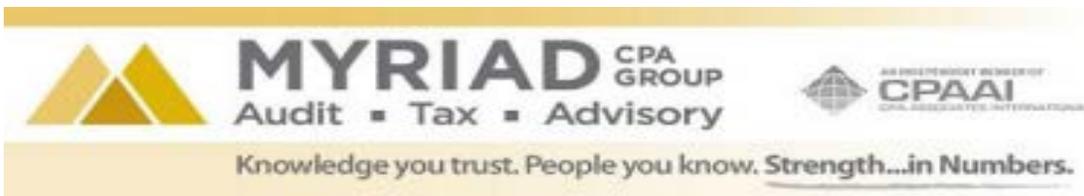


**HENDERSON WATER UTILITY-  
CITY OF HENDERSON, KENTUCKY - WATER AND SEWER  
COMMISSION**

Report on Audited Financial Statements  
For the fiscal years ended June 30, 2016 and 2015

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## **Independent Auditors' Report**

To the Board of Commissioners  
Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission  
Henderson, Kentucky

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer 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.

### **Auditors' Responsibility**

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### **Opinions**

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission as of June 30, 2016 and 2015, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis on pages 3 through 10 and schedules of the Commission's Proportionate Share of Net Pension Liabilities and Commission Contributions, on pages 41 and 42, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole. The Supplemental Schedules of Revenues, Expenses, and Changes in Net Position by Division for the fiscal years ended June 30, 2016 and 2015 on pages 39 and 40 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The schedules have been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such schedules directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedules 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 on our consideration of the Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission's internal control over financial reporting and 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 an audit performed in accordance with *Government Auditing Standards* in considering Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission's internal control over reporting and compliance.



Henderson, Kentucky  
November 17, 2016

## Management's Discussion and Analysis

As management of the Henderson Water Utility- City of Henderson, Kentucky- Water and Sewer Commission (Commission), we offer readers of the Commission's financial statement this overview and analysis of the financial activities of the Commission for the fiscal year ended June 30, 2016. The Commission is in the business of providing water, wastewater and stormwater services for the City of Henderson, Kentucky as well as parts of Henderson, Webster and McLean counties. It is our intent that these comments provide all parties interested in the Commission's financial condition, especially the citizens of Henderson, a better understanding of the Commission's operations and financial condition. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in the Commission's financial statements, which begin on page 11 of this report.

### Financial Highlights

- The Commission's total assets decreased by 2.2% from \$94,990,325 at June 30, 2015 to \$92,892,622 at June 30, 2016 primarily due to the expenditure of cash and investments to continue the various capital projects including the expansion of the north wastewater treatment plant and make improvements to the two water treatment plants.
- Operating revenues increased \$591,756 or 3.4% from \$17,605,009 to \$18,196,765 due primarily to a 5.85% rate increase on non-contractual customers that went into effect in July 2015 partially offset by decreased commercial and industrial usage.
- Operating expenses increased by \$1,229,874 or 7.9% from \$15,419,716 to \$16,649,590 due primarily to higher personnel related expenses (wages and benefits). This increase in expense outpaced the change in operating revenues resulting in a \$638,118 or 29.2% decrease in operating income compared to the year ago period.
- The Commission produced a negative cash flow of \$3,259,660 for the year. The Commission generated approximately \$7.4 million in cash from operations, investments and proceeds from asset sales. The sources of cash were exceeded by capital expenditures of approximately \$6.8 million and debt-related payments of approximately \$3.8 million.
- During the fiscal year ending June 30, 2015, the Commission implemented GASB Statement No. 68, which required the Commission to report and fully disclose its proportionate share of net pension liability and related deferred outflows and inflows of resources and pension expense from the Commission's participation in the County Employees' Retirement System (CERS). This implementation required the Commission to restate beginning net position for the net beginning balances related to the pension plan. This restatement resulted in an approximate \$5.2 million decrease in net position as of July 1, 2014. For more information on this restatement and current year pension activity, please refer to Note 7 of these financial statements.

### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Commission's basic financial statements. These basic financial statements are comprised of four components: 1) the financial statements, 2) notes to the financial statements, 3) supplemental information and 4) required supplemental information.

The Commission is a business-type activity and the Commission's basic financial statements include: the *Statement of Net Position*, the *Statement of Revenues, Expenses, and Changes in Net Position* and the *Statement of Cash Flows*. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB) and can be found on pages 11-15 of this report.

## **Overview of the Financial Statements, continued**

The *Statement of Net Position* presents information on all of the Commission's assets, deferred outflows of resources, liabilities and deferred inflows, with the difference reported as net position. Net position is an important measure of the Commission's overall financial health and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Commission's creditors (liabilities). It also provides the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of Commission. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Commission is improving or deteriorating.

The *Statement of Revenues, Expenses, and Changes in Net Position* presents information on how the Commission's net position changed, including operating revenues, operating expenses, non-operating income and expenses, capital contributions and any other changes in net position, during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. This statement measures the success of the Commission's operations over the past year and can be used to determine whether the company has successfully recovered all of its costs through water and wastewater charges, has earned a profit, and has maintained credit worthiness.

The *Statement of Cash Flows* presents information showing how the Commission's cash and cash equivalents position changed during the fiscal year. The primary purpose of this statement is to provide information about the Commission's cash receipts, cash payments, and net changes in cash resulting from operations, investing, capital and financing activities and provides information on the sources and uses of cash and the changes in cash balances during the year.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 16-38.

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the Commission's funding of its obligation to provide pension benefits to its employees. The required supplementary information can be found on pages 41-42 of this report. Additional, not required, supplementary information reporting revenues, expenses and changes in net assets by division can be found on pages 39-40.

## Condensed Comparative Financial Statements

<b>Statement of Net Position</b>				
(in thousands)				
	6/30/2016	6/30/2015	Increase (Decrease)	Percent Change
<b>Assets:</b>				
Current Assets	\$ 10,654	\$ 15,696	\$ (5,042)	-32.1%
Restricted Assets	535	888	(353)	-39.8%
Non-Current Assets	16	148	(132)	-89.2%
Capital Assets	81,687	78,258	3,429	4.4%
Total Assets	<u>92,892</u>	<u>94,990</u>	<u>(2,098)</u>	<u>-2.2%</u>
Deferred Outflows of Resources	<u>1,341</u>	<u>655</u>	<u>686</u>	<u>104.7%</u>
<b>Liabilities:</b>				
Current Liabilities	4,758	5,209	(451)	-8.7%
Long-term Liabilities	<u>44,752</u>	<u>45,392</u>	<u>(640)</u>	<u>-1.4%</u>
Total Liabilities	<u>49,510</u>	<u>50,601</u>	<u>(1,091)</u>	<u>-2.2%</u>
Deferred Inflows of Resources	<u>-</u>	<u>560</u>	<u>(560)</u>	<u>-100.0%</u>
<b>Net Position:</b>				
Invested in capital assets, net of related debt	41,761	36,390	5,371	14.8%
Restricted for debt service	288	362	(74)	-20.4%
Unrestricted	<u>2,674</u>	<u>7,732</u>	<u>(5,058)</u>	<u>-65.4%</u>
Total Net Position	<u>\$ 44,723</u>	<u>\$ 44,484</u>	<u>\$ 239</u>	<u>0.5%</u>

### Summary

The Commission's assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources by \$44.7 million at fiscal year end, an increase of \$238,816 or 0.5% from the prior year. The increase in net position was driven by decreases in liabilities and deferred inflows of resources offset by decreases in assets and changes in deferred outflows of resources.

### Assets and Deferred Outflows of Resources

Total assets decreased by \$2,097,703 or 2.2% from the prior period. A \$3,428,350 increase in capital assets was offset by a \$5,041,496 reduction in current assets. The decrease in current assets were primarily due to a decrease in cash and investments of approximately \$5.1 million which were primarily used for capital expenditures on ongoing construction projects. The Commission's capital expenditures for the fiscal year were approximately \$6.8 million compared to annual depreciation expense of \$3.1 million and net capital assets disposals of \$300 thousand. Deferred outflows of resources increased \$685,783 and was driven by pension related adjustments from the Commission's participation in CERS.

## Liabilities and Deferred Inflows of Resources

Total liabilities decreased \$1,090,736 or 2.2% due to a decrease in current liabilities of \$450,786 and a decrease in non-current liabilities of \$639,950. The decrease in non-current liabilities is largely due to a decrease in long-term debt of \$2,392,473 offset by an increase in the net pension liability of \$1,716,606 from the Commission's participation in CERS. Deferred inflows of resources decreased by \$560,000 which were fully related to pension related adjusts associated with the Commission's CERS participation.

## Net Position

There are three components of the Commission's net position. The largest portion, Invested in Capital Assets, Net of Related Debt, represents the Commission's investment in capital assets, net of any related debt (debt used to finance the purchase of capital assets) and reflects the Commission's investment in property, plant and equipment. The component, Restricted for Debt Service, represents amounts restricted by debt covenants to be maintained for specific debt issue and consist of funds to meet principal and interest requirements and reserves. The remaining Unrestricted Net Position is available to the Commission to meet its ongoing obligations. The Commission's overall net position is simply a function of its assets and deferred outflows of resources minus its liabilities and deferred inflows of resources. During the period, the Commission's net position increased as previously noted.

<b>Statement of Revenues, Expenses, and Changes in Net Position</b>				
(in thousands)				
	<u>6/30/2016</u>	<u>6/30/2015</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Operating revenues	\$ 18,197	\$ 17,605	\$ 592	3.4%
Operating expenses	<u>16,650</u>	<u>15,420</u>	<u>1,230</u>	<u>8.0%</u>
Operating income	1,547	2,185	(638)	-29.2%
Net non-operating activity	<u>(1,103)</u>	<u>(1,445)</u>	<u>342</u>	<u>-23.7%</u>
Change in net position before contributions and transfers	444	740	(296)	-40.0%
Transfers	(400)	(400)	-	0.0%
Capital contributions	<u>195</u>	<u>150</u>	<u>45</u>	<u>30.0%</u>
Change in net position	239	490	(251)	-51.2%
Net position at beginning of year as restated (1)	<u>44,484</u>	<u>43,994</u>	<u>490</u>	<u>1.1%</u>
Net position at end of year	<u>\$ 44,723</u>	<u>\$ 44,484</u>	<u>\$ 239</u>	<u>0.5%</u>

- (1) The Commission implemented GASB Statements Nos. 68 and 71 during the year ended June 30, 2015. For additional information, refer to Notes 7 and 16 in the accompanying financial statements.

## Summary

The Commission's operating revenues increased 3.4% and operating expenses increased 8.0% resulting in a decrease in operating income of 29.2% or \$638,118. Non-operating activity (net) improved by 23.7% due to decreases in interest and amortization expense and no loss realized on capital asset activity. Change in net position decreased \$251,500 or 51.2% compared to the year-ago period.

## Operating Revenues

Operating revenues increased by approximately \$592,000 or 3.4%. The increase in water and wastewater sales was primarily due to an increase in non-contractual volumetric rates offset by variations in both contractual rates and usage in addition to non-contractual customer usage. Fee and surcharge income increased due to additional current year billings to commercial and industrial customers for various regulatory and contractual issues.

<b>Operating Revenues</b>				
(in thousands)				
	<u>6/30/2016</u>	<u>6/30/2015</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
North:				
Water sales	\$ 5,242	\$ 4,906	\$ 336	6.8%
Wastewater sales	7,536	7,142	394	5.5%
Penalties, fees and surcharges	<u>432</u>	<u>314</u>	<u>118</u>	<u>37.6%</u>
Total North	<u>13,210</u>	<u>12,362</u>	<u>848</u>	<u>6.9%</u>
South				
Water sales	2,012	1,994	18	0.9%
Wastewater sales	2,909	3,210	(301)	-9.4%
Penalties, fees and surcharges	<u>66</u>	<u>39</u>	<u>27</u>	<u>69.2%</u>
Total South	<u>4,987</u>	<u>5,243</u>	<u>(256)</u>	<u>-4.9%</u>
Total operating revenues	<u>\$ 18,197</u>	<u>\$ 17,605</u>	<u>\$ 592</u>	<u>3.4%</u>

## Operating Expenses

Operating expenses increased by approximately \$1.2 million or 8.0%. The key components of operating expenses are: Operation and maintenance expenses and depreciation expense. Operation and maintenance expense increased by approximately \$1.4 million primarily due to increased personnel related costs (wages, health insurance and retirement) and electric utilities partially offset by lower contractual service and repairs and maintenance expenses. Depreciation expense decreased by approximately \$227,000 as capitalized assets reaching end of depreciable lives exceeded new capital assets being placed in service.

## Operating Expenses, continued

<b>Operating Expenses</b>				
(in thousands)				
	<u>6/30/2016</u>	<u>6/30/2015</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Salaries and benefits	\$ 6,980	\$ 5,693	\$ 1,287	22.6%
Contractual services	2,053	2,146	(93)	-4.3%
Supplies and materials	1,629	1,630	(1)	-0.1%
Utilities	1,552	1,295	257	19.8%
Repairs and maintenance	570	630	(60)	-9.5%
Other services and expenses	767	700	67	9.6%
Depreciation	<u>3,099</u>	<u>3,326</u>	<u>(227)</u>	<u>-6.8%</u>
Total operating expenses	<u>\$ 16,650</u>	<u>\$ 15,420</u>	<u>\$ 1,230</u>	<u>8.0%</u>

## Cash Flows

<b>Statement of Cash Flows</b>				
(in thousands)				
	<u>6/30/2016</u>	<u>6/30/2015</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Cash Provided (Used) by:				
Operating Activities	\$ 4,936	\$ 5,832	\$ (896)	-15.4%
Financing Activities				
Non-capital	(400)	(400)	-	0.0%
Capital	(10,085)	(3,420)	(6,665)	194.9%
Investing Activities	<u>2,289</u>	<u>406</u>	<u>1,883</u>	<u>463.8%</u>
Net Change in Cash	<u>\$ (3,260)</u>	<u>\$ 2,418</u>	<u>\$ (5,678)</u>	<u>-234.8%</u>

Cash from Operating Activities decreased by approximately \$896,000 primarily due to higher cash expenses and decreased current liabilities partially offset by increased receipts from customers. Cash from Capital and Related Financing Activities decreased by approximately \$6.6 million due to increased capital spending and principal payments long term debt. Cash Provided by Investing Activities decreased by approximately \$1.9 million primarily due to maturity of investments that were converted to cash in the current year.

## Capital Assets

Commission staff has prepared a Strategic Plan for Capital Spending in the water, wastewater and stormwater systems. This document provides an overview of the anticipated needs of the Henderson Water Utility to repair, replace and add to our existing infrastructure for the period through fiscal year 2025. This plan will be updated annually, and will assist in the annual capital budgeting process.

The Commission entered into a Consent Judgment with the Commonwealth of Kentucky's Environmental & Public Protection Cabinet (EPPC) in 2007 related to reducing the negative environmental impacts of the City's combined sewer system on water quality. An Agreed Order was also issued by the U.S. EPA.

### **Capital Assets, continued**

Under that Consent Judgment, the Commission was required to prepare and submit a Long Term Control Plan (LTCP) to the EPPC and EPA in early 2009. The LTCP and the projects incorporated in the plan were approved by both regulatory agencies in April 2012. The Commission is required by the Agreed Order to complete all components of the plan before December 2017. The purpose of the LTCP is to mitigate the negative environmental impacts of the City's combined sewer system on water quality in the Ohio River and Canoe Creek. Those projects are now nearly complete. We have completed the Downtown Sewer Separation Project (Phase I) and the Canoe Creek Interceptor (Phase II) components, and the third major component, the expansion of the North Wastewater Treatment Plant is nearing completion and will be completed in the third quarter of calendar year 2016. The current estimate of costs related to the LTCP is \$44.4 million of which approximately \$800,000 remaining.

The major concern of focusing all our capital investments on the LTCP to meet the Consent Judgment requirements is that we have been unable to fund other necessary infrastructure and operating needs at desired levels. The Commission's treatment plants, water distribution system, sewer and storm water collection systems must be routinely repaired, replaced and upgraded. With extremely limited funds available for other capital needs outside the LTCP projects, we have been forced to delay investments in other critical infrastructure. Additional borrowing of \$ 3 million completed in September 2014 was used to fund critical projects in both the North and South Water systems. That process included painting of the 500,000 gallon Frontier water storage tank, and planning and implementation of various projects at the South Water Treatment Plant. Plans have been prepared for a new 800,000 gallon pre-stressed concrete clearwell. A project to further the useful life of conical clarifiers and other critical items in the plant was completed in spring 2016. In addition, plans have been prepared for a large upgrade of the water plant, switching to a membrane filtration system. An additional project in the North water system was the painting and upgrading of the Vine street water storage tank, completed in fall 2016.

Stormwater needs are ongoing and growing. The Commission has completed several small drainage projects over the previous fiscal years, and maintains a prioritized list of future projects. One notable project completed in fiscal year was the Cooper Park Project, which utilized a State grant to provide stormwater relief in an older subdivision located on the North Fork of Canoe Creek. This project was constructed by Utility crews.

We also know that new, more stringent regulations are on the horizon that will require greater capital investment in advanced water and sewer treatment technology within the upcoming years. As our projects are completed, other requirements within the Consent Judgment will require investments in equipment and technology to collect data and monitor our progress toward improving water quality.

Our challenge continues to be to balance these competing capital needs while providing our customers with quality water and services at a reasonable competitive price.

The Commission's investment in capital assets as of June 30, 2016 amounted to approximately \$42.0 million (net of accumulated depreciation and related debt). The investment in capital assets includes land, buildings, improvements, machinery and equipment, vehicles, construction in progress and infrastructure acquired and disposed since the Commission's inception. The Commission's net capital assets for the current fiscal year increased approximately \$3.4 million or 4.4% due to current year acquisitions, exceeding current year depreciation expense. The Commission expended approximately \$6.8 million in the current fiscal year on the acquisition and construction of capital assets.

### **Capital Assets, continued**

Major capital events of the current fiscal year included the following:

- Construction of various water and wastewater projects totaling approximately \$5.9 million. Main projects consisted of NWWTP Headworks Project (\$2.4 million), NWTP Rehabilitation Project (\$1.2 million), and Frontier Tank (\$542,000). These projects will be completed in early fiscal year 2017.
- Purchase of new Wash Truck for approximately \$220,000 and five new crew trucks for approximately \$194,000.

Additional information on the City's capital assets can be found in Note 5 on page 23 of this report.

### **Debt Administration**

At June 30, 2016, the Commission had \$3,110,000 principal outstanding in bonded debt related to its Series 2006A Revenue Bonds. The Commission also had other debt of \$36,922,239 which consists of various notes to the City of Henderson issued in conjunction with City's General Obligation Bond Series 2010 A & B, 2012 A, 2013 A, 2014 A, 2015 B & C, and 2016 B. These bonds were issued to finance the Commission's various Long-Term Control Plan (LTCP) capital projects, necessary water plant improvements and refinance various Commission debt issues (bonds, KADD & KIA notes, and KACO leases). The Commission has committed to reimbursing the City for all debt service payments made for these issuances.

Additional information on the Commission's debt can be found in Note 6 on pages 24-25 of this report.

### **Economic Factors and Next Year's Budgets and Rates**

Water and wastewater revenues for the fiscal year ending June 30, 2017, are budgeted to increase approximately 2% from fiscal year 2016 actual revenues based primarily due to increased volumetric rates offset by the expected continued trend of volumetric decreases from our non-contractual customers. Operation and maintenance expenses in the fiscal year ending June 30, 2017 are budgeted to increase by \$590,898 or 5.3% from the fiscal year 2016 budget, primarily based on increased labor costs (salaries and benefits).

Management is continually monitoring our rates and rate structure in relation to capital, debt and operational needs, as well as weighing cost to our customers compared to other utilities. The Commission has a previously approved rate increase schedule that continues with annual 5.85% increases on July 1 through 2018. The Commission continues to evaluate and balance available revenue against expenditures, regulatory requirements and service levels and to seek operating efficiencies. Management emphasizes sound financial and operational decision-making with a focus on strategic thinking and planning. Key objectives at present include focusing on future capital needs and development of budgets that approaches both revenues and expenses conservatively and that focuses on long-term sustainability.

### **Request for Information**

The financial report is designed to provide our citizens, ratepayers, customers and creditors with a general overview of the Commission's finances and to show its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Commission at 111 Fifth Street, Henderson, Kentucky, 42420.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Statements of Net Position  
As of June 30, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
<b>Assets</b>		
<u>Current Assets:</u>		
Cash and cash equivalents	\$ 8,374,950	\$ 11,445,981
Investments	35,766	2,102,550
Accounts receivable, consumers	1,166,105	1,208,699
Accrued interest receivable	10	1,873
Inventories	1,030,522	902,859
Prepaid expenses	47,282	34,169
Total Current Assets	<u>10,654,635</u>	<u>15,696,131</u>
<u>Restricted Assets:</u>		
Cash and cash equivalents	-	188,629
Investments	534,909	699,042
Accrued interest receivable	91	5
Total Restricted Assets	<u>535,000</u>	<u>887,676</u>
<u>Capital Assets:</u>		
Non-depreciable	1,466,482	1,466,482
Depreciable, net of accumulated depreciation	63,009,675	64,939,581
Construction in progress	17,210,815	11,852,559
Total Capital Assets	<u>81,686,972</u>	<u>78,258,622</u>
<u>Other Assets</u>	<u>16,015</u>	<u>147,896</u>
Total Assets	<u>92,892,622</u>	<u>94,990,325</u>
<u>Deferred Outflows of Resources</u>		
Total Deferred Outflows of Resources	<u>1,340,953</u>	<u>655,170</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 94,233,575</u>	<u>\$ 95,645,495</u>

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

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Statements of Net Position, Continued  
As of June 30, 2016 and 2015**

**Liabilities, Deferred Inflows of Resources, and Net Position**

	<b>2016</b>	<b>2015</b>
<u>Current Liabilities:</u>		
Accounts payable	\$ 577,490	\$ 901,504
Retainage payable	477,082	513,404
Deposits payable	85,204	80,694
Accrued interest payable	147,474	160,571
Current portion, long-term debt	2,026,146	1,842,712
Compensated absences	371,967	468,247
Accrued liabilities	826,148	904,364
Total Current Liabilities	4,511,511	4,871,496
<u>Current Liabilities Payable from Restricted Assets:</u>		
Accrued interest payable	21,721	37,522
Current portion, long-term debt	225,000	215,000
Current portion, capital lease obligations	-	85,000
Total Current Liabilities Payable from Restricted Assets	246,721	337,522
Total Current Liabilities	4,758,232	5,209,018
<u>Non-Current Liabilities:</u>		
Compensated absences	342,225	200,677
Accrued pension liability	6,734,694	5,018,088
Capital lease obligations, net of current portion	-	1,700,000
Long-term debt, net of current portion	37,675,462	38,473,566
Total Non-Current Liabilities	44,752,381	45,392,331
Total Liabilities	49,510,613	50,601,349
<u>Deferred Inflows of Resources:</u>		
Total Deferred Inflows of Resources	-	560,000
<u>Net Position:</u>		
Invested in capital assets, net of related debt	41,760,364	36,103,169
Restricted for debt service	288,279	550,154
Unrestricted	2,674,319	7,830,823
Total Net Position	44,722,962	44,484,146
Total Liabilities, Deferred Inflows of Resources, and Total Net Position	\$ 94,233,575	\$ 95,645,495

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

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Statements of Revenues, Expenses, and Changes in Net Position  
For the fiscal years ended June 30, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
<b><u>Support and revenues:</u></b>		
Water sales	\$ 7,254,094	\$ 6,900,359
Water penalties, surcharges and fees	66,143	67,801
Wastewater fees	10,444,721	10,352,108
Wastewater penalties, surcharges and fees	431,807	284,741
Total operating revenues	<u>18,196,765</u>	<u>17,605,009</u>
<b><u>Operating expenses:</u></b>		
Water pumps and tanks	227,361	227,365
Water intake and treatment	3,371,069	3,330,630
Water transmission and distribution	1,720,696	1,208,528
Wastewater pumping stations	1,583,924	1,218,893
Wastewater lines and connections	1,327,075	562,369
Wastewater pretreatment and treatment	4,166,032	4,137,147
Stormwater	1,155,032	1,409,219
Depreciation	3,098,401	3,325,565
Total expenses	<u>16,649,590</u>	<u>15,419,716</u>
Operating income	<u>1,547,175</u>	<u>2,185,293</u>
<b><u>Non-operating revenues (expenses):</u></b>		
Investment income	42,921	31,150
Gain on sale/impairment of assets	26,967	(263,957)
Miscellaneous income	13,452	25,479
Interest expense	(1,171,858)	(1,213,579)
Amortization	(14,849)	(24,070)
Total non-operating revenues (expenses)	<u>(1,103,367)</u>	<u>(1,444,977)</u>
Increase in net position before contributions and transfers	443,808	740,316
Distribution to the City of Henderson	(400,000)	(400,000)
Capital contributions	195,008	150,000
Increase in net position	238,816	490,316
Cumulative effect of change in accounting principle- GASB 68	-	(5,176,088)
Net position at beginning of year	<u>44,484,146</u>	<u>49,169,918</u>
Net position at end of year	<u>\$ 44,722,962</u>	<u>\$ 44,484,146</u>

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

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Statements of Cash Flows  
For the fiscal years ended June 30, 2016 and 2015**

	<b>2016</b>	<b>2015</b>
<b><u>Cash flows from operating activities:</u></b>		
Receipts from customers	\$ 18,123,260	\$ 17,944,434
Payments to suppliers for goods or services	(6,744,981)	(6,199,081)
Payments to employees for services	(6,442,618)	(5,913,535)
Net cash provided by operating activities	4,935,661	5,831,818
<b><u>Cash flows from non-capital financing activities:</u></b>		
Distributions to the City of Henderson	(400,000)	(400,000)
Net cash used by non-capital financing activities	(400,000)	(400,000)
<b><u>Cash flows from capital and related financing activities:</u></b>		
Acquisition and construction of capital assets	(6,801,485)	(8,075,514)
Proceeds from issuance of long-term debt	11,585,000	8,045,812
Principal payments on long-term debt	(12,118,824)	(2,374,586)
Principal payments on capital lease obligations	(1,785,000)	(1,177,253)
Interest payments on long-term debt	(1,189,157)	150,000
Proceeds from contributed capital	195,008	2,400
Proceeds from sale of capital assets	30,067	9,413
Net cash used by capital and related financing activities	(10,084,391)	(3,419,728)
<b><u>Cash flows from investing activities:</u></b>		
Purchase of investment securities	(360,246)	(661,943)
Proceeds from sale and maturity of investment securities	2,583,088	1,021,468
Investment and other income	66,228	46,180
Net cash provided by investing activities	2,289,070	405,705
Net increase (decrease) in cash and cash equivalents	(3,259,660)	2,417,795
Cash and cash equivalents, beginning of year	11,634,610	9,216,815
Cash and cash equivalents, end of year	\$ 8,374,950	\$ 11,634,610
<b><u>Reconciliation of total cash and cash equivalents:</u></b>		
Current assets-cash and cash equivalents	\$ 8,374,950	\$ 11,445,981
Restricted assets-cash and cash equivalents	-	188,629
Total cash and cash equivalents	\$ 8,374,950	\$ 11,634,610

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

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Statements of Cash Flows, continued  
For the fiscal years ended June 30, 2016 and 2015**

	<b>2016</b>	<b>2015</b>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 1,547,175	\$ 2,185,293
Items to reconcile net operating income to net cash provided by operations:		
Depreciation	3,098,401	3,325,565
Net effect of GASB 68	470,823	
Changes in operation asset and liabilities		
Accounts receivable, consumers	42,594	68,533
Inventories	(127,663)	20,900
Prepaid expenses	(13,113)	(1,722)
Accounts payable	(324,014)	163,615
Retainage payable	(36,322)	-
Deposits payable	4,510	-
Compensated absences	45,268	14,250
Accrued liabilities	(78,216)	55,384
Net cash provided by operating activities	\$ 4,629,443	\$ 5,831,818

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

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 1 –SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies of the Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission ("Commission") conform to generally accepted accounting principles (GAAP) applicable to governmental enterprise units. The following summary of the more significant policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

Reporting Entity

The Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission is a component unit of the City of Henderson, Kentucky. Its purpose is to construct, operate, and maintain water and sewer service facilities and supply water to the City of Henderson and surrounding areas. It is legally separate from the City of Henderson but its governing body is appointed by the City Commission of Henderson. The financial statements presented here are also included in the comprehensive annual financial report of the City of Henderson, Kentucky.

Basis of Accounting Presentation

The Commission is a single-enterprise proprietary fund and uses the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recognized as soon as they result in liabilities for the benefits provided. Proprietary funds are used to account for operations (a) that are financed in a manner similar to private business enterprise-where the intent of the governing body is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges and (b) that a periodic determination of revenues earned, expenses incurred and/or change in net assets is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The financial statements are prepared on the basis of Governmental Accounting Standards Board (GASB), Statement Number 34, *Basic Financial Statements, Management Discussion and Analysis for State and Local Governments* and related standards.

The Henderson Water Utility is accounted for as an enterprise fund. The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. In accordance with the provisions of the GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, and GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre- November 30, 1989 FASB and AICPA Pronouncements*, the Utility applies all Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Charges for services include revenues based on exchange or exchange-like transactions, namely water and sewer use. Program-specific grants and contributions (operating and capital) include revenues arising from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program.

Allocation of overhead expenses from one function to another, and within one function, is eliminated in the statement of activities so that allocated expenses are reported only by the function in which they are allocated.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

Basis of Accounting Presentation, continued

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

Measurement Focus

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The financial statements for proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the statement of net position and the statement of revenues, expenses and changes in net position present increases (revenues) and decreases (expenses) in total net assets. Under the accrual basis of accounting revenues are recognized when earned, including unbilled utility services which are accrued. Expenses are recognized at the time the liability is incurred. Property tax revenues are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Cash and Cash Equivalents

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

Accounting and Related Services

The Water and Sewer Commission has an agreement with the City of Henderson to perform its billing and collection services. All monies collected and due to the Commission are maintained in the City of Henderson's Utility Clearing Fund and are paid to the Commission on a weekly basis. The City of Henderson also processes the recording and payment of vendor invoices and the biweekly payroll processing for the Commission. In addition, the City manages the Human Resource function's administration for the Commission.

Investments

KRS 66.480 permits the Commission to invest in U.S Treasury obligations, U.S. Agency obligations, certain Federal instruments, repurchase agreements, commercial bank certificates of deposit, savings and loan deposits, and the Commonwealth of Kentucky investment pool. Investments are recorded at fair market value based on quoted market prices. Any gains or losses are reflected in the statement of income, in accordance with GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

Inventories

Inventories of chemicals, parts, and supplies are recorded at cost using the FIFO method (first in, first out). The cost is recorded as an asset when purchased and as an expense when used (consumption method).

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 1 –SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

Restricted Assets

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

Capital Assets

Capital assets are stated at cost. All materials for capital improvements are capitalized when purchased. Construction in progress is not depreciated until completed and placed into service. Interest is capitalized on assets constructed and acquired with tax exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of borrowing until the completion of the project with interest earned on the invested proceeds from debt issuance over the same period.

Depreciation rates are based upon estimated useful lives and have been applied on the straight-line method. The estimated useful lives are as follows:

	<u>Years</u>
Structures, Lines, Mains and Accessories, and System Improvements	5-50
Equipment, Tools and Accessories, Office Equipment, Shop and Lab Equipment	7-10
Transportation Equipment	5
Rental Property	20

Debt Issuance Costs and Deferred Loss on Refunding of Long-Term Debt

The Commission's current rate methodology as it relates to contracts with certain large industrial concerns provides for recovery of debt issue costs through its rate structure; therefore, the Commission elected to follow the guidance under GASB No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, rather than GASB No. 65, Items Previously Reported as Assets and Liabilities. Under the guidance of GASB No. 62, the debt issuance costs are considered by management to be a regulatory asset and are amortized over the life of the related debt using the interest rate method.

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. A liability for compensated absences attributable to services already rendered and not contingent on a specific event that is outside the control of the Commission and its employees is accrued as employees earn the rights to the benefits. Employees of the Water and Sewer Commission are entitled to paid vacations and paid sick days, depending on job classification, length of service, and other factors. The Commission's policy is to recognize the costs of accumulated earned, but unused, vacation and sick pay benefits under the accrual method of accounting in accordance with Governmental Accounting Standards No. 16.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 1 –SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

Compensated Absences, Continued

Compensated absence activity for the year ended June 30, 2016 was as follows:

	<b>Balance July 01, 2015</b>	<b>Additions</b>	<b>Deductions</b>	<b>Balance June 30, 2016</b>
Compensated absences	\$ 668,924	\$ 417,235	\$(371,967)	\$ 714,192

Presented on the statement of net position under the following captions:

Current liabilities-compensated absences	\$ 371,967
Non-current liabilities-compensated absences	342,225
	\$ 714,192

Use of 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.

Net Position

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

- Invested in capital assets, net of related debt- consists of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance those assets.
- Restricted - consists of net assets that are restricted by the Commission's creditors (for example, through debt covenants), by state enabling legislation (through restrictions on shared revenues), by grantors (both federal and state), and by other contributors.
- Unrestricted- all other net assets are reported in this category.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, restricted resources are applied first.

Retirement Benefits

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

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

Deferred Outflows and Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. The Commission has only one item that qualifies for reporting in this category: the pension-related deferred outflows reported in the statement of net position totaling \$1,340,953 and \$655,170 at June 30, 2016 and 2015, respectively, as described in Note 7 to financial statements.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period and so will not be recognized as revenue until then. The Commission only has one item that meets this criteria: the pension deferred inflows reported in the statement of net position totaling \$0 and \$560,000 at June 30, 2016 and 2015, respectively, as described in Note 7 to financial statements.

**NOTE 2 – CASH AND CASH EQUIVALENTS**

At June 30, 2016, the Water and Sewer Commission maintained deposits in the amount of \$8,374,505 with one local financial institution. Of the bank balances, \$250,000 was insured by federal deposit insurance and the remaining balance was fully collateralized by pledged securities.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 3 – INVESTMENTS**

Investments are summarized as follows at June 30, 2016 and 2015:

<b>June 30, 2016</b>				
<b>Investment Type</b>	<b>Fair Value</b>	<b>Investment Maturities (in Years)</b>		
		<b>Less than 1</b>	<b>1-5</b>	<b>6-10</b>
<b>Unrestricted:</b>				
<b>Cash and equivalents</b>	\$ -	\$ -	\$ -	\$ -
U.S. Government Obligations Fund	-	-	-	-
U.S. Government Securities	-	-	-	-
Marketable Securities	35,766	35,766	-	-
	<u>\$ 35,766</u>	<u>\$ 35,766</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Restricted:</b>				
U.S Government Obligations Fund	\$ 534,909	\$ 534,909	\$ -	\$ -
	<u>\$ 534,909</u>	<u>\$ 534,909</u>	<u>\$ -</u>	<u>\$ -</u>
<b>June 30, 2015</b>				
<b>Investment Type</b>	<b>Fair Value</b>	<b>Investment Maturities (in Years)</b>		
		<b>Less than 1</b>	<b>1-5</b>	<b>6-10</b>
<b>Unrestricted:</b>				
<b>Cash and equivalents</b>	\$ 1,875	\$ 1,875	\$ -	\$ -
U.S. Government Obligations Fund	53,083	53,083	-	-
U.S. Government Securities	2,002,970	2,002,970	-	-
Marketable Securities	44,622	44,622	-	-
	<u>\$ 2,102,550</u>	<u>\$ 2,102,550</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Restricted:</b>				
U.S Government Obligations Fund	\$ 699,042	\$ 699,042	\$ -	\$ -
	<u>\$ 699,042</u>	<u>\$ 699,042</u>	<u>\$ -</u>	<u>\$ -</u>

**Interest Rate Risk**

As a means of limiting exposures to fair value losses arising from interest rates, the Commission manages the maturities of its investment portfolio. The Commission had no investments at June 30, 2016 subject to interest rate risk.

**Credit Risk**

The Water & Sewer Commission is authorized to invest in U.S. Government-backed securities, any corporation of the U.S. Government, Certificates of Deposit and Bankers Acceptances issued by highly rated banks, commercial paper in the highest rating category, and securities issued by a state or local government rated in one of the three highest categories by a nationally recognized rating agency, and any other investment permitted by KRS 66.480.

The only exceptions are the marketable securities owned by the Commission. These securities were obtained by the Commission at no cost when the Utility's life insurance provider converted to a publicly-traded company from a mutual company in 2002. The approximate fair value at June 30, 2016 was \$35,766.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 3 – INVESTMENTS, CONTINUED**

Custodial Credit Risk

For an investment, the custodial credit risk is the risk that in the event of the failure of the counterparty, the Commission will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All restricted and unrestricted investments of the Commission, except for the marketable securities, comprise of uninsured and unregistered investments for which the securities are held by the Commission's trustees in their trust department not in the name of the Henderson Water Utility. As of June 30, 2016, no investments are held by and in the name of Field and Main Bank, the counterparty.

Concentration of Credit Risk

The Commission places no limit on the amount that the Commission may invest in any one issuer. More than 5 percent of the Commission's investments are in U.S. Government Obligations Money Market Funds as of June 30, 2016.

**NOTE 4 -RESTRICTED ASSETS**

Certain assets of the Water and Sewer Commission, which are restricted by bond and loan covenants, consisted of the following at June 30, 2016 and 2015:

<b>June 30, 2016</b>				
	<b>Cash</b>	<b>U.S. Treasury</b>	<b>Accrued Interest</b>	<b>Total</b>
Bond Sinking	\$ -	\$ 172,143	\$ 23	\$ 172,166
Debt Service Reserve	-	362,766	68	362,834
Operating Reserve	-	-	-	-
	\$ -	\$ 534,909	\$ 91	\$ 535,000
<b>June 30, 2015</b>				
	<b>Cash</b>	<b>U.S. Treasury</b>	<b>Accrued Interest</b>	<b>Total</b>
Bond Sinking	\$ -	\$ 166,474	\$ 1	\$ 166,475
Debt Service Reserve	-	532,568	4	532,572
Operating Reserve	188,629	-	-	188,629
	\$ 188,629	\$ 699,042	\$ 5	\$ 887,676

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 5 – CAPITAL ASSETS**

Capital asset activity for the years ending June 30, 2016 and 2015 was as follows:

	<u>June 30, 2014</u>	<u>Additions</u>	<u>Disposals</u>	<u>June 30, 2015</u>	<u>Additions</u>	<u>Disposals</u>	<u>June 30, 2016</u>
<u>North:</u>							
Water pumps and tanks	\$ 5,732,696	\$ -	\$ -	\$ 5,732,696	\$ -	\$ -	\$ 5,732,696
Water treatment plant	4,809,573	-	(4,722)	4,804,851	71,970	(18,888)	4,857,933
Water transmission and distribution	20,590,505	395,070	-	20,985,575	19,205	(40,682)	20,964,098
Wastewater lines and collections	26,075,993	61,331	(16,854)	26,120,470	-	(47,019)	26,073,451
Wastewater pumping stations	6,714,286	-	-	6,714,286	27,545	-	6,741,831
Wastewater treatment plant	14,943,890	28,712	(258,932)	14,713,670	33,918	(26,045)	14,721,543
Stormwater system	12,376,118	1,436,892	-	13,813,010	267,225	-	14,080,235
<u>South:</u>							
Water pumps and tanks	1,645,225	-	-	1,645,225	-	-	1,645,225
Water treatment plant	3,136,477	30,394	-	3,166,871	46,909	-	3,213,780
Water transmission and distribution	1,200,900	-	-	1,200,900	-	-	1,200,900
Wastewater lines and collections	2,923,222	-	-	2,923,222	-	-	2,923,222
Wastewater pumping stations	1,035,100	-	-	1,035,100	-	-	1,035,100
Wastewater treatment plant	8,739,994	10,024	-	8,750,018	178,985	(21,113)	8,907,890
<u>Administration</u>	881,963	146,253	(16,725)	1,011,491	40,160	(116,981)	934,670
<u>System operations center</u>	3,721,333	425,493	(22,000)	4,124,826	491,434	(107,003)	4,509,257
	<u>114,527,275</u>	<u>2,534,169</u>	<u>(319,233)</u>	<u>116,742,211</u>	<u>1,177,351</u>	<u>(377,731)</u>	<u>117,541,831</u>
Less: accumulated depreciation	<u>(47,066,162)</u>	<u>55,579</u>	<u>(3,325,565)</u>	<u>(50,336,148)</u>	<u>368,875</u>	<u>(3,098,401)</u>	<u>(53,065,674)</u>
	67,461,113	2,589,748	(3,644,798)	66,406,063	1,546,226	(3,476,132)	64,476,157
Construction in progress	<u>7,379,185</u>	<u>6,449,360</u>	<u>(1,975,986)</u>	<u>11,852,559</u>	<u>5,899,125</u>	<u>(540,869)</u>	<u>17,210,815</u>
Capital assets, net	<u>\$ 74,840,298</u>	<u>\$ 9,039,108</u>	<u>\$ (5,620,784)</u>	<u>\$ 78,258,622</u>	<u>\$ 7,445,351</u>	<u>\$ (4,017,001)</u>	<u>\$ 81,686,972</u>

Depreciation expense for the years ended June 30, 2016 and 2015 was \$3,098,401 and \$3,325,565, respectively.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 6 – LONG-TERM DEBT**

Long-term debt of the Water and Sewer Commission consists of the following as of June 30, 2016 and 2015:

	<b>Balance June 30, 2014</b>	<b>Additions</b>	<b>Deductions</b>	<b>Balance June 30, 2015</b>	<b>Additions</b>	<b>Deductions</b>	<b>Balance June 30, 2016</b>	<b>Due Within One Year</b>
Series 2004A Water and Sewer	\$ 595,000	\$ -	\$ (595,000)	\$ -	\$ -	\$ -	\$ -	\$ -
Series 2006A Water and Sewer	3,530,000	-	(205,000)	3,325,000	-	(215,000)	3,110,000	225,000
Note to City of Henderson-2010A	8,860,000	-	(430,000)	8,430,000	-	(8,430,000)	-	-
Note to City of Henderson-2010B	1,251,200	-	(110,470)	1,140,730	-	(113,491)	1,027,239	116,146
Note to City of Henderson-2012A	9,165,000	-	(420,000)	8,745,000	-	(425,000)	8,320,000	435,000
Note to City of Henderson-2013A	9,320,000	-	(405,000)	8,915,000	-	(410,000)	8,505,000	420,000
Note to City of Henderson-2014A	-	8,000,000	-	8,000,000	-	(320,000)	7,680,000	325,000
Note to City of Henderson-2015B	-	-	-	-	1,870,000	(160,000)	1,710,000	155,000
Note to City of Henderson-2015C	-	-	-	-	1,700,000	-	1,700,000	110,000
Note to City of Henderson-2016B	-	-	-	-	8,015,000	(35,000)	7,980,000	465,000
Kentucky Infrastructure Authority Assistance Agreement	2,143,886	-	(133,553)	2,010,333	-	(2,010,333)	-	-
Total long-term debt	34,865,086	8,000,000	(2,299,023)	40,566,063	11,585,000	(12,118,824)	40,032,239	\$ 2,251,146
Unamortized premiums on bonds	(57,226)	-	22,441	(34,785)	(82,445)	11,599	(105,631)	-
	<u>\$ 34,807,860</u>	<u>\$ 8,000,000</u>	<u>\$ (2,276,582)</u>	<u>\$ 40,531,278</u>	<u>\$ 11,502,555</u>	<u>\$ (12,107,225)</u>	<u>\$ 39,926,608</u>	<u>\$ 2,251,146</u>

Presented on the statement of net assets under the following captions:

Current portion long-term debt	\$ 2,026,146
Current portion long-term debt payable from restricted assets	225,000
Long-term debt, net of current portion and deferred loss on defeasance of bonds	<u>37,675,462</u>
	<u>\$ 39,926,608</u>

Principal and interest requirements to retire the Commission's long-term obligation at June 30, 2016 were as follows:

<u>For the fiscal year ending June 30th:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 2,251,146	\$ 991,409	\$ 3,242,555
2017	2,283,613	942,943	3,226,556
2018	2,341,297	892,842	3,234,139
2019	2,389,090	840,916	3,230,006
2020	2,451,671	787,019	3,238,690
2021-2025	12,885,422	3,023,932	15,909,354
2026-2030	11,625,000	1,405,131	13,030,131
2031-2035	3,805,000	184,341	3,989,341
	<u>\$ 40,032,239</u>	<u>\$ 9,068,533</u>	<u>\$ 49,100,772</u>

**Henderson Water Utility –  
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**NOTE 6 – LONG-TERM DEBT, CONTINUED**

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

	<u>Interest Rate</u>	<u>Final Maturity</u>	<u>Principal Balance</u>	<u>Security</u>
Water and Sewer Refunding Revenue Bonds, Series 2006A (Due annually in amounts ranging from \$225,000 to \$355,000)	3.70%-4.375%	11/1/26	\$ 3,110,000	Utility revenues
Note payable to City of Henderson, (Due annually in amounts ranging from \$116,246 to \$144,403)	2.00%-3.50%	11/1/23	\$ 1,027,239	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$435,000 to \$640,000)	1.00%	11/1/31	\$ 8,320,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$420,000 to \$600,000)	2.00%-2.75%	11/1/32	\$ 8,505,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$325,000 to \$520,000)	2.00%-2.50%	11/01/34	\$ 7,680,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$70,000 to \$180,000)	1.00%-2.50%	11/1/2026	\$ 1,710,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$105,000 to \$140,000)	2.00%-2.75%	11/1/2029	\$ 1,700,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$465,000 to \$605,000)	2.00%-2.50%	11/1/2030	\$ 7,980,000	Unsecured

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**NOTE 7 – COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS)**

**General Information about the CERS Pension Plan**

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

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

Non-hazardous members:

Tier 1:

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

**Age and service requirement:**

Unreduced Benefit:	Age 65, with at least 48 months of service credit. Age 65, with at least one month of non-hazardous duty service credit. Any age with 27 or more years of service credit
Reduced Benefit:	Age 55, with at least five (5) years of service credit Any age with at least 25 and up to 27 years of service credit

**Benefit Amount:**

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

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

**Compensation:**

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

Tier 2:

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



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**NOTE 7 – COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS), CONTINUED:**

For all tiers, cost of living adjustments (COLA) are provided only if authorized by the Legislature and are at the discretion of the General Assembly. Death and disability benefits are available to members based on years of service, compensation, retirement date and other factors. Please refer to the Summary Plan Description, available from KRS, for a complete description of all Plan benefits and provisions.

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

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

The Commission contributes at an actuarially determined contribution rate determined by KRS Board. The Commission's required contribution rates for the year ended June 30, 2016 and 2015, were 12.42% and 12.75%, respectively for non-hazardous employees. Contributions to CERS by the Commission were \$494,745 and \$472,746 for the years ended June 30, 2016 and 2015.

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

At June 30, 2016 and 2015, the Commission reported a liability of \$6,734,694 and \$5,018,000, respectively for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015 and 2014, respectively and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of those dates. The Commission's proportion of the net pension liability was based on a projection of the Commission's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2015 and 2014, the Commission's proportion was 0.15664% and 0.15467%, respectively.

For the year ended June 30, 2016, the Commission recognized pension expense of \$965,568. At June 30, 2016, the Commission reported deferred outflows and inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience	\$ 55,968	\$ -
Changes in assumptions	679,120	-
Net difference between projected and actual earnings on plan investments	60,371	-
Changes in proportion and differences between employer contributions and proportionate share of contributions	50,749	-
Commission contributions subsequent to the measurement date	494,745	-
	<u>\$ 1,340,953</u>	<u>\$ -</u>

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**NOTE 7 – COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS), CONTINUED:**

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

The \$494,745 reported as deferred outflows of resources related to pensions resulting from Commission contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year ended June 30:</u>		
2017	\$	328,176
2018		328,176
2019		174,764
2020		15,092
2021		-
Thereafter		-
	<u>\$</u>	<u>846,208</u>

*Actuarial assumptions:* The total pension liability in the June 30, 2015, actuarial valuation for non-hazardous liabilities was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%	
Salary increases	4.0% average, including inflation	
Investment rate of return	7.50% net of pension plan investment expense, including inflation	

The rates of mortality for the period after service retirement are according to the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back one year for females) for all retired members and beneficiaries and the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females) for all active members. The RP-2000 Combined Disability Mortality Table projected with Scale BB to 2013 set back four years is used for the period after disability retirement for disable members.

The actuarial assumptions used in the June 30, 2015, valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

Discount rate: The discount rate used to measure the total pension liability was 7.50%.

Projected cash flows: The projection of cash flows used to determine the discount rate assumed the local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 28-year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period.

Long term rate of return: The long term rate of return assumption on plan assets is reviewed as part of the regular experience studies prepared every five years for the System. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014.

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**NOTE 7 – COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS), CONTINUED:**

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

Several factors are considered in evaluating the long-term rate of return assumption including long term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe. The assumption is intended to be a long term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

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

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

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

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

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**NOTE 7 – COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS), CONTINUED**

*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 7.5%, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate the is one percentage point lower (6.5%) or one percentage point higher (8.5%) than the current rate:

	<b>1% Decrease</b>	<b>Current Discount Rate</b>	<b>1% Increase</b>
Discount rate	6.50%	7.50%	8.50%
Commission's proportionate share of net pension liability	\$ 8,597,673	\$ 6,734,694	\$ 5,139,217

*Pension plan fiduciary net position:* Detailed information about the pension plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems financial report.

*Method and Assumptions Used in Calculations of Actuarially Determined Contributions:* The actuarially determined contribution rates are determined on a biennial basis beginning with the fiscal years ended 2016 and 2017, determined as of July 1, 2015. The amortization period of the unfunded liability has been reset as of July 1, 2013 to a closed 30-year period. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

Actuarial cost method	Entry age
Amortization method	Level percentage of payroll, closed
Remaining amortization period	28 years
Asset valuation method	5-year smoothed market
Inflation	3.25 percent
Salary increase	4.00 percent, average, including inflation
Investment rate of return	7.50 percent, net of pension plan investment expense, including inflation

*Changes in Assumptions and Benefit Terms:* Since the prior measurement date, the demographic and economic assumptions that affect the measurement of the total pension liability have been changed. The changes are noted below:

- The assumed investment rate of return was decreased from 7.75% to 7.50%.
- The assumed rate of inflation was reduced from 3.50% to 3.25%.
- The assumed rate of wage inflation was reduced from 1.00% to 0.75%.
- Payroll growth assumption was reduced from 4.50% to 4.00%.
- The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females).
- For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.
- The assumed rates of Retirement, Withdrawal and Disability were updated to more accurately reflect experience.

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**NOTE 7 – COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS), CONTINUED**

*Changes since Measurement Date:* There were no changes between the measurement date of the collective net pension liability and the employer's reporting date.

*Payables to the Pension Plan:* At June 30, 2016, the Commission did not have a payable for the outstanding amount of contractually required contributions due to CERS.

**NOTE 8 - OTHER POSTEMPLOYMENT BENEFITS**

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

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

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for members who began participating on, or after, July 1, 2003. Once members reach a minimum vesting period of ten years, nonhazardous employees whose participation began on, or after, July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on or after July 1, 2003 earn \$15 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon death of a hazardous employee, the employee's spouse receives \$10 per month for insurance benefits for each year of the deceased employee's earned hazardous service. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is at the discretion of the Kentucky General Assembly who reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

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

In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

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

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**NOTE 9 - DEFERRED COMPENSATION**

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

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

**NOTE 10 - RELATED PARTY TRANSACTIONS**

The Water and Sewer Commission's members are appointed by the Mayor and Commissioners of the City of Henderson. The Water and Sewer Commission is organized to operate, manage, and control the City of Henderson's Wastewater and Stormwater Systems and the City of Henderson is contingently liable for the outstanding bonded indebtedness (Note 6) of the system in the event user charges are inadequate to fulfill the system's debt service requirements. Other transactions with the City of Henderson during the years ended June 30, 2016 and 2015 were as follows:

- a. Payments to the City of \$599,000 and \$580,000 for the years ended June 30, 2016 and 2015, respectively, for data processing; meter-reading; customer service and other services relating to water, wastewater and stormwater billings and collections.
- b. Payments to the City of Henderson of \$400,000 in distributions each year for the years ended June 30, 2016 and 2015.
- c. Payments to the City of \$1,329,762 and \$1,125,738 for health insurance, for the years ended June 30, 2016 and 2015, respectively. The Commission participates in the City of Henderson's self-insurance plan. Risk is minimized by the purchase of re-insurance for amounts in excess of the stop loss limit. Charges are based on amounts determined to fund claims as they become due and payable and are adjusted periodically.
- d. The Commission has recorded payables to the City of Henderson of \$84,527 and \$91,408 as of June 30, 2016 and 2015, respectively. These payables consisted of electric and gas utility payments, reimbursements of street repairs and other expenses and payroll tax liabilities.
- e. The Commission has recorded receivables from the City of Henderson of \$813,052 and \$826,107 as of June 30, 2016 and 2015, respectively. These receivables related to billings and collections of water and wastewater services by the City of Henderson and not yet remitted to the Commission.
- f. During December 2010, the City of Henderson issued General Obligation Bonds Series 2010A and 2010B.

The City's General Obligation Bonds, Taxable Series 2010A Build America Bonds, were issued solely for the Commission to complete construction of the Downtown Sewer separation project. The City of Henderson designated in the bond ordinance that the proceeds of \$10,000,000 were solely for the benefit of the Commission. The Commission is to fully reimburse the City annually for all required debt service payments, net of the Build America bond subsidy received by the City, until the bonds are retired. This issue was refinanced in May 2016.

**Henderson Water Utility –  
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**NOTE 10 - RELATED PARTY TRANSACTIONS, CONTINUED**

The City's General Obligation Bonds, Tax-Exempt Series 2010B, were issued to refund various debt issues of the City of Henderson and the Commission. The City of Henderson designated in the bond ordinance that \$1,591,251 of the 2010B issue, which totaled \$3,605,000, be used to refund the Commission's Kentucky Council of Area Development District 2002 Series 065 debt. The Commission is to fully reimburse the City for its pro-rate share of the debt service payments on the 2010B issue.

- g. During October 2013, the City of Henderson issued General Obligation Bond Series 2013A.

The City's General Obligation Bonds, Tax-Exempt Series 2013A, were used to complete construction of the Canoe Creek Phase Two Project and continue construction on the North Wastewater Plan Head Works Project. The City of Henderson designated in the bond ordinance that the proceeds of \$9,730,000 were solely for the benefit of the Commission. The Commission is to fully reimburse the City annually for all required debt service payments until the bonds are retired. The proceeds from the bond issue are held in a restricted construction fund by the City and are transferred to the Commission as needed for project costs.

- h. During September 2014, the City of Henderson issued General Obligation Bond Series 2014.

The City's General Obligation Bonds, Tax-Exempt Series 2014, were issued to complete projects in the North and South water systems. The City of Henderson designated in the bond ordinance that the proceeds of \$8,000,000 were solely for the benefit of the Commission. The Commission is to fully reimburse the City annually for all required debt service payments until the bonds are retired. The proceeds from the bond issue are held in a restricted construction fund by the City and are transferred to the Commission as needed for project costs.

- i. During August 2015, the City of Henderson issued General Obligation Bond Series 2015B.

The City's General Obligation Bonds, Tax-Exempt Series 2015B, were issued to refund the Commission's Kentucky Infrastructure Authority loan from 1996. The City of Henderson designated in the bond ordinance that the proceeds of \$1,870,000 were solely for the benefit of the Commission. The Commission is to fully reimburse the City annually for all required debt service payments until the bonds are retired.

- j. During October 2015 the City of Henderson issued General Obligation Bond Series 2015C.

The City's General Obligation Bonds, Tax-Exempt Series 2015C, were issued to refund the Commission's Kentucky Area Development District loan of 2005. The City of Henderson designated in the bond ordinance that the proceeds of \$1,700,000 were solely for the benefit of the Commission. The Commission is to fully reimburse the City annually for all required debt service payments until the bonds are retired.

- k. During May 2016, the City of Henderson issued General Obligation Bond Series 2016B.

The City's General Obligation Bonds, Tax-Exempt Series 2016B, were issued to refund the City's Series 2010A Build America Bonds that were loaned to the Commission for the Downtown Sewer Separation Project. The City of Henderson designated in the bond ordinance that the proceeds of \$8,015,000 were solely for the benefit of the Commission. The Commission is to fully reimburse the City annually for all required debt service payments until the bonds are retired.

**Henderson Water Utility –  
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**NOTE 11 – COMMITMENTS AND CONTRACTUAL OBLIGATIONS**

The Commission operates a secondary water and wastewater treatment facility located in Southeastern Henderson County, Kentucky, capable of producing 4 million gallons on a daily basis. The commission has an inter-local agreement with the Counties of Henderson, McLean and Webster to share equally in the debt service in the event adequate funds are not generated by this facility to cover the amount of the annual debt service. The commission also has agreements to provide water to the following communities:

a. City of Sebree:

In September 1995, the Water and Sewer Commission entered into an agreement with the City of Sebree, Kentucky whereby the Commission agrees to sell and deliver to the City and the City agrees to purchase and receive from the Commission all of the water and sewer services required by the City. The agreement outlines a specific rate, which will be charged by the Commission to the City for water and sewer service. Sales to the City of Sebree totaled \$247,009 and \$269,906 for the years ended June 30, 2016 and 2015, respectively.

b. City of Beech Grove:

In October 2014, the Commission entered into a new agreement with the Beech Grove Water System, whereby the Commission agrees to sell and deliver to the System and the System will purchase and receive from the Commission all of the water services required by the System. The agreement outlines a specific rate, which will be charged by the Commission to the system for water service. The term of the contract will be twenty-five years, expiring on September 30, 2039. Sales to the Beech Grove Water System totaled 196,940 and \$209,358 for the years ended June 30, 2016 and 2015, respectively.

c. City of Corydon:

In April 2015, the Commission entered into a new agreement with the City of Corydon, Kentucky whereby the Commission agrees to sell and deliver to the City and the City agrees to purchase and receive from the Commission all of the sewer services required by the City. The agreement outlines a specific flat rate, adjusted annually for inflation, which will be charged by the Commission to the City for sewer service. The term of the contract will be forty years expiring on April 30, 2055. Sales to the City of Corydon totaled \$38,428 and \$39,634 for the years ended June 30, 2015 and 2014, respectively.

d. Henderson County Water District:

In June 1989, amended February 1997, the Water and Sewer Commission entered into an agreement with the Henderson County Water District, whereby the Commission agrees to sell and deliver to the District and the District will purchase and receive from the Commission all of the water services required by the District. The agreement outlines a specific rate, which will be charged by the Commission to the District for water service. The term of the contract will be forty years, expiring in July 2029. Sales to the Henderson County Water District totaled \$1,154,254 and \$1,077,418 for the years ended June 30, 2016 and 2015, respectively.

e. Tyson Foods, Inc.:

In November 1994, amended February 1998 and October 2000, the Water and Sewer Commission entered into an agreement with Tyson Foods, Inc. (formerly Hudson Foods, Inc.) whereby the Commission agrees to sell and deliver to Tyson and Tyson agrees to purchase and receive from the Commission all of the water and sewer service. The term of the contract will be twenty years, expiring in June 2018. The agreement outlines a specific rate, which will be charged by the Commission to the Tyson Foods, Inc. for water and sewer service. Sales to Tyson Foods, Inc. totaled \$4,322,516 and \$4,639,781 for the years ended June 30, 2016 and 2015, respectively.

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City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 11 – COMMITMENTS AND CONTRACTUAL OBLIGATIONS, CONTINUED**

f. International Paper Company (formerly Weyerhaeuser Company):

In January 1996, amended October 1998, and July 1999, the Water and Sewer Commission entered into an agreement with the International Paper Company (formerly Weyerhaeuser Company) whereby the Commission agrees to sell and deliver to the International Paper Company and the International Paper Company agrees to purchase and receive from the Commission all of the water and sewer services required by the International Paper Company. The terms of the contract expire December 31, 2018 but shall continue until eighteen-month notice by either party in event International Paper Company is not in default at end of original contract term. The agreement outlines a specific rate, which will be charged by the Commission to the International Paper Company for water and sewer service. Sales to the International Paper Company totaled \$2,108,469 and \$1,893,731 for the years ended June 30, 2016 and 2015, respectively.

g. Big Rivers Electric Corporation:

In March 1995, amended October 2000 and September 2015, the Water and Sewer Commission entered into an agreement with Big Rivers Electric Corporation, whereby the Commission agrees to sell and deliver to Big Rivers Electric Corporation and Big Rivers Electric Corporation will receive from the Commission all of the water and sewer services required by Big Rivers Electric Corporation. The agreement outlines that no rate or fee will be charged by the Commission to Big Rivers Electric Company for water service, on up to 75,000 gallons per day, and sewer service. The term of the contract will be twenty-five years expiring in September 2040, with an automatic renewal for successive five year terms until terminated by either party with two-year notice. The commission has elected to waive any charge due to the fact that Big Rivers Electric Corporation provides power for pumping equipment at the South Water Treatment Plan free of charge to the Commission.

**NOTE 12 - CONCENTRATION OF SALES**

For the year ended June 30, 2016, two industrial and one governmental customers accounted for \$7,585,239 in sales and surcharges for approximately 42% of the Commission's total operating revenues. For the year ended June 30, 2015, sales attributable to these customers were \$7,553,441 or approximately 43% of total revenues.

**NOTE 13 - RISK MANAGEMENT**

The 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. The Commission carries commercial insurance for these types of risks of loss, including workers' compensation. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

**NOTE 14 - DEFEASANCE ON ADVANCED REFUNDING**

During August of 2015, the Commission issued \$1,870,000 Series 2015B general obligation refunding bonds through the City of Henderson, Kentucky for the purpose of partially refunding the 1996 Kentucky Infrastructure Authority Loan. The interest rate on the bonds ranges from 1.00% to 2.50% with a final maturity at November 1, 2026. Debt service payments are scheduled semi-annually at amounts that range from \$70,875 to \$184,000. The economic gain resulting from this refunding is \$448,239 (based upon NPV from delivery date.) The difference in cash flow requirements to service the old debt of \$2,034,088 and the cash flows to service the new debt of \$1,870,000 is \$507,465.

During September of 2015, the Commission issued \$1,700,000 Series 2015C general obligation refunding bonds through the City of Henderson, Kentucky for the purpose of partially refunding the 2005 Kentucky Area Development Districts Financing Trust Lease Agreement. The interest rate on the bonds ranges from 2.00% to 2.75% with a final maturity at November 1, 2029. Debt service payments are scheduled semi-annually at amounts that range from \$23,101

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 14 - DEFEASANCE ON ADVANCED REFUNDING, CONTINUED**

to \$146,875. The economic gain resulting from this refunding is \$319,945 (based upon NPV from delivery date.) The difference in cash flow requirements to service the old debt of \$1,828,888 and the cash flows to service the new debt of \$1,700,000 is \$376,224.

During February of 2016, the Commission issued \$8,015,000 Series 2016B general obligation refunding bonds through the City of Henderson, Kentucky for the purpose of refunding the Series 2010A bonds. The interest rate on the bonds ranges from 2.00% to 2.50% with a final maturity at November 1, 2030. Debt service payments are scheduled semi-annually at amounts that range from \$62,466 to \$625,850. The economic gain resulting from this refunding is \$880,146 (based upon NPV from delivery date.) The difference in cash flow requirements to service the old debt of \$8,430,000 and the cash flows to service the new debt of \$8,015,000 is \$1,035,529.

**NOTE 15 - CONTINGENCIES**

Long Term Control Plan

On August 30, 2007, a Consent Judgment between Henderson Water Utility and the Commonwealth of Kentucky was accepted by the Franklin Circuit Court under Civil Action 07-CI-1250. Under the terms of the Consent Judgment Henderson Water Utility had committed to complete improvements to its sewer system infrastructure in order to comply with certain regulatory requirements of the Federal Clean Water Act.

The Consent Judgment required the development of a Long Term Control Plan and identified sewer system infrastructure improvements that when completed would bring the Commission's combined sewer system into regulatory compliance.

The Long Term Control Plan (LTCP) was submitted to the Kentucky Environmental & Public Protection Cabinet (EPPC) and the U.S. Environmental Protection Agency (EPA) in March 2009 and that LTCP was approved by both agencies in April 2012. The projects identified in the Commission's LTCP must be completed no later than December 2017 under an Administrative Order (AO) issued by the EPA, although that AO has since been rescinded, some projects in the LTCP were modified or dropped in an Amendment approved in February 2014.

Several major components of the LTCP have already been completed and other major components are currently under construction, or are under design. Based upon construction costs for completed projects; currently approved construction budgets; and estimated costs of projects under design; the final estimated cost to complete the LTCP and satisfy this component of the Consent Judgment is approximately \$44.4 million. The current estimate of costs remaining as of June 30, 2016 is \$800,000.

Self-Funded Health Insurance Plan

The Commission participates in the City of Henderson, Kentucky's self-insured health plan for the purpose of providing health insurance to its employees. The plan limits its losses via the purchase of stop loss insurance. Specific losses to claims are limited to \$125,000.

The City of Henderson estimates the annual amount of the premiums as part of its budgetary process each year. Each department is billed based on its percentage of employees in the plan. Charges to each department or component unit participating in the plan may increase depending on the dollar volume of claims activity. The Commission's share of the unpaid claims and incurred but not reported liability is immaterial to the financial statements as of June 30, 2016 and 2015.

**NOTE 16 - RECLASSIFICATIONS**

Certain amounts from prior year have been reclassified to conform with the presentation of the current year. These reclassifications had no impact on net position.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Notes to the Financial Statements**

**NOTE 17 - SUBSEQUENT EVENTS**

Subsequent events were evaluated through November 17, 2016, the date that the most recent statement of net assets has been evaluated for possible adjustment to the financial statements or disclosure and on which the financial statements were available to be issued.

During September 2016, the Commission approved a capital project to install new equipment and perform additional improvements on two clarifiers at the North Wastewater Plant. As a result, the Commission has entered into a contract with M Bowling, Inc. for this project with an estimated cost of approximately \$714,000.

During fiscal year 2015, the Commission and the Henderson County Fiscal Court participated in a sewer project which was developed to provide sewer service in Hwy 41A, Springfield Drive, and Winchester Road area of Henderson County, currently adjacent to the City of Henderson limits.

The project has been completed at the cost of approximately \$1.4 million, and the Henderson County Fiscal Court is discussing the possibility of transferring the assets to the Commission via a capital contribution of the cost. However, as of November 17, 2016, no official action has been taken by any party.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Supplemental Schedule of Revenues, Expenses, and Changes in Net Position by Division  
For the fiscal year ended June 30, 2016**

	<u>North Water</u>	<u>North Wastewater</u>	<u>Storm water</u>	<u>South Water</u>	<u>South Wastewater</u>	<u>Total</u>
<b>Operating revenues:</b>						
Sales	\$ 5,241,817	\$ 7,535,537	\$ -	\$ 2,012,277	\$ 2,909,184	\$ 17,698,815
Penalties, surcharges and fees	66,122	366,259	-	21	65,548	497,950
Total operating revenues	<u>5,307,939</u>	<u>7,901,796</u>	<u>-</u>	<u>2,012,298</u>	<u>2,974,732</u>	<u>18,196,765</u>
<b>Operating expenses:</b>						
Water pumps and tanks	215,583	-	-	11,778	-	227,361
Depreciation	216,978	-	-	35,050	-	252,028
Water intake and treatment	2,032,331	-	-	1,338,738	-	3,371,069
Depreciation	180,788	-	-	99,245	-	280,033
Water transmission and distribution	1,654,517	-	-	66,179	-	1,720,696
Depreciation	533,806	-	-	41,399	-	575,205
Wastewater pumping stations	-	1,356,916	-	-	227,008	1,583,924
Depreciation	-	334,509	-	-	26,577	361,086
Wastewater lines and collections	-	1,317,874	-	-	9,201	1,327,075
Depreciation	-	618,340	-	-	39,508	657,848
Wastewater pretreatment and treatment	-	2,276,859	-	-	1,889,173	4,166,032
Depreciation	-	373,225	-	-	206,274	579,499
Stormwater	-	-	1,155,032	-	-	1,155,032
Depreciation	-	-	392,702	-	-	392,702
Total operating expenses	<u>4,834,003</u>	<u>6,277,723</u>	<u>1,547,734</u>	<u>1,592,389</u>	<u>2,397,741</u>	<u>16,649,590</u>
Operating income (loss)	<u>473,936</u>	<u>1,624,073</u>	<u>(1,547,734)</u>	<u>419,909</u>	<u>576,991</u>	<u>1,547,175</u>
<b>Non-operating income (expense):</b>						
Investment income	42,921	-	-	-	-	42,921
Loss on sale/impairment of assets	26,967	-	-	-	-	26,967
Miscellaneous	13,452	-	-	-	-	13,452
Interest expense	(182,792)	(709,781)	(185,180)	(60,905)	(33,200)	(1,171,858)
Amortization	(2,461)	(4,106)	(5,761)	(574)	(1,947)	(14,849)
Total non-operating income (expense)	<u>(101,913)</u>	<u>(713,887)</u>	<u>(190,941)</u>	<u>(61,479)</u>	<u>(35,147)</u>	<u>(1,103,367)</u>
Change in net position before contributions and transfers	<u>\$ 372,023</u>	<u>\$ 910,186</u>	<u>\$ (1,738,675)</u>	<u>\$ 358,430</u>	<u>\$ 541,844</u>	<u>\$ 443,808</u>

See independent auditors' report.

**Henderson Water Utility –  
City of Henderson, Kentucky - Water and Sewer Commission  
Supplemental Schedule of Revenues, Expenses, and Changes in Net Position by Division  
For the fiscal year ended June 30, 2015**

	<u>North Water</u>	<u>North Wastewater</u>	<u>Storm water</u>	<u>South Water</u>	<u>South Wastewater</u>	<u>Total</u>
<b>Operating revenues:</b>						
Sales	\$ 4,905,944	\$ 7,142,225	\$ -	\$ 1,994,415	\$ 3,209,883	\$ 17,252,467
Penalties, surcharges and fees	67,789	245,439	-	12	39,302	352,542
Total operating revenues	<u>4,973,733</u>	<u>7,387,664</u>	<u>-</u>	<u>1,994,427</u>	<u>3,249,185</u>	<u>17,605,009</u>
<b>Operating expenses:</b>						
Water pumps and tanks	209,785	-	-	17,580	-	227,365
Depreciation	218,676	-	-	35,061	-	253,737
Water intake and treatment	2,019,106	-	-	1,311,524	-	3,330,630
Depreciation	178,913	-	-	109,488	-	288,401
Water transmission	1,187,581	-	-	20,947	-	1,208,528
Depreciation	495,681	-	-	39,155	-	534,836
Wastewater pumping stations	-	1,081,860	-	-	137,033	1,218,893
Depreciation	-	312,153	-	-	51,028	363,181
Wastewater lines and collections	-	562,369	-	-	-	562,369
Depreciation	-	565,920	-	-	144,189	710,109
Wastewater pretreatment and treatment	-	2,239,297	-	-	1,897,850	4,137,147
Depreciation	-	388,265	-	-	390,214	778,479
Stormwater	-	-	1,409,219	-	-	1,409,219
Depreciation	-	-	396,822	-	-	396,822
Total operating expenses	<u>4,309,742</u>	<u>5,149,864</u>	<u>1,806,041</u>	<u>1,533,755</u>	<u>2,620,314</u>	<u>15,419,716</u>
Operating income (loss)	<u>663,991</u>	<u>2,237,800</u>	<u>(1,806,041)</u>	<u>460,672</u>	<u>628,871</u>	<u>2,185,293</u>
<b>Non-operating income (expense):</b>						
Investment income	31,150	-	-	-	-	31,150
Loss on sale/impairment of assets	(263,957)	-	-	-	-	(263,957)
Miscellaneous	25,479	-	-	-	-	25,479
Interest expense	(173,558)	(694,569)	(213,954)	(74,683)	(56,815)	(1,213,579)
Amortization	(6,767)	(10,679)	(5,984)	-	(640)	(24,070)
Total non-operating income (expense)	<u>(387,653)</u>	<u>(705,248)</u>	<u>(219,938)</u>	<u>(74,683)</u>	<u>(57,455)</u>	<u>(1,444,977)</u>
Change in net position before contributions and transfers	<u>\$ 276,338</u>	<u>\$ 1,532,552</u>	<u>\$ (2,025,979)</u>	<u>\$ 385,989</u>	<u>\$ 571,416</u>	<u>\$ 740,316</u>

See independent auditors' report.

**Henderson Water Utility- City of Henderson, Kentucky- Water and Sewer Commission  
Schedule of the Commission's Proportionate Share of the Net Pension Liability  
County Employees' Retirement system  
Last 10 Fiscal Years\***

	<u>2016</u>	<u>2015</u>
Commission's proportion of the net pension liability	0.15664%	0.15467%
Commission's proportionate share of the net pension liability	\$ 6,734,694	\$ 5,018,000
Commission's covered-employee payroll	\$ 3,983,454	\$ 3,707,812
Commission's proportionate share of the net pension liability as a percentage of its covered-employee payroll	169.07%	135.34%
Plan fiduciary net position as a percentage of the total pension liability	59.97%	66.80%

\*Information for years prior to 2015 is not available.

See independent auditors' report.

**Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission  
Schedule of Commission Contributions  
County Employees' Retirement system  
Last 10 Fiscal Years\***

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Statutorily required contribution	\$ 494,745	\$ 472,746	\$ 487,534	\$ 460,855
Contributions in relation to the statutorily required contribution	<u>(494,745)</u>	<u>(472,746)</u>	<u>(487,534)</u>	<u>(460,855)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Commission's covered-employee payroll	\$3,983,454	\$ 3,707,812	\$ 3,548,282	\$3,651,783
Contributions as a percentage of covered-employee payroll	12.42%	12.75%	13.74%	12.62%

\*Information prior to 2013 is not available.

**NOTES TO REQUIRED SUPPLEMENTAL INFORMATION**

*Changes of benefit terms:* A cash balance plan was introduced for members whose participation date is on or after January 1, 2014.

*Changes of assumptions:* The following changes in actuarial assumptions were made for amounts reported in fiscal year 2016:

	<u>FY 2016</u>	<u>Prior Periods</u>
Investment Rate of Return	7.50%	7.75%
Inflation	3.25%	3.50%
Wage Inflation	0.75%	1.00%
Payroll Growth	4.00%	4.50%

For amounts reported in fiscal year 2016, 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 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. The assumed rates of Retirement, Withdrawal and Disability were updated to more accurately reflect experience.

For periods prior to fiscal year 2016, the rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward 5 years is used for the period after disability retirement.

See independent auditors' report.



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

Board of Commissioners

Henderson Water Utility - City of Henderson, Kentucky - Water and Sewer Commission

Henderson, 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 Henderson Water Utility - City of Henderson, Kentucky - Water and Sewer Commission, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City of Henderson, Kentucky - Water and Sewer Commission's basic financial statements and have issued our report thereon dated November 17, 2016.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements, we considered Henderson Water Utility - City of Henderson, Kentucky - Water and Sewer 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 Henderson Water Utility - City of Henderson, Kentucky - Water and Sewer Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of City of Henderson, Kentucky - Water and Sewer 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.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether Henderson Water Utility - City of Henderson, Kentucky - Water and Sewer Commission's financial statements are free of 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*.

**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.

A handwritten signature in black ink that reads "Myriad Co Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky  
November 17, 2016