

MOUNTAIN WATER DISTRICT

REPORT OF AUDIT

DECEMBER 31, 2017

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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Mountain Water District
Pikeville, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of the business-type activities of Mountain Water District, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the Mountain Water District's basic financial statement listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedure to obtain audit evidence about the amounts and disclosures in the financial statements. The procedure selected depends 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 presentations of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

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

Emphasis of Matter

As discussed in Note 3 page 21 to the financial statements, effective December 1, 2014, Mountain Water District adopted Governmental Accounting Standards Board No. 68, Accounting and Financial Reporting for Pensions. My Opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and budgetary comparison information on pages 3-5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about 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 I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide assurance.

Other Reporting Required by Governmental Auditing Standards

In accordance with Governmental Auditing Standards, I have also issued my report dated August 27, 2018, on my consideration of Mountain Water District's internal control over financial reporting and on tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Governmental Auditing Standards in considering Mountain Water District's internal control over financial reporting and compliance.

Richard F. Paulmann

Richard F. Paulmann CPA, LLC
Pewee Valley, KY
August 27, 2018

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017

Our discussion and analysis of the Mountain Water (the District) financial performance provides an overview of the District's financial activities for the fiscal year ended December 31, 2017. Please read it in conjunction with the accompanying basic financial statements. It is our intent that this discussion provide all parties interested in the District's financial condition, especially the users of the facilities, a better understanding of the District's operations and financial status.

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

Financial Highlights

- Net assets decreased this year by \$847,251 from operating activities and before capital contributions.
- The District's total long-term debt decreased by \$870,162 from the prior year.
- The District acquired several vehicles through financing.
- The District was able to make the following purchases:
 1. Significant water and sewer line extensions to the outlying areas of Pike County.
 2. Assorted new equipment for treatment plant and distribution system to facilitate daily operations.

Overview of the Financial Statements

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

Fund Financial Statements

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

MOUNTAIN WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017
(CONTINUED)

Notes to the financial statements

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

Reporting on the District as a Whole

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

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

The District's total revenues decreased from a year ago by \$120,589 (1.1%). The decrease was the result of a loss of customers of 1% as well. Total cost of all programs and services (including depreciation) increased by \$208,845 (2%). Interest expense decreased by \$12,503, due in large part to the refinancing of bonds in 2012 at lower interest rates. This trend is expected to remain approximately the same through the next fiscal year end.

Financial Analysis of the District's Proprietary Fund

At year-end, the District's proprietary fund reported total net assets of \$74,121,991, which is an increase of \$319,539 from last year.

Capital Assets

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

Debt/Advances in Construction

At year-end, the District had various bond/notes payables to various lenders with a combined remaining principal balance of \$11,223,076 to be paid from utility revenues.

As of December 31, 2017, the District received advances for construction towards projects not completed in the amount of \$3,214,134. During 2017, various construction projects were completed allowing the advances for construction from the prior year in the amount of \$2,778,101 to be transferred to capital contributions from government grants.

MANAGEMENT'S DISCUSSION AND ANALYSIS
ANNUAL FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017
(CONTINUED)

Contacting the District's Financial Management

This financial report is designed to provide our customers, creditors, and other users with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Treasurer, at the Mountain Water District, P. O. Box 3157, Pikeville, KY41502, telephone number (606) 631-9162.

MOUNTAIN WATER DISTRICT
STATEMENT OF FINANCIAL POSITION
December 31, 2017
(with prior year data for comparison purposes only)

	2017	2016
ASSETS		
<u>CURRENT ASSETS</u>		
Cash and Cash Equivalents	\$ 579,614	\$ 570,549
Accounts Receivable (Net of Allowance for Delinquencies of \$44,000 in 2017 and \$43,000 in 2016)	1,239,098	1,413,077
Prepaid Expenses	36,651	14,322
Inventory	186,473	185,656
TOTAL CURENT ASSETS	2,041,836	2,183,604
<u>NONCURRENT ASSETS</u>		
Restricted Cash		
Cash-Depreciation Reserve	851,428	881,412
Cash-Construction	286,943	350,548
Cash-Customer Deposits	354,301	338,760
Cash-Recycling Account	3,589	2,096
Cash-Operation and Maintence Reserve	99,441	16,583
Cash-Wastewater Operation and Maintenance Reserve	867,267	866,399
Cash-Sinking Fund	629,224	571,601
TOTAL RESTRICTED CASH	3,092,193	3,027,399
Capital Assets		
Supply & Pumping	3,566,550	3,566,550
Water Treatment Equipment	12,748,517	11,278,705
Transmission & Distribution	88,971,553	87,012,032
General Plant	4,176,767	4,176,767
Land and Land Rights	559,455	553,267
Sewer Utility Plant	29,368,099	29,368,099
Sewer General Plant	725,012	725,012
Total Capital Assets	140,115,953	136,680,432
Less: Accumulated Depreciation	(58,317,342)	(54,433,806)
Net Capital Assets	81,798,611	82,246,626
Construction in Progress	6,214,134	5,771,746
OTHER ASSETS		
Deposit on Leased Vehicles	625	625
FEMA receivable	122,546	92,798
Rate Case Cost- Net of Amortization	47,758	105,098
TOTAL OTHER ASSETS	170,929	198,521
TOTAL NONCURRENT ASSETS	91,275,867	91,244,292
TOTAL ASSETS	\$ 93,317,703	\$ 93,427,896
<u>DEFERRED OUT FLOW OF RESOURCES</u>		
Deferred Pension Contributions	\$ 3,236,797	\$ 190,569

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF FINANCIAL POSITION (CONTINUED)
,December 31, 2017
(with prior year data for comparison purposes only)

	<u>2017</u>	<u>2016</u>
<u>LIABILITIES</u>		
<u>CURRENT LIABILITIES</u>		
Accounts Payable Trade	\$ 116,327	\$ 184,500
Accounts Payable UMG, Current	-	1,246,932
Other Accrued Liabilities	94,201	64,724
Accrued Interest	154,305	156,481
Customer Deposits	338,260	321,041
Line of Credit	134,943	225,613
Bonds Payable, Current	73,000	69,000
Notes Payable and Capital Leases, Current	<u>1,084,029</u>	<u>1,092,233</u>
TOTAL CURRENT LIABILITIES	1,995,065	3,360,524
<u>LONG-TERM LIABILITIES</u>		
Bonds Payable, Long-Term	3,577,500	3,651,500
Notes Payable and Capital		
Net Pension Liability	4,126,991	242,159
Leases, Long-Term	6,353,604	7,004,500
Advances For Construction	6,071,937	5,632,615
Less - Deferred Financing Cost	<u>(74,241)</u>	<u>(77,681)</u>
TOTAL LONG-TERM LIABILITIES	20,055,791	16,453,093
<u>TOTAL LIABILITIES</u>	<u>22,050,856</u>	<u>19,813,617</u>
<u>DEFERRED INFLOWS OF RESOURCES</u>		
Deferred Pension Investment Earnings	381,835	2,396
NET POSITION		
Invested in Capital Assets, Net of Related Debt	70,710,478	70,429,393
Restricted for:		
Construction	286,943	350,548
Depreciation, Maintenance and Replacement- Capital Assets	2,077,782	2,051,461
Customer Deposits	29,747	17,719
Unrestricted (Deficit)	<u>1,016,859</u>	<u>953,331</u>
<u>TOTAL NET POSITION</u>	<u>74,121,809</u>	<u>73,802,452</u>

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
 FOR THE YEAR ENDED DECEMBER 31, 2017
 (With prior year data for comparison purposes only)

	<u>2017</u>	<u>2016</u>
<u>OPERATING REVENUE</u>		
Metered Sales-Residential	\$7,224,799	\$7,672,034
Metered Sales-Commercial	603,748	625,572
Sewage Revenue	1,721,969	1,331,787
Metered Sales-Multi-Family	338,742	356,014
Metered Sales-Public Authorities	305,446	297,278
Customer Late Payment Charges	247,711	254,949
Other Water Service Revenue	173,045	170,411
Service Connection Fees	133,932	145,876
Metered Sales-Industrial	65,997	82,157
Fire Protection Revenue	<u>1,100</u>	<u>1,000</u>
<u>TOTAL OPERATING REVENUE</u>	10,816,489	10,937,078
<u>OPERATING EXPENSES</u>		
Contract Service-Management	-	4,105,790
Depreciation	3,883,536	3,843,906
Water Purchased	1,159,604	498,554
Material and Supplies	569,453	441,179
Wages	2,063,742	888,058
Contract Service-Accounting	90,730	82,459
Education, Dues and Meetings	67,258	63,977
Employee Benefits	609,829	274,958
Contract Service-Legal Engineering	131,550	168,028
Taxes & Licenses	-	17,541
Payroll Taxes	128,700	68,708
Retirement Expense	239,476	46,989
Settlement Fees	580	4,500
Sewage fees	128,588	37,415
Rate Study Expense	-	33,267
Repairs and Maintenance	1,009,582	339,591
Utilities	1,324,396	561,049
Telephone Expense	48,212	18,333
Bad debts	141,170	-
Advertising	6,553	6,243
Amortization Expense	<u>60,781</u>	<u>60,781</u>
<u>TOTAL OPERATING EXPENSE</u>	<u>11,663,740</u>	<u>11,561,326</u>
<u>OPERATING LOSS</u>	<u>(847,251)</u>	<u>(624,248)</u>
<u>NON-OPERATING REVENUE (EXPENSES)</u>		
Gain On Sale of Assets	-	-
Interest Income	4,816	3,161
Interest Expense	<u>(388,054)</u>	<u>(400,557)</u>
<u>TOTAL NON-OPERATING REVENUE (EXPENSES)</u>	<u>(383,238)</u>	<u>(397,396)</u>
<u>LOSS BEFORE CAPITAL CONTRIBUTIONS AND OTHER CHANGES IN NET POSITION</u>	<u>(\$1,230,489)</u>	<u>(\$1,021,644)</u>

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION (CONTINUED)
 FOR THE YEAR ENDED DECEMBER 31, 2017
 (With prior year data for comparison purposes only)

	2017	2016
<u>CAPITAL CONTRIBUTIONS AND OTHER CHANGES</u>		
<u>IN NET ASSETS</u>		
Capital Contributions from:		
Government and State Grants	\$2,774,101	\$669,102
Customers through Tap-on Fees	222,424	78,598
<u>TOTAL CAPITAL CONTRIBUTIONS AND</u>		
<u>OTHER CHANGES IN NET POSITION</u>	2,996,525	747,700
<u>CHANGE IN NET POSITION</u>	1,766,036	(273,944)
<u>NET POSITION, BEGINNING OF YEAR</u>	72,355,955	74,076,396
SEE NOTE 3 PG 21		
<u>NET POSITION, END OF YEAR</u>	\$ 74,121,991	\$ 73,802,452

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017
(with prior year data for comparison purposes only)

	2017	2016
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Receipts from Customers	\$10,991,468	\$10,824,090
Payment to Suppliers	(5,086,126)	(5,861,950)
Payment to Employees	(3,942,253)	(1,278,633)
<u>NET CASH PROVIDED BY OPERATING ACTIVITIES</u>	1,963,089	3,683,507
<u>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</u>		
(Decrease) In Customer Deposits	(15,541)	(7,632)
<u>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</u>		
Proceeds From Tap-On Fees	222,424	78,598
Payments for rate increase		
Government Grants	2,774,101	669,102
Advances for Construction	439,322	1,636,255
Purchases of Equipment	(3,435,521)	(1,284,707)
Construction in Progress	(442,388)	(1,800,805)
Principal Payments	(977,213)	(737,137)
Interest Payments	(390,230)	(395,033)
Notes Payable Bonds & UMG	(69,000)	(1,226,333)
Proceeds from Sale of Vehicles	-	-
<u>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</u>	(1,878,505)	(3,060,060)
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Interest Income	4,816	3,161
<u>NET INCREASE IN CASH AND EQUIVALENTS AND RESTRICTED CASH</u>	73,859	618,976
<u>CASH AND CASH EQUIVALENTS AND RESTRICTED CASH, BEGINNING OF YEAR</u>		
	3,597,948	2,978,972
<u>CASH AND CASH EQUIVALENTS AND RESTRICTED CASH, END OF YEAR</u>		
	\$ 3,671,807	\$ 3,597,948

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017
(with prior year date for comparison purposes only)
"Continued"

	2017	2016
<u>RECONCILIATION OF OPERATING LOSS</u>		
<u>TO NET CASH PROVIDED BY</u>		
<u>OPERATING ACTIVITIES</u>		
Operating Loss	\$ (847,251)	\$ (624,248)
Adjustments to Reconcile Operating Loss to Net Cash Provided by Operating Activities		
Depreciation	3,883,536	3,843,906
Amortization	60,781	60,781
Increase (Decrease) in Provision for Uncollectible Accounts	1,000	3,000
Decrease (Increase) In:		
Customer Accounts Receivable	173,979	(112,988)
Other Accounts Receivable	-	446,334
Prepaid Expenses	(22,329)	(14,322)
Inventory	(817)	(185,656)
Increase (Decrease) In:		
Accounts Payable Trade	(68,173)	65,491
Other Accrued Liabilities	(1,217,637)	201,209
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 1,963,089	\$ 3,683,507
 NON-CASH CAPITAL AND RELATED FINANCINGS ACTIVITIES		
During the period the District purchased Vehicles in exchange for long term debt.	\$ 108,349	\$ 129,266
During the period the District completed certain construction projects that were transferred to capital assets.	\$ 3,071,306	\$ 989,473
Gain on Sale of Assets	\$ -	\$ -

See Accompanying notes to the basic financial statements

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The following is a summary of the more significant policies:

A. Organization

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

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

B. Reporting Entity

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

C. Basis of Presentation-Funds Accounting

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

Proprietary Funds/Enterprises Funds

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

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Basis of Accounting

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

E. Encumbrance Accounting

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

F. Customer Accounts Receivable

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

G. Capital Assets

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

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

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

H. Cash and Cash Equivalents

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

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

Petty Cash	\$ 320
Cash in Bank	579,294
Restricted Cash	<u>3,092,193</u>
Total	<u>\$ 3,671,807</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

I. Bad Debts

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

J. Inventory

Inventory is valued at lower of cost or market on a First-In, First-Out Basis. The management service company took over ownership of the inventory and its maintenance until the contract with them is completed July 2016. December 31, 2017 and 2016 inventory balances were \$186,473 and 185,656 respectively.

K. Investment Policy

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

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

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

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

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

As of December 31, 2017 and 2016, the accrued liability for vacation leave was -0- and -0-, respectively.

M. Advertising

The District expenses advertising costs as incurred. Total advertising costs charged to expense for the years ended December 31, 2017 and 2016 are \$6,553 and \$6,243, respectively.

N. Net Position Classifications

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

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

N. Accounting Policy for Loan Cost

Comparative loan costs are amortized on the straight line method over the remaining life of the loan and A direct deduction from the carrying amount of the debt liability. Amortization for 2017 and 2016 was \$3,441 and charged to amortization expense. Original Deferred Financial Cost \$92,316 both years.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. EMPLOYEE RETIREMENT SYSTEMS

The District's employees are provided a pension plan through the County Employees Retirement System.

General information about the County Employees Retirement System Non-Hazardous ("CERS") Plan Description-CERS is a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement Systems, an agency of the Commonwealth of Kentucky. Under the provisions of the Kentucky Revised Statute ("KRS") Section 61.645, the Board of Trustees of the Kentucky Retirement System administers CERS and has authority to establish and amend benefit provisions. The Kentucky Retirement Systems issues a public available financial report that includes financial statements and required supplementary information for CERS. That report may be obtained from <http://kyret.ky.gov/>.

Benefits provided – CERS provides retirement, health insurance, death and disability benefits to Plan employees and beneficiaries. Employees are vested in the plan after five years' service. For retirement purposes, employees are grouped into three tiers, based on hire date:

Tier 1	Participation date	Before September 1, 2008
	Unreduced retirement	27 years' service or 65 years old
	Reduced retirement	At least 5 years' service and 55 years old At least 25 years' service and any age
Tier 2	Participation date	September 1, 2008 – December 31, 2013
	Unreduced retirement	At least 5 years' service and 65 years old Or age 57+ and sum of service years plus age equal 87
	Reduced retirement	At least 10 years' service and 60 years old
Tier 3	Participation date	After December 31, 2013
	Unreduced retirement	At least 5 years' service and 65 years old Or age 57+ and sum of service years plus age equal 87
	Reduced retirement	Not available

Cost of living adjustments are provided at the discretion of the General Assembly. Retirement is based on a factor of the number of years' service and hire date multiplied by the average highest five years' earnings. Reduced benefits are based on factors of both of these components. Participating employees become eligible to receive the health insurance benefit after at least 180 months of service. Death benefits are provided for both death after retirement and death prior to retirement. Death benefits after retirement are \$5,000 in lump sum. Five years' service is required for death benefits prior to retirement and the employee must have suffered a duty – related death. The decedent's beneficiaries will receive the higher of the normal death benefit and \$10,000 plus 25% of the decedent's monthly final rate of pay and any dependent child will receive 10% of the decedent's monthly final rate of pay up to 40% for all dependent children. Five years' service is required for nonservice-related disability benefits.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2.) EMPLOYEE RETIREMENT SYSTEM (Continued)

Contributions – Required Contributions by the employee are based on the tier:

	<u>Required contributions</u>
Tier 1	5%
Tier 2	5% + 1% for insurance
Tier 3	5% + 1% for insurance

Non-hazardous covered employees are required to contribute 5 percent of their salary to the Plan. The District's contribution rate for non-hazardous employees was 19.18 percent.

The District's payroll for the year ended December 31, 2017 was \$1,965,659. The payroll for employees covered under CERS was \$1,965,659. The contributions required for CERS for the year was \$484,962 which consisted of \$372,135 of District contributions and \$98,283 of employee contributions and \$14,544 health.

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

CERS issues a standalone financial report, which may be obtained from Kentucky Retirements Systems, 120 Louisville Road, Frankfort Kentucky, 40601, or by calling (502) 564-4646 or at <https://kyret.ky.gov>.

FISCAL YEAR <u>FUNDING</u>	ANNUAL PENSION COST <u>(APC)</u>
12/31/15	\$20,562
12/31/16	\$20,562
12/31/17	\$239,476

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

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

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. EMPLOYEE RETIREMENT SYSTEM (Continued)

As of December 31, 2017 Mountain Water District reported a liability of \$4,126,991 for its proportionate share of the net pension liability. The net pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

Mountain Water District proportion of the net pension liability was based on a projection of Mountain Water District's long term share of contributions of all to the pension relative to the projected contributions of all participating organizations, actuarially determined. At December 31, 2017, Mountain Water District proportion was 0.070507%.

At December 31, 2017 Mountain Water District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
<u>Nonhazardous</u>		
Difference between Expected and Actual experience	\$ 5,119	\$
Change in Assumption	761,542	
Net difference between projected and Actual earnings on investment	326,853	
Difference between paid and District computed proportionate share	1,960,622	
Deferred pension investment earnings District contributions subsequent to The measurement date	<u>182,661</u>	381,835
Total	<u>\$ 3,236,797</u>	<u>\$ 381,835</u>

The amounts of \$182,661 and \$153,919 reported as deferred outflows of resources related to pension resulting from District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the years ended December 31, 2017 and 2016. Amounts reported as deferred inflow and outflows resources due to the net difference projected and recognized in d actual investment earnings on pension plan investments will be netted over five years and recognized in pension expense. Amounts reported as deferred outflows of resources due to the difference between expected and actual experience, change of assumptions, and changes in proportion and differences between employer contributions and proportionate share of contributions will be amortized and recognized in pension expense over the expected remaining service lives of all employees. Total amortization to be recognized in pension expense is presented below as follows:

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. EMPLOYEE RETIREMENT SYSTEM (Continued)

Year Ended December 31, 2017	Increase (Decrease) to Pension Expense
2018	\$ 1,098,742
2019	1,095,983
2020	530,569
2021	(52,993)

Actuarial assumption – The total pension liability in the June 30 2017 and 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the investments:

Inflation	3.25 percent both years
Salary increases	4.0 percent, average, including inflation both years
Investment rate –	
Of return	7.5 percent 2017 and 6.75 percent 2016, net of pension plan investments Expense, including inflation

For the June 30, 2017 and 2016 valuations, the mortality table used for active members is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% of males and 30% for females). For healthy retired members and beneficiaries, the mortality table is the RP-2000 Combined Mortality Table projected with the Scale BB to 2013 (set back 1 years 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 retirement.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years. The most recent analysis performed for the period covering fiscal years 2008 through 2013 is outlined in a report dated December 3, 2015. The period analysis used for the June 30, 2015 audit system, was performed for the period covering fiscal years 2005 through 2008, and is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term rate of 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 weighing the expected future real rates of return by the target asset allocation percentage and by then adding expected inflation. The capital market assumptions developed by the investment consultants 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 assets 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 arithmetical real rates of return for each major assets class are summarized in the following tables.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

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

Measurement Period 2017 <u>Asset Class</u>	Target <u>Allocation</u>	Long Term Nominal Rate <u>of Return</u>
US Equity	17.5%	5.97%
International Equity	17.5%	7.85%
Global Bonds	4%	2.63%
Global Credit	2%	3.63%
High Yield	7%	5.75%
Emerging Market Debt	5%	5.50%
Private Credit	10%	8.75%
Real Return (Diversified Inflation strategies)	10%	6.13%
Absolute Return (Diversified Hedge Funds)	10%	5.63%
Private Equity	10%	5.63%
Cash + Equivalent	<u>2%</u>	1.88%
Total	100%	

Measurement Period 2016 <u>Asset Class</u>	Target <u>Allocation</u>	Long Term Nominal Rate <u>of Return</u>
Combined Equity	44%	5.40%
Combined Fixed Income	19%	1.50%
Real Return (Diversified Inflation Strategies)	10%	3.50%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.50%
Real Estate	5%	4.50%
Cash + Equivalent	<u>2%</u>	-0.25%
Total	100%	

Discount rate – For CERS, the discount rate used to measure the total pension liability was 7.5% for 2017 and 7.5% for 2016. The projection of cash flows used to determine the discount rate assumed that contributions from plan employees and employers will be made at statutory contribution rates. Projected inflows from investment earning were calculated using the long-term assumed investment return of 7.5% for 2017 and 7.5% for 2016. The Long-term investment rate of return was applied to all periods of projected benefit payment to determine the total pension liability.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. EMPLOYEE RETIREMENT SYSTEM (Continued)

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

2017	1% Decrease <u>(6.50%)</u>	Discount Rate <u>(7.50%)</u>	Current 1% Increase <u>(8.50%)</u>
Mountain Water District Share Of the net pension liability	<u>\$ 5,205,028</u>	<u>\$ 4,126,991</u>	<u>\$ 3,225,222</u>
2016	1% Decrease <u>(6.50%)</u>	Discount Rate <u>(7.50%)</u>	Current 1% Increase <u>(8.50%)</u>
Mountain Water District Share Of the net pension liability	<u>\$ 309,162</u>	<u>\$ 242,159</u>	<u>\$ 184,800</u>

3. CORRECTION OF NET POSITION FOR PROPRIETARY FUNDS

The beginning Net Position of the Public Utility has been restated to record prior period adjustment to implement GASB 68 to include all eligible employees.

	Unrestricted Net Assets (Deficit)
Net Position as Previously Reported December 31, 2016	\$ 953,331
Implementation GASB 68 all eligible employees:	
CERS Net Pension Liability Measurement Date as of June 30, 2017	(3,884,832)
Deferred Outflows resources	2,817,774
Deferred Pension Investment Earning	(379,439)
Beginning Net Position, As restated December 31, 2016	<u>\$ (493,166)</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

4. CUSTOMER DEPOSIT FUND

Deposits required from customers when they sign up for the water service are deposited into the customer deposit escrow account. When services are terminated or a customer has paid in a timely fashion, a refund of the deposit plus interest is given after a year of water service. Customer deposits as of December 31, 2017 and December 31, 2016 were \$338,260 and \$321,041, respectively, and are currently held in escrow.

5. COMMITMENTS AND CONTINGENCIES

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

6. RECLASSIFICATIONS

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

7. SUBSEQUENT EVENTS

In preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through August 26, 2018 the date the financial statements were available to be issued

8. RESTRICTED ASSETS AND RESERVE NET ASSETS

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

9. DEPOSITS WITH FINANCIAL INSTITUTIONS

At December 31, 2017, the carrying amount of the District's deposits with financial institutions was \$3,671,807 and the bank balance, per statements was \$4,144,008. The Bank balance is collateralized as follows:

Amount insured by FDIC	\$ 750,000
Amount collateralized by securities held by third party trust company in the District's name	<u>4,027,722</u>
<u>Total Bank Balance</u>	<u>\$ 4,777,722</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

9. DEPOSITS WITH FINANCIAL INSTITUTIONS (Continued)

Pledged collateral was obtained for amounts up to \$3,166,658 for money on deposit at Community Trust Bank in the name of the District. Pledged collateral was obtained for accounts up to \$861,064 for money on deposit with BB&T and Community Trust Bank in the name of the District.

10. CAPITAL ASSETS

The following is a summary of changes in fixed asset:

Description	Balance			Balance
	January 1, <u>2017</u>	<u>Additions</u>	<u>Dispositions</u>	December 31, <u>2017</u>
Supply & Pumping	\$3,566,550	\$ -0-	\$ -0-	\$3,566,550
Water Treatment Equipment	11,278,705	1,469,812	-0-	12,748,517
Transmission & Distribution	87,012,032	1,959,521	-0-	88,971,553
General Plant	4,176,767	-0-	-0-	4,176,767
Land and Land Rights	553,267	6,188	-0-	559,455
Sewer Utility Plant	29,368,099	-0-	-0-	29,368,099
Sewer General Plant	<u>725,012</u>	<u>-0-</u>	<u>-0-</u>	<u>725,012</u>
Totals	136,680,432	3,435,521	-0-	140,115,953
Accumulated Depreciation	<u>(54,433,806)</u>	<u>(3,883,536)</u>	<u>-0-</u>	<u>(58,317,342)</u>
Net Utility Plant	<u>\$82,246,626</u>	<u>\$ (448,015)</u>	<u>\$ -0-</u>	<u>\$81,798,611</u>
	January 1,			December 31,
Description	<u>2016</u>	<u>Additions</u>	<u>Dispositions</u>	<u>2016</u>
Supply & Pumping	\$3,547,281	\$ 19,269	\$ -0-	\$3,566,550
Water Treatment Equipment	11,261,985	16,720	-0-	11,278,705
Transmission & Distribution	85,807,060	1,204,972	-0-	87,012,032
General Plant	4,176,916	-0-	149	4,176,767
Land and Land Rights	549,443	3,824	-0-	553,267
Sewer Utility Plant	29,345,539	22,560	-0-	29,368,099
Sewer General Plant	<u>707,650</u>	<u>17,362</u>	<u>-0-</u>	<u>725,012</u>
Totals	135,385,874	1,284,707	149	136,680,432
Accumulated Depreciation	<u>(50,590,049)</u>	<u>(3,843,906)</u>	<u>149</u>	<u>(54,433,806)</u>
Net Utility Plant	<u>\$84,805,825</u>	<u>\$(2,559,199)</u>	<u>\$ -0-</u>	<u>\$82,246,626</u>

Depreciation expense was \$3,883,536 and \$3,843,906 for the years ended December 31, 2017 and 2016, respectively.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

11. CONSTRUCTION FUNDS

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

	<u>2017</u>	<u>2016</u>
Big Creek Sewer Coal Settlement	\$5,401	\$ 5,401
John Creek Project	3,341	-0-
District Wide Tap Fees	45,562	33,473
Misc. Line Extensions	40,183	118,391
MWD Special Projects	772	940
Penny Road Water and Sewer	-0-	3,158
Cowpen Waste Water Project	1,860	1,860
Elk Creek Project	5,372	2,272
Water Treatment Plant Upgrade	1	1
Water Treatment Raw Water Intake	25	25
LMI Service Contract	656	656
Various Short Line Extensions	191	191
Telemetry Project	100	100
Watson Hill Water Line	85	85
Long Fork Virgie Sewer Project	100	100
Belfry Pond Sewer Project	100	100
Smith Fork Waste Water Phase II	100	100
Pike County Fiscal Court Projects	135,903	158,566
Repair and Maintenance Reimbursement	18,761	435
MWD Rehabilitation Project	5,160	5,160
Sewer Customer Deposit	<u>23,300</u>	<u>19,534</u>
Total Construction Funds	<u>\$ 286,943</u>	<u>\$ 350,548</u>

12 RESTRICTED ASSETS AND RESERVE NET ASSETS

As of December 31, 2017 and 2016 restricted cash were as follows:

	<u>2017</u>	<u>2016</u>
Depreciation Reserve	\$ 851,428	\$ 881,412
Sinking Fund	629,224	571,601
Customer Deposit Escrow Account	354,301	338,760
Operation & Maintenance reserve	99,441	16,583
Waste Water O & M Reserve	867,267	866,399
Recycling Account	3,589	2,096
Construction Account	<u>286,943</u>	<u>350,548</u>
Total Restricted Cash	<u>\$3,092,193</u>	<u>\$3,027,399</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

12. RESTRICTED ASSETS AND RESERVE NET ASSETS Continued)

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

	Maximum Required Balance	Required Balance at <u>12/31/17</u>	Actual Balance At <u>12/31/17</u>
Depreciation Reserve Funds	\$851,400	\$ 844,440	\$ 851,428
Repairs and Maintenance Funds	866,168	<u>860,543</u>	<u>966,708</u>
Total		<u>\$1,704,983</u>	<u>\$1,818,136</u>

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

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

The USDA-Rural Development (RD) loan agreements also include a requirement for an Operation and Maintenance Fund. The funding of this reserve is secondary to the Depreciation Reserve Funds. Mountain Water's management stated during the field work that there is verbal agreement to transfer \$6,000 monthly O & M reserve to Rural Development Reserves until equal to 6 month's revenue. These payments were transferred during 2017.

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

13. CONSTRUCTION IN PROGRESS

Mountain Water District has overseen several construction projects. As of December 31, 2017 and 2016, the following projects were in progress.

	<u>2017</u>	<u>2016</u>
<u>Water Projects</u>		
FEMA Mitigation Project	\$ -0-	\$ 958,438
Tank Rehab Southern Corrosion	90,100	57,582
Jonican	908,105	908,105
Bad Fork	-0-	-0-
Pompey	1,634,002	824,140
Majesterial District 2	8,299	8,298
Various In House Projects	657,230	1,950,453
<u>Sewer Projects</u>		
Phelps/Buskirk	67,038	67,038
Residential Grinder Replacement	224,549	-0-
Henry Clay	138,708	138,708
Belfry Pond Sewer	732,774	690,454
Douglas	<u>1,753,329</u>	<u>168,530</u>
<u>Total Construction in Progress</u>	<u>\$ 6,214,134</u>	<u>\$ 5,771,746</u>

14. BONDS PAYABLE

	<u>2017</u>	<u>2016</u>
Shelby Waste Water Project Fund		
The 4.125% sewer system revenue bonds issued July 22, 2005 in the original amount of \$740,000 are payable to USDA-Rural Development to the year 2045. The bonds are secured by a statutory mortgage lien on the utility plant service and a pledge of all water revenues from the system	\$633,500	\$645,500
Phelps Waste Water Project Bond		
The 4.5% sewer system revenue bonds issued October 23, 2003 in the original amount of \$426,000 are payable to USDA-Rural Development to the year 2043. The bonds are secured by a statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system.	357,000	364,000

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

14 BONDS PAYABLE (Continued)

	<u>2017</u>	<u>2016</u>
Feds Creek Project		
The 3.5% revenue bonds issued July 2002 in the original amount of \$800,000 are payable to USDA-Rural Development to the year 2035. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system.	\$626,000	\$642,000
Johns Creek		
The 4.125% revenue bonds issued November 2005 in the original amount of \$1,650,000 are payable to USDA-Rural Development to the year 2027. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and a pledge of all water revenues from the system.	1,439,000	1,465,000
Russell Fork Water Plant Project		
The 4.5% revenue bonds issued April 2009 in the original amount of \$650,000 are payable to USDA-Rural Development to the year 2047. The bonds are secured by a secondary statutory mortgage lien on the utility plant in service and pledge of all water revenue from the system.	<u>\$ 595,000</u>	<u>\$ 604,000</u>
Total bonds	\$3,650,500	\$ 3,720,500
Less current portion	<u>(73,000)</u>	<u>(69,000)</u>
Long Term Bonds Payable	<u>\$3,577,500</u>	<u>\$3,351,500</u>

Maturities of these long-term bonds are as follows:

<u>December 31</u>	<u>Principal</u>	<u>Interest</u>
2018	73,000	147,461
2019	76,000	144,494
2020	78,500	141,293
2021	82,000	138,491
2022	86,000	135,423
2023-2027	503,500	623,328
2028-2032	595,000	538,321
2033-2037	731,500	399,175
2038-2042	852,500	246,262
2043-2047	538,500	72,796
2048-2052	<u>34,000</u>	<u>8,000</u>
	<u>\$3,650,500</u>	<u>\$2,595,044</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENT
DECEMBER 31, 2017 AND 2016

14 NOTES PAYABLE AND CAPITAL LEASES

	<u>2017</u>	<u>2016</u>
<p>Kentucky Rural Water Finance Corporation The 3.14% note issued August 2012 120 the original amount of \$6,270,000, payable in monthly installments, with payments through August 2039, secured by water revenues from the system.</p>	\$ 4,675,000	\$ 5,040,000
<p>Kentucky Infrastructure Authority-Multi-Area The 2.9% note issued June 1994 in the original Amount of \$5,165,093, payable in semi-annual Installments of \$129,479, with payments through the year 2023, secured by water revenues from the system.</p>	1,416,706	1,629,931
<p>Kentucky Infrastructure Authority-Indian Creek The 3% note issued June 1994 in the original amount of \$377,760, payable in semi-annual installments of \$8,577, with payments though the year 2023, secured by water revenue from the system.</p>	93,553	107,583
<p>Kentucky Infrastructure Authority-F01-07 The 1.8% note issued January 2002 in the original amount of \$1,197,072 payable in semi-annual of \$35,769, with payments through the year 20024 secured by water revenues from the system.</p>	436,977	499,800
<p>Kentucky Infrastructure Authority A03-06 The 1% note issued June 2004 in the original Amount of \$226,776, payable in semi-annual Installments of \$6,846 with payments through the year 2023, secured by water revenues from the system.</p>	68,873	78,325
<p>Kentucky Infrastructure Authority A209-32 The 1% note issued January 2010 in the original amount of \$750,000 with \$390,750 in principle forgiveness, payable in semi-annual installments of \$5,212, with payments through the year 2031, secured by water revenues from the system.</p>	255,781	273,393

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

14 NOTES PAYABLE AND CAPITAL LEASES (Continued)

	<u>2017</u>	<u>2016</u>
<u>US Bank</u> Loan to finance rate study, original balance \$149,956 at 2.9% interest; payments are \$6,441 for 24 months, maturing December 2017.	\$ 6,421	\$ 83,321
<u>Community Trust Bank</u> A purchase agreement, original balance \$29,128 at 4.0% interest, secured by vehicle; payments are \$660 for 48 months, maturing April 2020.	17,000	24,078
<u>US Bank</u> A purchase agreement, original balance \$26,853 at 3.0% interest, secured by vehicle; payments are \$568 for 25 months, maturing July 2018.	16,400	23,119
<u>Community Trust Bank</u> A purchase agreement, original balance \$22,111 at 4.0% interest, secured by vehicle; payments are \$500 for 48 months, maturing September 2020	15,578	20,830
<u>Community Trust Bank</u> A purchase agreement, original balance \$22,111 at 4.0% interest, secured by vehicle; payments are \$500 for 48 months, maturing September 2020	15,578	20,830
<u>US Bank</u> Loan to finance Big Fork Project, original balance \$272,145 at 3.1% interest; payments are \$4,153 beginning June 26, 2016 for 24 months, maturing December 2017	175,623	219,191
<u>Community Trust Bank</u> A lease purchase agreement, original balance \$34,625; at 3.99% interest; secured by a vehicle; payments are \$638 for 23 months and a final Balloon payment of \$22,246, maturing April 2017.	-0-	2,472
<u>Community Trust Bank</u> A lease purchase agreement, original balance \$29,119; at 2.01% interest; secured by a vehicle; payments are \$658 for 48 months and a final maturing June 2020.	10,853	18,145

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENT
DECEMBER 31, 2017 AND 2016

14 NOTES PAYABLE AND CAPITAL LEASES (Continued)

	<u>2017</u>	<u>2016</u>
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,772; at 3.035% interest; secured by a vehicle; payments are \$460 for 48 months and a final Balloon payment of \$22,246, maturing June 2018.	\$ 2,735	\$ 8,085
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$27,256; at 3.99% interest; secured by vehicle; payments are \$503 for 23 months with a final balloon payment of \$17,511, maturing May 2017.	-0-	2,468
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,772; at 3.035% interest; secured by a vehicle; payments are \$460 for 48 months and a final balloon payment of \$22,246, maturing June 2018.	2,734	8,085
<u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,772; at 3.035% interest; secured by a vehicle; payments are \$460 for 48 months and a final balloon payment of \$22,246, maturing June 2018.	2,734	8,085
<u>US BANK</u>		
A lease purchase agreement, original balance \$33,789; at 3.853% interest; secured by a vehicle; payments are \$761 for 28 months, maturing 2021.	31,826	-0-
<u>US BANK</u>		
A lease purchase agreement, original balance \$22,814; at 3.8% interest; secured by a vehicle; payments are \$514 for 48 months maturing in 2021.	20,598	-0-

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

<u>14 NOTES PAYABLE AND CAPITAL LEASES (Continued)</u>	<u>2017</u>	<u>2016</u>
<u>Community Trust Bank</u>		
A purchase agreement, original balance \$30,198 at 4.051% interest, secured by vehicle; payments are \$683 for 48 months, maturing March 2020.	17,584	24,902
 <u>Community Trust Bank</u>		
Line of credit AEP currently at 3.75% Index rate maximum rate of 3.75% renews every August	-0-	2,750
 <u>Community Trust Bank</u>		
A purchase agreement, original balance \$28,897 at 4.18% interest, secured by vehicle; payments are \$655 for 48 months, maturing March 2021.	23,840	-0-
 <u>US BANK</u>		
A lease purchase agreement, original balance \$22,849; at 3.754% interest; secured by a vehicle; payments are \$513 for 48 months maturing in 2021.	20,178	-0-
 <u>Community Trust Bank</u>		
Line of credit, at 4.75% due upon demand	111,061	-0-
 <u>Community Trust Bank</u>		
A lease purchase agreement, original balance \$20,039; at 3.99% interest; secured by a vehicle; Payments are \$453 for 23 months with a final balloon payment of \$13,294, maturing May 2017.	-0-	2,340
Total Notes Payable and Capital Leases	7,437,633	8,096,733
Less current portion	<u>(1,084,029)</u>	<u>(1,092,233)</u>
Total Long-term Portion	<u>\$6,353,604</u>	<u>\$7,004,500</u>
Maturity of the notes payable and capital leases are as follows:		
	<u>Principal</u>	<u>Interest</u>
2018	829,721	87,978
2019	831,350	74,195
2020	763,523	59,920
2021	630,792	47,620
2022	581,167	36,097
2023-2027	1,696,267	83,705
2028-2032	1,097,916	41,171
2033-2037	684,167	15,780
2038-2042	<u>211,668</u>	<u>1,750</u>
	<u>\$7,326,571</u>	<u>\$448,216</u>

MOUNTAIN WATER DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

15 ADVANCES FOR CONSTRUCTION

	<u>2017</u>	<u>2016</u>
<u>Water Projects</u>		
In House Projects	\$ 629,030	\$ 2,021,424
Pompey	1,634,000	824,140
Booster Pump	-0-	829,820
Tank Rehabilitation		
Coal Severance	908,105	901,105
<u>Sewer Projects</u>		
Phelps Waste Water		
Kentucky Infrastructure Authority	57,110	57,110
Residential Grinders	224,549	-0-
Douglas WTP		
LGEDF Funds	1,748,338	163,530
Henry Clay Sewer Projects:		
COE Section 531	45,391	45,391
LGEDF Funds	92,640	92,640
Belfry Pond		
Coal Severance	<u>732,774</u>	<u>690,455</u>
<u>Total Advances for Construction</u>	<u>\$6,071,937</u>	<u>\$ 5,632,615</u>

16 MANAGEMENT SERVICE AGREEMENT

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

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

13. MANAGEMENT SERVICE AGREEMENT (Continued)

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

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

In July 2016 Mountain Water District Board effectively terminated the contracts with the management service company. An agreement was made for Mountain Water to pay the management service Company \$50,000 per month through March 2016 then \$100,000 monthly until the balance is paid off. As of the yearend of these financials the balances had been paid off.

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INDEPENDENT AUDITORS'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GAS

To the Board of Commissioners
Mountain Water District
Pikeville, KY

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in GAS issued by the Comptroller General of the United States, the financial statements of the business type activities of Mountain Water District as of and for the year December 31, 2017, and the related notes to the financial statements, which collectively comprise Mountain Water District's basic financial statements, and have issued my report thereon dated August 28, 2018.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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



Richard F. Paulmann, CPA, LLC.
Pewee Valley, KY
August 28, 2018