Mount Sterling Water and Sewer Commission

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Independent Auditor's Report
and Basic Financial Statements
June 30, 2015 and 2014

Mount Sterling Water and Sewer Commission
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June 30, 2015 and 2014

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the years ended June 30, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as June 30, 2015 and 2014, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As described in Note 7 to the financial statements, in 2015, the Mount Sterling Water and Sewer Commission adopted new accounting guidance, *GASB Statement No. 68, Accounting and Financial Reporting for Pensions*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedule of proportionate share of the net pension liability and the schedule of contributions on pages 24 and 25 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Mount Sterling Water and Sewer Commission's basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual and the Schedule of Debt Service Requirements are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2015, on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commission's internal control over financial reporting and compliance.

Faulkner, King & Wenz, PSC

October 15, 2015

Mount Sterling Water and Sewer Commission
Statements of Net Position
June 30, 2015 and 2014

		2015		2014
Assets				
Current assets:				
Cash and investments	$	3,594,449	$	2,994,089
Accounts receivable, net		706,395		650,623
Interest receivable		184		499
Other receivables		40,388		12,311
Inventory		174,249		170,491
Prepaid expenses		73,103		175,055
Total current assets		4,588,768		4,003,068
Non-current assets:				
Restricted cash and cash equivalents		1,463,594		1,419,582
Capital Assets:				
Land and building		1,262,868		1,260,362
Water and sewer system		59,752,668		59,390,569
Equipment		1,115,934		979,244
Vehicles		339,942		346,571
Construction in progress		60,439		0
Less accumulated depreciation		(30,022,658)		(28,204,020)
Total non-current assets		33,972,787		35,192,308
Deferred Outflows of Resources				
Deferred outflows - pension		164,134		172,611
Total assets and deferred outflows of resources	$	38,725,689	$	39,367,987
Liabilities				
Current liabilities:				
Accounts payable	$	145,417	$	56,495
Other accrued liabilities		292,158		287,627
Accrued interest on bonds		6,754		8,462
Customer deposits		608,743		565,580
Notes payable		1,134,228		1,229,232
Total current liabilities		2,187,300		2,147,396
Non-current liabilities:				
Notes payable		5,693,738		6,827,965
Net pension liability		1,781,540		2,010,266
Total non-current liabilities		7,475,278		8,838,231
Total liabilities		9,662,578		10,985,627
Deferred Inflows of Resources				
Deferred inflows - pension		158,650		0
Net Position				
Invested in capital assets, net of related debt		25,681,227		25,715,529
Restricted for debt service		854,851		854,002
Unrestricted		2,368,383		1,812,829
Total net position		28,904,461		28,382,360
Total liabilities, deferred inflows of resources and net position	$	38,725,689	$	39,367,987

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

Mount Sterling Water and Sewer Commission
Statements of Revenues, Expenses And Changes in Net Position
For the Years Ended June 30, 2015 and 2014

Operating revenues	2015	2014
Water sales	$ 3,114,244	$ 2,750,666
Sewer sales	2,430,870	2,360,447
Other income	173,877	202,425
Total operating revenues	5,718,991	5,313,538
Operating expenses		
Water	2,362,158	2,361,465
Sewer	1,607,360	1,617,155
General and administrative costs:		
Water	712,891	747,975
Sewer	396,162	371,732
Total operating expenses	5,078,571	5,098,327
Operating income	640,420	215,211
Nonoperating revenues (expenses)		
Interest income	12,622	15,374
Grants	3,000	3,496
Gain (Loss) on sale of fixed assets	1,650	0
Other expense	(34,294)	(34,257)
Interest expense	(101,297)	(119,968)
Total net nonoperating revenues (expenses)	(118,319)	(135,355)
Income before contributions	522,101	79,856
Capital contributions	0	200,808
Change in net position	522,101	280,664
Total net position, beginning of year (restated)	28,382,360	28,101,696
Total net position, end of year	$ 28,904,461	$ 28,382,360

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

Mount Sterling Water and Sewer Commission
Statements of Cash Flows
For the Years Ended June 30, 2015 and 2014

Cash Flows from Operating Activities	2015	2014
Cash received from customers	$ 5,461,265	$ 5,233,612
Other cash receipts	173,877	202,425
Cash payments to vendors for water services and supplies	(733,657)	(751,783)
Cash payments to vendors for sewer services and supplies	(352,421)	(390,903)
Cash payments to employees for services	(1,341,937)	(1,308,761)
Cash payments for water administrative costs	(461,427)	(671,541)
Cash payments for sewer administrative costs	(210,155)	(352,285)
Net cash provided by operating activities	2,535,545	1,960,764
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(585,393)	(589,285)
Proceeds from sale of assets	1,650	0
Interest paid on revenue bonds	(103,005)	(121,633)
Principal paid on debt	(1,229,231)	(1,205,584)
Increase in customer deposits	43,163	50,760
Other expense	(34,294)	(34,257)
Grant contributions	3,000	3,496
Net cash used in capital and related financing activities	(1,904,110)	(1,896,503)
Cash Flows from Investing Activities		
Interest income from investments	12,937	15,439
Net cash provided by investing activities	12,937	15,439
Net change in cash and cash equivalents	644,372	79,700
Cash and cash equivalents, beginning of year	4,413,671	4,333,971
Total cash and cash equivalents, end of year	$ 5,058,043	$ 4,413,671
Restricted cash and cash equivalents	$ 1,463,594	$ 1,419,582
Unrestricted cash and cash equivalents	3,594,449	2,994,089
Total cash and cash equivalents, end of year	$ 5,058,043	$ 4,413,671

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

Mount Sterling Water and Sewer Commission
Statements of Cash Flows (continued)
For the Years Ended June 30, 2015 and 2014

Reconciliation of operating income to net cash provided by operating activities:	2015	2014
Operating income	$ 640,420	$ 215,211
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,848,926	1,815,193
Provision for bad debts	17,600	14,937
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	(101,449)	107,562
(Increase) decrease in inventories	(3,758)	3,638
Decrease (increase) in prepaids	101,952	(4,629)
Increase (decrease) in accounts payable and accrued expenses	93,453	(176,651)
(Decrease) increase in net pension obligation	(61,599)	(14,497)
Total adjustments	1,895,125	1,745,553
Net cash provided by operating activities	$ 2,535,545	$ 1,960,764

Note 1. Summary of Significant Accounting Policies

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

Basis of accounting

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

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

Investments

Investments are carried at cost. Some of the investments are restricted as to use (Note 2). Funds of the Commission are required to be invested in accordance with the investment policy adopted by the Commission. The investment policy allows the Commission to invest in those instruments authorized by KRS 66.480. Bank deposits were substantially secured by FDIC insurance and collateral or invested in direct obligations of the United States at June 30, 2015 and 2014.

Custodial credit risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2015 $4,149,479 of the Commission's bank balance of $5,149,479 was exposed to custodial credit risk, as follows:

Insured	$ 1,000,000
Collateral held by pledging bank's trust department in the Commission's name	4,149,479
Total bank deposits	$ 5,149,479

Accounts receivable

Customer receivables are recorded as receivables and revenues at their original invoice amount. Management regularly reviews the customer receivable accounts and determines the allowance for doubtful accounts. A receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 60 days. For the years ended June 30, 2015 and 2014, accounts receivable is stated less an allowance for doubtful accounts of $150,174 and $132,986, respectively. A schedule of allowance for doubtful accounts at June 30, 2015 and 2014, follows:

	2015	2014
Beginning balance	$132,986	$117,874
Provisions	17,600	14,937
Recoveries (Charge-offs)	(412)	175
Ending balance	$150,174	$132,986

Note 1. Summary of Significant Accounting Policies (Continued)

Inventories

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

Budgets

In June of 2014, the Commission adopted the annual management budget in the amount of $5,457,996 for the fiscal year ended June 30, 2015, detailed as follows:

Water	$2,389,098
Sewer	1,683,592
General and administrative costs:	
Water	928,326
Sewer	456,980
Total operating expenses	$5,457,996

Property, plant and equipment

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

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

Total depreciation expense was $1,848,926 and $1,815,193 for the years ended June 30, 2015 and 2014, respectively.

Prior period adjustment - Unamortized debt discount and expense

In prior years, these costs were being amortized as non-operating expenses over the life of the debt issue using the straight line method. Amortization expense was $10,961 for the year ended June 30, 2013. MSWS recorded a prior period adjustment of $61,196, effective July 1, 2012, to write off bond issuance costs which were previously capitalized. Governmental Accounting Standards Board Statement No. 65 mandated this accounting change. This adjustment is reported as an adjustment to the beginning of year net position. The impact of this retroactive accounting change on previously-reported amounts for the year ended June 30, 2013, prior to pension liability adjustment, was as follows:

	July 1, 2012 Net Position	2013 Change in Net Position	June 30, 2013 Net Position
Amounts as previously reported	$28,746,827	$1,257,256	$30,004,083
Prior-period adjustment	(61,196)	10,961	(50,235)
Amounts as restated	$28,685,631	$1,268,217	$29,953,848

Cash and cash equivalents

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

Note 1. Summary of Significant Accounting Policies (Continued)

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.

Capital and operating grants

Grants that are restricted to the purchase of property, plant and equipment are recorded as other income, per GASB 33. The Commission received $3,000 and $3,496 in grants of this type for the years ended June 30, 2015 and 2014.

Infrastructure assets constructed by outside entities then taken over by the Commission are also recorded as other income per GASB 33. The total amount of the assets taken over were $0 for the years ended June 30, 2015 and 2014. These amounts constitute noncash transactions.

Capitalized interest

The Commission follows the policy of capitalizing interest as a component of construction cost. For the year ended June 30, 2015, total interest cost incurred was $101,297 of which $0 was capitalized. For the year ended June 30, 2014, total interest cost incurred was $119,968 of which $0 was capitalized.

Pensions

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 Employers' Retirement System Plan (CERS) and additions to/deductions from CERS' fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments, (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value.

Note 2. Restricted Assets

The restricted assets in the accompanying financial statements are restricted as to use by ordinance (Note 5), external parties, or by board designation. A schedule of restricted assets at June 30, 2015, follows:

Description	Cash	Investments at Cost	Total
Assets restricted by grant agreement or bond ordinance:			
Customer deposits	$ 608,743	$ -0-	$ 608,743
Reserve accounts	604,851	-0-	604,851
Depreciation accounts	250,000	-0-	250,000
	$1,463,594	$ -0-	$1,463,594

A schedule of restricted assets at June 30, 2014, follows:

Description	Cash	Investments at Cost	Total
Assets restricted by grant agreement or bond ordinance:			
Customer deposits	$ 565,580	$ -0-	$ 565,580
Reserve accounts	604,002	-0-	604,002
Depreciation accounts	250,000	-0-	250,000
	$1,419,582	$ -0-	$1,419,582

Note 3. Long-Term Debt

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2015 and 2014, are summarized as follows:

	Rate	Original Issue		2015	2014
Kentucky Bond Corporation					
2010 Series C	2.70%	$ 2,760,000		$ 614,583	$ 1,050,833
KIA Fund A	1.20%	1,055,969		117,324	174,942
KIA Fund B	1.50%	2,448,213		418,648	554,078
KIA Fund A Loan	1.00%	13,202,540	*	5,677,411	6,277,344
		$ 19,466,722		6,827,966	8,057,197
Less current maturities				(1,134,228)	(1,229,232)
Total long term debt				$ 5,693,738	$ 6,827,965

- The original issue of the KIA Fund A Loan is $13,202,540. As of June 30, 2015, the Commission had borrowed $11,936,783 of this amount.

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2015 and 2014, are detailed as follows:

	Balance June 30 2013	Advances	Repayments	Balance June 30 2014	Advances	Repayments	Balance June 30 2015
Kentucky Bond Corporation							
2010 Series C	$ 1,472,084	$0	$ (421,251)	$ 1,050,833	$0	$ (436,250)	$ 614,583
KIA Fund A	231,875	0	(56,933)	174,942	0	(57,618)	117,324
KIA Fund B	687,499	0	(133,421)	554,078	0	(135,430)	418,648
KIA Fund A Loan	6,871,323	0	(593,979)	6,277,344	0	(599,933)	5,677,411
Total	$ 9,262,781	$0	$ (1,205,584)	$ 8,057,197	$0	($1,229,231)	$ 6,827,966

Note 3. Long-Term Debt (Continued)

	Balance June 30, 2015 Current	Long-Term
Kentucky Bond Corporation 2010 Series C	$ 332,500	$ 282,083
KIA Fund A	58,311	59,013
KIA Fund B	137,469	281,179
KIA Fund A Loan	605,948	5,071,463
Total	$ 1,134,228	$ 5,693,738

The long-term debt service requirements are as follows:

Fiscal Year	Principal	Interest	Total
2015-2016	$ 1,134,228	$ 80,701	$ 1,214,929
2016-2017	987,655	61,882	1,049,537
2017-2018	864,800	47,799	912,599
2018-2019	624,355	36,856	661,211
2019-2020	630,614	30,597	661,211
2020-2024	2,586,314	58,531	2,644,845
	$ 6,827,966	$ 316,366	$ 7,144,332

KIA Fund A and KIA Fund B

As of June 30, 2015 and 2014, the Commission had drawn on a KIA loan which was made to finance the construction of the water treatment plant sludge facilities. The loan is secured by a pledge of revenues, and has been drawn up to $1,055,969. The loan bears an interest rate of 1.2% and has a life of 20 years and matures in 2017.

As of June 30, 2015 and 2014, the Commission had also drawn on a KIA loan which was made to finance the construction of ground storage tanks and a water strengthening main. The loan is secured by a pledge of revenues, and has been drawn up to $2,448,213. The loan bears an interest rate of 1.5% and has a life of 20 years and matures in 2018.

Kentucky Infrastructure Authority - A02-01

The Commission had drawn $11,936,783 as of June 30, 2015 and 2014, from the Kentucky Infrastructure Authority. The loan was made for the construction of a new trunk sewer and wastewater treatment plant. The loan is secured by a pledge of revenues and can be drawn up to $13,202,540. The loan bears an interest rate of 1% and has a life of 20 years.

Note 3. Long-Term Debt (Continued)

Kentucky Bond Corporation 2010 Series C Bonds

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

Note 4. Net Position

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

The balance of capital investments represents funds that have been used to acquire pump stations, storage facilities, meter stations, etc., constructed and operated by the Mount Sterling Water and Sewer Commission, net of outstanding debt. The balance was $25,681,227 and $25,715,529 at June 30, 2015 and 2014, respectively.

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

	2015	2014
Operation and Maintenance	$274,211	$ 273,527
Replacement	328,238	328,073
Depreciation	250,000	250,000
Other	2,402	2,402
Total Restricted	$854,851	$ 854,002

The Commission has a balance of $2,368,383 and $1,812,829 for unrestricted net assets at June 30, 2015 and 2014, respectively.

Note 5. Compliance with Bond Ordinance

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

Operation and Maintenance Fund - This reserve is required to maintain a balance equal to three month's cost of operating, maintaining, and insuring the system. The balance of this reserve at June 30, 2015 and 2014 was $274,211 and $273,527.

Depreciation Fund - This reserve is required for major repairs and replacements. Funds may be withdrawn only to pay the cost of making unusual or extraordinary maintenance, repairs, renewals, and/or replacements to the system not included in the annual budget of current expenses, or for the purpose of paying the cost of construction improvements. The balance of this reserve at June 30, 2015 and 2014 was $250,000.

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

Replacement Reserve - This reserve requires the Commission to deposit $32,790 each December 1 into a separate account until the balance reaches $327,900 and be maintained for the life of the loan. The balance of this reserve at June 30, 2015 and 2014, was $330,640 and $330,475, respectively.

Note 6. Property, Plant and Equipment

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

	Balance June 30, 2013	Additions	Reclassifications and Disposals	Balance June 30, 2014	Additions	Disposals	Balance June 30, 2015
Land and building	$1,260,362	$0	$0	$1,260,362	$2,506	$0	$1,262,868
Water and sewer system	57,660,738	1,729,831	0	59,390,569	362,099	0	59,752,668
Equipment	819,467	161,772	(1,995)	979,244	136,690	0	1,115,934
Construction in progress	1,128,409	0	(1,128,409)	0	60,439	0	60,439
Vehicles	319,672	26,899	0	346,571	23,659	(30,288)	339,942
	61,188,648	1,918,502	(1,130,404)	61,976,746	585,393	(30,288)	62,531,851
Accumulated depreciation	(26,390,822)	(1,815,193)	1,995	(28,204,020)	(1,848,926)	30,288	(30,022,658)
Total net property, plant and equipment	$34,797,826	$103,309	$(1,128,409)	$33,772,726	$(1,263,533)	$0	$32,509,193

Note 7. Pension Plan

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

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

Contributions – For the year ended June 30, 2015, plan members were required to contribute 5.00% of wages for non-hazardous job classifications. Employees hired after September 1, 2008 are required to contribute an additional 1% to cover the cost of medical insurance that is provided through CERS. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 78.545(33), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contributions rates are necessary to satisfy requirements determined in accordance with actuarial basis adopted by the Board. For the year ended June 30, 2015, participating employers contributed 18.89% of each employee's wages, which is equal to the actuarially determined rate set by the Board. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

Plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their

Note 7. Pension Plan (continued)

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

The Company contributed $227,470 for the year ended June 30, 2015, or 100% of the required contribution. The contribution was allocated $164,134 to the CERS pension fund and $63,336 to the CERS insurance fund.

Pension Liabilities, Expense, Deferred Outflows of Resources and Deferred Inflows of Resources – At June 30, 2015, the Company reported a liability of $1,781,540 or its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Company's proportion of the net pension liability was based on a projection of the Company's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2014, the Company's proportion was .05 percent, which was equal to its proportion measured as of June 30, 2013.

For the year ended June 30, 2015, the Company recognized pension expense of $102,535. At June 30, 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual results	$ -	$ -
Changes of assumptions	-	-
Net difference between projected and actual earnings on Plan investments	-	158,650
Changes in proportion and differences between Company contributions and proportionate share of contributions	-	-
Company contributions subsequent to the measurement date	164,134	-
Total	$ 164,134	$ 158,650

The $164,134 of deferred outflows of resources resulting from the Company's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year ending June 30,	
2016	$ (39,662)
2017	(39,663)
2018	(39,662)
2019	(39,663)

Note 7. Pension Plan (continued)

Actuarial Assumptions – The total pension liability in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.50%
Salary increases	4.50%, average, including inflation
Investment rate of return	7.75%, net of Plan investment expense, including inflation

Mortality rates were based on 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 actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the period January 1, 2005 - June 30, 2008.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years. Several factors are considered in evaluating the long-term rate of return assumptions 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 time frame. 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.

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

Asset Class	Target Allocation	Long-term Nominal Real Rate of Return
Domestic Equity	30%	8.45%
International Equity	22%	8.85%
Emerging Market Equity	5%	10.50%
Private Equity	7%	11.25%
Real Estate	5%	7.00%
Core US Fixed Income	10%	5.25%
High Yield US Fixed Income	5%	7.25%
Non US Fixed Income	5%	5.50%
Commodities	5%	7.75%
TIPS	5%	5.00%
Cash	1%	3.25%
Total	100%	

Discount Rate – The discount rate used to measure the total pension liability was 7.75 percent. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 29 year amortization

Note 7. Pension Plan (continued)

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. The discount rate does not use a municipal bond rate.

Sensitivity of the Company's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate – The following presents the Company's proportionate share of the net pension liability calculated using the discount rate of 7.75 percent, as well as what the Company's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75 percent) or 1-percentage-point higher (8.75 percent) than the current rate:

	Discount rate	Company's proportionate share of net pension liability
1% decrease	6.75%	$ 2,337,892
Current discount rate	7.75%	$ 1,781,540
1% increase	8.75%	$ 1,280,693

Payable to the Pension Plan – At June 30, 2015, the Company reported a payable of $18,038 for the outstanding amount of contributions to the pension plan required for the year ended June 30, 2015. The payable includes both the pension and insurance contribution allocation.

Note 8. Restatement of Net Position

Implementation of new accounting standard GASB Statement No. 68

During 2015 the Company implemented GASB Statement No. 68, Accounting and Financial Reporting for Pensions, which addresses financial reporting for state and local government employers whose employees are provided with pensions through pension plans that are covered under Statement No. 67, Financial Reporting for Pension Plans.

The guidance contained in Statement 68 changed how governments calculate and report the costs and obligations associated with pensions. Under the new standards GASB requires that cost-sharing governments report a net pension liability, pension expense, and pension related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan. In addition, GASB requires Statement 68 to be applied retroactively, which has resulted in a restatement of beginning net position as follows:

	2015	2014
Net position, at beginning of year	$ 30,220,015	$ 29,953,848
Beginning net pension liability and deferred outflows	(1,837,655)	(1,852,152)
Net position, at beginning of year, as restated	$ 28,382,360	$ 28,101,696
Change in net position as previously reported		$ 266,167
Pension expense adjustment		14,497
		$ 280,664

Note 9. Risk Management

The Mount Sterling Water and Sewer Commission is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. In addition to its general liability insurance, the Commission also carries commercial insurance for all other risks of loss such as workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The following is a schedule of insurance in force as of June 30, 2015:

Coverage	Amount of Coverage	Premium	Policy Term
Buildings & property	$ 30,608,950	*	7/1/14 - 7/1/15
General & automobile liability (ea)	3,000,000	*	7/1/14 - 7/1/15
Public officials liability	3,000,000	*	7/1/14 - 7/1/15
Automobile physical	Actual Value	*	7/1/14 - 7/1/15
Crime:			
Forgery or alteration	100,000	*	7/1/14 - 7/1/15
Theft-inside & outside premises (ea)	100,000	*	7/1/14 - 7/1/15
Public dishonesty	250,000	*	7/1/14 - 7/1/15
Counterfeit paper	100,000	*	7/1/14 - 7/1/15
Workers compensation insurance:			
Waterworks	746,772	*	7/1/14 - 7/1/15
Sewage	280,395	*	7/1/14 - 7/1/15
Clerical	295,802	*	7/1/14 - 7/1/15
Health & life insurance	Various	$ 243,204	Monthly

*Blanket coverage; total premium $159,924.

Note 10. Subsequent Events

Subsequent events for Mount Sterling Water and Sewer Commission have been evaluated through October 15, 2015, which is the date the financial statements were available to be issued.

Mount Sterling Water and Sewer Commission
Schedule of Revenues, Expenses And Changes in Net Assets Budget and Actual
For the Year Ended June 30, 2015

	Enacted Budget	Actual	Favorable (Unfavorable)
Operating revenues			
Water sales	$ 3,098,362	$ 3,114,244	$ 15,882
Sewer sales	2,371,469	2,430,870	59,401
Other income	183,606	173,877	(9,729)
Total operating revenues	5,653,437	5,718,991	65,554
Operating expenses			
Water	2,389,098	2,362,158	26,940
Sewer	1,683,592	1,607,360	76,232
General and administrative costs:			
Water	832,601	712,891	119,710
Sewer	405,713	396,162	9,551
Total operating expenses	5,311,004	5,078,571	232,433
Operating income	342,433	640,420	297,987
Nonoperating revenues (expenses)			
Interest income	13,307	12,622	(685)
Grants	0	3,000	3,000
Loss on sale of fixed assets	0	1,650	1,650
Other expense	(44,458)	(34,294)	10,164
Interest expense	(102,534)	(101,297)	1,237
Total net nonoperating revenues (expenses)	(133,685)	(118,319)	15,366
Income before contributions	208,748	522,101	313,353
Capital contributions	0	0	0
Change in net assets	208,748	522,101	313,353
Total net assets, beginning of year	28,382,360	28,382,360	0
Total net assets, end of year	$ 28,591,108	$ 28,904,461	$ 313,353

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority Fund A
June 30, 2015

Fiscal Year Ending June 30	Principal Due Dec. 1 & June 1	Interest December 1	Interest June 1	Total Debt Requirements	Principal Outstanding at End of Year
2016	$ 58,311	$ 704	$ 530	$ 59,545	$ 59,013
2017	59,013	354	178	59,545	0
	$ 117,324	$ 1,058	$ 708	$ 119,090	

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority Fund B
June 30, 2015

Fiscal Year Ending June 30	Principal Due Dec. 1 & June 1	Interest December 1	Interest June 1	Total Debt Requirements	Principal Outstanding at End of Year
2016	$ 137,469	$ 3,140	$ 2,626	$ 143,235	$ 281,179
2017	139,537	2,109	1,589	143,235	141,642
2018	141,642	1,062	534	143,238	0
	$ 418,648	$ 6,311	$ 4,749	$ 429,708	

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority A02-01
June 30, 2015

Fiscal Year Ending June 30	Principal Due Dec. 1 & June 1	Interest Due Dec. 1 & June 1	Admin. Fees	Total Debt Requirements	Principal Outstanding at End of Year
2016	$ 605,948	$ 55,263	$ 11,053	$ 672,264	$ 5,071,463
2017	612,022	49,188	9,838	671,048	4,459,441
2018	618,158	43,053	8,610	669,821	3,841,283
2019	624,355	36,856	7,372	668,583	3,216,928
2020	630,614	30,597	6,119	667,330	2,586,314
2021	636,936	24,275	4,855	666,066	1,949,378
2022	643,321	17,889	3,578	664,788	1,306,057
2023	649,771	11,440	2,288	663,499	656,286
2024	656,286	4,925	985	662,196	0
	$ 5,677,411	$ 273,486	$ 54,698	$ 6,005,595	

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Bond Corporation Financing Program Revenue Bonds 2010 First Series C
June 30, 2015

Fiscal Year Ending June 30	Principal Payments	Interest	Admin. Fees	Total Debt Requirements	Principal Outstanding at End of Year
2016	$ 332,500	$ 18,438	$ 1,986	$ 352,924	$ 282,083
2017	177,083	8,463	1,155	186,701	105,000
2018	105,000	3,150	525	108,675	0
	$ 614,583	$ 30,051	$ 3,666	$ 648,300	

Mount Sterling Water and Sewer Commission
Schedule of Proportionate Share of the Net Pension Liability
For the Year Ended June 30, 2015 and 2014

	2015	2014
Company's proportion of the net pension liability	0.05%	0.05%
Company's proportionate share of the net pension liability (asset)	$ 1,781,540	$ 2,010,266
Company's covered employee payroll	$ 1,287,153	$ 1,256,270
Company's share of the net pension liability (asset) as a percentage of its covered employee payroll	138.41%	160.02%
Plan fiduciary net position as a percentage of the total pension liability	66.80%	61.22%

Notes:
There were no changes in benefit terms, size or composition of the population covered by the benefit terms, or the assumptions used in the last two fiscal years.

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

Mount Sterling Water and Sewer Commission
Schedule of Pension Contributions
For the Year Ended June 30, 2015, 2014 and 2013

	2015	2014	2013
Contractually required employer contribution	$ 164,134	$ 172,611	$ 158,114
Contributions relative to contractually required employer contribution	$ 164,134	$ 172,611	$ 158,114
Contribution deficiency (excess)	$ -	$ -	$ -
Company's covered employee payroll	$ 1,287,153	$ 1,256,270	$ 1,252,885
Employer contributions as a percentage of covered-employee payroll	12.75%	13.74%	12.62%

Notes:
There were no changes in benefit terms, size or composition of the population covered by the benefit terms, or the assumptions used in the last two fiscal years.

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

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

Mount Sterling Water and Sewer Commission
Mount Sterling, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements and have issued our report, which includes an explanatory paragraph regarding the omission of Management Discussion and Analysis, thereon dated October 15, 2015.

Internal Control Over Financial Reporting

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

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

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

Finding: 2015-1

- Condition: While management is knowledgeable in regard to the numbers reported in the financial statements, identifying and applying new authoritative guidance in regard to information reported in the notes to those statements is outside the scope of management's training and experience.

- Management Response and Corrective Action Plan: It does not appear that it would be economically feasible for our organization to enlarge its staff or contract an individual with appropriate skill and knowledge in applying new authoritative guidance. Thus, it is important that our Board provide oversight and independent review functions.

Compliance and Other Matters

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

Response to Findings

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

Purpose of this Report

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

Faulkner, King & Wenz, PSC

October 15, 2015