accounts are maintained on the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred or prepaid amounts have been utilized.

**Investments**

Investments are carried at cost. Some of the investments are restricted as to use (Note 2). Funds of the Commission are required to be invested in accordance with the investment policy adopted by the Commission. The investment policy allows the Commission to invest in those instruments authorized by KRS 66.480. Bank deposits were substantially secured by FDIC insurance and collateral or invested in direct obligations of the United States at June 30, 2017 and 2016.

**Custodial credit risks – Deposits**

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2017 \$5,360,616 of the Commission's bank balance of \$6,360,616 was exposed to custodial credit risk, as follows:

|   |                     |
|---|---------------------|
| Insured   | \$ 1,000,000        |
| Collateral held by pledging bank's trust department<br>in the Commission's name | <u>5,360,616</u>    |
| Total bank deposits   | <u>\$ 6,360,616</u> |

**Accounts receivable**

Customer receivables are recorded as receivables and revenues at their original invoice amount. Management regularly reviews the customer receivable accounts and determines the allowance for doubtful accounts. A receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 60 days. For the years ended June 30, 2017 and 2016, accounts receivable is stated less an allowance for doubtful accounts of \$154,918 and \$149,094, respectively. A schedule of allowance for doubtful accounts at June 30, 2017 and 2016, follows:

|                          | <u>2017</u>      | <u>2016</u>      |
|--------------------------|------------------|------------------|
| Beginning balance        | \$149,094        | \$150,174        |
| Provisions               | 5,939            | 3,180            |
| Recoveries (Charge-offs) | <u>(115)</u>     | <u>(4,260)</u>   |
| Ending balance           | <u>\$154,918</u> | <u>\$149,094</u> |

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 1. Summary of Significant Accounting Policies (Continued)**

**Inventories**

Inventories are stated at the lower of cost or market on the basis of "first-in, first-out" (FIFO) inventory method.

**Budgets**

In May of 2016, the Commission adopted the annual management budget in the amount of \$5,606,745 for the fiscal year ended June 30, 2017, detailed as follows:

|                                   |                    |
|-----------------------------------|--------------------|
| Water                             | \$2,508,311        |
| Sewer                             | 1,651,269          |
| General and administrative costs: |                    |
| Water                             | 940,075            |
| Sewer                             | <u>507,090</u>     |
| Total operating expenses          | <u>\$5,606,745</u> |

**Property, plant and equipment**

Property, plant and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method. The range of useful lives used in computing depreciation is:

| <u>Classification</u> | <u>Range of lives</u> |
|-----------------------|-----------------------|
| Buildings             | 20-40 years           |
| Water plant           | 25-40 years           |
| Water systems         | 10-30 years           |
| Sewer system          | 10-40 years           |
| Office equipment      | 7-10 years            |
| Other equipment       | 7 years               |
| Vehicles              | 5 years               |

Total depreciation expense was \$1,891,279 and \$1,884,170 for the years ended June 30, 2017 and 2016, respectively.

**Prior period adjustments**

In prior year, Deferred Inflows of Resources was understated and amortized over 5 years. The effect of this was pension expense and deferred inflows were understated by \$39,662 for the year ended June 30, 2015. This understatement is reported as an adjustment to the June 30, 2015 financial statements as it relates to pension expense and deferred inflows of resources. Previously-reported amounts are included in Note 8.

During 2016, the Commission determined that the liability for customer deposits had been overstated in prior years, resulting in a corresponding cumulative understatement of water revenue totaling \$325,398. See details in Note 8.

**Cash and cash equivalents**

All cash, unrestricted and restricted, is considered cash for the purposes of the statement of cash flows.

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 1. Summary of Significant Accounting Policies (Continued)**

**Estimates**

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

**Capital and operating grants**

Grants that are restricted to the purchase of property, plant and equipment are recorded as other income, per GASB 33. The Commission received \$0 in grants of this type for the years ended June 30, 2017 and 2016.

Infrastructure assets constructed by outside entities then taken over by the Commission are also recorded as other income per GASB 33. The total amount of the assets taken over were \$0 for the years ended June 30, 2017 and 2016. Such amounts would constitute noncash transactions.

**Capitalized interest**

The Commission follows the policy of capitalizing interest as a component of construction cost. For the year ended June 30, 2017, total interest cost incurred was \$61,466 of which \$0 was capitalized. For the year ended June 30, 2016, total interest cost incurred was \$79,567 of which \$0 was capitalized.

**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 Employers' Retirement System Plan (CERS) and additions to/deductions from CERS' 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 benefit terms. Investments are reported at fair value.

**Note 2. Restricted Assets**

The restricted assets in the accompanying financial statements are restricted as to use by ordinance (Note 5), external parties, or by board designation. A schedule of restricted assets at June 30, 2017, follows:

| <u>Description</u>                                      | <u>Cash</u>        | <u>Investments<br/>at Cost</u> | <u>Total</u>       |
|---|--------------------|--------------------------------|--------------------|
| Assets restricted by grant agreement or bond ordinance: |                    |                                |                    |
| Customer deposits                                       | \$ 314,794         | \$ -0-                         | \$ 314,794         |
| Reserve accounts  | 728,179            | -0-                            | 728,179            |
| Depreciation accounts                                   | 250,000            | -0-                            | 250,000            |
|   | <u>\$1,292,973</u> | <u>\$ -0-</u>                  | <u>\$1,292,973</u> |

A schedule of restricted assets at June 30, 2016, follows:

| <u>Description</u>                                      | <u>Cash</u>        | <u>Investments<br/>at Cost</u> | <u>Total</u>       |
|---|--------------------|--------------------------------|--------------------|
| Assets restricted by grant agreement or bond ordinance: |                    |                                |                    |
| Customer deposits                                       | \$ 290,495         | \$ -0-                         | \$ 290,495         |
| Reserve accounts  | 806,965            | -0-                            | 806,965            |
| Depreciation accounts                                   | 250,000            | -0-                            | 250,000            |
|   | <u>\$1,347,460</u> | <u>\$ -0-</u>                  | <u>\$1,347,460</u> |

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

**Note 3. Long-Term Debt**

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2017 and 2016, are summarized as follows:

|                           | <u>Rate</u> | <u>Original<br/>Issue</u> | <u>2017</u>         | <u>2016</u>         |
|---------------------------|-------------|---------------------------|---------------------|---------------------|
| Kentucky Bond Corporation |             |                           |                     |                     |
| 2010 Series C             | 2.70%       | \$ 2,760,000              | \$ 105,000          | \$ 282,083          |
| KIA Fund A                | 1.20%       | 1,055,969                 | 0                   | 59,013              |
| KIA Fund B                | 1.50%       | 2,448,213                 | 141,640             | 281,179             |
| KIA Fund A Loan           | 1.00%       | <u>13,202,540</u> *       | <u>4,459,440</u>    | <u>5,071,463</u>    |
|                           |             | <u>\$ 19,466,722</u>      | <u>4,706,080</u>    | <u>5,693,738</u>    |
| Less current maturities   |             |                           | <u>(864,798)</u>    | <u>(987,655)</u>    |
| Total long term debt      |             |                           | <u>\$ 3,841,282</u> | <u>\$ 4,706,083</u> |

- The original issue of the KIA Fund A Loan is \$13,202,540. As of June 30, 2017, the Commission had borrowed \$11,936,783 of this amount.

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2017 and 2016, are detailed as follows:

|                           | <u>Balance<br/>June 30<br/>2015</u> |            |                       | <u>Balance<br/>June 30<br/>2016</u> |            |                    | <u>Balance<br/>June 30<br/>2017</u> |
|---------------------------|-------------------------------------|------------|-----------------------|-------------------------------------|------------|--------------------|-------------------------------------|
|                           | Advances                            | Repayments | Advances              | Repayments                          | Advances   | Repayments         |                                     |
| Kentucky Bond Corporation |                                     |            |                       |                                     |            |                    |                                     |
| 2010 Series C             | \$ 614,583                          | \$0        | \$ (332,500)          | \$ 282,083                          | \$0        | \$ (177,083)       | \$ 105,000                          |
| KIA Fund A                | 117,324                             | 0          | (58,311)              | 59,013                              | 0          | (59,013)           | 0                                   |
| KIA Fund B                | 418,648                             | 0          | (137,469)             | 281,179                             | 0          | (139,539)          | 141,640                             |
| KIA Fund A Loan           | <u>5,677,411</u>                    | <u>0</u>   | <u>(605,948)</u>      | <u>5,071,463</u>                    | <u>0</u>   | <u>(612,023)</u>   | <u>4,459,440</u>                    |
| Total                     | <u>\$ 6,827,966</u>                 | <u>\$0</u> | <u>\$ (1,134,228)</u> | <u>\$5,693,738</u>                  | <u>\$0</u> | <u>(\$987,658)</u> | <u>\$4,706,080</u>                  |

|   | <u>Balance<br/>June 30, 2017</u> |                     |
|---|----------------------------------|---------------------|
|   | <u>Current</u>                   | <u>Long-Term</u>    |
| Kentucky Bond Corporation 2010 Series C | \$ 105,000                       | \$ -                |
| KIA Fund B                              | 141,640                          | -                   |
| KIA Fund A Loan                         | <u>618,158</u>                   | <u>3,841,282</u>    |
| Total                                   | <u>\$ 864,798</u>                | <u>\$ 3,841,282</u> |

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 3. Long-Term Debt (Continued)**

The long-term debt service requirements are as follows:

| <u>Fiscal Year</u> | <u>Principal</u>    | <u>Interest</u>   | <u>Total</u>        |
|--------------------|---------------------|-------------------|---------------------|
| 2017-2018          | \$ 864,798          | \$ 47,799         | \$ 912,597          |
| 2018-2019          | 624,355             | 36,856            | 661,211             |
| 2019-2020          | 630,614             | 30,597            | 661,211             |
| 2020-2021          | 636,936             | 24,275            | 661,211             |
| 2021-2022          | 643,322             | 17,889            | 661,211             |
| 2022-2024          | <u>1,306,055</u>    | <u>16,366</u>     | <u>1,322,421</u>    |
|                    | <u>\$ 4,706,080</u> | <u>\$ 173,782</u> | <u>\$ 4,879,862</u> |

**KIA Fund A and KIA Fund B**

As of June 30, 2017 and 2016, the Commission had drawn on a KIA loan which was made to finance the construction of the water treatment plant sludge facilities. The loan was secured by a pledge of revenues, and had been drawn up to \$1,055,969. The loan bears an interest rate of 1.2% and had a life of 20 years and matured in 2017.

As of June 30, 2017 and 2016, the Commission had also drawn on a KIA loan which was made to finance the construction of ground storage tanks and a water strengthening main. The loan is secured by a pledge of revenues, and has been drawn up to \$2,448,213. The loan bears an interest rate of 1.5% and has a life of 20 years and matures in 2018.

**Kentucky Infrastructure Authority - A02-01**

The Commission had drawn \$11,936,783 as of June 30, 2017 and 2016, from the Kentucky Infrastructure Authority. The loan was made for the construction of a new trunk sewer and wastewater treatment plant. The loan is secured by a pledge of revenues and can be drawn up to \$13,202,540. The loan bears an interest rate of 1% and has a life of 20 years.

**Kentucky Bond Corporation 2010 Series C Bonds**

On November 4, 2010, the Commission borrowed the aggregate principal amount of \$2,760,000 with the Kentucky Bond Corporation 2010 Series C Bonds. The purpose of the issue was for the refunding in advance of the obligations of the City of Danville, Kentucky designated as its Multi-City Lease Revenue Bonds (City of Mount Sterling, Kentucky Water and Sewer System Revenue Refunding & Improvement Project) Series 1998-B and the Kentucky Municipal League Pooled Lease Financing Program. The bonds are secured by a pledge of revenues. The bonds are subject to optional and mandatory redemption prior to maturity.

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 4. Net Position**

GASB Statement No. 34 requires the delineation of Net Position as Invested in Property, Plant and Equipment (capital investments), Restricted and Unrestricted.

The balance of capital investments represents funds that have been used to acquire pump stations, storage facilities, meter stations, etc., constructed and operated by the Mount Sterling Water and Sewer Commission, net of outstanding debt. The balance was \$25,687,109 and \$25,966,416 at June 30, 2017 and 2016, respectively.

The Commission has the following restricted net assets that are reserved in accordance with the Commission's various bond ordinances (Note 5) or Board designations:

|                           | <u>2017</u>       | <u>2016</u>        |
|---------------------------|-------------------|--------------------|
| Operation and Maintenance | \$ 274,211        | \$ 274,211         |
| Replacement               | 451,566           | 530,352            |
| Depreciation              | 250,000           | 250,000            |
| Other                     | <u>2,402</u>      | <u>2,402</u>       |
| Total Restricted          | <u>\$ 978,179</u> | <u>\$1,056,965</u> |

The Commission has a balance of \$3,480,754 and \$2,691,450 for unrestricted net assets at June 30, 2017 and 2016, respectively.

**Note 5. Compliance with Bond Ordinance**

The Kentucky Bond Corporation 2010 Series C bond ordinance requires the Commission to maintain certain reserves and restricted assets as follows:

**Operation and Maintenance Fund** - This reserve is required to maintain a balance equal to three month's cost of operating, maintaining, and insuring the system. The balance of this reserve at June 30, 2017 and 2016 was \$274,211.

**Depreciation Fund** - This reserve is required for major repairs and replacements. Funds may be withdrawn only to pay the cost of making unusual or extraordinary maintenance, repairs, renewals, and/or replacements to the system not included in the annual budget of current expenses, or for the purpose of paying the cost of construction improvements. The balance of this reserve at June 30, 2017 and 2016 was \$250,000.

The Kentucky Infrastructure Authority requires the Commission to maintain certain reserves and restricted assets as follows:

**Replacement Reserve** - This reserve requires the Commission to deposit \$32,790 each December 1 into a separate account until the balance reaches \$327,900 and be maintained for the life of the loan. In addition, \$78,600 (for 2016 only) and \$123,350 balances are also required for the remaining loans. The total required balance of this reserve is \$451,250 and \$529,850 for year ending June 30, 2017 and 2016, respectively. The balance of this reserve at June 30, 2017 and 2016, was \$453,968 and \$532,754, respectively.

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

**Note 6. Property, Plant and Equipment**

A summary of changes in property, plant and equipment is as follows:

|   | Balance<br>June 30,<br>2015 | Additions   | Reclassifications<br>and<br>Disposals | Balance<br>June 30,<br>2016 | Additions     | Reclassifications<br>and<br>Disposals | Balance<br>June 30,<br>2017 |
|---|-----------------------------|-------------|---------------------------------------|-----------------------------|---------------|---------------------------------------|-----------------------------|
| Land and building                       | \$1,262,868                 | \$499,379   | \$0                                   | \$1,762,247                 | \$11,335      | \$0                                   | \$1,773,582                 |
| Water and sewer system                  | 59,752,668                  | 305,657     | 60,439                                | 60,118,764                  | 280,042       | 0                                     | 60,398,806                  |
| Equipment                               | 1,115,934                   | 177,322     | 0                                     | 1,293,256                   | 120,645       | 0                                     | 1,413,901                   |
| Construction in progress                | 60,439                      | 2,325       | (60,439)                              | 2,325                       | 164,079       | (2,325)                               | 164,079                     |
| Vehicles                                | 339,942                     | 50,448      | (31,463)                              | 358,927                     | 50,538        | (31,254)                              | 378,211                     |
|   | 62,531,851                  | 1,035,131   | (31,463)                              | 63,535,519                  | 626,639       | (33,579)                              | 64,128,579                  |
| Accumulated depreciation                | (30,022,658)                | (1,884,170) | 31,463                                | (31,875,365)                | (1,891,279)   | 31,254                                | (33,735,390)                |
| Total net property, plant and equipment | \$32,509,193                | (\$849,039) | \$0                                   | \$31,660,154                | (\$1,264,640) | (\$2,325)                             | \$30,393,189                |

**Note 7. Pension Plan**

Mount Sterling Water and Sewer Commission is a participating employer of the County Employees' Retirement System (CERS). Under the provisions of Kentucky Revised Statute 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS. The plan issues publicly available financial statements which may be downloaded from the Kentucky Retirement Systems website.

*Plan Description* – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of state legislature.

*Contributions* – For the year ended June 30, 2017, plan members were required to contribute 5.00% of wages for non-hazardous job classifications. Employees hired after September 1, 2008 are required to contribute an additional 1% to cover the cost of medical insurance that is provided through CERS. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.545(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contributions rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended June 30, 2017, participating employers contributed 18.68% of each employee's wages, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

Plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

**Note 7. Pension Plan (continued)**

defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own account. Plan members contribute 5.00% of wages to their own account and 1% to the health insurance fund. The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of each member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. For non-hazardous members, their account is credited with a 4% employer pay credit. The employer pay credit represents a portion of the employer contribution.

The Company contributed for the years ended June 30, 2017 and 2016 \$249,895 and \$234,269, respectively, or 100% of the required contribution. The contribution was allocated for the years ended June 30, 2017 and 2016 \$186,618 and \$170,553, respectively to the CERS pension fund and \$63,277 and \$63,716, respectively, to the CERS insurance fund.

*Pension Liabilities, Expense, Deferred Outflows of Resources and Deferred Inflows of Resources* – At June 30, 2017, the Company reported a liability of \$2,834,255 or its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Company's proportion of the net pension liability was based on a projection of the Company's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2016, the Company's proportion was .057564 percent, while at June 30, 2015, the Company's proportion was .055168 percent.

For the year ended June 30, 2017, the Company recognized pension expense of \$423,976. At June 30, 2017, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

|  | <b>Deferred<br/>Outflows of<br/>Resources</b> | <b>Deferred<br/>Inflows of<br/>Resources</b> |
|--|---|--|
| Differences between expected and actual results  | \$ 12,374                                     | \$ -   |
| Changes of assumptions   | 150,144                                       | -  |
| Net difference between projected and actual earnings on Plan investments                                     | 266,449                                       | -  |
| Changes in proportion and differences between Company contributions and proportionate share of contributions | 70,556  | -  |
| Company contributions subsequent to the measurement date   | <u>186,618</u>                                | <u>-</u>                                     |
| Total  | <u>\$ 686,141</u>                             | <u>\$ -</u>                                  |

The \$186,618 of deferred outflows of resources resulting from the Company's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

| <b>Year ending June 30,</b> |              |
|-----------------------------|--------------|
| 2018                        | \$ (190,185) |
| 2019                        | (135,390)    |
| 2020                        | (114,754)    |
| 2021                        | (59,194)     |

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 7. Pension Plan (continued)**

*Actuarial Assumptions* – The total pension liability in the June 30, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

|                           |  |
|---------------------------|--|
| Inflation                 | 3.25%  |
| Salary increases          | 4.00%, average, including inflation                        |
| Investment rate of return | 7.50%, net of plan investment expense, including inflation |

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 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 actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years. Several factors are considered in evaluating the long-term rate of return assumptions 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 the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer time frame. 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.

The target allocation and best estimates of nominal real rates of return for each major asset class at June 30, 2016 are summarized in the following table:

| <b>Asset Class</b>                             | <b>Target Allocation</b> | <b>Long-term Nominal Real Rate of Return</b> |
|--|--------------------------|--|
| 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  | 100%                     |  |

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 7. Pension Plan (continued)**

*Discount Rate* – The discount rate used to measure the total pension liability was 7.50 percent at June 30, 2016. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 28 year amortization period of the unfunded actuarial accrued liability. The discount rate does not use a municipal bond rate.

*Sensitivity of the Company's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate* – The following presents the Company's proportionate share of the net pension liability calculated using the discount rate of 7.50 percent, as well as what the Company'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 percent) or 1-percentage-point higher (8.50 percent) than the current rate:

|                       | <b>Discount rate</b> | <b>Company's<br/>proportionate share<br/>of net pension<br/>liability</b> |           |
|-----------------------|----------------------|---|-----------|
| 1% decrease           | 6.50%                | \$  | 3,531,941 |
| Current discount rate | 7.50%                | \$  | 2,834,255 |
| 1% increase           | 8.50%                | \$  | 2,236,200 |

*Payable to the Pension Plan* – At June 30, 2017 and 2016, the Company reported a payable of \$28,433 and \$25,553, respectively, for the outstanding amount of contributions to the pension plan required for the year then ended. The payable includes both the pension and insurance contribution allocation.

**Note 8. Restatement of Net Position**

During 2015 the Company implemented GASB Statement No. 68, Accounting and Financial Reporting for Pensions, which addresses financial reporting for state and local government employers whose employees are provided with pensions through pension plans that are covered under Statement No. 67, Financial Reporting for Pension Plans.

The guidance contained in Statement 68 changed how governments calculate and report the costs and obligations associated with pensions. Under the new standards GASB requires that cost-sharing governments report a net pension liability, pension expense, and pension related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan. In addition, GASB requires Statement 68 to be applied retroactively. This accounting change, along with the other prior period adjustments described in Note 1, results in the following changes to previously-reported amounts (see next page):

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 8. Restatement of Net Position (continued)**

|   | <b>Net Position</b>  | <b>Change in<br/>Net Position</b> |
|---|----------------------|-----------------------------------|
| Net position, at July 1, 2014, as originally reported | \$ 30,220,015        |                                   |
| Beginning net pension liability and deferred outflows | (1,837,655)          |                                   |
| Correction of customer deposit liability              | <u>287,591</u>       |                                   |
| Net position, at July 1, 2014, as restated            | 28,669,951           |                                   |
| Correction of customer deposit liability              | 37,807               | \$37,807                          |
| Correction of deferred inflows                        | (39,662)             | (39,662)                          |
| Change in net position, as previously reported        | <u>522,101</u>       | <u>522,101</u>                    |
| Balances, at June 30, 2015, as restated               | <u>\$ 29,190,197</u> | <u>\$520,246</u>                  |

**Note 9. Risk Management**

The Mount Sterling Water and Sewer Commission 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. In addition to its general liability insurance, the Commission also carries commercial insurance for all other risks of loss such as workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The following is a schedule of insurance in force as of June 30, 2017:

| <u>Coverage</u>                     | <u>Amount of<br/>Coverage</u> | <u>Premium</u> | <u>Policy Term</u> |
|-------------------------------------|-------------------------------|----------------|--------------------|
| Buildings & property                | \$ 32,028,317                 | *              | 7/1/16 - 7/1/17    |
| General & Employment Practices (ea) | 3,000,000                     | *              | 7/1/16 - 7/1/17    |
| Public officials liability          | 3,000,000                     | *              | 7/1/16 - 7/1/17    |
| Cyber and Automobile liability (ea) | 1,000,000                     | *              | 7/1/16 - 7/1/17    |
| Automobile physical                 | Actual Value                  | *              | 7/1/16 - 7/1/17    |
| Crime:                              |                               |                |                    |
| Employee dishonesty                 | 250,000                       | *              | 7/1/16 - 7/1/17    |
| Workers compensation insurance:     |                               |                |                    |
| Waterworks                          | 761,707                       | *              | 7/1/16 - 7/1/17    |
| Sewage                              | 286,008                       | *              | 7/1/16 - 7/1/17    |
| Clerical                            | 301,718                       | *              | 7/1/16 - 7/1/17    |
| Health & life insurance             | Various                       | \$ 300,354     | Monthly            |

\*Blanket coverage; total premium \$113,012.

**Note 10. Subsequent Events**

Subsequent events for Mount Sterling Water and Sewer Commission have been evaluated through September 7, 2017, which is the date the financial statements were available to be issued.

**Mount Sterling Water and Sewer Commission**  
**Notes to the Financial Statements**  
**June 30, 2017 and 2016**

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**Note 10. Subsequent Events (continued)**

In June 2015, the GASB approved Statement No. 75 "*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*" which reflects substantial changes to the accounting and financial reporting of state and local government employers. The objective of Statement No. 75 is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). Statement No. 75 replaces the requirements of Statement No. 45, "*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*," as amended.

The guidance contained in this Statement changes how governments calculate and report the costs and obligations associated with OPEB in important ways. It is designed to improve the decision usefulness of reported OPEB information and to increase the transparency, consistency, and comparability of OPEB information across governments. Under the OPEB standards now in effect, cost-sharing employers have not been required to present actuarial information about OPEB. Instead, information has been required to be presented in the OPEB plan's own financial statements for all the participating governments combined.

Through its research, the GASB concluded that the needs of users of information regarding cost-sharing employers do not differ significantly from those interested in single and agent employers. Therefore, the GASB believes it is important to give users of the financial statements of cost-sharing employers access to better, more transparent financial information. Consequently, under the new standard the GASB is requiring that cost-sharing governments report a net OPEB liability, OPEB expense, and OPEB-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan.

Statement No. 75 will take effect for pension plan employers in fiscal years beginning after June 15, 2017 (that is, for years ended June 30, 2018 or later). The Commission is currently evaluating the effects of this statement on its financial statements. The actual liability for June 30, 2017 for Mount Sterling Water and Sewer Commission is not known at this time.

**Mount Sterling Water and Sewer Commission  
Schedule of Revenues, Expenses And Changes  
in Net Assets Budget and Actual  
For the Year Ended June 30, 2017**

|   | Enacted<br>Budget    | Actual               | Favorable<br>(Unfavorable) |
|---|----------------------|----------------------|----------------------------|
| <b>Operating revenues</b>                     |                      |                      |                            |
| Water sales                                   | \$ 3,350,503         | \$ 3,367,522         | \$ 17,019                  |
| Sewer sales                                   | 2,310,817            | 2,392,946            | 82,129                     |
| Other income                                  | 172,609              | 164,042              | (8,567)                    |
| Total operating revenues                      | <u>5,833,929</u>     | <u>5,924,510</u>     | <u>90,581</u>              |
| <b>Operating expenses</b>                     |                      |                      |                            |
| Water   | 2,508,311            | 2,417,908            | 90,403                     |
| Sewer   | 1,651,269            | 1,540,556            | 110,713                    |
| General and administrative costs:             |                      |                      |                            |
| Water   | 891,691              | 1,008,988            | (117,297)                  |
| Sewer   | 458,706              | 471,069              | (12,363)                   |
| Total operating expenses                      | <u>5,509,977</u>     | <u>5,438,521</u>     | <u>71,456</u>              |
| Operating income                              | <u>323,952</u>       | <u>485,989</u>       | <u>162,037</u>             |
| <b>Nonoperating revenues (expenses)</b>       |                      |                      |                            |
| Interest income                               | 10,598               | 11,570               | 972                        |
| Gain (Loss) on sale of fixed assets           | 0                    | 12,631               | 12,631                     |
| Other expense                                 | (14,848)             | (17,513)             | (2,665)                    |
| Interest expense                              | (81,920)             | (61,466)             | 20,454                     |
| Total net nonoperating<br>revenues (expenses) | <u>(86,170)</u>      | <u>(54,778)</u>      | <u>31,392</u>              |
| Income before contributions                   | 237,782              | 431,211              | 193,429                    |
| Capital contributions                         | <u>0</u>             | <u>0</u>             | <u>0</u>                   |
| Change in net assets                          | 237,782              | 431,211              | 193,429                    |
| Total net assets, beginning of year           | <u>29,714,831</u>    | <u>29,714,831</u>    | <u>0</u>                   |
| Total net assets, end of year                 | <u>\$ 29,952,613</u> | <u>\$ 30,146,042</u> | <u>\$ 193,429</u>          |

**Mount Sterling Water and Sewer Commission**  
**Schedule of Debt Service Requirements**  
**Kentucky Infrastructure Authority Fund B**  
**June 30, 2017**

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| <u>Fiscal Year</u><br><u>Ending June 30</u> | <u>Principal</u><br><u>Due</u><br><u>Dec. 1 &amp;</u><br><u>June 1</u> | <u>Interest</u>   |               | <u>Total Debt</u><br><u>Requirements</u> | <u>Principal</u><br><u>Outstanding at</u><br><u>End of Year</u> |
|---|--|-------------------|---------------|--|---|
|   |  | <u>December 1</u> | <u>June 1</u> |  |   |
| 2018  | \$ 141,640   | \$ 1,062          | \$ 534        | \$ 143,236                               | \$ -  |
|   | <u>\$ 141,640</u>  | <u>\$ 1,062</u>   | <u>\$ 534</u> | <u>\$ 143,236</u>                        |   |

**Mount Sterling Water and Sewer Commission**  
**Schedule of Debt Service Requirements**  
**Kentucky Infrastructure Authority A02-01**  
**June 30, 2017**

| <u>Fiscal Year<br/>Ending June 30</u> | <u>Principal<br/>Due<br/>Dec. 1 &amp;<br/>June 1</u> | <u>Interest<br/>Due<br/>Dec. 1 &amp;<br/>June 1</u> | <u>Admin.<br/>Fees</u> | <u>Total Debt<br/>Requirements</u> | <u>Principal<br/>Outstanding at<br/>End of Year</u> |
|---------------------------------------|--|---|------------------------|------------------------------------|---|
| 2018                                  | \$ 618,158   | \$ 43,053   | \$ 8,610               | \$ 669,821                         | \$ 3,841,282  |
| 2019                                  | 624,355  | 36,856  | 7,372                  | 668,583                            | 3,216,927   |
| 2020                                  | 630,614  | 30,597  | 6,119                  | 667,330                            | 2,586,313   |
| 2021                                  | 636,936  | 24,275  | 4,855                  | 666,066                            | 1,949,377   |
| 2022                                  | 643,322  | 17,889  | 3,578                  | 664,789                            | 1,306,055   |
| 2023                                  | 649,770  | 11,440  | 2,288                  | 663,498                            | 656,285   |
| 2024                                  | 656,285  | 4,925   | 985                    | 662,195                            | 0   |
|                                       | <u>\$ 4,459,440</u>                                  | <u>\$ 169,035</u>                                   | <u>\$ 33,807</u>       | <u>\$ 4,662,282</u>                |   |

**Mount Sterling Water and Sewer Commission**  
**Schedule of Debt Service Requirements**  
**Kentucky Bond Corporation Financing Program Revenue Bonds 2010 First Series C**  
**June 30, 2017**

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| <u>Fiscal Year<br/>Ending June 30</u> | <u>Principal<br/>Payments</u> | <u>Interest</u> | <u>Admin.<br/>Fees</u> | <u>Total Debt<br/>Requirements</u> | <u>Principal<br/>Outstanding at<br/>End of Year</u> |
|---------------------------------------|-------------------------------|-----------------|------------------------|------------------------------------|---|
| 2018                                  | \$ 105,000                    | \$ 3,150        | \$ 525                 | \$ 108,675                         | \$ -  |
|                                       | <u>\$ 105,000</u>             | <u>\$ 3,150</u> | <u>\$ 525</u>          | <u>\$ 108,675</u>                  |   |

**Mount Sterling Water and Sewer Commission  
 Schedule of Proportionate Share of the Net Pension Liability  
 For the Year Ended June 30, 2017 and 2016**

|  | 2017         | 2016         | 2015         | 2014         |
|--|--------------|--------------|--------------|--------------|
| Company's proportion of the net pension liability  | 0.057564%    | 0.055168%    | 0.054759%    | 0.054759%    |
| Company's proportionate share of the net pension liability (asset)                                   | \$ 2,834,255 | \$ 2,371,971 | \$ 1,781,540 | \$ 2,010,266 |
| Company's covered employee payroll   | \$ 1,338,593 | \$ 1,373,209 | \$ 1,287,153 | \$ 1,256,270 |
| Company's share of the net pension liability (asset) as a percentage of its covered employee payroll | 211.73%      | 172.73%      | 138.41%      | 160.02%      |
| Plan fiduciary net position as a percentage of the total pension liability                           | 55.50%       | 59.97%       | 66.80%       | 61.22%       |

**Notes:**

Schedule is intended to show information for the last 10 fiscal years. Additional years will be displayed as they become available.

\* The amounts presented for each fiscal year were determined (measured) as of the previous fiscal year.

**Mount Sterling Water and Sewer Commission  
Schedule of Pension Contributions  
For the Year Ended June 30, 2017, 2016, 2015, 2014 and 2013**

|  | 2017         | 2016         | 2015         | 2014         | 2013         |
|--|--------------|--------------|--------------|--------------|--------------|
| Contractually required employer contribution                           | \$ 186,618   | \$ 170,553   | \$ 164,134   | \$ 172,611   | \$ 158,114   |
| Contributions relative to contractually required employer contribution | \$ 186,618   | \$ 170,553   | \$ 164,134   | \$ 172,611   | \$ 158,114   |
| Contribution deficiency (excess)                                       | \$ -         | \$ -         | \$ -         | \$ -         | \$ -         |
| Company's covered employee payroll                                     | \$ 1,338,593 | \$ 1,373,209 | \$ 1,287,153 | \$ 1,256,270 | \$ 1,252,885 |
| Employer contributions as a percentage of covered-employee payroll     | 13.94%       | 12.42%       | 12.75%       | 13.74%       | 12.62%       |

**Notes:**

Schedule is intended to show information for the last 10 fiscal years. Additional years will be displayed as they become available.

Contractually required employer contributions exclude the portion of contributions paid to CERS but allocated to the insurance fund of the CERS. The above contributions only include those contributions allocated directly to the CERS pension fund.

**Mount Sterling Water and Sewer Commission  
Schedule of Changes in Benefits and Assumptions  
For the Year Ended June 30, 2017**

**County Employee Retirement System**

*Changes of benefit terms - None.*

*Changes in assumptions - None.*

**FAULKNER, KING & WENZ, PSC**  
**CERTIFIED PUBLIC ACCOUNTANTS**

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

Mount Sterling Water and Sewer Commission  
Mount Sterling, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements and have issued our report, which includes an explanatory paragraph regarding the omission of Management Discussion and Analysis, thereon dated September 7, 2017.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Commission'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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described below that we consider to be a significant deficiency.

Finding: 2017-1

- **Condition:** While management is knowledgeable in regard to the numbers reported in the financial statements, identifying and applying new authoritative guidance in regard to information reported in the notes to those statements is outside the scope of management's training and experience.
- **Management Response and Corrective Action Plan:** It does not appear that it would be economically feasible for our organization to enlarge its staff or contract an individual with appropriate skill and knowledge in applying new authoritative guidance. Thus, it is important that our Board provide oversight and independent review functions.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Commission'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*.

### **Response to Findings**

The Commission's response to the findings identified in our audit is described in this report. The Commission's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **Purpose of this Report**

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

*Faulkner, King & Wenz, PSC*

September 7, 2017