

**Mount Sterling Water and
Sewer Commission**

**Independent Auditor's Report
and Basic Financial Statements
June 30, 2018 and 2017**

Mount Sterling Water and Sewer Commission
Table of Contents
June 30, 2018 and 2017

| | |
|---|-------|
| Independent Auditor's Report on Financial Statements | 1-3 |
| Basic Financial Statements: | |
| Statements of Net Position | 4 |
| Statements of Revenues, Expenses and Changes in Net Position | 5 |
| Statements of Cash Flows | 6-7 |
| Notes to Basic Financial Statements | 8-23 |
| Supplemental Information: | |
| Schedule of Revenues, Expenses and Changes in Net Position - Budget and Actual | 24 |
| Schedule of Debt Service Requirements | 25 |
| Schedule of Proportionate Share of the Net Pension Liability | 26 |
| Schedule of Pension Contributions | 27 |
| Schedule of Proportionate Share of the Net OPEB Liability | 28 |
| Schedule of OPEB Contributions | 29 |
| Schedule of Changes in Benefits and Assumptions | 30 |
| 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 | 31-32 |

FAULKNER, KING & WENZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS

JOSEPH C. KING, CPA
JOHN M. WENZ, CPA
KEVIN M. ROMENESKO, CPA
KAREN S. TRENT, CPA
EUGENE C. WEATHERS, CPA

P.O. BOX 285
117 WEST HIGH STREET
MT. STERLING, KY 40353
(859) 498-1836 FAX (859) 498-2116

LANA J. McCANN, CPA
ERICA M. SNOWDEN, CPA
JENNIFER T. COLLINGWOOD, CPA

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Mount Sterling Water and
Sewer Commission and
the City Council
Mount Sterling, Kentucky 40353
Page 2

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as June 30, 2018 and 2017, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As described in Notes 8 and 9 to the financial statements, in 2018, the Mount Sterling Water and Sewer Commission adopted new accounting guidance, *GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedules of selected pension and other postemployment benefits information on pages 26 through 30 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the Management's Discussion & Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Mount Sterling Water and Sewer Commission's basic financial statements. The Schedule of

Mount Sterling Water and
Sewer Commission and
the City Council
Mount Sterling, Kentucky 40353
Page 3

Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedule of Debt Service Requirements are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedule of Debt Service Requirements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedules of Debt Service Requirements are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2018, on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commission's internal control over financial reporting and compliance.

Faulkner, King & Wenz, PSC

September 7, 2018

Mount Sterling Water and Sewer Commission
Statements of Net Position
June 30, 2018 and 2017

| Assets | <u>2018</u> | <u>2017</u> |
|--|----------------------|----------------------|
| Current assets: | | |
| Cash and investments | \$ 6,423,465 | \$ 4,992,458 |
| Accounts receivable, net | 733,561 | 792,954 |
| Interest receivable | 1,975 | 169 |
| Other receivables | 38,586 | 26,028 |
| Inventory | 179,603 | 175,347 |
| Prepaid expenses | 26,116 | 43,525 |
| Total current assets | <u>7,403,306</u> | <u>6,030,481</u> |
| Non-current assets: | | |
| Restricted cash and cash equivalents | 685,102 | 1,292,973 |
| Capital Assets: | | |
| Land and building | 1,773,582 | 1,773,582 |
| Water and sewer system | 61,007,304 | 60,398,806 |
| Equipment | 1,559,303 | 1,413,901 |
| Vehicles | 424,427 | 378,211 |
| Construction in progress | 0 | 164,079 |
| Less accumulated depreciation | (35,597,138) | (33,735,390) |
| Total non-current assets | <u>29,852,580</u> | <u>31,686,162</u> |
| Deferred Outflows of Resources | | |
| Deferred outflows - pension | 870,556 | 686,141 |
| Deferred outflows - OPEB | 316,533 | 70,183 |
| Total deferred outflows | <u>1,187,089</u> | <u>756,324</u> |
| Total assets and deferred outflows of resources | <u>\$ 38,442,975</u> | <u>\$ 38,472,967</u> |
| Liabilities | | |
| Current liabilities: | | |
| Accounts payable | \$ 95,793 | \$ 123,399 |
| Other accrued liabilities | 344,161 | 274,085 |
| Accrued interest on bonds | 3,201 | 4,129 |
| Customer deposits | 356,372 | 314,794 |
| Implicit subsidy for OPEB | 13,453 | 6,907 |
| Notes payable | 624,355 | 864,798 |
| Total current liabilities | <u>1,437,335</u> | <u>1,588,112</u> |
| Non-current liabilities: | | |
| Notes payable | 3,216,927 | 3,841,282 |
| Net pension liability | 3,205,037 | 2,834,255 |
| Net OPEB liability | 1,100,783 | 863,421 |
| Total non-current liabilities | <u>7,522,747</u> | <u>7,538,958</u> |
| Total liabilities | <u>8,960,082</u> | <u>9,127,070</u> |
| Deferred Inflows of Resources | | |
| Deferred inflows - pension | 162,795 | 0 |
| Deferred inflows - OPEB | 57,633 | 0 |
| Total deferred inflows | <u>220,428</u> | <u>0</u> |
| Net Position | | |
| Invested in capital assets, net of related debt | 25,326,196 | 25,687,109 |
| Restricted for debt service | 328,730 | 978,179 |
| Unrestricted | 3,607,539 | 2,680,609 |
| Total net position | <u>29,262,465</u> | <u>29,345,897</u> |
| Total liabilities, deferred inflows of resources and net position | <u>\$ 38,442,975</u> | <u>\$ 38,472,967</u> |

Mount Sterling Water and Sewer Commission
Statements of Revenues, Expenses And Changes in Net Position
For the Years Ended June 30, 2018 and 2017

| Operating revenues | <u>2018</u> | <u>2017</u> |
|--|----------------------|----------------------|
| Water sales | \$ 3,279,452 | \$ 3,367,522 |
| Sewer sales | 2,224,400 | 2,392,946 |
| Other income | 134,144 | 164,042 |
| Total operating revenues | <u>5,637,996</u> | <u>5,924,510</u> |
| | | |
| Operating expenses | | |
| Water | 2,398,577 | 2,417,908 |
| Sewer | 1,600,104 | 1,540,556 |
| General and administrative costs: | | |
| Water | 1,182,132 | 1,015,895 |
| Sewer | 529,603 | 471,069 |
| Total operating expenses | <u>5,710,416</u> | <u>5,445,428</u> |
| Operating (deficit) income | <u>(72,420)</u> | <u>479,082</u> |
| | | |
| Nonoperating revenues (expenses) | | |
| Interest income | 13,529 | 11,570 |
| Gain on sale of fixed assets | 7,347 | 12,631 |
| Other expense | (17,015) | (17,513) |
| Interest expense | (48,482) | (61,466) |
| Total net nonoperating revenues (expenses) | <u>(44,621)</u> | <u>(54,778)</u> |
| (Deficit) income before contributions | (117,041) | 424,304 |
| Capital contributions | <u>33,609</u> | <u>0</u> |
| Change in net position | (83,432) | 424,304 |
| Total net position, beginning of year | <u>29,345,897</u> | <u>28,921,593</u> |
| Total net position, end of year | <u>\$ 29,262,465</u> | <u>\$ 29,345,897</u> |

Mount Sterling Water and Sewer Commission
Statements of Cash Flows
For the Years Ended June 30, 2018 and 2017

| Cash Flows from Operating Activities | <u>2018</u> | <u>2017</u> |
|--|---------------------|---------------------|
| Cash received from customers | \$ 5,550,687 | \$ 5,732,353 |
| Other cash receipts | 134,144 | 164,042 |
| Cash payments to vendors for water services and supplies | (658,890) | (702,755) |
| Cash payments to vendors for sewer services and supplies | (331,924) | (295,591) |
| Cash payments to employees for services | (1,487,873) | (1,426,333) |
| Cash payments for water administrative costs | (727,679) | (642,964) |
| Cash payments for sewer administrative costs | (151,797) | (182,394) |
| Net cash provided by operating activities | <u>2,326,668</u> | <u>2,646,358</u> |
| | | |
| Cash Flows from Capital and Related Financing Activities | | |
| Acquisition and construction of capital assets | (639,503) | (624,314) |
| Proceeds from sale of assets | 7,347 | 12,631 |
| Interest paid on revenue bonds | (49,410) | (62,608) |
| Principal paid on debt | (864,798) | (987,658) |
| Increase in customer deposits | 48,124 | 24,299 |
| Other expense | (17,015) | (17,513) |
| Net cash used in capital and related financing activities | <u>(1,515,255)</u> | <u>(1,655,163)</u> |
| | | |
| Cash Flows from Investing Activities | | |
| Interest income from investments | 11,723 | 11,600 |
| Net cash provided by investing activities | <u>11,723</u> | <u>11,600</u> |
| | | |
| Net change in cash and cash equivalents | 823,136 | 1,002,795 |
| | | |
| Cash and cash equivalents, beginning of year | <u>6,285,431</u> | <u>5,282,636</u> |
| | | |
| Total cash and cash equivalents, end of year | <u>\$ 7,108,567</u> | <u>\$ 6,285,431</u> |
| | | |
| Restricted cash and cash equivalents | \$ 685,102 | \$ 1,292,973 |
| Unrestricted cash and cash equivalents | <u>6,423,465</u> | <u>4,992,458</u> |
| Total cash and cash equivalents, end of year | <u>\$ 7,108,567</u> | <u>\$ 6,285,431</u> |

Mount Sterling Water and Sewer Commission
Statements of Cash Flows (continued)
For the Years Ended June 30, 2018 and 2017

| Reconciliation of operating income to net cash provided by operating activities: | <u>2018</u> | <u>2017</u> |
|---|----------------------------|----------------------------|
| Operating (deficit) income | \$ (72,420) | \$ 479,082 |
| Adjustments to reconcile operating (deficit) income to net cash provided by operating activities: | | |
| Depreciation | 1,898,823 | 1,891,279 |
| Provision for bad debts | 7,767 | 5,939 |
| Change in assets and liabilities: | | |
| Decrease (increase) in accounts receivable | 39,068 | (34,054) |
| Increase in inventories | (4,256) | (7,029) |
| Decrease in prepaids | 17,409 | 95,885 |
| Increase (decrease) in accounts payable and accrued expenses | 42,470 | (22,143) |
| Increase in net pension obligation | 397,807 | 237,399 |
| Total adjustments | <u>2,399,088</u> | <u>2,167,276</u> |
| Net cash provided by operating activities | <u><u>\$ 2,326,668</u></u> | <u><u>\$ 2,646,358</u></u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 1. Summary of Significant Accounting Policies

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

Basis of accounting

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

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

Investments

Investments are carried at cost. Some of the investments are restricted as to use (Note 2). Funds of the Commission are required to be invested in accordance with the investment policy adopted by the Commission. The investment policy allows the Commission to invest in those instruments authorized by KRS 66.480. Bank deposits were substantially secured by FDIC insurance and collateral or invested in direct obligations of the United States at June 30, 2018 and 2017.

Custodial credit risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2018 \$5,988,203 of the Commission's bank balance of \$6,738,203 was exposed to custodial credit risk, as follows:

| | |
|---|---------------------|
| Insured | \$ 750,000 |
| Collateral held by pledging bank's trust department in the Commission's name | <u>5,988,203</u> |
| Total bank deposits | <u>\$ 6,738,203</u> |

Accounts receivable

Customer receivables are recorded as receivables and revenues at their original invoice amount. Management regularly reviews the customer receivable accounts and determines the allowance for doubtful accounts. A receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 60 days. For the years ended June 30, 2018 and 2017, accounts receivable is stated less an allowance for doubtful accounts of \$160,975 and \$154,918, respectively. A schedule of allowance for doubtful accounts at June 30, 2018 and 2017, follows:

| | <u>2018</u> | <u>2017</u> |
|--------------------------|------------------|------------------|
| Beginning balance | \$154,918 | \$149,094 |
| Provisions | 7,767 | 5,939 |
| Recoveries (Charge-offs) | <u>(1,710)</u> | <u>(115)</u> |
| Ending balance | <u>\$160,975</u> | <u>\$154,918</u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 1. Summary of Significant Accounting Policies (Continued)

Inventories

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

Budgets

In June of 2017, the Commission adopted the annual management budget in the amount of \$5,740,945 for the fiscal year ended June 30, 2018, detailed as follows:

| | |
|-----------------------------------|--------------------|
| Water | \$2,526,025 |
| Sewer | 1,672,691 |
| General and administrative costs: | |
| Water | 1,006,667 |
| Sewer | <u>535,562</u> |
| Total operating expenses | <u>\$5,740,945</u> |

Property, plant and equipment

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

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

Total depreciation expense was \$1,898,823 and \$1,891,279 for the years ended June 30, 2018 and 2017, respectively.

Cash and cash equivalents

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

Estimates

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

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 1. Summary of Significant Accounting Policies (Continued)

Capital and operating grants

Grants that are restricted to the purchase of property, plant and equipment are recorded as other income, per GASB 33. The Commission received \$0 in grants of this type for the years ended June 30, 2018 and 2017.

Infrastructure assets constructed by outside entities then taken over by the Commission are also recorded as other income per GASB 33. The total amount of the assets taken over were \$33,609 and \$0 for the years ended June 30, 2018 and 2017. Such amounts would constitute noncash transactions.

Capitalized interest

The Commission follows the policy of capitalizing interest as a component of construction cost. For the year ended June 30, 2018, total interest cost incurred was \$48,482 of which \$0 was capitalized. For the year ended June 30, 2017, total interest cost incurred was \$61,466 of which \$0 was capitalized.

Pensions

For purposes of measuring the net pension liability and net OPEB liability, deferred outflows of resources and deferred inflows of resources related to pensions and OPEB, and pension and OPEB expense, information about the fiduciary net position of the County Employers' Retirement System Plan (CERS) and additions to/deductions from CERS' fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments, (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value.

Note 2. Restricted Assets

The restricted assets in the accompanying financial statements are restricted as to use by ordinance (Note 5), external parties, or by board designation. A schedule of restricted assets at June 30, 2018, follows:

| <u>Description</u> | <u>Cash</u> | <u>Investments at Cost</u> | <u>Total</u> |
|---|-------------------|--------------------------------|-------------------|
| Assets restricted by grant agreement or bond ordinance: | | | |
| Customer deposits | \$ 356,372 | \$ -0- | \$ 356,372 |
| Reserve accounts | <u>328,730</u> | <u>-0-</u> | <u>328,730</u> |
| | <u>\$ 685,102</u> | <u>\$ -0-</u> | <u>\$ 685,102</u> |

A schedule of restricted assets at June 30, 2017, follows:

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

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 3. Long-Term Debt

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2018 and 2017, are summarized as follows:

| | <u>Rate</u> | <u>Original Issue</u> | <u>2018</u> | <u>2017</u> |
|---------------------------|-------------|---------------------------|---------------------|---------------------|
| Kentucky Bond Corporation | | | | |
| 2010 Series C | 2.70% | \$ 2,760,000 | \$ 0 | \$ 105,000 |
| KIA Fund B | 1.50% | 2,448,213 | 0 | 141,640 |
| KIA Fund A Loan | 1.00% | <u>13,202,540</u> | <u>3,841,282</u> | <u>4,459,440</u> |
| | | <u>\$ 18,410,753</u> | 3,841,282 | 4,706,080 |
| Less current maturities | | | <u>(624,355)</u> | <u>(864,798)</u> |
| Total long term debt | | | <u>\$ 3,216,927</u> | <u>\$ 3,841,282</u> |

- The original issue of the KIA Fund A Loan is \$13,202,540. As of June 30, 2018, the Commission had borrowed \$11,936,783 of this amount.

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2018 and 2017, are detailed as follows:

| | <u>Balance June 30 2016</u> | | | <u>Balance June 30 2017</u> | | | <u>Balance June 30 2018</u> |
|---------------------------|-------------------------------------|-------------------|---------------------|-------------------------------------|-------------------|--------------------|-------------------------------------|
| | <u>Advances</u> | <u>Repayments</u> | <u>2016</u> | <u>Advances</u> | <u>Repayments</u> | <u>2017</u> | <u>2018</u> |
| Kentucky Bond Corporation | | | | | | | |
| 2010 Series C | \$ 282,083 | \$0 | \$ (177,083) | \$ 105,000 | \$0 | \$ (105,000) | \$0 |
| KIA Fund A | 59,013 | 0 | (59,013) | 0 | 0 | 0 | 0 |
| KIA Fund B | 281,179 | 0 | (139,539) | 141,640 | 0 | (141,640) | 0 |
| KIA Fund A Loan | 5,071,463 | 0 | (612,023) | 4,459,440 | 0 | (618,158) | 3,841,282 |
| Total | <u>\$ 5,693,738</u> | <u>\$0</u> | <u>\$ (987,658)</u> | <u>\$4,706,080</u> | <u>\$0</u> | <u>(\$864,798)</u> | <u>\$3,841,282</u> |

| | <u>Balance June 30, 2018</u> | |
|-----------------|----------------------------------|---------------------|
| | <u>Current</u> | <u>Long-Term</u> |
| KIA Fund A Loan | <u>\$ 624,355</u> | <u>\$ 3,216,927</u> |
| Total | <u>\$ 624,355</u> | <u>\$ 3,216,927</u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 3. Long-Term Debt (Continued)

The long-term debt service requirements are as follows:

| <u>Fiscal Year</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|--------------------|---------------------|-------------------|---------------------|
| 2018-2019 | \$ 624,355 | \$ 36,856 | \$ 661,211 |
| 2019-2020 | 630,614 | 30,597 | 661,211 |
| 2020-2021 | 636,936 | 24,275 | 661,211 |
| 2021-2022 | 643,321 | 17,890 | 661,211 |
| 2022-2023 | 649,771 | 11,440 | 661,211 |
| 2023-2024 | <u>656,285</u> | <u>4,926</u> | <u>661,211</u> |
| | <u>\$ 3,841,282</u> | <u>\$ 125,984</u> | <u>\$ 3,967,266</u> |

KIA Fund A and KIA Fund B

As of June 30, 2018 and 2017, the Commission had drawn on a KIA loan which was made to finance the construction of the water treatment plant sludge facilities. The loan was secured by a pledge of revenues, and had been drawn up to \$1,055,969. The loan bears an interest rate of 1.2% and had a life of 20 years and matured in 2017.

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

Kentucky Infrastructure Authority - A02-01

The Commission had drawn \$11,936,783 as of June 30, 2018 and 2017, from the Kentucky Infrastructure Authority. The loan was made for the construction of a new trunk sewer and wastewater treatment plant. The loan is secured by a pledge of revenues and can be drawn up to \$13,202,540. The loan bears an interest rate of 1% and has a life of 20 years.

Kentucky Bond Corporation 2010 Series C Bonds

On November 4, 2010, the Commission borrowed the aggregate principal amount of \$2,760,000 with the Kentucky Bond Corporation 2010 Series C Bonds. The purpose of the issue was for the refunding in advance of the obligations of the City of Danville, Kentucky designated as its Multi-City Lease Revenue Bonds (City of Mount Sterling, Kentucky Water and Sewer System Revenue Refunding & Improvement Project) Series 1998-B and the Kentucky Municipal League Pooled Lease Financing Program. The bonds were secured by a pledge of revenues. The bonds were subject to optional and mandatory redemption prior to maturity. The bonds matured in 2018.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 4. Net Position

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

The balance of capital investments represents funds that have been used to acquire pump stations, storage facilities, meter stations, etc., constructed and operated by the Mount Sterling Water and Sewer Commission, net of outstanding debt. The balance was \$25,326,196 and \$25,687,109 at June 30, 2018 and 2017, respectively.

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

| | <u>2018</u> | <u>2017</u> |
|---------------------------|-------------------|-------------------|
| Operation and Maintenance | \$ - | \$ 274,211 |
| Replacement | 328,730 | 451,566 |
| Depreciation | - | 250,000 |
| Other | - | <u>2,402</u> |
| Total Restricted | <u>\$ 328,730</u> | <u>\$ 978,179</u> |

The Commission has a balance of \$3,607,539 and \$2,680,609 for unrestricted net assets at June 30, 2018 and 2017, respectively.

Note 5. Compliance with Bond Ordinance

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

Operation and Maintenance Fund - This reserve was required to maintain a balance equal to three month's cost of operating, maintaining, and insuring the system. The balance of this reserve at June 30, 2018 and 2017 was \$- and \$274,211. This bond matured in 2018, therefore, the reserve is no longer required.

Depreciation Fund - This reserve was required for major repairs and replacements. Funds could be withdrawn only to pay the cost of making unusual or extraordinary maintenance, repairs, renewals, and/or replacements to the system not included in the annual budget of current expenses, or for the purpose of paying the cost of construction improvements. The balance of this reserve at June 30, 2018 and 2017 was \$- and \$250,000. This bond matured in 2018, therefore, the reserve is no longer required.

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

Replacement Reserve - This reserve requires the Commission to deposit \$32,790 each December 1 into a separate account until the balance reaches \$327,900 and be maintained for the life of the loan. In addition, \$123,350 (for 2017 only) balance was also required for the remaining loan. The total required balance of this reserve is \$327,900 and \$451,250 for year ending June 30, 2018 and 2017, respectively. The balance of this reserve at June 30, 2018 and 2017, was \$328,730 and \$453,968, respectively.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 6. Property, Plant and Equipment

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

| | Balance June 30, 2016 | Additions | Reclassifications and Disposals | Balance June 30, 2017 | Additions | Reclassifications and Disposals | Balance June 30, 2018 |
|---|-----------------------------|---------------|---------------------------------------|-----------------------------|---------------|---------------------------------------|-----------------------------|
| Land and building | \$1,762,247 | \$11,335 | \$0 | \$1,773,582 | \$0 | \$0 | \$1,773,582 |
| Water and sewer system | 60,118,764 | 280,042 | 0 | 60,398,806 | 608,498 | 0 | 61,007,304 |
| Equipment | 1,293,256 | 120,645 | 0 | 1,413,901 | 147,702 | (2,300) | 1,559,303 |
| Construction in progress | 2,325 | 164,079 | (2,325) | 164,079 | 0 | (164,079) | 0 |
| Vehicles | 358,927 | 50,538 | (31,254) | 378,211 | 80,991 | (34,775) | 424,427 |
| | 63,535,519 | 626,639 | (33,579) | 64,128,579 | 837,191 | (201,154) | 64,764,616 |
| Accumulated depreciation | (31,875,365) | (1,891,279) | 31,254 | (33,735,390) | (1,898,823) | 37,075 | (35,597,138) |
| Total net property, plant and equipment | \$31,660,154 | (\$1,264,640) | (\$2,325) | \$30,393,189 | (\$1,061,632) | (\$164,079) | \$29,167,478 |

Note 7. Pension Plan

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

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

Contributions – For the year ended June 30, 2018, plan members were required to contribute 5.00% of wages for non-hazardous job classifications. Employees hired after September 1, 2008 are required to contribute an additional 1% to cover the cost of medical insurance that is provided through CERS. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.545(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contributions rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended June 30, 2018, participating employers contributed 14.48% of each employee's wages to the pension fund, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

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

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 7. Pension Plan (continued)

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

The Commission contributed for the years ended June 30, 2018 and 2017 \$195,811 and \$186,618, respectively, or 100% of the required contribution to the pension fund.

Pension Liabilities, Expense, Deferred Outflows of Resources and Deferred Inflows of Resources – At June 30, 2018, the Commission reported a liability of \$3,205,037 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2016, rolled-forward from the valuation date to June 30, 2017 using generally accepted actuarial principles. The Commission's proportion of the net pension liability was determined using the Commission's actual contributions for the year ended June 30, 2017. This method is expected to be reflective of the Commission's long-term contribution effort. For the year ended June 30, 2017, the Commission's proportion was .054756 percent, while at June 30, 2016, the Commission's proportion was .057564 percent.

For the year ended June 30, 2018, the Commission recognized pension expense of \$544,334. At June 30, 2018, the Commission 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 |
|---|---|--|
| Effects of changes of assumptions | \$ 591,416 | \$ - |
| Commission contributions subsequent to the measurement date | 195,811 | - |
| Differences between projected and actual earnings on plan investments | 39,643 | - |
| Changes in proportion and differences between Commission contributions and proportionate share of contributions | 39,711 | 81,437 |
| Differences between expected and actual liability experience | <u>3,975</u> | <u>81,358</u> |
| Total | <u>\$ 870,556</u> | <u>\$ 162,795</u> |

The \$195,811 of deferred outflows of resources resulting from the Commission's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

| | |
|------|------------|
| 2019 | \$ 241,188 |
| 2020 | 220,689 |
| 2021 | 91,229 |
| 2022 | (41,156) |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 7. Pension Plan (continued)

Actuarial Assumptions – The total pension liability, net pension liability, and sensitivity information as of June 30, 2017 were based on an actuarial valuation date of June 30, 2016. The total pension liability was rolled-forward from the valuation date (June 30, 2016) to the plan’s fiscal year ending June 30, 2017, using generally accepted actuarial principles. There was no legislation enacted during the 2017 legislative session that had a material change in benefit provisions for any of the systems. However, subsequent to the actuarial valuation date (June 30, 2016), but prior to the measurement date, and before the required 2019 experience study, the KRS Board of Trustees reviewed investment trends, inflation, and payroll growth historical trends. Based on this review the Board adopted the following updated actuarial assumptions which were used in performing the actuarial valuation as of June 30, 2017.

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

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set-back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set-back 4 years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.

Assumptions and funding policies are reviewed against actual plan experience at least once every five years through the completion of an actuarial experience study. The actuarial assumptions used in the June 30, 2017 valuation were based on the results of the most recent actuarial experience study for the period July 1, 2008 - June 30, 2013. The investment return, price inflation, and payroll growth assumptions were adopted by the Board in May and July 2017, for use with the June 30, 2017 valuation.

The target allocation and best estimates of arithmetic nominal rates of return for each major asset class at June 30, 2017 are summarized in the following table:

| Asset Class | Target Allocation | Long-term Expected Real Rate of Return |
|----------------------|--------------------------|---|
| US Equity | 17.50% | 5.97% |
| International Equity | 17.50% | 7.85% |
| Global Bonds | 4.00% | 2.63% |
| Global Credit | 2.00% | 3.63% |
| High Yield | 7.00% | 5.75% |
| Emerging Market Debt | 5.00% | 5.50% |
| Private Credit | 10.00% | 8.75% |
| Real Estate | 5.00% | 7.63% |
| Absolute Return | 10.00% | 5.63% |
| Real Return | 10.00% | 6.13% |
| Private Equity | 10.00% | 8.25% |
| Cash Equivalent | 2.00% | 1.88% |
| Total | 100.00% | |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 7. Pension Plan (continued)

Discount Rate – The discount rate used to measure the total pension liability was 6.25 percent at June 30, 2017. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26 year amortization period of the unfunded actuarial accrued liability. The discount rate does not use a municipal bond rate.

Sensitivity of the Commission's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate – The following presents the Commission's proportionate share of the net pension liability calculated using the discount rate of 6.25 percent, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.25 percent) or 1-percentage-point higher (7.25 percent) than the current rate:

| | Discount rate | Commission's proportionate share of net pension liability |
|-----------------------|----------------------|--|
| 1% decrease | 5.25% | \$ 4,042,250 |
| Current discount rate | 6.25% | \$ 3,205,037 |
| 1% increase | 7.25% | \$ 2,504,723 |

Payable to the Pension Plan – At June 30, 2018 and 2017, the Commission reported a payable of \$19,530 and \$21,233, respectively, for the outstanding amount of contributions to the pension plan required for the year then ended. The payable only includes the pension portion of the contribution. Please refer to Note 8 for the amount due to the insurance fund.

Note 8. Other Post Employment Benefit Plan

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

Plan Description – The Kentucky Retirement Systems' (KRS) Insurance Fund was established to provide hospital and medical insurance for eligible members receiving benefits from KERS, CERS, and SPRS. Although the assets of the systems are invested as a whole, each system's assets are used only for the payment of benefits to the members of that plan and the administrative costs incurred by those receiving an insurance benefit.

The CERS Non-hazardous Insurance Fund is a cost-sharing multiple-employer defined benefit Other Postemployment Benefits (OPEB) plan that covers substantially all regular full-time members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for health insurance benefits to plan members. OPEB may be extended to beneficiaries of plan members under certain circumstances.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 8. Other Post Employment Benefit Plan (continued)

Membership in the CERS Non-hazardous Insurance Fund consisted of the following at June 30, 2016, the date of the latest actuarial valuation:

Membership Status

| | |
|---|----------------|
| Inactive plan members currently receiving benefits: | 32,161 |
| Inactive plan members entitled to but not yet receiving benefits: | 8,946 |
| Active plan members: | <u>80,409</u> |
| Total plan members: | <u>121,516</u> |

Actuarial Assumptions – The total OPEB liability, net OPEB liability, and sensitivity information as of June 30, 2017, were based on an actuarial valuation date of June 30, 2016. The total OPEB liability was rolled forward from the valuation date (June 30, 2016) to the plan's fiscal year ending June 30, 2017, using generally accepted actuarial principles. There was no legislation enacted during the 2017 legislative session that had a material change in benefit provisions for any of the systems. However, subsequent to the actuarial valuation date (June 30, 2016), but prior to the measurement date, and before the required 2019 experience study, the KRS Board of Trustees reviewed investment trends, inflation, and payroll growth historical trends. Based on this review the Board adopted the following updated actuarial assumptions which were used in performing the actuarial valuation as of June 30, 2017.

| | |
|---------------------------|--|
| Inflation | 2.30% |
| Payroll Growth Rate | 2.00%, CERS non-hazardous |
| Salary Increase | 3.05%, average |
| Investment Rate of Return | 6.25% |
| Healthcare Trend Rates | |
| Pre – 65 | Initial trend starting at 7.25% at January 1, 2019, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 13 years. |
| Post – 65 | Initial trend starting at 5.10% at January 1, 2019, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 11 years. |

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement.

Assumptions and funding policies are reviewed against actual plan experience at least once every five years through the completion of an actuarial experience study. The actuarial assumptions used in the June 30, 2017 valuation were based on the results of the most recent actuarial experience study for the period July 1, 2008 - June 30, 2013. The investment return, price inflation, and payroll growth assumptions were adopted by the Board in May and July 2017, for use with the June 30, 2017 valuation.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 8. Other Post Employment Benefit Plan (continued)

Discount Rate – The single discount rate of 5.84% for CERS Non-hazardous is based on the long-term expected rate of return on OPEB plan investments of 6.25% and a long-term municipal bond rate of 3.56% as reported in Fidelity Index’s “20-Year Municipal GO AA Index” as of June 30, 2017. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26-year amortization period of the unfunded actuarial accrued liability.

The target allocation and best estimates of arithmetic nominal rates of return for each major asset class at June 30, 2017 are summarized in the following table:

| Asset Class | Target Allocation | Long-term Expected Real Rate of Return |
|----------------------|-------------------|--|
| US Equity | 17.50% | 5.97% |
| International Equity | 17.50% | 7.85% |
| Global Bonds | 4.00% | 2.63% |
| Global Credit | 2.00% | 3.63% |
| High Yield | 7.00% | 5.75% |
| Emerging Market Debt | 5.00% | 5.50% |
| Private Credit | 10.00% | 8.75% |
| Real Estate | 5.00% | 7.63% |
| Absolute Return | 10.00% | 5.63% |
| Real Return | 10.00% | 6.13% |
| Private Equity | 10.00% | 8.25% |
| Cash Equivalent | 2.00% | 1.88% |
| Total | 100.00% | |

Implicit Subsidy - The fully-insured premiums KRS pays for the KERS, CERS, and SPRS Health Insurance Plans are blended rates based on the combined experience of active and retired members. Since the average cost of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees, there is an implicit employer subsidy for non-Medicare eligible retirees. Participating employers should adjust their contributions by the implicit subsidy in order to determine the total employer contribution for GASB Statement No. 75 purposes. This adjustment is needed for contributions made during the measurement period and for the purpose of deferred outflows related to contributions made after the measurement date. Mount Sterling Water and Sewer Commission’s implicit subsidy for the years ended June 30, 2018 and 2017 was \$13,453 and \$6,907 respectively.

Contributions – Participating employers are required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.545(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contributions rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board.

For the fiscal year ended June 30, 2018, participating employers contributed 4.70% of each employee’s covered payroll to the Kentucky Retirement Systems’ Insurance Fund, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 8. Other Post Employment Benefit Plan (continued)

Employees hired after September 1, 2008 are required to contribute an additional 1% of their covered payroll to the insurance fund. Contributions are deposited to an account created for the payment of health insurance benefits under 26 USC Section 401(h). These members are classified in the Tier 2/Tier 3 structure of benefits and the 1% contribution to the 401(h) account is non-refundable.

Mount Sterling Water and Sewer Commission contributed for the years ended June 30, 2018 and 2017, \$63,557 and \$63,276, respectively, or 100% of the required contribution to the insurance fund. Total contributions to the insurance fund, including the implicit subsidy for the years ended June 30, 2018 and 2017, were \$77,010 and \$70,183, respectively. For additional information regarding contributions, please refer to Note 7.

OPEB Liabilities, Expense, Deferred Outflows of Resources and Deferred Inflows of Resources – At June 30, 2018, the Commission reported a liability of \$1,100,783 for its proportionate share of the net OPEB liability. The net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of June 30, 2016, rolled-forward to June 30, 2017 using generally accepted actuarial principles. The Commission's proportion of the net OPEB liability was determined using the Commission's actual contributions for the year ended June 30, 2017. This method is expected to be reflective of the Commission's long-term contribution effort. For the year ended June 30, 2018, the Commission's proportion was 0.054756 percent, which is equal to its proportion measured as of June 30, 2017.

For the year ended June 30, 2018, the Commission recognized OPEB expense of \$119,387. At June 30, 2018, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|--------------------------------------|-------------------------------------|
| Effects of changes of assumptions | \$ 239,523 | \$ - |
| Commission contributions subsequent to the measurement date (including implicit subsidy) | 77,010 | - |
| Differences between projected and actual earnings on plan investments | - | 52,022 |
| Differences between expected and actual liability experience | - | 3,057 |
| Changes in proportion and differences between Commission contributions and proportionate share of contributions | - | 2,554 |
| Total | <u>\$ 316,533</u> | <u>\$ 57,633</u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 8. Other Post Employment Benefit Plan (continued)

The \$77,010 of deferred outflows of resources resulting from the Commission's contributions subsequent to the measurement date and June 30, 2018 implicit subsidy will be recognized as a reduction of the net OPEB liability in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in OPEB expense as follows:

| Year ending June 30, | |
|----------------------|-----------|
| 2019 | \$ 31,296 |
| 2020 | 31,296 |
| 2021 | 31,296 |
| 2022 | 31,296 |
| 2023 | 44,301 |
| Thereafter | 12,405 |

Sensitivity of the Commission's Proportionate Share of the Net OPEB Liability to Changes in the Discount Rate – The following presents the Commission's proportionate share of the net OPEB liability calculated using the single discount rate of 5.84 percent, as well as what the Commission's proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (4.84 percent) or 1-percentage-point higher (6.84 percent) than the current rate.

| | Discount rate | Commission's proportionate share of net OPEB liability |
|-----------------------|------------------|---|
| 1% decrease | 4.84% | \$ 1,400,685 |
| Current discount rate | 5.84% | \$ 1,100,783 |
| 1% increase | 6.84% | \$ 851,217 |

Sensitivity of the Commission's Proportionate Share of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rate – The following presents the Commission's proportionate share of the net OPEB liability calculated using the current healthcare cost trend rates (see details in *Actuarial Assumptions* above), as well as what the Commission's proportionate share of the net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1 percentage point lower or 1 percentage point higher than the current rates.

| | Commission's proportionate share of net OPEB liability |
|---------------------------------------|---|
| 1% decrease | \$ 844,357 |
| Current healthcare cost trend rate | \$ 1,100,783 |
| 1% increase | \$ 1,434,121 |

Payable to the OPEB Plan – At June 30, 2018 and 2017, the Commission reported a payable of \$6,339 and \$7,200, respectively, for the outstanding amount of contributions to the insurance plan required for the years then ended. The payable only includes the insurance portion of the contribution. Please refer to Note 7 for the amount due to the pension plan.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 9. Restatement of Net Position

During 2018 the Commission implemented GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, which addresses financial reporting for state and local government employers whose employees are provided with postemployment benefits other than pensions. Statement No. 75, replaces the requirements of Statemen No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended .

The guidance contained in Statement 75 changed how governments calculate and report the costs and obligations associated with postemployment benefits other than pensions (OPEB). Under the new standards GASB requires that cost-sharing governments report a net OPEB liability, OPEB expense, and OPEB related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan. In addition, GASB requires Statement 75 to be applied retroactively. This accounting change, results in the following changes to previously-reported amounts:

| | Net Position | Change in Net Position |
|---|----------------------|-----------------------------------|
| Net position, at July 1, 2017, as originally reported | \$ 29,714,831 | |
| Beginning net OPEB liability and deferred outflows | <u>(793,238)</u> | |
| Net position, at July 1, 2017, as restated | 28,921,593 | |
| Correction of deferred inflows | (6,907) | \$ (6,907) |
| Change in net position, as previously reported | <u>431,211</u> | <u>431,211</u> |
| Balances, at June 30, 2017, as restated | <u>\$ 29,345,897</u> | <u>\$424,304</u> |

Note 10. Risk Management

The Mount Sterling Water and Sewer Commission is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the Commission also carries commercial insurance for all other risks of loss such as workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The following is a schedule of insurance in force as of June 30, 2018:

| <u>Coverage</u> | <u>Amount of Coverage</u> | <u>Premium</u> | <u>Policy Term</u> |
|-------------------------------------|-------------------------------|----------------|--------------------|
| Buildings & property | \$ 32,421,519 | * | 7/1/17 - 7/1/18 |
| General & Employment Practices (ea) | 3,000,000 | * | 7/1/17 - 7/1/18 |
| Public officials liability | 3,000,000 | * | 7/1/17 - 7/1/18 |
| Cyber and Automobile liability (ea) | 1,000,000 | * | 7/1/17 - 7/1/18 |
| Automobile physical | Actual Value | * | 7/1/17 - 7/1/18 |
| Crime: | | | |
| Employee dishonesty | 250,000 | * | 7/1/17 - 7/1/18 |
| Workers compensation insurance: | | | |
| Waterworks | 784,558 | * | 7/1/17 - 7/1/18 |
| Sewage | 294,583 | * | 7/1/17 - 7/1/18 |
| Clerical | 310,770 | * | 7/1/17 - 7/1/18 |
| Health & life insurance | Various | \$ 302,625 | Monthly |

*Blanket coverage; total premium \$109,269.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2018 and 2017

Note 11. Subsequent Events

Subsequent events for Mount Sterling Water and Sewer Commission have been evaluated through September 7, 2018, which is the date the financial statements were available to be issued.

**Mount Sterling Water and Sewer Commission
Schedule of Revenues, Expenses And Changes
in Net Assets Budget and Actual
For the Year Ended June 30, 2018**

| | Enacted Budget | Actual | Favorable (Unfavorable) |
|---|----------------------|----------------------|----------------------------|
| Operating revenues | | | |
| Water sales | \$ 3,450,387 | \$ 3,279,452 | \$ (170,935) |
| Sewer sales | 2,392,697 | 2,224,400 | (168,297) |
| Other income | 151,391 | 134,144 | (17,247) |
| Total operating revenues | <u>5,994,475</u> | <u>5,637,996</u> | <u>(356,479)</u> |
| Operating expenses | | | |
| Water | 2,526,025 | 2,398,577 | 127,448 |
| Sewer | 1,672,691 | 1,600,104 | 72,587 |
| General and administrative costs: | | | |
| Water | 969,698 | 1,182,132 | (212,434) |
| Sewer | 498,593 | 529,603 | (31,010) |
| Total operating expenses | <u>5,667,007</u> | <u>5,710,416</u> | <u>(43,409)</u> |
| Operating income (deficit) | <u>327,468</u> | <u>(72,420)</u> | <u>(399,888)</u> |
| Nonoperating revenues (expenses) | | | |
| Interest income | 11,040 | 13,529 | 2,489 |
| Gain on sale of fixed assets | 0 | 7,347 | 7,347 |
| Other expense | (26,138) | (17,015) | 9,123 |
| Interest expense | (47,800) | (48,482) | (682) |
| Total net nonoperating revenues (expenses) | <u>(62,898)</u> | <u>(44,621)</u> | <u>18,277</u> |
| Income (deficit) before contributions | 264,570 | (117,041) | (381,611) |
| Capital contributions | <u>0</u> | <u>33,609</u> | <u>33,609</u> |
| Change in net assets | 264,570 | (83,432) | (348,002) |
| Total net assets, beginning of year | <u>29,345,897</u> | <u>29,345,897</u> | <u>0</u> |
| Total net assets, end of year | <u>\$ 29,610,467</u> | <u>\$ 29,262,465</u> | <u>\$ (348,002)</u> |

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority A02-01
June 30, 2018

| <u>Fiscal Year Ending June 30</u> | <u>Principal Due Dec. 1 & June 1</u> | <u>Interest Due Dec. 1 & June 1</u> | <u>Admin. Fees</u> | <u>Total Debt Requirements</u> | <u>Principal Outstanding at End of Year</u> |
|---------------------------------------|--|---|------------------------|------------------------------------|---|
| 2019 | \$ 624,355 | \$ 36,856 | \$ 7,372 | \$ 668,583 | \$ 3,216,927 |
| 2020 | 630,614 | 30,597 | 6,119 | 667,330 | 2,586,313 |
| 2021 | 636,936 | 24,275 | 4,855 | 666,066 | 1,949,377 |
| 2022 | 643,322 | 17,889 | 3,578 | 664,789 | 1,306,055 |
| 2023 | 649,770 | 11,440 | 2,288 | 663,498 | 656,285 |
| 2024 | 656,285 | 4,926 | 985 | 662,196 | 0 |
| | <u>\$ 3,841,282</u> | <u>\$ 125,983</u> | <u>\$ 25,197</u> | <u>\$ 3,992,462</u> | |

**Mount Sterling Water and Sewer Commission
 Schedule of Proportionate Share of the Net Pension Liability
 As of and for the year ended June 30, 2018**

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|--------------|--------------|--------------|--------------|--------------|
| Commission's proportion of the net pension liability | 0.054756% | 0.057564% | 0.055168% | 0.054759% | 0.054759% |
| Commission's proportionate share of the net pension liability (asset) | \$ 3,205,037 | \$ 2,834,255 | \$ 2,371,971 | \$ 1,781,540 | \$ 2,010,266 |
| Commission's covered employee payroll | \$ 1,352,285 | \$ 1,338,593 | \$ 1,373,209 | \$ 1,287,153 | \$ 1,256,270 |
| Commission's share of the net pension liability (asset) as a percentage of its covered employee payroll | 237.01% | 211.73% | 172.73% | 138.41% | 160.02% |
| Plan fiduciary net position as a percentage of the total pension liability | 53.32% | 55.50% | 59.97% | 66.80% | 61.22% |

Notes:

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

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

**Mount Sterling Water and Sewer Commission
Schedule of Pension Contributions
As of and for the year ended June 30, 2018**

| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| Contractually required employer contribution | \$ 195,811 | \$ 186,618 | \$ 170,553 | \$ 164,134 | \$ 172,611 | \$ 158,114 |
| Contributions relative to contractually required employer contribution | \$ 195,811 | \$ 186,618 | \$ 170,553 | \$ 164,134 | \$ 172,611 | \$ 158,114 |
| Contribution deficiency (excess) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Company's covered employee payroll | \$ 1,352,285 | \$ 1,338,593 | \$ 1,373,209 | \$ 1,287,153 | \$ 1,256,270 | \$ 1,252,885 |
| Employer contributions as a percentage of covered-employee payroll | 14.48% | 13.94% | 12.42% | 12.75% | 13.74% | 12.62% |

Notes:

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

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

**Mount Sterling Water and Sewer Commission
 Schedule of Proportionate Share of the Net OPEB Liability
 As of and for the year ended June 30, 2018**

| | 2018 | 2017 |
|--|--------------|--------------|
| Commission's proportion of the net OPEB liability | 0.054756% | 0.054756% |
| Commission's proportionate share of the net OPEB liability (asset) | \$ 1,100,783 | \$ 863,421 |
| Commission's covered employee payroll | \$ 1,352,285 | \$ 1,338,593 |
| Commission's share of the net OPEB liability (asset) as a percentage of its covered employee payroll | 81.40% | 64.50% |
| Plan fiduciary net position as a percentage of the total OPEB liability | 52.40% | 55.24% |

Notes:

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

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

Mount Sterling Water and Sewer Commission
Schedule of OPEB Contributions
As of and for the year ended June 30, 2018

| | 2018 | 2017 |
|--|------------------|------------------|
| Contractually required employer contribution | \$ 63,557 | \$ 63,277 |
| Contributions relative to contractually required employer contribution | <u>\$ 63,557</u> | <u>\$ 63,277</u> |
| Contribution deficiency (excess) | <u>\$ -</u> | <u>\$ -</u> |
| | | |
| Company's covered employee payroll | \$ 1,352,285 | \$ 1,338,593 |
| Employer contributions as a percentage of covered-employee payroll | 4.70% | 4.73% |

Notes:

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

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

**Mount Sterling Water and Sewer Commission
Schedule of Changes in Benefits and Assumptions
As of and for the year ended June 30, 2018**

County Employee Retirement System - Pension & Insurance Funds

Changes of benefit terms - None.

Changes in assumptions

The following changes were adopted by the Board of Trustees and reflected in the valuation performed as of **June 30, 2017**:

- The assumed investment rate of return was decreased from 7.50% to 6.25%.
- The assumed rate of inflation was reduced from 3.25% to 2.30%.
- The payroll growth assumption was reduced from 4.00% to 2.00%.
- The salary increase assumption was reduced from 4.00% average to 3.05% average.

The following changes were adopted by the Board of Trustees and reflected in the valuation performed as of **June 30, 2015**:

- The assumed investment rate of return was decreased from 7.75% to 7.50%.
- The assumed rate of inflation was reduced from 3.50% to 3.25%.
- The assumed rate of wage inflation was reduced from 1% to 0.75%.
- The payroll growth assumption was reduced from 4.50% to 4.00%.
- The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB 2013 (multiplied by 50% for males and 30% for females).
- For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set-back one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set-back four years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.
- Assumed rates of retirement, withdrawal, and disability were updated to more accurately reflect experience.

FAULKNER, KING & WENZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS

JOSEPH C. KING, CPA
JOHN M. WENZ, CPA
KEVIN M. ROMENESKO, CPA
KAREN S. TRENT, CPA
EUGENE C. WEATHERS, CPA

P.O. BOX 285
117 WEST HIGH STREET
MT. STERLING, KY 40353
(859) 498-1836 FAX (859) 498-2116

LANA J. McCANN, CPA
ERICA M. SNOWDEN, CPA
JENNIFER T. COLLINGWOOD, CPA

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

Mount Sterling Water and Sewer Commission
Mount Sterling, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements and have issued our report, which includes an explanatory paragraph regarding the omission of Management Discussion and Analysis, thereon dated September 7, 2018.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described below that we consider to be a significant deficiency.

Finding: 2018-1

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

Compliance and Other Matters

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

Response to Findings

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

Purpose of this Report

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

Faulkner, King & Wenz, PSC

September 7, 2018