

**MERCER COUNTY SANITATION DISTRICT**  
**AUDITED FINANCIAL STATEMENTS**

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**JUNE 30, 2017**

**KERBAUGH, RODES & BUTLER, PLLC**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**DANVILLE, KENTUCKY**

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## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Mercer County Sanitation District  
Harrodsburg, Kentucky 40330

### Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Mercer County Sanitation District (the District) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District'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 District'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.

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the District as of June 30, 2017, and the changes in financial position, and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## Other Matters

### *Required Supplementary Information*

Management has omitted Management's Discussion and Analysis that accounting principles generally accepted in the United States of America requires 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 District's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The 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 expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

### *Prior Year Comparative Information*

We have previously audited the District's 2016 financial statements, and we expressed an unmodified opinion on the financial statements of the business-type activities in our report dated November 1, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2017, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting 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 the audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

*Kerbaugh, Rodes & Butler, PLLC*

Kerbaugh, Rodes & Butler, PLLC  
Certified Public Accountants

Danville, Kentucky  
November 30, 2017

MERCER COUNTY SANITATION DISTRICT  
STATEMENT OF NET POSITION  
JUNE 30, 2017  
(WITH COMPARATIVE TOTALS AS OF JUNE 30, 2016)

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
<u>ASSETS</u>		
Current Assets:		
Cash	\$ -	\$ 6,456
Receivables:		
Customers (Net of Allowance)	34,173	31,898
Grants	24,500	24,197
Prepaid Expenses	<u>1,212</u>	<u>1,842</u>
Total Current Assets	<u>59,885</u>	<u>64,393</u>
Non-current Assets:		
Restricted Cash	3,418,488	19,828
Restricted Certificate of Deposit	-	1,300
Property and Equipment:		
Distribution System	1,900,135	1,900,135
Flow Meters	40,598	40,598
Pump Stations	702,376	702,376
Equipment	90,146	90,146
Construction in Process	6,870,784	668,096
Less: Accumulated Depreciation	<u>(516,412)</u>	<u>(431,473)</u>
Net Property and Equipment	<u>9,087,627</u>	<u>2,969,878</u>
Total Assets	<u>\$ 12,566,000</u>	<u>\$ 3,055,399</u>

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

**MERCER COUNTY SANITATION DISTRICT  
STATEMENT OF NET POSITION  
JUNE 30, 2017  
(WITH COMPARATIVE TOTALS AS OF JUNE 30, 2016)**

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
<u>LIABILITIES</u>		
Current Liabilities:		
Cash Overdraft	\$ 1,310	\$ -
Accounts Payable	6,558	8,521
Accounts Payable - Contractors	679,114	25,746
Refundable Advance	10,000	10,000
Unearned Grant Revenue	2,567,627	-
Accrued Interest	26,434	8,170
Line of Credit	-	30,000
Bonds Payable - Current Portion	<u>9,000</u>	<u>6,000</u>
Total Current Liabilities	<u>3,300,043</u>	<u>88,437</u>
Non-Current Liabilities:		
Line of Credit	60,000	-
Bonds Payable	<u>4,486,500</u>	<u>622,500</u>
Total Non-Current Liabilities	<u>4,546,500</u>	<u>622,500</u>
Total Liabilities	<u>7,846,543</u>	<u>710,937</u>
<u>NET POSITION</u>		
Net Investment in Capital Assets	4,592,127	2,311,378
Restricted	169,813	11,409
Unrestricted	<u>(42,483)</u>	<u>21,675</u>
Total Net Position	<u>4,719,457</u>	<u>2,344,462</u>
Total Liabilities and Net Position	<u>\$ 12,566,000</u>	<u>\$ 3,055,399</u>

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

**MERCER COUNTY SANITATION DISTRICT**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**  
**FOR THE YEAR ENDED JUNE 30, 2017**  
**(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2016)**

	Year Ended	
	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Operating Revenue:		
Sewer Service	\$ 167,169	\$ 165,863
Mercer County Fiscal Court Contribution	<u>35,000</u>	<u>35,000</u>
Total Operating Revenue	202,169	200,863
Operating Expenses:		
Cost of Service	81,423	97,243
Commissioner Fees	10,500	10,800
Management Fees	34,167	25,000
Repairs & Maintenance	3,471	1,620
Legal & Professional	13,671	7,109
Insurance	9,895	8,156
Utilities	4,744	4,174
Miscellaneous	2,768	3,540
Depreciation	<u>84,939</u>	<u>78,566</u>
Total Operating Expenses	245,578	236,208
Operating Income (Loss)	(43,409)	(35,345)
Nonoperating Expenses:		
Interest Expense	<u>42,811</u>	<u>20,042</u>
Income (Loss) Before Capital Contributions	(86,220)	(55,387)
Capital Contributions:		
Rural Development Grant	2,325,581	155,277
Kentucky Infrastructure Authority Grant	129,674	216,103
Tap Fees	<u>5,960</u>	<u>10,944</u>
Total Capital Contributions	2,461,215	382,324
Change in Net Position	2,374,995	326,937
Net Position - Beginning of Year	<u>2,344,462</u>	<u>2,017,525</u>
Net Position - End of Year	<u>\$ 4,719,457</u>	<u>\$ 2,344,462</u>

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

**MERCER COUNTY SANITATION DISTRICT  
STATEMENT OF CHANGES IN NET POSITION  
FOR THE YEARS ENDED JUNE 30, 2017  
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2016)**

	Contributions In Aid Of Construction	Retained Earnings	Total
Balance at July 1, 2015	\$ 2,451,937	\$ (434,412)	\$ 2,017,525
Capital Contributions:			
Intergovernmental	371,380	-	371,380
Tap Fees	10,944	-	10,944
June 30, 2016 Net Income (Loss) Before Capital Contributions	-	(55,387)	(55,387)
Balance at June 30, 2016	2,834,261	(489,799)	2,344,462
Capital Contributions:			
Intergovernmental	2,455,255	-	2,455,255
Tap Fees	5,960	-	5,960
June 30, 2017 Net Income (Loss) Before Capital Contributions	-	(86,220)	(86,220)
Balance at June 30, 2017	\$ 5,295,476	\$ (576,019)	\$ 4,719,457

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

**MERCER COUNTY SANITATION DISTRICT  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2017  
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2016)**

	Year Ended	
	June 30, 2017	June 30, 2016
Cash Flows From Operating Activities:		
Receipts From Customers	\$ 164,894	\$ 161,948
Mercer County Fiscal Court Contribution	35,000	52,500
Payments to Suppliers	<u>(161,972)</u>	<u>(155,141)</u>
Net Cash Provided by (Used in) Operating Activities	<u>37,922</u>	<u>59,307</u>
Cash Flows From Capital and Related Financing Activities:		
Capital Contributions	2,460,913	456,174
Unearned Capital Grant Proceeds	2,567,627	-
Proceeds from Interim Financing	3,400,604	-
Repayment of Interim Financing	(3,400,604)	-
Principal Repayments on Capital Debt	(6,000)	(5,500)
Proceeds from Bond Issuance	3,873,000	-
Proceeds from Line of Credit	30,000	63,995
Principal Repayments on Line of Credit	-	(49,995)
Interest Payments on Capital Debt	(24,548)	(21,273)
Purchase of Fixed Assets/Construction in Progress	<u>(5,549,320)</u>	<u>(496,821)</u>
Net Cash Provided by (Used in) Financing Activities	<u>3,351,672</u>	<u>(53,420)</u>
Cash Flows From Investing Activities:		
Maturity of Certificate of Deposit	<u>1,300</u>	<u>-</u>
Net Increase (Decrease) in Cash	3,390,894	5,887
Cash at Beginning of Year	<u>26,284</u>	<u>20,397</u>
Cash at End of Year	<u>\$ 3,417,178</u>	<u>\$ 26,284</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities:		
Operating Income (Loss)	\$ (43,409)	\$ (35,345)
Depreciation	84,939	78,566
Decrease (Increase) in Accounts Receivable	(2,275)	(3,915)
Decrease (Increase) in Accounts Receivable-Government	-	17,500
Decrease (Increase) in Prepaid Expenses	630	(134)
Increase (Decrease) in Accounts Payable	<u>(1,963)</u>	<u>2,635</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 37,922</u>	<u>\$ 59,307</u>
Noncash Investing, Capital, and Financing Activities:		
Construction activity in accounts payable	\$ 679,114	\$ 25,746
Capital contributions in accounts receivable	24,500	24,197

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

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**1. GENERAL**

The Mercer County Sanitation District, (the "District") is a special-district governmental entity created on July 26, 2005, via ordinance enacted by the Mercer County Fiscal Court in accordance with KRS 67.715 (2) and 67.083 (3). The District is governed by a board consisting of three members, all of whom are appointed by the Mercer County Judge Executive. The District provides sewer services to certain rural sections of Mercer County.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- A. The District uses the accrual method of accounting which focuses on the measurement of net income similar to the approach used by commercial enterprises. Revenues are recorded when earned and expenses are recorded when incurred. The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's ongoing operations. The principal operating revenues of the utility are charges to customers for sewer service. Operating expenses include the cost of providing services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.
- B. Cash and investments include amounts in demand deposits and certificates of deposit only. For the purpose of the statement of cash flows, the District considers cash equivalents to be highly liquid investments (as applicable), including restricted assets, with an original maturity of three months or less when purchased.
- C. Receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. All receivables in excess of 90 days old comprise the accounts receivable allowance for uncollectibles (when applicable).
- D. Property and equipment are stated at cost, and are depreciated over the estimated useful life of the asset using the straight-line method of depreciation. Assets of the distribution system are being depreciated over a 33-year life and equipment over lives of 5 to 20 years. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Interest (as applicable) incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.
- E. Prepaid items include payments made to vendors that will benefit periods beyond the end of the fiscal year.
- F. Restricted assets represent cash and investments for which use is limited to specific construction projects or by bond covenants.
- G. 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.
- H. The District's financial statements classify equity as net position and is displayed in three components:
  - a) Net investment in capital assets – Consists of capital assets including restricted capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds, leases,

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

other borrowings, or payables that are attributable to the acquisition, construction, or improvement of those assets.

- b) Restricted net position – Consists of net position with constraints placed on the use either by 1) External groups such as creditors, grantors, contributors, or laws or regulations of other governments, and 2) Law through constitutional provisions or enabling legislation.
- c) Unrestricted net position – Consists of all other net position that does not meet the definition of “restricted” or “net investment in capital assets”.

I. When both restricted and unrestricted resources are available for use, it is the District’s policy to use restricted resources first, then unrestricted resources as they are needed.

J. The District has evaluated and considered the need to recognize or disclose subsequent events through November 30, 2017, which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the fiscal year ended June 30, 2017, have not been evaluated by the District.

**3. CASH AND INVESTMENTS**

Cash and investments are composed of the following as of June 30, 2017, with restriction for use noted:

Cash on Deposit - Operating Account	A	\$	(1,310)
Cash on Deposit - Construction	B		100
Cash on Deposit - Construction	B		3,223,955
Cash on Deposit - Construction	B		100
Cash on Deposit - Depreciation	C		3,400
Cash on Deposit - Debt Service	D		<u>190,933</u>
Total Cash and Investments		<u>\$</u>	<u>3,417,178</u>

In 2017, the United States Department of Agriculture inadvertently sent the entire amount of a Rural Development grant to the District, rather than the amount requested by the District. Farmer’s National Bank issued the District a letter of credit up to \$3.2 million to secure the excess cash received. The cash deposits at June 30, 2017 are insured by the FDIC or secured through the letter of credit with Farmer’s National Bank.

- (A) The operating account is used to meet the current expenses of operating and maintaining the system.
- (B) These construction accounts are used to account for various grant and loan receipts, and related capital expenditures for various projects funded by the grants and loans.
- (C) The depreciation account was established as required by Rural Development Agency bond covenants for the purpose of funding unusual or extraordinary repairs and maintenance not included in the annual budget or for paying for the cost of future extensions, additions and improvements to the system.
- (D) The debt service account was established as required by Rural Development Agency bond covenants for the purpose of paying the scheduled principal and interest on the District’s debt.

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**4. RECEIVABLES**

(A) Customer Accounts Receivable Aging at June 30, 2017:

Current	\$	32,602
30-59 Days		1,350
60-89 Days		334
		34,286
	\$	34,286

(B) Accounts Receivable is comprised of the following as of June 30, 2017:

Customers	\$	34,286
Intergovernmental		24,500
Allowance for Bad Debts		(113)
		58,673
	\$	58,673

All receivables 90 days and older are included in the allowance for uncollectible accounts.

**5. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2017 was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Distribution System	\$ 1,900,135	\$ -	\$ -	\$ 1,900,135
Flow Meters	40,598	-	-	40,598
Pump Stations	702,376	-	-	702,376
Equipment	90,146	-	-	90,146
Construction in Process	668,096	6,202,688	-	6,870,784
Total	3,401,351	6,202,688	-	9,604,039
Less accumulated depreciation for:				
Distribution System	(299,191)	(57,580)	-	(356,771)
Flow Meters	(8,466)	(1,230)	-	(9,696)
Pump Stations	(81,687)	(21,284)	-	(102,971)
Equipment	(42,129)	(4,845)	-	(46,974)
Total accumulated depreciation	(431,473)	(84,939)	-	(516,412)
Capital Assets, Net	\$ 2,969,878	\$ 6,117,749	\$ -	\$ 9,087,627

**6. DEBT**

During the fiscal year ended June 30, 2010, the District issued the "Mercer County Sanitation District Sewer System Revenue Bonds, Series 2008" in the amount of \$434,000 for the purpose of financing certain sewer system improvements. The interest rate on this bond issue is 4.0%. Annual principal payments are due January 1 each year. Semi-annual interest payments are due on January 1 and July 1 each year.

During the fiscal year ended June 30, 2017, the District renewed a \$60,000 secured line of credit at the Farmers National Bank of Danville to provide funds to pay expenses while awaiting the release of loan and/or grant funds related to their various construction projects. As of June 30, 2017, the District had \$60,000 outstanding against the line of credit. The line of credit matures on August 6, 2018. The current interest rate on the line of credit is 4.0%. Interest is due quarterly.

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

During the fiscal year ended June 30, 2015, the District issued the "Mercer County Sanitation District Sewer System Revenue Bonds, Series 2015" in the aggregate principal amount of \$220,000, consisting of \$110,000 of Series A Bonds and \$110,000 of Series B Bonds for the purpose of financing certain sewer system improvements. The interest rate on this bond issue is 2.75%. Annual principal payments are due January 1 of each year (beginning in 2018). Semi-annual interest payments are due on January 1 and July each year.

Prior to the issuance of the 2015 bonds, the District obtained interim financing from Regions Bank for the purpose of funding various construction projects. Interest related to the interim financing amounted to \$1,121 for the year ended June 30, 2015, and was capitalized as a component of Construction in Progress. The interim financing was paid in full upon the issuance of the 2015 bond issue.

During the fiscal year ended June 30, 2017, the District issued the "Mercer County Sanitation District Sewer System Revenue Bonds, Series 2016" in the aggregate principal amount of \$3,873,000, consisting of \$3,335,000 of Series A Bonds and \$538,000 of Series B Bonds for the purpose of financing certain sewer system improvements. The interest rate on this bond issue is 2.75% for the Series A Bonds and 2.25% for the Series B Bonds. Annual principal payments are due January 1 of each year (beginning in 2019). Semi-annual interest payments are due on January 1 and July each year.

Prior to the issuance of the 2016 bonds, the District obtained interim financing from Kentucky Rural Water Finance Corporation for the purpose of funding the Burgin Sewer Project. Interest related to the interim financing amounted to \$55,046 for the year ended June 30, 2017, and was capitalized as a component of Construction in Progress. The interim financing was paid in full upon the issuance of the 2016 bond issue.

Long-term liability activity for the year ended June 30, 2017, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
2008 Sewer System Revenue Bond	\$ 408,500	\$ -	\$ (6,000)	\$ 402,500	\$ 6,000
2015 Series A Sewer System Revenue Bonds	110,000	-	-	110,000	1,500
2015 Series B Sewer System Revenue Bonds	110,000	-	-	110,000	1,500
Note payable - interim financing	-	3,400,604	(3,400,604)	-	-
2016 Series A Sewer System Revenue Bonds	-	3,335,000	-	3,335,000	-
2016 Series B Sewer System Revenue Bonds	-	538,000	-	538,000	-
<b>Total</b>	<b>\$ 628,500</b>	<b>\$ 7,273,604</b>	<b>\$ (3,406,604)</b>	<b>\$ 4,495,500</b>	<b>\$ 9,000</b>

Short-term debt activity for the year ended June 30, 2017, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Farmer's National Bank - Line of Credit	\$ 30,000	\$ 30,000	\$ -	\$ 60,000	\$ -
<b>Total</b>	<b>\$ 30,000</b>	<b>\$ 30,000</b>	<b>\$ -</b>	<b>\$ 60,000</b>	<b>\$ -</b>

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

The annual principal and interest requirements of the District as of June 30, 2017, are as follows:

Year Ending June 30,	Principal	Interest	Total
2018	\$ 9,000	\$ 89,844	\$ 98,844
2019	124,100	126,230	250,330
2020	66,300	124,423	190,723
2021	68,500	122,556	191,056
2022	71,200	120,624	191,824
2023-27	390,100	571,706	961,806
2028-32	457,700	512,844	970,544
2033-37	535,500	443,523	979,023
2038-42	628,200	362,009	990,209
2043-47	737,700	265,995	1,003,695
2048-52	790,000	155,957	945,957
2053-56	677,200	46,116	723,316
Total	<u>\$ 4,555,500</u>	<u>\$ 2,941,827</u>	<u>\$ 7,497,327</u>

**Bond Covenants and Provisions**

Certain financial covenants pertaining to the bond issues are as follows:

**2008 Bond Issue**

- 1) The District shall establish a "sinking fund" into which funds will be transferred from the revenue fund in a sufficient amount on a monthly basis to pay the annual debt service.
- 2) The District shall establish a "depreciation reserve fund" into which \$200 shall be transferred each month until the fund reaches a balance of \$24,000.

**2015 Bond Issue**

- 1) The District shall establish a "sinking fund" into which funds will be transferred from the revenue fund in a sufficient amount on a monthly basis to pay the annual debt service.
- 2) The District shall establish a "depreciation reserve fund" into which \$80 shall be transferred each month until the fund reaches a balance of \$9,600.

**2016 Bond Issue**

- 1) The District shall establish a "sinking fund" into which funds will be transferred from the revenue fund in a sufficient amount on a monthly basis to pay the annual debt service.
- 2) The District shall establish a "depreciation fund" into which \$1,465 will be transferred each month until the fund reaches \$175,800.

The District was in substantial compliance with the above covenants for the year ended June 30, 2017.

**7. RISK MANAGEMENT**

The District is exposed to a variety of accidental losses, and has attempted to minimize its risk by carrying commercial insurance. There have been no significant reductions in coverage from coverage in the prior year.

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**8. MANAGEMENT AGREEMENT**

On March 1, 2014, the District entered into an agreement with Lake Village Water Association, Inc. whereby Lake Village Water Association will provide management, secretarial, billing, bookkeeping, budgeting, office space, and various other services to the District for an annual fee of \$25,000 payable in equal monthly installments of \$2,083.33. The contract term is five years and is cancelable by either party upon 60 days written notice. In 2017, the District approved an increase in the contract rate to \$35,000 annually.

**9. PRESENT PROJECTS AND FUTURE PLANS**

As of June 30, 2017, there are two major construction projects in progress.

The first is the Burgin Wastewater System Project. The budgeted amount for the Burgin Wastewater System Project is \$9,718,000. As of June 30, 2017, \$6,758,628 had been spent on the above project. This project is being funded by the following:

1. Rural Development Loan	\$ 3,873,000
2. Rural Development Grant	4,105,000
3. Community Development Block Grant	1,000,000
4. Kentucky Infrastructure Authority Grant	<u>740,000</u>
Total Funding	<u>\$ 9,718,000</u>

In 2017, Rural Development mistakenly sent \$3,925,000 of the grant money to the District instead of the amount requested for reimbursement. Rural Development directed the District to keep the funds in their account and they would monitor the use of the funds. The excess of cash received over the expenditures incurred is included in unearned grant revenue on the statement of net position.

The second major project in progress is referred to as the Kennedy Bridge Road Project. The budgeted amount for the Kennedy Bridge Road Project is \$848,000 which is being funded by a loan from Kentucky Infrastructure Authority in the amount of \$424,000 and a Community Development Block Grant in the amount of \$424,000. As of June 30, 2017, \$77,440 had been spent on this project.

## **COMPLIANCE SECTION**

**MERCER COUNTY SANITATION DISTRICT  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2017**

Grant/Program Title	Federal CFDA Number	Contract Number	Expenditures
U.S. Department of Agriculture Rural Development:			
Direct:			
RUS Loan	10.760	N/A	\$ 3,873,000
RUS Grant	10.760	N/A	<u>1,357,373</u>
			<u>5,230,373</u>
U.S. Department of Environmental Protection Passed through Commonwealth of Kentucky, Kentucky Department for Local Government: Community Development Block Grant Passed through the City of Burgin			
	14.228	13-041	<u>968,209</u> *
U.S. Department of Environmental Protection: Passed through Commonwealth of Kentucky, Kentucky Infrastructure Authority: Revolving Loan Fund			
	66.458	A16-004	<u>40,378</u> **
			<u>\$ 6,238,960</u>

\* \$24,500 of this amount is to be reimbursed from grant proceeds and is recorded as a receivable in the financial statements.

\*\* \$40,378 of these expenditures are to be reimbursed from loan proceeds, thus no receivable or liability has been included in the financial statements for these funds.

**MERCER COUNTY SANITATION DISTRICT  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2017**

**1. BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards (schedule) includes the federal award activity of the District and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because of the schedule presents only a selected portion of the operation of District, it is not intended to and does not present the financial position, changes in net position, or cash flows of the District.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Expenditures reported on the schedule are reported on the actual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance wherein certain types of expenditures are not allowable or are limited as to reimbursement. The District has not elected not to use the 10 percent de minimis indirect cost rate as allowed under the Uniform Guidance.

**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***

Board of Directors  
Mercer County Sanitation District  
Harrodsburg, Kentucky 40330

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 Mercer County Sanitation District (the District) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued our report thereon dated November 30, 2017.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the 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 our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District'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. However, as discussed below, we identified a deficiency in internal control that we consider to be a material weakness.

1. As is common within the system of internal control of most small organizations, the accounting function of the District does not prepare the financial statements complete with footnotes in accordance with the accounting principles generally accepted in the United States of America. Accordingly, the District has not established internal controls over the preparation of its financial statements. This condition is considered to be a material weakness in the District's system of internal control over financial reporting.

During the course of performing an audit, it is not unusual for the auditor to prepare various journal entries to present the financial statements in accordance with generally accepted accounting principles. This reliance on the auditor to detect and make these necessary adjustments is considered to be a material weakness in the system of internal control. SAS No. 115 does not make exceptions for reporting deficiencies that are adequately mitigated with non-audit services rendered by the auditor or deficiencies for which the remedy would be cost prohibitive.

Communication of the control deficiency above helps to emphasize that the responsibility for financial reporting rests entirely with the organization and not the auditor. Stated another way, if an organization is unable to issue, without the auditor's involvement, complete financial statements with footnotes in accordance with generally accepted accounting principles and free of material misstatement, that inability is a symptom of a material weakness in the system of internal control.

#### Management's Response

The District engages consultants who possess industry knowledge and expertise to provide financial services, as well as legal, engineering, and other professional services. Based on the auditor's unmodified opinion and after reading the financial statements, management believes the financial statements to be materially correct. Management does not think that the addition of an employee or consultant to oversee the annual financial reporting process is necessary nor would it be cost effective.

#### **Compliance and Other Matters**

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

#### **District's Response to Findings**

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

#### **Purpose of This Report**

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

*Kerbaugh, Rodes & Butler, PLLC*

Kerbaugh, Rodes & Butler, PLLC  
Certified Public Accountants

Danville, Kentucky  
November 30, 2017

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

Board of Directors  
Mercer County Sanitation District  
Harrodsburg, Kentucky 40330

**Report on Compliance for Each Major Federal Program**

We have audited the District's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended June 30, 2017. The District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**

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

**Auditor's Responsibility**

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

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the District's compliance.

**Opinion on Each Major Federal Program**

In our opinion, the District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.

**Report on Internal Control over Compliance**

Management of the District, is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in

accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

*Kerbaugh, Rodes & Butler, PLLC*

Kerbaugh, Rodes & Butler, PLLC  
Certified Public Accountants

Danville, Kentucky  
November 30, 2017

**MERCER COUNTY SANITATION DISTRICT  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2017**

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**Section I – Summary of Auditor’s Results**

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**Financial Statements**

Type of auditor’s report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified are not considered to be material weaknesses?	None reported
Noncompliance material to financial statements noted?	No

**Federal Awards**

Internal control over major programs:	
• Material weakness(es) identified?	No
• Significant deficiency(ies) identified are not considered to be material weakness(es)?	None reported
Type of auditor’s report issued on compliance for major programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
10.760	USDA, Rural Development Water & Waste Disposal Systems For Rural Communities Grant and Loan Program
14.228	Department of Housing and Urban Development Community Development Block Grant

Dollar threshold used to distinguish Between type A and type B programs:	\$ <u>750,000</u>
Auditee qualified as low-risk auditee?	No

**MERCER COUNTY SANITATION DISTRICT  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2017**

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**Section II – Financial Statement Findings**

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See 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 on pages 16-17.

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**Section III – Federal Award Findings and Questioned Costs**

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None

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**Section IV – Prior Year Audit Findings**

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Prior year financial statement finding related to issues concerning the ability of the District to prepare the financial statements. Management has determined that the addition of an employee to oversee the financial reporting process would not be cost effective for the District. Therefore, the finding related to incomplete financial statement preparation was repeated in the current year audit.