

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

Report on Audited Financial Statements
For the fiscal years ended June 30, 2017 and 2016

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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, 2017 and 2016, 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, 2017 and 2016, 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 11 and schedules of the Commission's Proportionate Share of Net Pension Liabilities and Commission Contributions, on pages 42 and 43, 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, 2017 and 2016 on pages 40 and 41 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, 2017

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, 2017. 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 12 of this report.

Financial Highlights

- The Commission's total assets decreased by 1.3% from \$92,892,622 at June 30, 2016 to \$91,635,346 at June 30, 2017 primarily due to the expenditure of cash and investments to continue the various capital projects.
- Operating revenues increased \$861,112 or 4.7% from \$18,196,764 to \$19,057,876 due primarily to a 5.85% rate increase on non-contractual customers that went into effect in July 2016 offset by decreased usage across all sectors (residential, commercial and industrial).
- Operating expenses increased by \$1,312,995 or 7.9% from \$16,649,590 to \$17,962,585 due primarily to higher personnel related expenses (wages and benefits), utilities and depreciation. This increase in expense outpaced the change in operating revenues resulting in a \$451,884 or 29.2% decrease in operating income compared to the year ago period.
- The Commission produced a negative cash flow of \$1,587,785 for the year. The Commission generated approximately \$5.8 million in cash from operations, investments and proceeds from asset sales. The sources of cash were exceeded by capital expenditures of approximately \$3.3 million and debt-related payments of approximately \$3.7 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 Employer Retirement System (CERS). The Commission's pension related liability increased approximately \$1.4 million from \$6,734,694 to \$8,132,373. For more information on 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 12-16 of this report.

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 17-39.

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 42-43 of this report. Additional, not required, supplementary information reporting revenues, expenses and changes in net assets by division can be found on pages 40-41.

Condensed Comparative Financial Statements

Statement of Net Position				
(in thousands)				
	<u>6/30/2017</u>	<u>6/30/2016</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Assets:				
Current Assets	\$ 9,291	\$ 10,654	\$ (1,363)	-12.8%
Restricted Assets	-	535	(535)	-100.0%
Non-Current Assets	-	16	(16)	-100.0%
Capital Assets	<u>82,344</u>	<u>81,687</u>	<u>657</u>	<u>0.8%</u>
Total Assets	<u>91,635</u>	<u>92,892</u>	<u>(1,257)</u>	<u>-1.4%</u>
Deferred Outflows of Resources	<u>2,053</u>	<u>1,341</u>	<u>712</u>	<u>53.1%</u>
Liabilities:				
Current Liabilities	4,169	4,758	(589)	-12.4%
Long-term Liabilities	<u>43,426</u>	<u>44,752</u>	<u>(1,326)</u>	<u>-3.0%</u>
Total Liabilities	<u>47,595</u>	<u>49,510</u>	<u>(1,915)</u>	<u>-3.9%</u>
Deferred Inflows of Resources	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net Position:				
Invested in capital assets, net of related debt	45,085	42,002	3,083	7.3%
Restricted for debt service	-	288	(288)	-100.0%
Unrestricted	<u>1,007</u>	<u>2,433</u>	<u>(1,426)</u>	<u>-58.6%</u>
Total Net Position	<u>\$ 46,092</u>	<u>\$ 44,723</u>	<u>\$ 1,369</u>	<u>3.1%</u>

Summary

The Commission's assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources by \$46.1 million at fiscal year-end, an increase of \$1,369,225 or 3.1% 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 \$1,257,276 or 1.3% from the prior period. A \$657,218 increase in capital assets was offset by a \$1,914,494 reduction in current and other assets. The decrease in current assets were primarily due to a decrease in cash and investments of approximately \$1.6 million which were primarily used for capital expenditures on ongoing construction projects. The Commission's capital expenditures for the fiscal year were approximately \$4.3 million compared to annual depreciation expense of \$3.6 million. Deferred outflows of resources increased \$711,893 and was driven by pension related adjustments from the Commission's participation in CERS.

Liabilities and Deferred Inflows of Resources

Total liabilities decreased \$1,914,608 or 3.8% due to a decrease in current liabilities of \$588,783 and a decrease in non-current liabilities of \$1,325,825. The decrease in non-current liabilities is largely due to a decrease in long-term debt of \$2.8 million offset by an increase in the net pension liability of \$1.4 million from the Commission's participation in CERS. The Commission had no deferred inflows of resources decreased related to pension related adjustments associated with the Commission's CERS participation.

Net Position

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.

Statement of Revenues, Expenses and Changes in Net Position

	(in thousands)		Increase (Decrease)	Percent Change
	6/30/2017	6/30/2016		
Operating revenues	\$ 19,058	\$ 18,197	\$ 861	4.7%
Operating expenses	17,963	16,650	1,313	7.9%
Operating income	1,095	1,547	(452)	-29.2%
Net non-operating activity	(863)	(1,103)	240	-21.8%
Change in net position before contributions and transfers	232	444	(212)	-47.7%
Transfers	(400)	(400)	-	0.0%
Capital contributions	1,537	195	1,342	688.2%
Change in net position	1,369	239	1,130	472.8%
Net position at beginning of year	44,723	44,484	239	0.5%
Net position at end of year	\$ 46,092	\$ 44,723	\$ 1,369	3.1%

Summary

The Commission's operating revenues increased 4.7% and operating expenses increased 7.9% resulting in a decrease in operating income of 29.2% or \$451,884. Non-operating activity (net) improved by 21.7% due to decreases in interest and amortization expense and gains realized on capital asset activity and investment earnings. Additionally, Commission received capital contribution of fixed assets of

approximately \$1.3 million. Change in net position increased \$1,130,409 compared to the year-ago period.

Operating Revenues

Operating revenues increased by approximately \$861,000 or 4.7%. 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.

Operating Revenues				
(in thousands)				
	<u>6/30/2017</u>	<u>6/30/2016</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
North:				
Water sales	\$ 5,305	\$ 5,242	\$ 63	1.2%
Wastewater sales	8,207	7,536	671	8.9%
Penalties, fees and surcharges	394	432	(38)	-8.8%
Total North	<u>13,906</u>	<u>13,210</u>	<u>696</u>	<u>5.3%</u>
South				
Water sales	2,098	2,012	86	4.3%
Wastewater sales	2,906	2,909	(3)	-0.1%
Penalties, fees and surcharges	148	66	82	124.2%
Total South	<u>5,152</u>	<u>4,987</u>	<u>165</u>	<u>3.3%</u>
Total operating revenues	<u>\$ 19,058</u>	<u>\$ 18,197</u>	<u>\$ 861</u>	<u>4.7%</u>

Operating Expenses

Operating expenses increased by approximately \$1.3 million or 7.9%. The key components of operating expenses are: Operation and maintenance expenses and depreciation expense. Operation and maintenance expense increased by approximately \$778,000 primarily due to increased personnel related costs (wages, health insurance and retirement) and electric utilities. Depreciation expense increased by approximately \$535,000 due to capitalized assets including significant completed construction projects being placed in service during fiscal year.

Operating Expenses

	(in thousands)			
	6/30/2017	6/30/2016	Increase (Decrease)	Percent Change
Salaries and benefits	\$ 7,217	\$ 6,980	\$ 237	3.4%
Contractual services	2,114	2,053	61	3.0%
Supplies and materials	1,683	1,629	54	3.3%
Utilities	1,863	1,552	311	20.0%
Repairs and maintenance	672	570	102	17.9%
Other services and expenses	781	767	14	1.8%
Depreciation	3,633	3,099	534	17.2%
Total operating expenses	\$ 17,963	\$ 16,650	\$ 1,313	7.9%

Cash Flows

Statement of Cash Flows

	(in thousands)			
	6/30/2017	6/30/2016	Increase (Decrease)	Percent Change
Cash Provided (Used) by:				
Operating Activities	\$ 5,036	\$ 4,936	\$ 100	2.0%
Financing Activities				
Non-capital	(400)	(400)	-	0.0%
Capital	(6,836)	(10,085)	3,249	-32.2%
Investing Activities	612	2,289	(1,677)	-73.3%
Net Change in Cash	\$ (1,588)	\$ (3,260)	\$ 1,672	-51.3%

Cash from Operating Activities increased by approximately \$100,000 primarily due to increased receipts from customers partially offset by higher cash expenses and decreased current liabilities. Cash from Capital and Related Financing Activities decreased by approximately \$3.2 million due to decreased capital spending and scheduled principal payments long term debt. Cash Provided by Investing Activities decreased by approximately \$1.7 million primarily due to maturity of investments that were converted to cash in the prior 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 2027. 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.

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), the Canoe Creek Interceptor (Phase II), and the expansion of the North Wastewater Treatment Plant (Phase III). The final component is nearing completion and will be completed in the fourth quarter of calendar year 2017. 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 stormwater 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. Plans have been prepared for various projects including a new pre-stressed concrete clearwell, upgrades of the water plant, switching to a membrane filtration system and others. In July 2017, the Commission approved and awarded a contract on a \$3.5 million project to renovate and upgrade three aeration basins at the South Wastewater facility in response to liner failure and ongoing aeration equipment maintenance and performance issues. This project will continue thru mid-year 2018.

Stormwater needs are ongoing and growing. The Commission has completed several small drainage projects over the previous fiscal year, and maintains a prioritized list of future projects. One notable project going forward is the Countryview Subdivision Stormwater Project to reduce flooding issues that have been ongoing. Project is being funded by both the Commission and the City.

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, 2017 amounted to approximately \$45 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 \$657,000 or 0.8% due to current year acquisitions, exceeding current year depreciation expense. The Commission expended approximately \$3.2 million in the current fiscal year on the acquisition and construction of capital assets and received \$1.3 in capital contributions

relating to the Finley Addition sewer project in an area that was annexed into City upon project completion.

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

- Construction of various water and wastewater projects totaling approximately \$4.0 million. Main projects consisted of completion of NWWTP Headworks Project and various others around plant and system (\$1.3 million), Finley Addition sewer project (\$1.4 million), North Main Street Pressure Zone (\$394,000), and Vine Street Tank (\$921,000). These projects will be completed in early fiscal year 2017.
- Purchase of two new crew trucks for approximately \$78,500, mini excavator and trailer \$55,000, various SCADA software and IT equipment \$80,000.

Additional information on the City's capital assets can be found in Note 5 on page 24 of this report.

Debt Administration

At June 30, 2017, the Commission no longer had any principal outstanding in bonded debt. The Commission's Series 2006A Revenue Bonds were refunded during the current year. The Commission has other debt of \$37,286,093 which consists of various notes to the City of Henderson issued in conjunction with City's General Obligation Bond Series 2010 B, 2012 A, 2013 A, 2014 A, 2015 B & C, 2016 B and 2017 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 (revenue 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 25-26 of this report.

Economic Factors and Next Year's Budgets and Rates

Water and wastewater revenues for the fiscal year ending June 30, 2018, are budgeted to increase approximately 3.3% from fiscal year 2017 budgeted 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, 2018 are budgeted to increase by approximately \$674,000 or 3.7% from the fiscal year 2017 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 thru 2018. Additionally, the Commission approved a fixed stormwater fee (variable based on meter size) that was effective July 1, 2017. This fee is estimated to generate approximately \$735,000 annually. 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 a 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, 2017 and 2016**

Assets	2017	2016
<u>Current Assets:</u>		
Cash and cash equivalents	\$ 6,787,165	\$ 8,374,950
Investments	55,741	35,766
Accounts receivable, consumers	1,445,730	1,166,105
Accrued interest receivable	400	10
Inventories	937,974	1,030,522
Prepaid expenses	64,146	47,282
Total Current Assets	9,291,156	10,654,635
<u>Restricted Assets:</u>		
Investments	-	534,909
Accrued interest receivable	-	91
Total Restricted Assets	-	535,000
<u>Capital Assets:</u>		
Non-depreciable	1,466,482	1,466,482
Depreciable, net of accumulated depreciation	78,995,215	62,968,227
Construction in progress	1,882,493	17,252,263
Total Capital Assets	82,344,190	81,686,972
<u>Other Assets</u>	-	16,015
Total Assets	91,635,346	92,892,622
<u>Deferred Outflows of Resources</u>		
Total Deferred Outflows of Resources	2,052,846	1,340,953
Total Assets and Deferred Outflows of Resources	\$ 93,688,192	\$ 94,233,575

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, 2017 and 2016**

Liabilities, Deferred Inflows of Resources, and Net Position

	2017	2016
<u>Current Liabilities:</u>		
Accounts payable	\$ 648,001	\$ 577,490
Retainage payable	38,136	477,082
Deposits payable	86,998	85,204
Accrued interest payable	152,966	147,474
Current portion, long-term debt	2,253,613	2,026,146
Compensated absences	406,726	371,967
Accrued liabilities	583,009	826,148
Total Current Liabilities	4,169,449	4,511,511
<u>Current Liabilities Payable from Restricted Assets:</u>		
Accrued interest payable	-	21,721
Current portion, long-term debt	-	225,000
Total Current Liabilities Payable from Restricted Assets	-	246,721
Total Current Liabilities	4,169,449	4,758,232
<u>Non-Current Liabilities:</u>		
Compensated absences	288,346	342,225
Accrued pension liability	8,132,373	6,734,694
Other liabilities	127,192	-
Long-term debt, net of current portion	34,878,645	37,675,462
Total Non-Current Liabilities	43,426,556	44,752,381
Total Liabilities	47,596,005	49,510,613
<u>Deferred Inflows of Resources:</u>		
Total Deferred Inflows of Resources	-	-
<u>Net Position:</u>		
Invested in capital assets, net of related debt	45,084,740	41,760,364
Restricted for debt service	-	288,279
Unrestricted	1,007,447	2,674,319
Total Net Position	46,092,187	44,722,962
Total Liabilities, Deferred Inflows of Resources, and Total Net Position	\$ 93,688,192	\$ 94,233,575

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, 2017 and 2016**

	2017	2016
<u>Support and revenues:</u>		
Water sales	\$ 7,402,926	\$ 7,254,094
Water penalties, surcharges and fees	92,091	66,143
Wastewater fees	11,113,101	10,444,721
Wastewater penalties, surcharges and fees	449,758	431,807
Total operating revenues	19,057,876	18,196,765
<u>Operating expenses:</u>		
Water pumps and tanks	180,758	227,361
Water intake and treatment	3,494,888	3,371,069
Water transmission and distribution	2,501,506	1,720,696
Wastewater pumping stations	1,278,233	1,583,924
Wastewater lines and connections	1,301,017	1,327,075
Wastewater pretreatment and treatment	4,541,690	4,166,032
Stormwater	1,031,366	1,155,032
Depreciation	3,633,127	3,098,401
Total expenses	17,962,585	16,649,590
Operating income	1,095,291	1,547,175
<u>Non-operating revenues (expenses):</u>		
Investment income	82,612	42,921
Gain on sale/impairment of assets	21,081	26,967
Miscellaneous income	14,714	13,452
Interest expense	(981,329)	(1,171,858)
Amortization	-	(14,849)
Total non-operating revenues (expenses)	(862,922)	(1,103,367)
Increase in net position before contributions and transfers	232,369	443,808
Distribution to the City of Henderson	(400,000)	(400,000)
Capital contributions	1,536,856	195,008
Increase in net position	1,369,225	238,816
Net position at beginning of year	44,722,962	44,484,146
Net position at end of year	\$ 46,092,187	\$ 44,722,962

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, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 18,508,373	\$ 18,123,260
Payments to suppliers for goods or services	(6,928,940)	(6,744,981)
Payments to employees for services	(6,543,324)	(6,442,618)
Net cash provided by operating activities	<u>5,036,109</u>	<u>4,935,661</u>
<u>Cash flows from non-capital financing activities:</u>		
Distributions to the City of Henderson	(400,000)	(400,000)
Net cash used by non-capital financing activities	<u>(400,000)</u>	<u>(400,000)</u>
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(3,287,149)	(6,801,485)
Proceeds from issuance of long-term debt	2,390,000	11,585,000
Principal payments on long-term debt	(5,136,146)	(12,118,824)
Principal payments on capital lease obligations	-	(1,785,000)
Interest payments on long-term debt	(981,132)	(1,189,157)
Proceeds from contributed capital	156,449	195,008
Proceeds from sale of capital assets	22,123	30,067
Net cash used by capital and related financing activities	<u>(6,835,855)</u>	<u>(10,084,391)</u>
<u>Cash flows from investing activities:</u>		
Purchase of investment securities	(207,031)	(360,246)
Proceeds from sale and maturity of investment securities	741,940	2,583,088
Investment and other income	77,052	66,228
Net cash provided by investing activities	<u>611,961</u>	<u>2,289,070</u>
Net increase (decrease) in cash and cash equivalents	(1,587,785)	(3,259,660)
Cash and cash equivalents, beginning of year	<u>8,374,950</u>	<u>11,634,610</u>
Cash and cash equivalents, end of year	<u>\$ 6,787,165</u>	<u>\$ 8,374,950</u>
<u>Reconciliation of total cash and cash equivalents:</u>		
Current assets-cash and cash equivalents	\$ 6,787,165	\$ 8,374,950
Restricted assets-cash and cash equivalents	-	-
Total cash and cash equivalents	<u>\$ 6,787,165</u>	<u>\$ 8,374,950</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, continued
For the fiscal years ended June 30, 2016 and 2015**

	2017	2016
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,095,291	\$ 1,547,175
Items to reconcile net operating income to net cash provided by operations:		
Depreciation	3,633,127	3,098,401
Net effect of GASB 68	685,786	470,823
Changes in operation asset and liabilities		
Accounts receivable, consumers	(279,625)	42,594
Inventories	92,548	(127,663)
Prepaid expenses	(16,864)	(13,113)
Accounts payable	91,222	(54,118)
Deposits payable	1,794	4,510
Compensated absences	(19,120)	45,268
Accrued liabilities	(248,050)	(78,216)
Net cash provided by operating activities	\$ 5,036,109	\$ 4,935,661

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. During the year ended June 30, 2017, all restricted assets were transferred to other accounts as there are no longer any revenue bonds outstanding which require such.

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, 2017 was as follows:

	Balance	Additions	Deductions	Balance
	July 01, 2016	June 30, 2016	June 30, 2016	June 30, 2017
Compensated absences	\$ 714,192	\$ 417,235	\$(371,967)	\$ 695,072

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

Current liabilities-compensated absences	\$ 406,726
Non-current liabilities-compensated absences	288,346
	\$ 695,072

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 \$2,052,846 and \$1,340,953 at June 30, 2017 and 2016, 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 \$0 at June 30, 2017 and 2016, respectively, as described in Note 7 to financial statements.

New Accounting Pronouncements

The GASB has issued Statement No. 72, entitled *Fair Value Measurement and Application*; Statement No. 76; entitled, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Government*. These statements did not have a material effect on the Commission's financial statements.

The GASB has also issued Statement No. 74 entitled, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*; GASB Statement No. 75, entitled, *Accounting and Financial Reporting for Post-Employment Benefits Other Than Pensions*; and GASB Statement No. 77; entitled, *Tax Abatement Disclosures*, which will require adoption in the future, if applicable. These statements may or will have a material effect on the Commission's financial statements once implemented. The Commission will be analyzing the effects of these pronouncements and plans to adopt them as applicable by their effective date.

NOTE 2 – CASH AND CASH EQUIVALENTS

At June 30, 2017, the Water and Sewer Commission maintained deposits in the amount of \$ 6,786,720 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, 2017 and 2016:

June 30, 2017				
Investment Type	Fair Value	Investment Maturities (in Years)		
		Less than 1	1-5	6-10
Unrestricted:				
Marketable Securities	\$ 55,741	\$ 55,741	\$ -	\$ -
	<u>\$ 55,741</u>	<u>\$ 55,741</u>	<u>\$ -</u>	<u>\$ -</u>
Restricted:				
U.S Government Obligations Fund	\$ -	\$ -	\$ -	\$ -
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
June 30, 2016				
Investment Type	Fair Value	Investment Maturities (in Years)		
		Less than 1	1-5	6-10
Unrestricted:				
Marketable Securities	\$ 35,766	\$ 35,766	\$ -	\$ -
	<u>\$ 35,766</u>	<u>\$ 35,766</u>	<u>\$ -</u>	<u>\$ -</u>
Restricted:				
U.S Government Obligations Fund	\$ 534,909	\$ 534,909	\$ -	\$ -
	<u>\$ 534,909</u>	<u>\$ 534,909</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, 2017 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, 2017 was \$55,741.

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, 2017, no investments are held by and in the name of Field and Main Bank, the counterparty.

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

NOTE 3 – INVESTMENTS, CONTINUED

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, 2017.

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, 2017 and 2016:

June 30, 2017				
	Cash	U.S. Treasury	Accrued Interest	Total
Bond Sinking	\$ -	\$ -	\$ -	\$ -
Debt Service Reserve	-	-	-	-
	\$ -	\$ -	\$ -	\$ -
June 30, 2016				
	Cash	U.S. Treasury	Accrued Interest	Total
Bond Sinking	\$ -	\$ 172,143	\$ 1	\$ 172,144
Debt Service Reserve	-	362,766	90	362,856
	\$ -	\$ 534,909	\$ 91	\$ 535,000

**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, 2017 and 2016 was as follows:

	<u>June 30, 2015</u>	<u>Additions</u>	<u>Disposals</u>	<u>June 30, 2016</u>	<u>Additions</u>	<u>Disposals</u>	<u>June 30, 2017</u>
North:							
Water pumps and tanks	\$ 5,732,696	\$ -	\$ -	\$ 5,732,696	\$ 1,509,532	\$ -	\$ 7,242,228
Water treatment plant	4,804,851	71,970	(18,888)	4,857,933	1,685,533	-	6,543,466
Water transmission and distribution	20,985,575	19,205	(40,682)	20,964,098	664,107	-	21,628,205
Wastewater lines and collections	26,120,470	-	(47,019)	26,073,451	1,221,207	(159,587)	27,135,071
Wastewater pumping stations	6,714,286	27,545	-	6,741,831	201,689	(8,408)	6,935,112
Wastewater treatment plant	14,713,670	33,918	(26,045)	14,721,543	13,581,371	(17,751)	28,285,163
Stormwater system	13,813,010	267,225	-	14,080,235	35,301	-	14,115,536
South:							
Water pumps and tanks	1,645,225	-	-	1,645,225	-	-	1,645,225
Water treatment plant	3,166,871	46,909	-	3,213,780	185,715	(1,804)	3,397,691
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	8,750,018	178,985	(21,113)	8,907,890	-	(5,544)	8,902,346
Administration	1,011,491	40,160	(116,981)	934,670	304,877	(22,485)	1,217,062
System operations center	4,124,826	491,434	(107,003)	4,509,257	229,335	(64,663)	4,673,929
	116,742,211	1,177,351	(377,731)	117,541,831	19,618,667	(280,242)	136,880,256
Less: accumulated depreciation	(50,336,148)	(3,098,401)	368,875	(53,065,674)	(3,633,127)	280,242	(56,418,559)
	66,406,063	(1,921,050)	(8,856)	64,476,157	15,985,540	-	80,461,697
Construction in progress	11,852,559	5,899,125	(540,869)	17,210,815	4,014,782	(19,343,104)	1,882,493
Capital assets, net	<u>\$ 78,258,622</u>	<u>\$ 3,978,075</u>	<u>\$ (549,725)</u>	<u>\$ 81,686,972</u>	<u>\$ 20,000,322</u>	<u>\$ (19,343,104)</u>	<u>\$ 82,344,190</u>

Depreciation expense for the years ended June 30, 2017 and 2016 was \$3,633,127 and \$3,098,401, 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, 2017 and 2016:

	Balance June 30, 2015	Additions	Deductions	Balance June 30, 2016	Additions	Deductions	Balance June 30, 2017
Series 2006A Water and Sewer	\$ 3,325,000	\$ -	\$ (215,000)	\$ 3,110,000	\$ -	\$ (3,110,000)	\$ -
Note to City of Henderson-2010A	8,430,000	-	(8,430,000)	-	-	-	-
Note to City of Henderson-2010B	1,140,730	-	(113,491)	1,027,239	-	(116,146)	911,093
Note to City of Henderson-2012A	8,745,000	-	(425,000)	8,320,000	-	(435,000)	7,885,000
Note to City of Henderson-2013A	8,915,000	-	(410,000)	8,505,000	-	(420,000)	8,085,000
Note to City of Henderson-2014A	8,000,000	-	(320,000)	7,680,000	-	(325,000)	7,355,000
Note to City of Henderson-2015B		1,870,000	(160,000)	1,710,000	-	(155,000)	1,555,000
Note to City of Henderson-2015C		1,700,000	-	1,700,000	-	(110,000)	1,590,000
Note to City of Henderson-2016B		8,015,000	(35,000)	7,980,000	-	(465,000)	7,515,000
Kentucky Infrastructure Authority Assistance Agreement	2,010,333	-	(2,010,333)	-			
Note to City of Henderson-2017B	-	-	-	-	2,390,000	-	2,390,000
Total long-term debt	40,566,063	11,585,000	(12,118,824)	40,032,239	2,390,000	(5,136,146)	37,286,093
Unamortized premiums on bonds	(34,785)	(82,445)	11,599	(105,631)	(69,287)	21,083	(153,835)
	<u>\$ 40,531,278</u>	<u>\$ 11,502,555</u>	<u>\$ (12,107,225)</u>	<u>\$ 39,926,608</u>	<u>\$ 2,320,713</u>	<u>\$ (5,115,063)</u>	<u>\$ 37,132,258</u>

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

Current portion long-term debt	\$ 2,253,613
Long-term debt, net of current portion and deferred loss on defeasance of bonds	<u>34,878,645</u>
	<u>\$ 37,132,258</u>

Principal and interest requirements to retire the Commission's long-term obligation at June 30, 2017 were as follows:

<u>For the fiscal year ending June 30th:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 2,253,613	\$ 894,918	\$ 3,148,531
2019	2,306,297	848,167	3,154,464
2020	2,354,090	799,791	3,153,881
2021	2,411,671	749,785	3,161,456
2022	2,464,202	697,329	3,161,531
2023-2027	12,646,220	2,617,870	15,264,090
2028-2032	10,740,000	1,095,277	11,835,277
2033-2035	2,110,000	88,750	2,198,750
Totals	<u>\$ 37,286,093</u>	<u>\$ 7,791,887</u>	<u>\$ 45,077,980</u>

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

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>
Note payable to City of Henderson, (Due annually in amounts ranging from \$118,613 to \$144,403)	2.00%-3.50%	11/1/23	\$ 911,093	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$440,000 to \$640,000)	1.00%	11/1/31	\$ 7,885,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$430,000 to \$600,000)	2.00%-2.75%	11/1/32	\$ 8,085,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$330,000 to \$520,000)	2.00%-2.50%	11/01/34	\$ 7,355,000	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	\$ 1,555,000	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	\$ 1,590,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$475,000 to \$605,000)	2.00%-2.50%	11/1/2030	\$ 7,515,000	Unsecured
Note payable to City of Henderson, (Due annually in amounts ranging from \$200,000 to \$280,000)	2.00%-3.00%	3/1/2025	<u>2,390,000.00</u>	Unsecured
			<u>\$ 37,286,093</u>	

**Henderson Water Utility –
City of Henderson, Kentucky - Water and Sewer Commission
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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 employed 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.

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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Notes to the Financial Statements**

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

Non-hazardous members, continued:

Age and service requirement:

Unreduced Benefit: Age 65, with at least 60 months of service credit.
 Age 57, if members age and years of service equal 87 (Rule of 87)

Reduced Benefit: Age 60, with at least 120 months of service credit

Benefit Amount:

The monthly benefit is the following benefit factor based on service credit at retirement multiplied by final average compensation, multiplied by years of service.

Service Credit	Benefit Factor
120 months or less	1.30%
121 to 240 months	1.50%
241 to 299 months	2.25%
Ovr 300 months	2.50%

Benefits are reduced by varying percentage based on years of age or service from full retirement criteria.

Compensation:

Final compensation is calculated by taking the average of the last (not highest) five (5) complete fiscal years of salary. Each fiscal year used to determine final compensation must contain twelve (12) months of service credit.

Tier 3:

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

Age and service requirement:

Unreduced Benefit: Age 65, with at least 60 months of service credit.
 Age 57, if members age and years of service equal 87 (Rule of 87)

Reduced Benefit: Not available

Benefit Amount:

Plan members in Tier 3 participate in and contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a Defined Benefit Plan and a Defined Contribution Plan. Each year that a member is an active contributing member to the System, the member and the member's employer will contribute 5.00% and 4.00%, respectively, of creditable compensation into a hypothetical account.

The employer pay credit represents a portion of the employer contribution. The hypothetical account will earn interest annually on both the member's and employer's contribution at a minimum rate of 4%. If the System's geometric average net investment return for the previous five years exceeds 4%, then the hypothetical account will be credited with an additional amount of interest equal to 75% of the amount of the return which exceeds 4%. All interest credits will be applied to the hypothetical account balance on June 30 based on the account balance as of June 30 of the previous year. Upon retirement the hypothetical account which includes member contributions, employer contributions and interest credits can be withdrawn from the System as a lump sum or annuitized into a single life annuity option.

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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, 2017 and 2016, were 13.95% and 12.42%, respectively for non-hazardous employees. Contributions to CERS by the Commission were \$567,048 and \$494,745 for the years ended June 30, 2017 and 2016.

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

At June 30, 2017 and 2016, the Commission reported a liability of \$8,132,373 and \$6,734,694, respectively for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016 and 2015, respectively and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015. 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, 2016 and 2015, the Commission's proportion was 0.16517% and 0.15664%, respectively.

For the years ended June 30, 2017 and 2016, the Commission recognized pension expense of \$1,252,834 and \$965,568, respectively. At June 30, 2017, 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	\$ 35,504	\$ -
Changes in assumptions	430,809	-
Net difference between projected and actual earnings on plan investments	764,526	-
Changes in proportion and differences between employer contributions and proportionate share of contributions	254,959	-
Commission contributions subsequent to the measurement date	567,048	-
	<u>\$ 2,052,846</u>	<u>\$ -</u>

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

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

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

The \$567,048 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, 2018. 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>		
2018	\$	569,063
2019		413,425
2020		332,276
2021		171,034
2022		-
Thereafter		-
		<u>\$ 1,485,798</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%. The discount determination does not use a municipal bond rate. Projected future benefit payments for all current plan members was projected through 2117.

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 27-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 December 3, 2015.

**Henderson Water Utility –
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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.

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%
Total	100%	

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:

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
Discount rate	6.50%	7.50%	8.50%
Commission's proportionate share of net pension liability	<u>\$ 10,134,253</u>	<u>\$ 8,132,373</u>	<u>\$ 6,416,362</u>

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

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

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 2017 and 2018, determined as of July 1, 2016. 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	27 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 on June 30, 2014, 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.

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

Plan Fiduciary Net Position: Detailed information regarding the CERS fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Statement.

Payables to the Pension Plan: At June 30, 2017, the Commission did not have a payable for the outstanding amount of contractually required contributions due to CERS.

**Henderson Water Utility –
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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.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at 502-564-4646.

**Henderson Water Utility –
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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, 2017 and 2016 were as follows:

- a. Payments to the City of \$618,000 and \$599,000 for the years ended June 30, 2017 and 2016, 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, 2017 and 2016.
- c. Payments to the City of \$1,320,165 and \$1,329,762 for health insurance, for the years ended June 30, 2017 and 2016, 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 \$158,523 and \$84,527 as of June 30, 2017 and 2016, 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 \$944,727 and \$813,052 as of June 30, 2017 and 2016, 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 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 –
City of Henderson, Kentucky - Water and Sewer Commission
Notes to the Financial Statements**

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

NOTE 10 - RELATED PARTY TRANSACTIONS, CONTINUED

1. During February 2017, the City of Henderson issued General Obligation Bond Series 2017B. The City's General Obligation Bonds, Tax- Exempt Series 2017B, were issued to refund the City's Series 2006A 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 \$2,390,000 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.

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 \$234,203 and \$247,009 for the years ended June 30, 2017 and 2016, 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 \$181,023 and \$196,940 for the years ended June 30, 2017 and 2016, 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 \$38,650 and \$38,428 for the years ended June 30, 2017 and 2016, 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 \$1,000,813 and \$1,154,254 for the years ended June 30, 2017 and 2016, respectively.

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

NOTE 11 – COMMITMENTS AND CONTRACTUAL OBLIGATIONS, CONTINUED

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 \$4,659,730 and \$4,322,516 for the years ended June 30, 2017 and 2016, respectively.

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 \$2,569,461 and \$2,108,469 for the years ended June 30, 2017 and 2016, 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, 2017, two industrial and one governmental utility customers accounted for \$8,230,004 in sales and surcharges for approximately 43% of the Commission's total operating revenues. For the year ended June 30, 2016, sales attributable to these customers were \$7,585,239 or approximately 42% 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.

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

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 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.

During February of 2017, the Commission issued \$2,390,000 Series 2017B general obligation refunding bonds through the City of Henderson, Kentucky for the purpose of refunding the Series 2006A bonds. The interest rate on the bonds ranges from 2.00% to 3.00% with a final maturity at November 1, 2026. Debt service payments are scheduled semi-annually at amounts that range from \$268,700 to \$284,200. The economic gain resulting from this refunding is \$224,213 (based upon NPV from delivery date and after application of reserve funds of \$450,597.) The difference in cash flow requirements to service the old debt of \$3,110,000 and the cash flows to service the new debt of \$2,390,000 is \$751,566.

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, 2017 is \$800,000 with the estimated completion date of the fourth quarter of 2017.

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

NOTE 15 – CONTINGENCIES, Continued

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, 2017 and 2016.

NOTE 16 - SUBSEQUENT EVENTS

Subsequent events were evaluated through November 17, 2017, 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.

a. Aeration Basin Project

During July 2017, the Commission approved a capital project to install new equipment and perform additional improvements on three aeration basins at the South Wastewater Plant. As a result, the Commission has entered into an \$3.2 million agreement with M. Bowling Construction, Inc for this project.

**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, 2017**

	<u>North Water</u>	<u>North Wastewater</u>	<u>Storm water</u>	<u>South Water</u>	<u>South Wastewater</u>	<u>Total</u>
Operating revenues:						
Sales	\$ 5,305,115	\$ 8,206,970	\$ -	\$ 2,097,811	\$ 2,906,131	\$ 18,516,027
Penalties, surcharges and fees	91,213	302,614	-	878	147,144.00	541,849
Total operating revenues	<u>5,396,328</u>	<u>8,509,584</u>	<u>-</u>	<u>2,098,689</u>	<u>3,053,275</u>	<u>19,057,876</u>
Operating expenses:						
Water pumps and tanks	169,462	-	-	11,296	-	180,758
Depreciation	248,318	-	-	35,147	-	283,465
Water intake and treatment	2,010,389	-	-	1,484,499	-	3,494,888
Depreciation	208,950	-	-	111,189	-	320,139
Water transmission and distribution	2,427,741	-	-	73,765	-	2,501,506
Depreciation	572,226	-	-	42,120	-	614,346
Wastewater pumping stations	-	1,089,215	-	-	189,018	1,278,233
Depreciation	-	308,960	-	-	23,957	332,917
Wastewater lines and collections	-	1,263,762	-	-	37,255	1,301,017
Depreciation	-	624,309	-	-	40,748	665,057
Wastewater pretreatment and treatment	-	2,643,630	-	-	1,898,060	4,541,690
Depreciation	-	857,699	-	-	178,218	1,035,917
Stormwater	-	-	1,031,366	-	-	1,031,366
Depreciation	-	-	381,286	-	-	381,286
Total operating expenses	<u>5,637,086</u>	<u>6,787,575</u>	<u>1,412,652</u>	<u>1,758,016</u>	<u>2,367,256</u>	<u>17,962,585</u>
Operating income (loss)	<u>(240,758)</u>	<u>1,722,009</u>	<u>(1,412,652)</u>	<u>340,673</u>	<u>686,019</u>	<u>1,095,291</u>
Non-operating income (expense):						
Investment income	82,612	-	-	-	-	82,612
Loss on sale/impairment of assets	21,081	-	-	-	-	21,081
Miscellaneous	14,714	-	-	-	-	14,714
Interest expense	(132,037)	(641,987)	(128,647)	(53,298)	(25,360)	(981,329)
Amortization	-	-	-	-	-	-
Total non-operating income (expense)	<u>(13,630)</u>	<u>(641,987)</u>	<u>(128,647)</u>	<u>(53,298)</u>	<u>(25,360)</u>	<u>(862,922)</u>
Change in net position before contributions and transfers	<u>\$ (254,388)</u>	<u>\$ 1,080,022</u>	<u>\$ (1,541,299)</u>	<u>\$ 287,375</u>	<u>\$ 660,659</u>	<u>\$ 232,369</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, 2016**

	<u>North Water</u>	<u>North Wastewater</u>	<u>Storm water</u>	<u>South Water</u>	<u>South Wastewater</u>	<u>Total</u>
Operating revenues:						
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>
Operating expenses:						
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	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>
Non-operating income (expense):						
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
Schedule of the Commission's Proportionate Share of the Net Pension Liability
County Employees' Retirement system
As of the Measurement Date for the Last Three Years***

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Commission's proportion of the net pension liability	0.16517%	0.15664%	0.15467%
Commission's proportionate share of the net pension liability	\$ 8,132,373	\$ 6,734,694	\$ 5,018,000
Commission's covered-employee payroll	\$ 3,983,454	\$ 3,707,812	\$ 3,548,282
Commission's proportionate share of the net pension liability as a percentage of its covered-employee payroll	204.15%	181.64%	141.42%
Plan fiduciary net position as a percentage of the total pension liability	55.50%	59.97%	66.80%

*This table will present ten years of information as it becomes available.

See independent auditors' report.

**Henderson Water Utility- City of Henderson, Kentucky - Water and Sewer Commission
Schedule of Commission Contributions
County Employees' Retirement system
For the Last Three Years***

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutorily required contribution	\$ 567,048	\$ 494,745	\$ 472,746
Contributions in relation to the statutorily required contribution	<u>(567,048)</u>	<u>(494,745)</u>	<u>(472,746)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Commission's covered-employee payroll	\$ 4,064,860	\$ 3,983,454	\$ 3,707,812
Contributions as a percentage of covered-employee payroll	13.95%	12.42%	12.75%

*This table will present ten years of information as it becomes 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 beginning 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 beginning 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, 2017, 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, 2017.

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, 2017