

**SHELBYVILLE MUNICIPAL WATER
AND SEWER COMMISSION**

FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

JUNE 30, 2016

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

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REPORT OF INDEPENDENT AUDITORS

To the Board of Commissioners
Shelbyville Municipal Water and Sewer Commission
Shelbyville, Kentucky

We have audited the accompanying financial statements of the Shelbyville Municipal Water and Sewer Commission (the "Commission"), a component unit of the City of Shelbyville, Kentucky, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as presented 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Commission'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 Commission'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 Commission as of June 30, 2016, and the changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter – Prior Year Restatement

The financial statements of the Commission as of June 30, 2015, were audited by other auditors whose opinion dated December 4, 2015, expressed an unmodified opinion on those financial statements. As discussed in Note 12 to the financial statements, the Commission has restated net position as of July 1, 2015, for the correction of errors in deferred outflows, deferred inflows and net pension liability previously reported as of June 30, 2015. The other auditors reported on the 2015 financial statements before the restatement.

As part of our audit of the 2016 financial statements, we audited the adjustments described in Note 12 that were applied to restate the opening balances of the 2016 financial statements as of July 1, 2015. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review or apply any procedures to the 2015 financial statements of the Commission other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2015 financial statements as a whole.

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedule of Commission's proportionate share of net pension liability in the County Employees Retirement System ("CERS"), and the schedule of Commission's contributions to the CERS on pages 29 through 30, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The 2015 information presented on pages 29 and 30 was reported on by other auditors, prior to the restatement discussed above, whose report dated December 4, 2015, indicated they applied certain limited procedures to the information and, accordingly did not express an opinion or provide any assurance on the information because the

limited procedures did not provide them with sufficient evidence to express an opinion on provide any assurance.

Management has not presented Management's Discussion and 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 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.

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information presented on pages 31 through 36 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information 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 information is fairly stated in all material respects in relation to the financial statements as a whole. The supplementary information on page 37 has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on that information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 17, 2017 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.

Blue & Co., LLC

July 17, 2017
Louisville, Kentucky

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

STATEMENT OF NET POSITION

JUNE 30, 2016

Assets

Current assets:

Operating cash and cash equivalents	\$	1,961,466
Trade accounts receivable		565,068
Inter-governmental receivable		157,790
Materials inventory		113,446
Prepaid expenses		153,120
		<hr/>
Total current assets		2,950,890

Restricted cash and cash equivalents:

Debt service fund		572,093
Debt service reserve fund		750,306
Depreciation fund		1,819,342
Surplus fund		185,464
System development charge		1,698,167
Funds held by third party		3,199,847
		<hr/>
Total restricted cash		8,225,219

Noncurrent assets:

Capital assets:

Land		181,864
Water rights		165,652
Construction work in progress		2,742,869
Total non-depreciable assets		<hr/> 3,090,385
Water plant in service		24,620,204
Sewer plant in service		29,975,711
Administrative and general		1,831,497
Total depreciable assets		<hr/> 56,427,412
Less accumulated depreciation		(26,784,817)
Total depreciable assets, net		<hr/> 29,642,595
Total capital assets, net		<hr/> 32,732,980
		<hr/>
Total noncurrent assets		32,732,980

Deferred Outflows of Resources

394,412

Total Assets and Deferred Outflows

\$ 44,303,501

See accompanying notes to the financial statements.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

STATEMENT OF NET POSITION JUNE 30, 2016

Liabilities

Current liabilities:

Accounts payable	\$ 175,754
Accrued and withheld expenses	55,031
Customer deposits	283,673
Accrued interest - customer deposits	116,488
Unpaid claims	5,151
Payable from restricted assets	
Lease obligation	1,132,083
Accounts payable - construction	374,815
Total current liabilities	<u>2,142,995</u>

Noncurrent liabilities:

Lease obligation	12,859,167
Net pension liability	1,995,513
Total noncurrent liabilities:	<u>14,854,680</u>

Total liabilities

16,997,675

Deferred Inflows of Resources

-0-

Total Liabilities and Deferred Inflows

16,997,675

Net Position

Invested in capital assets, net of related debt	21,566,762
Restricted for debt service	1,322,399
Restricted for capital projects	3,517,509
Restricted surplus	185,464
Unrestricted	713,692
Total net position	<u>27,305,826</u>

Total net position

27,305,826

Total Liabilities, Deferred Inflows and Net Position

\$ 44,303,501

See accompanying notes to the financial statements.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEAR ENDED JUNE 30, 2016

Operating Revenues

Water sales	\$ 2,979,655
Sewer service	2,620,813
Other revenues	<u>138,081</u>
Total Operating Revenue	5,738,549

Operating Expenses

Direct water expenses	1,120,673
Direct sewer expenses	859,580
Administrative expenses	1,424,208
Depreciation-water plant	628,703
Depreciation-sewer plant	789,939
Depreciation-office building	<u>54,461</u>
Total Operating Expenses	4,877,564

Operating Income

860,985

Non-Operating Revenues (Expenses):

Interest income	21,108
Interest expense	(494,035)
Issuance costs	(190,000)
Capital contributions	699,284
Grants	417,492
Tap on fees	806,650
Debt administration fees	<u>(71,051)</u>
Total Non-Operating Revenues (Expenses)	1,189,448

Income Before Transfers

2,050,433

Transfers out - City of Shelbyville

(150,194)

Change in Net Position

1,900,239

Net Position, Beginning - previously stated

25,569,098

Prior period restatement (see note 12)

(163,511)

Net Position, Beginning - as restated

25,405,587

Net Position, Ending

\$ 27,305,826

Debt Service Coverage

Current year debt service coverage	1.60
Maximum year debt service coverage	1.43

See accompanying notes to the financial statements.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2016

Cash Flows from Operating Activities	
Cash received from customers	\$ 5,726,750
Cash payments to suppliers for goods and services	(1,571,088)
Cash payments for employees	(1,271,906)
Net cash flows from operating activities	2,883,756
Cash Flows from Non-Capital Financing Activities	
Transfer to City of Shelbyville	(150,194)
Net cash flows from non-capital financing activities	(150,194)
Cash Flows from Capital and Related Financing Activities	
Grants	417,492
Capital contributions	699,284
Tap on fees	806,650
Purchase of capital assets	(3,840,945)
Proceeds from long-term debt	4,190,000
Principal payments on long-term debt	(993,750)
Interest payments on long-term debt	(494,035)
Issuance costs	(190,000)
Debt administration fees	(71,051)
Net cash flows from capital and related financing activities	523,645
Cash Flows from Investing Activities	
Interest received	21,108
Net cash flows from for investing activities	21,108
Net change in cash and cash equivalents	3,278,315
Cash and cash equivalents - beginning of the year	6,908,370
Cash and cash equivalents - end of the year	\$ 10,186,685
Shown in the financial statements as:	
Operating cash and cash equivalents	\$ 1,961,466
Restricted cash	8,225,219
	\$ 10,186,685
Reconciliation of Operating Income to Net Cash Provided	
By Operating Activities	
Operating income (loss)	\$ 860,985
Adjustments:	
Depreciation expense	1,473,103
Net changes in assets and liabilities:	
Accounts receivable	(21,678)
Inventory	(5,422)
Prepaid expenses	(11,554)
Inter-governmental receivable	229,842
Deferred outflows	(203,072)
Accounts payable	246,265
Customer deposits	9,879
Other accrued liabilities	3,171
Net pension liability	467,237
Deferred inflows	(165,000)
Net cash flows from operating activities	\$ 2,883,756

See accompanying notes to the financial statements.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

1. SUMMARY OF SIGNIFICANT ACCOUNT POLICIES

Business activity

The Shelbyville Municipal Water and Sewer Commission (a component unit of the City of Shelbyville, Kentucky) operates a combined water and sewer system which serves Shelbyville and the surrounding area. The original Commission established in 1955 was dissolved, reestablished, and restructured during 1993. During 2000, the Shelby County Fiscal Court conveyed all property and assets of Sanitation District No. 1 to the Commission and the Commission assumed the debts and obligations of Sanitation District No. 1 to form a newly constituted Commission. The new Commission consists of seven voting members. The Mayor of the City of Shelbyville, Kentucky shall be one voting member and serve as chairperson. Three other members are appointed by the Mayor, with approval of the City Council. One of the three members appointed by the Mayor shall be a member of the City Council. Three members are to be appointed by the Shelby County Judge Executive, with approval of the Fiscal Court. One of the three members appointed by the Judge Executive shall be a member of the Fiscal Court.

Financial statement presentation

The financial statements of the Commission are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Commission's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements.

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 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.

Cash equivalents

For the purpose of the statement of cash flows, the Commission considers all money market funds and highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Trade accounts receivable

Trade accounts receivable are reported at the amount management expects to collect from outstanding balances. Management considers all accounts receivable as collectible at year-end, accordingly, no provision has been provided for doubtful accounts.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Materials inventory

The inventory is priced at cost on the first-in, first-out basis.

Capital assets

All property and equipment is recorded at cost. Certain interest costs incurred on funds borrowed for construction is capitalized during the construction period per Governmental Accounting Standards Board ("GASB") Section 1400.

The Commission uses the straight-line method for property, plant and equipment based on the following estimated useful life by major class of depreciable assets:

<u>Class</u>	
Buildings and improvements	20-50 years
Machinery and equipment	5-10 years
Water and sewer systems	50 years
Infrastructure	20-50 years

Customer deposits

Interest is accrued at the rate of 6% but not paid until service is discontinued.

Revenue

Customer meters are read and billed monthly at which time the receivable is recorded and revenue is recognized.

New customer service connection fees are recorded as an addition to the equity of the water and sewer system. The cost of installation of the new service is recorded as an addition to water or sewer plant in service and is subject to depreciation.

Operating revenue and expenses

Operating revenue and expenses for proprietary funds are those that result from providing services and producing and delivering goods and/or services. It also includes all revenue and expenses not related to capital and related financing, noncapital financing, or investing activities.

When both restricted and unrestricted resources are available for use, it is the Commission's policy to use restricted resources first, then unrestricted resources as needed.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Debt service coverage

The debt service coverage is computed by dividing operating income before depreciation and interest on long-term debt by the maximum annual principle and interest coming due on all system debt outstanding in any year (including base rentals.) The lease purchase agreements require debt service coverage of 1.20.

Accumulated vacation and sick leave

Vacation is earned at rates varying between 1 to 15 days per year depending on the length of service. Vacations must be taken during the year ended. Sick leave accrues at the rate of 1 day per month and shall accumulate to a maximum of 126 days. Unused sick days are not payable upon retirement or termination. The only benefit available for unused sick leave is limited to retirement credit by the County Employees Retirement System ("CERS") at a maximum of six months credit for 116-126 sick days accumulated at retirement. Any amount of accrued sick leave above 126 days will not be credited for retirement.

Retirement system

For purposes of measuring the net pension liability, deferred outflows of resources, deferred inflows of resources related to pension expense, information about the fiduciary net position of County Employees' Retirement Systems ("CERS") and addition to/deduction from CERS's fiduciary net position have been determined on the same basis as they were reported by CERS.

Equity Classifications

Equity is classified as net position and displayed in three components:

- a. Invested in capital assets, net of related debt – Consists of capital assets including restricted balances, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- b. Restricted – Consists of net position with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted – All other net position that does not meet the definition of "restricted" or "net investment in capital assets."

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

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

2. CASH AND CASH EQUIVALENTS

The Commission maintains numerous operating and restricted cash accounts at various depository institutions.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of a bank failure, the Commission's deposits may not be returned. At June 30, 2016, the carrying amount of the Commission's cash deposits were \$6,986,838. All cash equivalents were covered by collateral in the form of pledged treasury certificates held by the pledging financial institution. All of the bank balances were covered by the \$250,000 federal depository insurance or pledged treasury certificates.

3. COMPONENTS OF RESTRICTED ASSETS

This is a summary of the components of the restricted assets of the Commission:

- a. Debt service fund – This fund will be used for the payment of principal and interest on revenue bonds.
- b. Debt service reserve fund – Designated as an allowance or reserve for payment on principal and interest on revenue bonds for which there would otherwise be a default in payment.
- c. Depreciation fund – This fund shall be available and shall be utilized to balance depreciation, to make unforeseen major repairs and replacements to the Water and Sewer System ("System") and to pay the costs of constructing additions, extensions, betterments and improvements to the System.
- d. System Development Charge – This fund shall be maintained by the Commission for improvements and ongoing construction for improvements to the System.
- e. Surplus fund – This fund shall be maintained by the Commission and used to the extent necessary for payment of obligations, payments of principal and interest for costs of improving or extending the System, or for any other lawful municipal purpose.
- f. Funds held by third party – This fund is held by The Bank of New York Mellon Trust Company for the Kentucky Bond Corporation Financing Program Revenue Bonds and will be drawn by the Commission as needed for improvements to the System including the acquisition,

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

construction, renovation and equipping of the Shelbyville Wastewater Treatment Plant related to changing its disinfection process from free chlorine to chloramines.

4. UTILITY PLANT AND CAPITAL ASSETS

The water System acquired assets from the Kentucky Water Service Company in 1955 and all subsequent additions are recorded at cost. The sewer system is not recorded at cost. The actual cost to the Commission was the payment of outstanding Sewerage System Revenue Bonds in the amount of \$9,000. An appraisal made at the time of acquisition showed the system to have a net sound value of \$200,000. Consequently, entries were made in the Commission's records recording this amount as an asset. Subsequent additions have been recorded at cost. On April 1, 2000, the Sanitation District's assets were transferred to the Commission with a net book value of \$2,403,525.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

Following is a schedule of the utility plant:

<u>Water plant</u>	
Source of supply land	\$ 36,238
Power and pumping land	21,500
Source of supply structures	5,542,876
Pumping structures	417,840
Standpipes	3,409,071
Purification system	3,097,166
Dam and line	300,409
Miscellaneous structures	44,521
Pumping equipment	2,391,066
Distribution mains	6,130,330
Services and meters	2,930,798
Hydrants	356,127
Total water plant	<u>\$ 24,677,942</u>
<u>Sewer plant</u>	
Land	\$ 124,126
Structures	9,090,033
Distribution lines	12,792,339
Manholes	922,572
Disposal plant equipment	7,163,199
Office furniture and fixtures	7,568
Total sewer plant	<u>\$ 30,099,837</u>
<u>Administrative and general</u>	
Land and building	\$ 683,493
Office furniture and fixtures	337,578
Transportation equipment	591,114
Shop equipment	219,312
Total administrative and general	<u>\$ 1,831,497</u>
<u>Construction in progress</u>	
Water plant	\$ 1,256,169
Sewer plant	1,486,700
Total construction in process	<u>\$ 2,742,869</u>
<u>Water rights</u>	<u>\$ 165,652</u>

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Capital assets activity for the year ended June 30, 2016 is as follows:

	Balance June 30, 2015	Transfers and Additions	Transfers and Retirements	Balance June 30, 2016
Capital assets not being depreciated:				
Land	\$ 181,864	\$ -0-	\$ -0-	\$ 181,864
Water rights	165,652	-0-	-0-	165,652
Construction in process	912,566	3,466,459	1,636,156	2,742,869
Total capital assets not being depreciated	1,260,082	3,466,459	1,636,156	3,090,385
Capital assets being depreciated:				
Water plant in service	23,329,477	1,290,727	-0-	24,620,204
Sewer plant in service	29,397,763	577,948	-0-	29,975,711
Administrative and general	1,689,530	141,967	-0-	1,831,497
Total capital assets being depreciated	54,416,770	2,010,642	-0-	56,427,412
Less accumulated depreciation for:				
Water plant in service	(11,821,163)	(628,703)	-0-	(12,449,866)
Sewer plant in service	(12,281,582)	(789,939)	-0-	(13,071,521)
Administrative and general	(1,208,969)	(54,461)	-0-	(1,263,430)
Total accumulated depreciation	(25,311,714)	(1,473,103)	-0-	(26,784,817)
Total capital assets being depreciated, net	29,105,056	537,539	-0-	29,642,595
Capital assets, net	\$ 30,365,138	\$ 4,003,998	\$ 1,636,156	\$ 32,732,980

The construction in progress water plant includes the following projects:

- 1) Interstate 64 regional pipeline study

Engineering	\$ 206,395
Construction and other costs	47,144
	<u>\$ 253,539</u>

This contract is ongoing at year-end.

- 2) Building of downtown water storage tank

Engineering	\$ 74,402
Construction and other costs	878,165
	<u>\$ 952,567</u>

The estimated cost of this project is \$1,478,813.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

3) Water plant filter improvements study	
Engineering	\$ 18,200
Construction and other costs	614
	<u>\$ 18,814</u>

This contract is ongoing at year-end.

4) Relocation of water lines at Mt. Eden Road	
Engineering	\$ 1,651
	<u>\$ 1,651</u>

This contract is ongoing at year-end.

5) Water treatment plant rehabilitation	
Engineering	\$ 17,000
Construction and other costs	614
	<u>\$ 17,614</u>

This contract is ongoing at year-end.

6) 500,000 gallon Industrial Park tank	
Construction and other costs	\$ 4,316
	<u>\$ 4,316</u>

This contract is ongoing at year-end.

7) Relocation of water lines near U.S. 60	
Engineering	\$ 6,220
Construction and other costs	1,448
	<u>\$ 7,668</u>

The estimated cost of this project is \$133,200.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

The construction in progress sewer plant includes the following projects:

1) Phase II Force Main at KY 55	
Engineering	\$ 4,341
	<u>\$ 4,341</u>

This contract is in the design phase and has not been awarded.

2) Diaego Pump Station and Force Main	
Engineering	\$ 130,170
Construction and other costs	885,416
	<u>\$ 1,015,586</u>

The estimated cost of this project is \$1,250,000.

3) Benson Road gravity sewer line	
Engineering	\$ 71,310
Construction and other costs	156,709
	<u>\$ 228,019</u>

The estimated cost of this project is \$950,000.

4) Sludge processing and disposal study at Wastewater Treatment Plant	
Engineering	\$ 174,460
Construction and other costs	1,536
	<u>\$ 175,996</u>

The estimated cost of this project is \$3,994,000.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

5) Modifications to Oxidation ditches	
Engineering	\$ 703
Construction and other costs	62,055
	<u>\$ 62,758</u>

The estimated cost of this project is \$213,100.

5. LEASE OBLIGATIONS

The bonds sold under the 1998 lease agreement, dated June 1, 1998, were to be retired over a period of twenty (20) years with interest rates from 4.0% to 5.15%. The annual base period rentals, including interest, under the agreement ranged from \$680,515 to \$1,025,213. These bonds were paid in full with the new (2008) lease agreement. On June 30, 2008, the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky Municipal Finance Corporation for the refunding of prior 1998 lease. Under the agreement, revenue bonds of \$7,230,000 were sold at par. The bonds sold under the new 2008 lease agreement will be retired over a period of ten (10) years with interest rates from 2.75% to 4.00%. The annual base period rentals including interest, under the agreement range from \$655,241 to \$998,400. Proceeds from this lease agreement were used to finance the construction of improvements to the City's municipal water and sewer system (the "System") and to refund certain maturities of the City's Water System Revenue Bonds, Series 1991-H, the proceeds of which were used to finance the construction on improvements to the System.

On July 14, 2000, the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky League of Cities Funding Trust as lessor. Under the agreement, revenue bonds of \$715,000 were sold at par. Proceeds were used for water and sewer line extension and expansion.

The bonds sold under the lease agreement will be retired over a period of twenty (20) years with variable interest rates. The assumed rate of interest for base rental payments is 4.18%. After notice from the lessor, the Commission will either receive a credit against base rental payable on July 15 of each fiscal year in an amount equal to the excess, if any, of the aggregate of the interest components of base rentals paid by the Commission during the preceding fiscal year (at the assumed interest rate) over the Commission's proportionate share of all interest paid on variable rate bonds or the Commission will immediately pay as additional rentals, an amount equal to the excess, if any, of the Commission's proportionate share of all interest paid or to be paid on variable rate bonds over the aggregate of the interest components of base rentals then required to be paid by the Commission (at the assumed interest rate). Prior to May 1 of each fiscal year during the lease term, the lessor will inform the Commission of the amount of additional rentals that are estimated to be payable during the next ensuing fiscal year. The annual base period rentals, including interest and fiduciary fees, under the agreement range from \$40,729 to \$68,591.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

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On September 9, 2004, the City of Shelbyville entered into a variable rate lease agreement with the Kentucky League of Cities Funding Trust as lessor. Under the agreement revenue bonds of \$8,500,000 were sold at par. Proceeds were used for water treatment plant improvements and wastewater treatment plant expansion and improvements.

The bonds sold under the lease agreement will be retired over twenty-four (24) years with variable interest rates. The assumed rate of interest for base rental payments is 3.75%. After notice from the lessor, the Commission will pay additional rentals within fifteen (15) days. Any lease rental payment not paid within ten (10) days of the date due shall bear interest thereon up to the maximum rate of fifteen percent per annum. The Lessee will receive credit against the base rental payable on September 20th of each fiscal year in an amount equal to the excess, if any, of the aggregate of the interest components of base rentals paid by the Lessee during the preceding fiscal year (at such assumed rate) over the Lessee's proportionate share of all interest paid on variable rate bonds, and after notice from the Lessor, the Lessee will immediately pay as additional rentals, an amount equal to the excess, if any, of the Lessee's proportionate share of interest paid or to be paid on variable rate bonds over the aggregate of the interest components of base rental then required to be paid by the Lessee (at the then assumed rate). Prior to May 1st of each fiscal year during the lease term, the Lessor will inform the Lessee of the amount of additional rentals that are estimated to be payable during the next ensuing fiscal year. The annual base period rentals, including interest and fiduciary fees, under the agreement range from \$17,372 to \$97,637.

On December 2, 2015, the City of Shelbyville entered into a variable rate lease agreement with the Kentucky Bond Corporation as lessor. Under the agreement, revenue bonds of \$4,190,000 were sold at par. Proceeds were used for improvements to the Shelbyville Wastewater Treatment Plant including the acquisition, construction, renovation and equipping of the system related to changing its disinfection process from free chlorine to chloramines.

The bonds sold under the lease agreement will be retired over nineteen (19) years with a 3.00% interest rate. The lessee shall pay base rentals in the amounts specified in its lease agreement. After notice from the lessor, the Commission will pay additional rentals within fifteen (15) days. Any lease rental payment that is not paid within ten (10) days of the date due shall bear interest thereon at the late payment rate.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Future maturities of long-term debt is as follows:

<u>Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Amount</u>
2017	\$ 1,132,083	\$ 500,149	\$ 1,632,232
2018	1,192,083	457,312	1,649,395
2019	301,985	411,949	713,934
2020	1,037,886	388,282	1,426,168
2021	1,022,518	351,052	1,373,570
2022-2026	5,515,832	1,179,931	6,695,763
2027-2031	2,794,280	328,875	3,123,155
2032-2035	994,583	76,198	1,070,781
Total	<u>\$ 13,991,250</u>	<u>\$ 3,693,748</u>	<u>\$ 17,684,998</u>

A summary of changes in long-term liabilities of the Commission as of June 30, 2016 is as follows:

Lease obligations:	Beginning balance	Additions	Reductions	Ending balance	Due within a year
KLC Series 2000	\$ 280,000	\$ -0-	\$ 40,000	\$ 240,000	\$ 45,000
KLC Series 2004A	7,750,000	-0-	-0-	7,750,000	-0-
Series 2008 Revenue	2,765,000	-0-	885,000	1,880,000	920,000
Series 2015 Revenue	-0-	4,190,000	68,750	4,121,250	167,083
	<u>\$ 10,795,000</u>	<u>\$ 4,190,000</u>	<u>\$ 993,750</u>	<u>\$ 13,991,250</u>	<u>\$ 1,132,083</u>

6. RETIREMENT PLAN

General Information about the Pension Plan

Plan description. Employees of the Commission are provided a defined benefit pension plan through the County Employees Retirement System ("CERS"), a cost sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System ("KRS"). The KRS was created by state statute under Kentucky Revised Statute Section 61.645. The KRS Board of Trustees is responsible for the proper operation and administration of the KRS. The KRS issues a publically available financial report that can be obtained by writing to Kentucky Retirement System, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601, or by telephone at (502) 564-4646.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2016

Benefits provided: Nonhazardous

	Tier 1 Nonhazardous Participation beginning prior to 9/1/2008	Tier 2 Nonhazardous Participation beginning 9/1/2008 through 12/31/2013	Tier 3 Nonhazardous Participation beginning on or after 1/1/2014
Covered Employees:	All full-time employees	All full-time employees	All full-time employees
Benefit Formula:	Final compensation x Benefit factor x Years of service	Final compensation x Benefit factor x Years of service	Cash balance plan
Final Compensation:	Average of the highest 5 fiscal years (must contain at least 48 months and a minimum of 5 fiscal years)	5 complete fiscal years immediately preceeding retirement; Each year must contain 12 months	No final compensation factor
Benefit Factor:	2.00% - If member began participating after 8/1/2004 and before 9/1/2008. 2.20% - If member began participating prior to 8/1/2004	10 years or less = 1.10%. Greater than 10 years, but no more than 20 years = 1.30%. Greater than 20 years, but no more than 26 years = 1.50%. Greater than 26 years, but no more than 30 years = 1.75%. Additional years above 30 = 2.00% (2.00% benefit factor only applies to service earned in excess of 30 years)	No benefit factor. A life annuity can be calculated in accordance with actuarial assumptions and a method adopted by the KRS Board based on member's accumulated account balance.
Cost of Living Adjustment ("COLA"):	No COLA unless authorized by the Kentucky General Assembly	No COLA unless authorized by the Kentucky General Assembly	No COLA unless authorized by the Kentucky General Assembly
Unreduced Retirement Benefit:	Any age with 27 years of service. Age 65 with 1 month of service	Rule of 87: Member must be at least age 57 and age plus earned service must equal 87 years at retirement to retire under this provision. Age 65 with 5 years of earned service	Rule of 87: Member must be at least age 57 and age plus earned service must equal 87 years at retirement to retire under this provision. Age 65 with 5 years of earned service
Reduced Retirement Benefit:	Any age with 25 years of service. Age 55 with 5 years of service	Age 60 with 10 years of service. Excludes purchased service (exception: refunds, omitted, free military)	No reduced retirement benefit

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Contributions. Contributions for employees are established in the statutes governing the KRS and may only be changed by the Kentucky General Assembly. Employees contribute 5% of their salary if they were plan members prior to September 1, 2008. For employees that entered the plan after September 1, 2008, they are required to contribute 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member's account while the 1% was deposited to an account created for the payment of health insurance benefits under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). The Commission makes employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. For the year ended June 30, 2016, employers contributed 12.42% as set by KRS, respectively, of each Nonhazardous employee's creditable compensation. For the year ended June 30, 2016, employer contributions for the Commission were \$134,229. By law, employer contributions are required to be paid. The KRS may intercept the Commission's state shared taxes if required employer contributions are not remitted. The employer's actuarially determined contribution (ADC) and member contributions are expected to finance the costs of benefits earned by members during the year, the cost of administration, as well as an amortized portion of any unfunded liability.

Net Pension Liability

The Commission's net pension liability (asset) was measured as of June 30, 2015, and the total pension liability used to calculate net pension liability (asset) was determined by an actuarial valuation as of that date.

Actuarial assumptions. The total pension liability as of June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	4.00%, average, including inflation
Investment rate of return	7.50%, net of pension plan investment expense, including inflation

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 by the KRS Board's actuary when the next experience investigation is conducted.

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

- (a) *Discount rate*: The discount rate used to measure the total pension liability was 7.50%
- (b) *Projected cash flows*: The projection of cash flows used to determine the discount rate assumed that local employees would contribute the actuarially determined contribution rate of projected compensation over the remaining 28-year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period.
- (c) *Long-term rate of return*: The long-term expected rate of return on plan assets is reviewed as part of the regular experience study prepared every five years for KRS. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014. 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 (See chart below). 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 assumptions are 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.
- (d) *Municipal bond rate*: The discount rate determination does not use a municipal bond rate.
- (e) *Periods of projected benefit payments*: Projected future benefit payments for all current plan members were projected through 2117.
- (f) *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:

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NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>	<u>Target Allocation</u>
Combined Equity	5.40%	44.00%
Combined Fixed Income	1.50%	19.00%
Real Return (Diversified Inflation Strategies)	3.50%	10.00%
Real Estate	4.50%	5.00%
Absolute Return (Diversified Hedge Funds)	4.25%	10.00%
Private Equity	8.50%	10.00%
Cash	-0.25%	2.00%
		100.00%

(g) *Sensitivity analysis:* The following presents the net pension liability (asset) of the Commission calculated using the discount rate of 7.50%, as well as what the net pension liability (asset) would be if it were calculated using a discount rate that is 1-percentage-point lower (6.50%) or 1-percentage-point higher (8.50%) than the current rate:

	1% Decrease (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
Net pension liability - nonhazardous	\$ 2,547,388	\$ 1,995,513	\$ 1,522,689
Total	\$ 2,547,388	\$ 1,995,513	\$ 1,522,689

The Commission's proportionate share of the Plan's net pension liability, as indicated in the prior table, is \$1,995,513 of which all is nonhazardous. The Commission's proportioned share of the CERS plan was 0.04641% for nonhazardous.

Pension Expense (Income) and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension expense. The Commission's proportionate share of plan pension expense was \$224,511 for nonhazardous service employees.

Deferred outflows of resources and deferred inflows of resources. For the year ended June 30, 2016, the Commission reported deferred outflows of resources and deferred inflows of resources related to pensions for the following sources.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

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JUNE 30, 2016

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Nonhazardous		
Difference between expected and actual experience	\$ 16,584	\$ -0-
Change of assumptions	201,226	-0-
Net difference between projected and actual earnings on investments	17,888	-0-
Changes in proportion and differences between employer contributions and proportionate share of contributions	24,485	-0-
Contributions subsequent to the measurement date	134,229	-0-
	<u>\$ 394,412</u>	<u>\$ -0-</u>

The \$134,229 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability during the year ended June 30, 2017. Other amounts reported as deferred outflows of resources related to pensions will be recognized in pension expense as follows:

Deferred Outflows of Resources

<u>Original Deferral Year</u>	<u>Original Deferral Amount</u>	<u>06/30/17</u>	<u>06/30/18</u>	<u>06/30/19</u>	<u>06/30/20</u>
2015	\$ 260,183	\$ 65,046	\$ 65,046	\$ 65,046	\$ 65,045
	<u>\$ 260,183</u>	<u>\$ 65,046</u>	<u>\$ 65,046</u>	<u>\$ 65,046</u>	<u>\$ 65,045</u>

In the tables shown above, positive amounts will increase pension expense and negative amounts will decrease pension expense.

7. POST-EMPLOYMENT HEALTH CARE BENEFITS

Retired employees receive some health care benefits depending on their length of service. In accordance with Kentucky Revised Statutes, these benefits are provided and advanced-funded on an actuarially determined basis through the CERS. Covered employees hired after September 1, 2008, contribute 1.00% of their salaries to the CERS Insurance Fund. Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the CERS. The report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016

	Nonhazardous			Percentage of Annual OPEB Cost Contributed
	Statutorily Required Contribution Rate (As a Percentage of Covered Payroll)	Annual OPEB Cost	Annual OPEB Cost Contributed	
June 30,				
2016	4.64%	\$ 50,147	\$ 50,147	100%
2015	4.92%	\$ 53,276	\$ 53,276	100%
2014	5.15%	\$ 53,714	\$ 53,714	100%

8. EMPLOYEE HEALTH BENEFIT PLAN

Effective July 1, 2006, the City of Shelbyville implemented an employee health and welfare benefit plan providing medical benefits utilizing a preferred provider network, and prescription drug benefits. A copy of the Plan documents and insurance contracts, if any, are on file at the plan administrator's office and may be read by any covered person at any reasonable time.

The plan is fully funded by the employer. Funds for payment of claims considered under the plan are forwarded to accounts from which claims are to be paid. The City of Shelbyville maintains this fund and is the administrator, fiduciary and legal agent. Medical Benefits Administrators, Inc., 1975 Tamarack Road, P.O. Box 1099, Newark, Ohio 43058-1099 is the benefit manager.

The plan is funded by contributions made by the employer and employees who are participating under the plan. Participation contributions are currently required for both participant and dependent coverage. The Commission through the City of Shelbyville has purchased excess stop-loss insurance that exceeds \$55,000 per covered individual for the fiscal year ended June 30, 2016.

Changes in the balances of claims liabilities are as follows:

<u>Claims Liabilities</u>	<u>June 30, 2016</u>
Unpaid claims, beginning	\$ 12,760
Incurred claims & changes in estimates	255,059
Claims paid	<u>(262,668)</u>
Unpaid claims, ending	<u>\$ 5,151</u>

9. FAIR VALUE MEASUREMENTS

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTES TO FINANCIAL STATEMENTS

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priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Commission has the ability to access.
- Level 2: Inputs to the valuation methodology included quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified contractual term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimized the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2016.

- Money market mutual funds: Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV) however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.

The following table sets forth by level, within the hierarchy, the Commission's assets and liabilities measured at fair value on a recurring basis as of June 30, 2016 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Morgan Stanley Government				
Money Market Mutual Fund	\$ 750,306	\$ -0-	\$ -0-	\$ 750,306
	<u>\$ 750,306</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 750,306</u>

The Commission's policy is to recognize transfers between levels as of the actual date of the event or changes in circumstances. There were no transfers between levels during the year ended June 30, 2016.

The Commission holds investments which are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty

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related to changes in the value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying financial statements.

10. FUNDS HELD BY THIRD PARTY

The Commission through the City of Shelbyville has incurred debt for the financing of their improvement project for the Shelbyville Wastewater Treatment Plant. The lease agreement has established an account in the name of The Bank of New York Mellon Trust Company, as trustee. The balance in this account at year-end is \$3,199,847 and the Commission will receive distributions from this account as the project progresses.

11. TRANSFERS

Pursuant to an Interlocal Cooperation Agreement dated January 31, 2000 between the City of Shelbyville, the Shelbyville Municipal Water Commission, and the County of Shelby, the City of Shelbyville shall receive no more than 7% of the annual gross water and sewer revenues of the Commission, and any amounts transferred to the City of Shelbyville shall represent surplus funds of the Commission. The funds transferred for the current year ended June 30, 2016 were \$150,194.

12. RESTATEMENT OF BEGINNING NET POSITION RELATED TO FISCAL YEAR ENDING JUNE 30, 2015

Beginning net position as of July 1, 2015 reported on the statement of revenues, expenses and changes in net position has been restated to report deferred outflows for contributions made subsequent to the measurement date for only the pension portion of the employer contributions to CERS and to exclude the insurance portion of the contribution. In addition, unamortized debt issue expenses have been restated to show all debt issuance costs as being expensed in the year of acquisition.

Net position - July 1, 2015, prior to restatement	\$	25,569,098
Increase (decrease) in deferred outflows		(53,276)
Increase (decrease) in unamortized debt issue expenses		(110,235)
Increase (decrease) in net position		<u>(163,511)</u>
Net position - July 1, 2015, as restated	\$	<u><u>25,405,587</u></u>

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

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The impact of the above changes on the change in net position previously reported for the year ended June 30, 2015, is as follows:

Change in net position - as previously reported	\$	1,181,337
Change in pension expense		(53,276)
Change in interest expense		44,253
		<hr/>
Increase (decrease) in net position		(9,023)
		<hr/>
Change in net position - as corrected	\$	1,172,314
		<hr/>

13. RECENT GASB PRONOUNCEMENTS

Management has not currently determined what, if any, effects of implementation of the following statements may have on the financial statements:

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, issued June 2015, will be effective for periods beginning after June 15, 2017. This Statement addresses accounting and financial reporting for Other Postemployment Benefits (OPEB) that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosures and required supplementary information requirements about defined benefit OPEB will be enhanced.

GASB Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*, will be effective for periods beginning after June 15, 2016. This Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

REQUIRED SUPPLEMENTARY INFORMATION

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF COMMISSION'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
IN COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)
JUNE 30, 2016

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
	<u>Nonhazardous</u>	<u>Nonhazardous</u>
Commission's proportion of the net pension liability	0.046410%	0.045460%
Commission's proportionate share of the net pension liability	\$ 1,995,513	\$ 1,475,000
Commission's covered employee payroll	\$ 1,082,852	\$ 1,042,996
Commission's proportion of the net position liability as a percentage of its covered employee payroll	184.28%	141.42%
Total Pension Plan's Fiduciary Net Position as a percentage of Total Pension Liability	59.97%	66.80%

Note: This schedule is intended to present 10 years of the proportionate share of the net pension liability. Currently, only those years with information available are presented. The amounts presented above for the fiscal year were determined as of June 30 for the year prior (measurement date).

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF COMMISSION'S CONTRIBUTIONS TO THE COUNTY EMPLOYEES
RETIREMENT SYSTEM (CERS)
JUNE 30, 2016

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
	<u>Nonhazardous</u>	<u>Nonhazardous</u>
Statutorily required contribution for pension	\$ 134,229	\$ 138,064
Commission's contributions in relation to the statutorily required contribution	<u>(134,229)</u>	<u>(138,064)</u>
Annual contribution deficiency (excess)	<u>\$ -0-</u>	<u>\$ -0-</u>
Commission's contributions as a percentage of statutorily required contribution for pension	100.00%	100.00%
Commission's covered employee payroll	\$ 1,080,750	\$ 1,082,852
Contributions as a percentage of its covered employee payroll	12.42%	12.75%

Note: This schedule is intended to present 10 years of contributions and related ratios. Currently, only those years with information available are presented. The amounts presented above for the fiscal year were determined as of the fiscal year ended above.

See report of independent auditors.

OTHER SUPPLEMENTARY INFORMATION

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION – BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2016

	Budget		Actual	Variance - Over (Under)
	Original	Final		
Operating Revenues:				
Water sales	\$ 2,845,532	\$ 2,845,532	\$ 2,979,655	\$ 134,123
Sewer service	2,556,900	2,556,900	2,620,813	63,913
Other revenues	129,150	129,150	138,081	8,931
Total Operating Revenue	5,531,582	5,531,582	5,738,549	206,967
Operating Expenses:				
Direct water expenses	1,086,514	1,086,514	1,120,673	34,159
Direct sewer expenses	876,021	876,021	859,580	(16,441)
Administrative expenses	1,310,415	1,310,415	1,424,208	113,793
Depreciation-water plant	630,000	630,000	628,703	(1,297)
Depreciation-sewer plant	790,000	790,000	789,939	(61)
Depreciation-office building	55,000	55,000	54,461	(539)
Total Operating Expenses	4,747,950	4,747,950	4,877,564	129,614
Operating Income	783,632	783,632	860,985	77,353
Non-Operating Revenues (Expenses):				
Interest income	21,000	21,000	21,108	108
Interest expenses-long term debt	(532,420)	(532,420)	(494,035)	38,385
Issuance costs	-0-	-0-	(190,000)	(190,000)
Grants	210,000	210,000	417,492	207,492
Capital contributions	900,000	900,000	699,284	(200,716)
Tap on fees	806,000	806,000	806,650	650
Debt administration fees	(70,270)	(70,270)	(71,051)	(781)
Total Non-Operating Revenues (Expenses)	1,334,310	1,334,310	1,189,448	(144,862)
Income Before Transfers	2,117,942	2,117,942	2,050,433	(67,509)
Transfers out - City of Shelbyville	(151,000)	(151,000)	(150,194)	806
Change in Net Position	1,966,942	1,966,942	1,900,239	(66,703)
Net Position, July 1, 2015 - previously stated	25,569,098	25,569,098	25,569,098	-0-
Prior period restatement (see note 12)	-0-	-0-	(163,511)	(163,511)
Net Position, July 1, 2015 - as restated	25,569,098	25,569,098	25,405,587	(163,511)
Net Position, June 30, 2016	\$ 27,536,040	\$ 27,536,040	\$ 27,305,826	\$ (230,214)

See report of independent auditors and accompanying note to the budgetary information.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEUDLE OF OPERATING REVENUE – BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2016

	Budget		Actual	Variance - Over (Under)
	Original	Final		
Water Sales:				
Industrial sales	\$ 295,500	\$ 295,500	\$ 338,456	\$ 42,956
Residential sales	1,980,456	1,980,456	1,988,909	8,453
Commercial sales	279,557	279,557	273,816	(5,741)
Sales to West Shelby Water District	128,600	128,600	158,447	29,847
Sales to North Shelby Water District	34,000	34,000	82,641	48,641
Private fire protection	76,000	76,000	88,406	12,406
Public fire protection	5,419	5,419	5,418	(1)
Other water sales	46,000	46,000	43,562	(2,438)
Total Water Sales	<u>\$ 2,845,532</u>	<u>\$ 2,845,532</u>	<u>\$ 2,979,655</u>	<u>\$ 134,123</u>
Sewer Service:				
Industrial service	\$ 415,000	415,000	489,710	\$ 74,710
Residential service	1,730,000	1,730,000	1,737,982	7,982
Commercial service	316,210	316,210	312,212	(3,998)
Sewer pretreatment program	16,000	16,000	28,514	12,514
Other sewer service	79,690	79,690	52,395	(27,295)
Total Sewer Service	<u>\$ 2,556,900</u>	<u>\$ 2,556,900</u>	<u>\$ 2,620,813</u>	<u>\$ 63,913</u>
Other Revenues:				
Water meter turn ons	\$ 35,000	35,000	40,075	\$ 5,075
Miscellaneous income	24,000	24,000	26,388	2,388
Handling late fee	52,000	52,000	51,804	(196)
Rental income	18,150	18,150	19,814	1,664
Total Other Revenues	<u>\$ 129,150</u>	<u>\$ 129,150</u>	<u>\$ 138,081</u>	<u>\$ 8,931</u>

See report of independent auditors and accompanying note to the budgetary information.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF OPERATING EXPENSES – BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2016

	Budget		Actual	Variance - Over (Under)
	Original	Final		
Direct Water Expenses:				
Operation, supervision, and engineering	\$ 15,000	\$ 15,000	\$ 15,514	\$ 514
Source of supply and pumping labor	169,671	169,671	187,656	17,985
Laboratory expense	48,000	48,000	57,666	9,666
Operating supplies	189,900	189,900	246,206	56,306
Maintenance-structures	69,909	69,909	52,081	(17,828)
Maintenance-pumping and filtering	65,110	65,110	57,742	(7,368)
Power	164,000	164,000	162,788	(1,212)
Maintenance-water mains	53,428	53,428	99,107	45,679
Maintenance-services and meters	80,696	80,696	65,298	(15,398)
Maintenance-hydrants	10,800	10,800	8,743	(2,057)
Meter readings	78,000	78,000	71,620	(6,380)
Sludge removal	12,000	12,000	5,214	(6,786)
Misc labor	58,000	58,000	33,800	(24,200)
Vacation, holiday, sick-pay	72,000	72,000	57,238	(14,762)
Total Direct Water Expenses	\$ 1,086,514	\$ 1,086,514	\$ 1,120,673	\$ 34,159

See report of independent auditors and accompanying note to the budgetary information.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF OPERATING EXPENSES – BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2016

	Budget		Actual	Variance - Over (Under)
	Original	Final		
Sewer Service:				
Operation, supervision, and engineering	\$ 2,400	\$ 2,400	\$ 1,285	\$ (1,115)
Sewer plant labor	116,312	116,312	103,632	(12,680)
Laboratory expense	21,000	21,000	23,674	2,674
Operating supplies	124,000	124,000	126,774	2,774
Maintenance-structures	26,358	26,358	27,464	1,106
Maintenance-disposal plant equipment	55,443	55,443	36,535	(18,908)
Power	142,020	142,020	141,321	(699)
Power-SD pump station	44,280	44,280	61,365	17,085
Maintenance-sewer mains	29,990	29,990	24,432	(5,558)
Maintenance-sewer manholes	3,600	3,600	1,593	(2,007)
Maintenance-pump stations	15,940	15,940	20,441	4,501
Maintenance-SD pump stations	114,000	114,000	127,621	13,621
Maintenance-flow monitoring	3,690	3,690	5,476	1,786
Pretreatment expense	19,600	19,600	13,558	(6,042)
Chronic tox testing	21,400	21,400	11,117	(10,283)
Sludge removal	20,764	20,764	21,543	779
Vacation, holiday, sick-pay	31,883	31,883	51,177	19,294
Labor - comm pump station	18,390	18,390	16,126	(2,264)
Pretreatment outside lab expense	15,500	15,500	16,491	991
Materials comm pump station	8,400	8,400	8,087	(313)
Maintenance - sd pump station	15,431	15,431	13,151	(2,280)
Maintenance - sd mains	2,400	2,400	22	(2,378)
Power - sd pump station	23,220	23,220	6,695	(16,525)
Total Direct Sewer Expenses	\$ 876,021	\$ 876,021	\$ 859,580	\$ (16,441)

See report of independent auditors and accompanying note to the budgetary information.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF OPERATING EXPENSES – BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2016

	Budget		Actual	Variance - Over (Under)
	Original	Final		
Administrative Expenses:				
Office salaries	\$ 107,585	\$ 107,585	\$ 104,804	\$ (2,781)
Office supplies and expenses	72,000	72,000	82,794	10,794
Uncollectible revenue	2,400	2,400	322	(2,078)
Management salary	146,040	146,040	140,266	(5,774)
Management training	6,000	6,000	5,043	(957)
Legal and accounting	48,000	48,000	43,751	(4,249)
Commission member fees	31,500	31,500	30,600	(900)
Insurance	139,962	139,962	142,683	2,721
Employee insurance	236,000	236,000	262,699	26,699
Employee retirement	196,000	196,000	283,709	87,709
Miscellaneous expenses	72,200	72,200	86,777	14,577
Maintenance-general properties	9,600	9,600	11,535	1,935
Maintenance-safety equipment	9,600	9,600	10,034	434
Safety training	3,600	3,600	3,503	(97)
Truck and equipment expenses	96,000	96,000	82,037	(13,963)
Distribution shop supplies	14,000	14,000	16,665	2,665
Office cleaning and maintenance	800	800	-0-	(800)
Office utilities	7,780	7,780	5,986	(1,794)
Payroll taxes	84,000	84,000	82,005	(1,995)
Vacation, holiday, sick-pay	14,148	14,148	17,401	3,253
Office janitorial	6,000	6,000	6,000	-0-
Office maintenance	7,200	7,200	5,594	(1,606)
Total Administrative Expenses	\$ 1,310,415	\$ 1,310,415	\$ 1,424,208	\$ 113,793

See report of independent auditors and accompanying note to the budgetary information.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

NOTE TO THE SCHEDULE OF OPERATING REVENUE – BUDGET AND ACTUAL AND THE SCHEDULE OF OPERATING EXPENSES – BUDGET AND ACTUAL YEAR ENDED JUNE 30, 2016

The Chairman shall submit an annual budget to the Commission at the May monthly meeting. The budget shall provide for any request by the Commission for surplus funds deposited in the name of the City. The annual budget shall be approved no later than June 30 of each year. Surplus funds in excess of the amount required to be maintained under the provision of the lease agreements between Kentucky Municipal Finance Corporation and the City of Shelbyville shall be deposited in the name of the City as provided in the lease agreements and may be transferred to the general fund of the City as provided in the lease agreements.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

BOARD OF COMMISSIONERS
JUNE 30, 2016

Board of Commissioners

Wayne Stratton	June 30, 2017
Gil Tucker	June 30, 2018
Hubert Pollett	June 30, 2019
Val Owens	June 30, 2017
Al Andrews	June 30, 2018
Jon Swindler	December 31, 2019



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**REPORT OF INDEPENDENT AUDITORS 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**

To the Board of Commissioners
 Shelbyville Municipal Water and Sewer Commission

Report on the Financial Statements

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 Shelbyville Municipal Water and Sewer Commission (the "Commission"), a component unit of the City of Shelbyville, Kentucky, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated July 17, 2017.

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 opinion 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 Commission'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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses that we consider to be material weaknesses as item 2016-1 and 2016-2.

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 is required to be reported under *Government Auditing Standards*.

Commission's Response to Findings

The Commission's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. 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 Commission'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 Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Blue & Co., LLC

Louisville, Kentucky
July 17, 2017

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF FINDINGS AND RESPONSES

JUNE 30, 2016

Finding: 2016-1

Condition: During 2015, the amount reported as deferred outflow of resources – contributions subsequent to the measurement date were included in pension expense and included a portion of payments to the pension plan that related to retirement insurance payments.

Criteria: Under accounting principles generally accepted in the United States of America, contributions to the pension plan after the measurement date should offset the pension liability in the following year and should only include the amount contributed to the pension plan related to pension payments.

Cause: The nature and complexity of the transaction involved.

Effect: As a result of the above conditions, deferred outflows was overstated and pension expense was understated during 2015.

Recommendation: We recommend the Commission review its year-end procedures for recording net pension liability and pension expense.

Response: We accept the auditor's recommendation. Due to the complexity of the new pension calculations and year-end adjustments under the new accounting standards, we consulted with the predecessor auditor during the 2015 audit and the new external auditor during the 2016 audit for assistance with the year-end adjustments. We will work with the auditor in future years to ensure the amount contributed to the retirement system only includes the pension payment and to ensure the payments are offset against the net pension liability in the correct year.

Finding: 2016-2

Condition: In prior years, the amount reported as unamortized debt issue expenses were being amortized and should have been expensed as debt issuance costs in the year of acquisition per GASB 65.

Criteria: Under accounting principles generally accepted in the United States of America, debt issuance costs should be expensed in the year of acquisition.

Cause: The nature and complexity of the transaction involved.

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

SCHEDULE OF FINDINGS AND RESPONSES

JUNE 30, 2016

Effect: As a result of the above conditions, unamortized debt issue costs was overstated and issuance costs expense was understated during prior years.

Recommendation: We recommend the Commission review its year-end procedures for expensing debt issuance costs in the year those costs are incurred.

Response: We accept the auditor's recommendation. The Commission will review each debt issue with issuance costs and ensure that these costs are expensed in the year of acquisition per GASB 65.