

Shelbyville Municipal Water and Sewer Commission

Shelbyville, Kentucky

Financial Statements

And Independent Auditors' Report

For the Year Ended

June 30, 2019

Shelbyville Municipal Water and Sewer Commission
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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Shelbyville Municipal Water and Sewer Commission (the "Commission") a component unity of the City of Shelbyville, Kentucky, as of and for the year ended June 30, 2019, 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.

Auditors' Responsibility

Our responsibility is to express an opinion 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 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 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, 2019, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the pension schedules on page 26-27 and the OPEB schedules on pages 28-29 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 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 not presented the management's discussion and analysis that governmental 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 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 an opinion on the financial statements as a whole. The supplementary information presented on pages 30 through 34 is presented for purposes of additional analysis and are not a required part of the basic financial statements.

Such information is the responsibility of management and was 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 supplementary information is fairly stated in all material respects in relation to the basic financial statements as a whole.

The supplementary information presented on page 35 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 February 12, 2020, on our consideration of the Shelbyville Municipal Water and Sewer Commissions 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 Shelbyville Municipal Water and Sewer Commission's internal control over financial reporting and compliance.

Baldwin CPAs, PLLC

Richmond, Kentucky
February 12, 2020

Shelbyville Municipal Water and Sewer Commission
Statement of Net Position
June 30, 2019

Assets

Current assets:

| | |
|-------------------------------------|----------------|
| Operating cash and cash equivalents | \$ 1,668,988 |
| Accounts Receivable: | |
| Trade accounts receivable, net | 761,759 |
| Inter-governmental receivables | 260,109 |
| Other receivables, net | 57,617 |
| Materials inventory | 164,810 |
| Prepaid expenses | <u>148,878</u> |
| Total current assets | 3,062,161 |

Restricted cash and cash equivalents

| | |
|---------------------------|------------------|
| Debt service fund | 554,244 |
| Depreciation fund | 1,983,379 |
| Surplus fund | 185,347 |
| System development charge | 1,868,156 |
| Special bond account | <u>5,291,571</u> |
| Total restricted cash | 9,882,697 |

Non-current assets:

Capital assets:

| | |
|----------------------------------|------------------|
| Land | 181,864 |
| Water rights | 165,652 |
| Construction work in progress | <u>2,402,940</u> |
| Total non-depreciable assets | 2,750,456 |

| | |
|-------------------------------|---------------------|
| Water plant in service | 27,515,765 |
| Sewer plant in service | 36,821,248 |
| Administrative and general | <u>2,287,683</u> |
| Total depreciable assets | 66,624,697 |
| Less accumulated depreciation | <u>(31,492,064)</u> |
| Total depreciable assets, net | 35,132,633 |

| | |
|-------------------------|-------------------|
| Total noncurrent assets | <u>37,883,089</u> |
|-------------------------|-------------------|

| | |
|--------------|-------------------|
| Total assets | <u>50,827,948</u> |
|--------------|-------------------|

| | |
|--------------------------------|------------------|
| Deferred outflows of resources | <u>1,225,697</u> |
|--------------------------------|------------------|

| | |
|------------------------------------|-----------------------------|
| Total assets and deferred outflows | <u><u>\$ 52,053,645</u></u> |
|------------------------------------|-----------------------------|

See accompanying notes to the financial statements.

Shelbyville Municipal Water and Sewer Commission
Statement of Net Position
June 30, 2019

Liabilities

| | |
|--|-----------------------------|
| Current liabilities: | |
| Accounts payable | \$ 195,236 |
| Accrued expenses | 49,591 |
| Customer deposits | 296,244 |
| Unpaid claims | 10,242 |
| Accrued interest - customer deposits | 136,891 |
| Payable from restricted assets: | |
| Current portion of long-term debt | 1,223,897 |
| Accounts payable - construction | <u>157,928</u> |
| Total current liabilities | 2,070,029 |
| Non-current liabilities: | |
| Long-term debt | 16,210,750 |
| Net OPEB liability | 897,558 |
| Net pension liability | <u>3,078,771</u> |
| Total non-current liabilities | 20,187,079 |
| Total liabilities | <u>22,257,108</u> |
| Deferred inflows of resources | 400,466 |
| Total liabilities and deferred inflows | <u>22,657,574</u> |
| Net position | |
| Invested in capital assets, net of related debt | 17,697,986 |
| Restricted for: | |
| Debt service | 554,244 |
| Capital projects | 3,851,535 |
| Surplus | 185,347 |
| Unrestricted | <u>7,106,958</u> |
| Total net position | <u>29,396,071</u> |
| Total liabilities, deferred inflows and net position | <u><u>\$ 52,053,645</u></u> |

See accompanying notes to the financial statements.

Shelbyville Municipal Water and Sewer Commission
Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2019

| | |
|--|-----------------------------|
| Operating revenues | |
| Water sales | \$ 3,869,315 |
| Sewer sales | 3,272,207 |
| Other revenues | <u>117,585</u> |
| Total operating revenues | 7,259,107 |
| Operating expenses | |
| Direct water expenses | 1,371,490 |
| Direct sewer expenses | 1,085,409 |
| Administrative expenses | 1,839,381 |
| Depreciation - water plant | 757,208 |
| Depreciation - sewer plant | 1,018,263 |
| Depreciation - office building | <u>35,565</u> |
| Total operating expenditures | 6,107,315 |
| Operating income | 1,151,792 |
| Non-operating revenues (expenses): | |
| Interest income | 233,574 |
| Reimbursement from state relocation projects | 885,311 |
| Expenses from state relocation projects | (885,311) |
| Interest expense | (630,415) |
| Capital contributions | 165,871 |
| Tap on fees | 206,752 |
| Debt administration fees | <u>(71,183)</u> |
| Total non-operating revenues (expenses): | <u>(95,402)</u> |
| Income before transfers | 1,056,390 |
| Transfers out- City of Shelbyville | <u>(150,139)</u> |
| Net change in net position | 906,251 |
| Net position, June 30, 2018 | <u>28,489,820</u> |
| Net position, June 30, 2019 | <u><u>\$ 29,396,071</u></u> |

See accompanying notes to the financial statements.

Shelbyville Municipal Water and Sewer Commission
Statement of Cash Flows
For the Year Ended June 30, 2019

| | |
|--|-----------------------------|
| Cash flows from operating activities: | |
| Cash received from customers | \$ 6,918,440 |
| Cash payments to suppliers for goods and services | (2,898,376) |
| Cash payments to employees | <u>(938,208)</u> |
| Net cash provided by operating activities | 3,081,856 |
| Cash flows from noncapital financing activities | |
| Transfer to City of Shelbyville | <u>(150,139)</u> |
| Net cash used by noncapital financing activities | (150,139) |
| Cash flows from capital and related financing activities | |
| Capital contributions | 165,871 |
| Tap on fees | 206,752 |
| Purchase of capital assets | (2,049,740) |
| Principal payments on long-term debt | (615,672) |
| Interest payments on long-term debt | (630,415) |
| Debt administration fees | <u>(71,183)</u> |
| Net cash used in capital and related financing activities | (2,994,388) |
| Cash flows from investing activities | |
| Interest received | <u>233,574</u> |
| Net cash provided by investing activities | <u>233,574</u> |
| Net increase in cash | 170,903 |
| Cash, beginning of year | <u>11,380,782</u> |
| Cash, end of year | <u><u>\$ 11,551,685</u></u> |
| Shown in the financial statements as: | |
| Operating cash and cash equivalents | \$ 1,668,988 |
| Restricted cash | <u>9,882,697</u> |
| | <u><u>\$ 11,551,685</u></u> |
| Reconciliation of operating income to net cash provided by operating activities: | |
| Operating income | \$ 1,151,792 |
| Adjustments: | |
| Depreciation | 1,811,036 |
| Change in assets and liabilities: | |
| Accounts receivable | (308,110) |
| Inventory | (36,471) |
| Prepaid expenses | 9,525 |
| Inter-governmental receivable | (36,436) |
| Deferred outflows | 9,571 |
| Accounts payable | 83,479 |
| Customer deposits | 3,879 |
| Accrued expenses, interest, and unpaid claims | 18,855 |
| Net pension liability | 337,609 |
| Net OPEB liability | (43,905) |
| Deferred inflows | <u>81,032</u> |
| Net cash provided by operating activities | <u><u>\$ 3,081,856</u></u> |

See accompanying notes to the financial statements.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 1 - Summary of Significant Accounting 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.

Basis of Accounting and Measurement Focus

The Commission is accounted for as a governmental proprietary fund and as such, its financial statements include a Statement of Net Position, a Statement of Revenues, Expenses and Changes in Net Position, and a Statement of Cash Flows. The Commission is financed and operated in a manner similar to a private business where the intent of the governing body is that cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed primarily through user charges.

The Commission is accounted for using the "economic resources" measurement focus and the accrual basis of accounting. Accordingly, all assets, deferred outflows or resources, liabilities, and deferred inflows or resources are included on the Statement of Net Position. The Statement of Revenues, Expenses and Changes in Net Position presents increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred, regardless of the timing of related cash flows

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.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 1 - Summary of Significant Accounting Policies (Continued)

Accounts Receivable

Trade accounts receivable are reported at the amount management expects to collect from outstanding balances. Trade accounts receivable are for services to customers. Allowances for uncollectible accounts receivable totaled \$30,000 and are based upon historical trends and the periodic aging of accounts receivable. Intergovernmental receivables are reported at the amount management expects to collect from outstanding balances and represent amounts due from local and state governments related to water and sewer projects. Management considers 100% of intergovernmental receivables to be fully collectable and thus there is no allowance at June 30, 2019. Other receivables are reported at the amount management expects to collect from outstanding balances and represent amounts due from local entities for reimbursement of costs on water and sewer projects. The allowance for uncollectible accounts totaled \$27,000 at June 30, 2019. The allowance was based on Management's analysis of the account aging.

Materials Inventory

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

Investments

Investments consist of money market mutual funds reported at fair value. On the Statement of Net Position, the investments are presented as restricted cash and cash equivalents.

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:

Class

| | |
|----------------------------|-------------|
| 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.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 1 - Summary of Significant Accounting Policies (Continued)

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.

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.

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.

Accumulated Vacation and Sick leave

Vacation is earned at rates varying between 1 to 15 days per year depending on the length of service. Employees must use vacation time earned during the year as there is no carryover. 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, net OPEB liability, deferred outflows of resources, deferred inflows of resources related to pension and OPEB expense, information about the fiduciary net position of CERS and addition to/deduction from CERS’s fiduciary net position have been determined on the same basis as they were reported by CERS.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 2 – Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the Commission's deposits may not be returned. The Commission does have a deposit policy for custodial credit risk and follows the requirements of KRS 41.240(4). The Commission maintains numerous accounts at a depository bank. The Commission has pledged securities for those accounts with balances exceeding \$250,000.

The Commission's deposit and investment policies conform to state statutes. The Commission deposits its funds in banks insured by the Federal Deposit Insurance Corporation (FDIC). Collateral is required for all deposits in excess of FDIC insurance at 100% of the carrying amount at the bank. Collateral consists of pledged treasury certificates by the pledging financial institution. As of June 30, 2019, of the Commission's \$11,551,685 bank balances, \$11,301,685 was uninsured by FDIC, but 100% collateralized by pledged treasury certificates by the financial institution.

Note 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. 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.
- c. System Development Charge – This fund shall be maintained by the Commission for improvements and ongoing construction for improvements to the System.
- d. 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.
- e. Special bond account – This fund shall be maintained to account for the proceeds from 2017 revenue bond.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 4 – Utility Plant and Capital Assets

The water system assets and sewer system assets are recorded at cost.

Following is a schedule of the utility plant:

| | |
|----------------------------------|----------------------|
| Water Plant and Land | |
| Source of supply land | \$ 36,238 |
| Power and pumping land | 21,500 |
| Source of supply structures | 5,542,876 |
| Pumping structures | 417,840 |
| Standpipes | 5,227,801 |
| Purification system | 3,342,188 |
| Dam and line | 300,409 |
| Miscellaneous structures | 49,633 |
| Pumping equipment | 2,452,078 |
| Distribution mains | 6,294,824 |
| Services and meters | 3,515,673 |
| Hydrants | 372,441 |
| Total water plant and land | <u>\$ 27,573,501</u> |
| Sewer Plant and Land | |
| Land | \$ 124,126 |
| Structures | 11,762,047 |
| Distribution lines | 14,024,229 |
| Manholes | 1,074,238 |
| Disposal plant equipment | 9,949,043 |
| Office furniture and fixtures | 11,691 |
| Total sewer plant and land | <u>\$ 36,945,374</u> |
| Administrative and general | |
| Land improvements and building | \$ 690,922 |
| Office furniture and fixtures | 374,490 |
| Transportation equipment | 805,314 |
| Shop equipment | 416,958 |
| Total administrative and general | <u>\$ 2,287,683</u> |
| Construction in progress | |
| Water plant | \$ 2,189,765 |
| Sewer plant | 213,176 |
| Total construction in progress | <u>\$ 2,402,940</u> |
| Water rights | <u>\$ 165,652</u> |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 4 – Utility Plant and Capital Assets (Continued)

| | Balance July 1, 2018 | Additions | Deductions | Balance June 30, 2019 |
|--|-------------------------|---------------------|-----------------------|--------------------------|
| Capital assets not being depreciated | | | | |
| Land | \$ 181,864 | \$ - | \$ - | \$ 181,864 |
| Water rights | 165,652 | - | - | 165,652 |
| Construction in process | 989,158 | 2,645,193 | (1,231,411) | 2,402,940 |
| Total capital assets not being depreciated | <u>1,336,674</u> | <u>2,645,193</u> | <u>(1,231,411)</u> | <u>2,750,456</u> |
| Depreciable assets: | | | | |
| Water plant in service | 27,200,514 | 315,251 | - | 27,515,765 |
| Sewer plant in service | 36,657,223 | 164,025 | - | 36,821,248 |
| Administrative and general | 2,131,002 | 156,683 | - | 2,287,684 |
| Total depreciable assets | <u>65,988,739</u> | <u>635,959</u> | <u>-</u> | <u>66,624,698</u> |
| Total capital assets | <u>67,325,413</u> | <u>3,281,152</u> | <u>(1,231,411)</u> | <u>69,375,154</u> |
| Accumulated depreciation: | | | | |
| Water plant in service | (13,569,522) | (684,805) | - | (14,254,327) |
| Sewer plant in service | (14,764,594) | (1,018,264) | - | (15,782,858) |
| Administrative and general | (1,346,911) | (107,968) | - | (1,454,879) |
| Total accumulated depreciation | <u>(29,681,027)</u> | <u>(1,811,037)</u> | <u>-</u> | <u>(31,492,064)</u> |
| Capital assets, net | <u>\$ 37,644,386</u> | <u>\$ 1,470,115</u> | <u>\$ (1,231,411)</u> | <u>\$ 37,883,090</u> |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 5 – Long-Term Debt

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. The bond obligation was fully paid in fiscal year 2019.

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.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 5 – Long-Term Debt (continued)

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.

On November 3, 2017, the City of Shelbyville, Kentucky, for and on-behalf of the Commission issued General Obligation Bonds, Series 2017, in the principal amount of \$6,500,000 to acquire, construct and equip the water treatment plant and certain other improvements. Interest on the bonds shall accrue at 4% per annum and will mature in 20 years. Principal and interest is payable on monthly basis. The bonds are secured by the revenues of the City and the Commission. The bonds established sinking funds for bond payments and project proceeds.

| <u>Year Ending</u> | <u>Principal</u> | <u>Interest</u> | <u>Amount</u> |
|--------------------|----------------------|---------------------|----------------------|
| 2020 | \$ 1,223,897 | \$ 473,684 | \$ 1,697,581 |
| 2021 | 1,262,167 | 432,279 | 1,694,446 |
| 2022 | 1,299,945 | 392,975 | 1,692,920 |
| 2023 | 1,341,154 | 351,922 | 1,693,076 |
| 2024 | 1,383,546 | 400,346 | 1,783,892 |
| 2025-2029 | 5,882,084 | 1,289,850 | 7,171,934 |
| 2030-2034 | 3,503,102 | 556,183 | 4,059,284 |
| 2035-2037 | 1,538,753 | 90,038 | 1,628,790 |
| Total | <u>\$ 17,434,647</u> | <u>\$ 3,987,276</u> | <u>\$ 21,421,924</u> |

A summary of changes in long-term liabilities of the Commission as of June 30, 2019 is as follows:

| Lease/Bond obligations | <u>Beginning Balance</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending Balance</u> | <u>Due within a year</u> |
|------------------------|--------------------------|------------------|-------------------|-----------------------|--------------------------|
| KLC Series 2000 | \$ 135,000 | \$ - | \$ 135,000 | \$ - | \$ - |
| KLC Series 2004A | 7,750,000 | - | 64,901 | 7,685,099 | 795,803 |
| Series 2015 Revenue | 3,782,083 | - | 177,083 | 3,605,000 | 182,083 |
| Series 2017 Revenue | 6,383,236 | - | 238,688 | 6,144,548 | 246,011 |
| | <u>\$ 18,050,319</u> | <u>\$ -</u> | <u>\$ 615,672</u> | <u>\$ 17,434,647</u> | <u>\$ 1,223,897</u> |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 6 – Retirement 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.

Benefits provided. Kentucky Revised Statute Section 61.645 establishes the benefit terms and can be amended only by the Kentucky General Assembly. The chief legislative body may adopt the benefit terms permitted by statute. Members are eligible to retire with an unreduced benefit at age 65 with four years of service credit or after 27 years of service credit regardless of age. Benefits are determined by a formula using the member's highest five consecutive year average compensation and the member's year of service credit. Reduced benefits for early retirement are available at age 55 and vested or 25 years of service credit. Members vest with five years of service credit. Service related disability benefits are provided after five years of service.

Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the 12 months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce cost-of-living adjustments if, in its judgment, the welfare of the Commonwealth so demands.

Kentucky Revised Statutes provides authority for employee and employer contributions. Employees and the Commission have contributed all of the required contributions for the fiscal year ending June 30, 2019.

Contribution rates are as follows:

| | <u>Employee</u> | <u>Employer</u> |
|---------------|-----------------|-----------------|
| Non-hazardous | 5.0%-6.0% | 21.48% |

The Commission's contribution for the fiscal year ended June 30, 2019 amounted to \$336,250, of which \$272,778 was contributed by the Commission and \$63,472 by the Commission's employees.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 6 – Retirement Plan (continued)

For the fiscal year, ended June 30, 2019 the Commission's covered payroll for non-hazardous positions was \$1,269,947

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

At June 30, 2019, the Commission reported a liability of \$3,078,771 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Commission's proportion of the net pension liability was based on a projection of the Commission's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2018, the Commission's proportion was 0.051 percent for non-hazardous.

For the year ended June 30, 2019, the Commission recognized pension expense as follows.

| | |
|--|-------------------|
| Required cash contributions to the plan | \$ 272,778 |
| Commission's proportionate share of plan's pension expense (non-cash) | <u>283,553</u> |
| Total pension expense | <u>\$ 556,331</u> |

At June 30, 2019, the Commission reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|-----------------------------------|----------------------------------|
| Changes in proportion and differences between employer contribution and proportionate share of contribution | \$ 156,970 | \$ 5,050 |
| Differences between expected and actual results | 100,421 | 45,067 |
| Changes of assumptions | 300,885 | - |
| Net difference between projected and actual earnings on Plan investments | 143,165 | 180,081 |
| Commission's contributions subsequent to the measurement date | <u>212,623</u> | <u>-</u> |
| Total | <u>\$ 914,064</u> | <u>\$ 230,198</u> |

The \$212,623 of deferred outflows of resources resulting from the Commission's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2020. 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, | |
| 2020 | \$ 314,218 |
| 2021 | 185,278 |
| 2022 | (11,729) |
| 2023 | (16,525) |

The Schedule of Deferred Inflows and Outflows, and Pension Expense include only certain categories of deferred outflows of resources and deferred inflows of resources. These include differences between expected and actual experience, changes of assumptions and differences between projected and actual earnings on plan investments and for changes in the employer's proportionate share of contributions or employer contributions made subsequent to the measurement date.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 6 - Retirement Plan (continued)

Deferred outflows and inflows related to differences between projected and actual earnings on plan investments are netted and amortized over a closed five year period. Those changes in net pension liability that are recorded as deferred outflows or inflows of resources that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience are amortized over the weighted average remaining service life of all participants in the respective qualified pension plan and recorded as a component of pension expense beginning with the period in which they are incurred.

Actuarial Methods and Assumptions

For financial reporting, the actuarial valuation as of June 30, 2018, was performed by Gabriel Roeder Smith (GRS). The total pension liability, net pension liability, and sensitivity information as of June 30, 2018 were based on an actuarial valuation date of June 30, 2017. The total pension liability was rolled-forward from the valuation date (June 30, 2017) to the plan's fiscal year ending June 30, 2018, using generally accepted actuarial principles.

| | |
|-------------------------------|--|
| Valuation Date | June 30, 2016 |
| Measurement Date | June 20, 2018 |
| Experience Study | July 1, 2008 – June 30, 2013 |
| Actuarial Cost Method | Entry Age Normal |
| Amortization Method | Level percentage of payroll, closed |
| Remaining Amortization Period | 27 years, closed |
| Asset Valuation Method | 5-year smoothed market |
| Inflation | 3.25% |
| Salary Increase | 4.0%, 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.

The long-term expected rate of return was determined by using a building-block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 6 – Retirement Plan (continued)

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

| Asset Class | Long-Term Expected Rate of Return | Target Allocation |
|-----------------|--|----------------------|
| U.S. Equity | 5.97% | 17.50% |
| Non-U.S. Equity | 6.50% | 17.50% |
| Global Bonds | 3.00% | 4.00% |
| Credit Fixed | 8.50% | 24.00% |
| Real Estate | 9.00% | 5.00% |
| Absolute Return | 5.00% | 10.00% |
| Real Return | 7.00% | 10.00% |
| Private Equity | 6.50% | 10.00% |
| Cash | 1.50% | 2.00% |
| | <u>6.09%</u> | <u>100.00%</u> |

Discount Rate

The discount rate used to measure the total pension liability was 6.25%. 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 25 year amortization period of the unfunded actuarial accrued liability. The discount rate determination does not use a municipal bond rate.

Sensitivity of the Commission's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the Commission's proportionate share of the net pension liability calculated using the discount rate of 6.25 percent, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.25 percent) or 1-percentage-point higher (7.25 percent) than the current rate:

| | Discount rate | Commission's proportionate share of net pension liability |
|-----------------------|---------------|---|
| 1% decrease | 5.25% | \$ 3,875,854 |
| Current discount rate | 6.25% | \$ 3,078,771 |
| 1% increase | 7.25% | \$ 2,410,955 |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 6 – Retirement Plan (continued)

Payables to the pension plan: At June 30, 2019, the Commission reported a payable including insurance contributions of \$0 for the outstanding amount of contributions to the pension plan required for the year ended June 30, 2019.

Pension plan fiduciary net position: Detailed information about the pension plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report on the KRS website at www.kyret.ky.gov.

Note 7 – Other Post-Employment Benefits (OPEB)

At June 30, 2019, net OPEB liability and related deferred outflows of resources and deferred inflows of resources are as follows:

| | | |
|--------------------------------|----|---------|
| Deferred Inflows of Resources | \$ | 170,268 |
| Deferred Outflows of Resources | \$ | 311,633 |
| Net OPEB Liability: | \$ | 897,558 |

Plan Description

Employees of the Commission are provided hospital and medical insurance through the Kentucky Retirement Systems' Insurance Fund (Insurance Fund), a cost-sharing multiple-employer defined benefit OPEB plan. 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 publicly 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.

Benefits provided. The Insurance Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. Because of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for members who began participating on, or after, July 1, 2003. Once members reach a minimum vesting period of 10 years, non-hazardous employees whose participation began on, or after, July 1, 2003, earn \$10 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on or after July 1, 2003 earn \$15 per month for insurance benefits at retirement for every year of earned services without regard to a maximum dollar amount.

Contributions

Contribution requirements of the participating employers are established and may be amended by the KRS Board of Trustees. The Commission has contractually required contribution rate for the year ended June 30, 2019 was 5.26% (non-hazardous) of covered payroll. Contributions to the Insurance Fund from the Commission were \$68,952 for the year ended June 30, 2019 for non-hazardous. Employees that entered the plan prior to September 1, 2008 are not required to contribute to the Insurance Fund. Employees that entered the plan after September 1, 2008 are required to contribute 1% of their annual creditable compensation which is 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).

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 7 – Other Post-Employment Benefits (OPEB)

Net OPEB Liability

For financial reporting the actuarial valuation as of June 30, 2018, was performed by Gabriel Roeder Smith (GRS). The total OPEB liability, net OPEB liability, and sensitivity information as of June 30, 2018, were based on an actuarial valuation date of June 30, 2017. The total OPEB liability was rolled-forward from the valuation date (June 30, 2017) to the plan's fiscal year ending June 30, 2018, using generally accepted actuarial principles.

The following actuarial methods and assumptions were used to determine the actuarially determined contributions effective for fiscal year ending June 30, 2018:

| | |
|-------------------------------|---|
| Valuation Date | June 30, 2016 |
| Experience Study | July 1, 2008 – June 30, 2013 |
| Actuarial Cost Method | Entry Age Normal |
| Amortization Method | Level percentage of pay |
| Remaining Amortization Period | 27 years, Closed |
| Payroll Growth Rate | 4.00% |
| Asset Valuation Method | 20% of the difference between the market value of assets and the expected actuarial value of assets is recognized |
| Inflation | 3.25% |
| Salary Increase | 4.00%, average |
| Investment Rate of Return | 7.50% |
| Healthcare Trend Rate | Initial trend starting at 7.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 5 years. |
| Pre – 65 | |
| Post – 65 | Initial trend starting at 5.50% and gradually decreasing to an ultimate trend rate of 5.00% over a period of 2 years. |

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

Discount Rate

The projection of cash flows used to determine the discount rate of 5.85% for CERS Non-hazardous assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 25 years (closed) amortization period of the unfunded actuarial accrued liability. The discount rate determination used an expected rate of return of 6.25%, and a municipal bond rate of 3.62%, as reported in Fidelity Index's "20 – Year Municipal GO AA Index" as of June 30, 2018. However, the cost associated with the implicit employer subsidy was not included in the calculation of the System's actuarial determined contributions, and any cost associated with the implicit subsidy will not be paid out of the System's trusts. Therefore, the municipal bond rate was applied to future expected benefit payments associated with the implicit subsidy.

The long-term expected rate of return was determined by using a building-block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage.

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 7 – Other Post-Employment Benefits (OPEB) (Continued)

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

| Asset Class | Long-Term Expected Rate of Return | Target Allocation |
|-----------------|--|----------------------|
| U.S. Equity | 5.97% | 17.50% |
| Non-U.S. Equity | 6.50% | 17.50% |
| Global Bonds | 3.00% | 4.00% |
| Credit Fixed | 8.50% | 24.00% |
| Real Estate | 9.00% | 5.00% |
| Absolute Return | 5.00% | 10.00% |
| Real Return | 7.00% | 10.00% |
| Private Equity | 6.50% | 10.00% |
| Cash | 1.50% | 2.00% |
| | <u>6.09%</u> | <u>100.00%</u> |

Sensitivity of the Net OPEB Liability to Changes in the Discount Rate

The net OPEB liability of the Commission, as well as what the Commission's net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (4.85%) or one percentage point higher (6.85%) follows:

| | Discount Rate | Commission's proportionate share of net OPEB liability |
|-----------------------|---------------|---|
| 1% decrease | 4.85% | \$ 1,165,785 |
| Current discount rate | 5.85% | \$ 897,558 |
| 1% increase | 6.85% | \$ 669,079 |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 7 – Other Post-Employment Benefits (OPEB) (Continued)

Sensitivity of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rates

The net OPEB liability of the Commission, as well as what the Commission's net OPEB liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower(6.5%) or one percentage point higher (8.5%) than current healthcare cost trend rates follows:

| | Healthcare Cost Trend Rate | | Commission's proportionate share of net OPEB liability |
|-------------------------|----------------------------------|----|---|
| 1% decrease | 6.5% | \$ | 668,241 |
| Current healthcare rate | 7.5% | \$ | 897,558 |
| 1% increase | 8.5% | \$ | 1,167,858 |

OPEB Expense and Deferred Inflows of Resources Related to OPEB

For the year ended June 30, 2019, the Commission recognized OPEB expense of \$123,329. At June 30, 2019, the Commission reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

| | Deferred Outflows of Resources | | Deferred Inflows of Resources |
|---|-----------------------------------|----|----------------------------------|
| Changes in proportion and differences between employer contribution and proportionate share of contribution | \$ 48,946 | \$ | 1,771 |
| Implicit subsidy | 14,479 | | - |
| Differences between expected and actual results | - | | 104,599 |
| Changes of assumptions | 179,256 | | 2,074 |
| Net difference between projected and actual earnings on Plan investments | - | | 61,824 |
| District contributions subsequent to the measurement date | 68,952 | | - |
| Total | \$ 311,633 | \$ | 170,268 |

The \$68,952 of deferred outflows of resources resulting from the Commission's contributions subsequent to the measurement date will be recognized as a reduction of the OPEB liability in the year ending June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in OPEB expense as follows:

| | |
|----------------------|----------|
| Year ending June 30, | |
| 2020 | \$12,016 |
| 2021 | 12,016 |
| 2022 | 12,016 |
| 2023 | 24,023 |
| 2024 | 1,011 |
| Thereafter | (3,138) |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 7 – Other Post-Employment Benefits (OPEB) (Continued)

Deferred outflows and inflows related to differences between projected and actual earnings on plan investments are netted and amortized over a closed five year period. Those changes in net OPEB liability that are recorded as deferred outflows or inflows of resources that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience are amortized over the weighted average remaining service life of all participants in the respective qualified OPEB plan and recorded as a component of OPEB expense beginning with the period in which they are incurred.

Note 8 – Transfer

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, 2019 were \$150,139.

Note 9 – Employee Health Benefit Plan and Claims Liability

Effective July 1, 2006, the Commission 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 Commission maintains these funds 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 has purchased excess stop-loss insurance for medical expenses that exceed \$55,000 per covered individual for fiscal year June 30, 2019.

The Commission records an estimated liability for indemnity health care claims. Claims liabilities are based on estimates of the ultimate cost of reported claims (including future claim adjustment expenses) and an estimate for claims incurred but not reported based on historical experience. Eligible claims are required to be presented within one-year of the date of service.

Changes in the balances of claims liability are summarized below:

| | <i>Claims Liability</i> |
|----------------------------------|-----------------------------|
| Liability Balance, June 30, 2018 | \$ 6,685 |
| Claims and changes in estimates | 199,405 |
| Claims payments | (195,848) |
| Liability Balance, June 30, 2019 | \$ 10,242 |

Shelbyville Municipal Water and Sewer Commission
Notes to Financial Statements
June 30, 2019

Note 10 – Budgeting

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.

Note 11 – Recently Issued Accounting Standards Update

GASB Statement No. 84—In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018, or the 2019–20 fiscal year. The Commission has not determined the effect of this pronouncement.

GASB Statement No. 87—In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The Statement is effective for the reporting periods beginning after December 15, 2019. The Commission has not determined the effect of this pronouncement.

Note 12- Subsequent Events

The Commission has evaluated and considered the need to recognize or disclose subsequent events through February 12, 2020 which represents the date that these financial statements were available to be issued. Subsequent events past this date, as they pertain to the fiscal year ended June 30, 2019, have not been evaluated by the Commission.

REQUIRED SUPPLEMENTARY INFORMATION

Shelbyville Municipal Water and Sewer Commission
Schedule of the Commission's Proportionate Share of the Net Pension Liability
County Employees' Retirement System
Last Five Fiscal Years

| | <u>June 30, 2015</u> | <u>June 30, 2016</u> | <u>June 30, 2017</u> | <u>June 30, 2018</u> | <u>June 30, 2019</u> |
|--|----------------------|----------------------|----------------------|----------------------|----------------------|
| | <u>Non-Hazardous</u> | <u>Non-Hazardous</u> | <u>Non-Hazardous</u> | <u>Non-Hazardous</u> | <u>Non-Hazardous</u> |
| Commission's proportion of the net pension liability | 0.045460% | 0.046410% | 0.045350% | 0.046831% | 0.050552% |
| Commission's proportionate share of the net pension liability | \$1,475,000 | \$1,995,513 | \$2,230,629 | \$2,741,162 | \$3,078,771 |
| Commission's covered employee payroll | \$1,042,996 | \$1,080,750 | \$1,141,499 | \$1,250,688 | \$1,269,947 |
| Commission's proportion of the net position liability as a percentage of its covered-employee payroll | 141.42% | 184.64% | 195.41% | 219.17% | 242.43% |
| Plan fiduciary net position as a percentage of the total pension liability | 66.80% | 59.97% | 55.50% | 53.50% | 53.54% |

Shelbyville Municipal Water and Sewer Commission
Schedule of the Commission's Pension Contributions
County Employees' Retirement System
Last Five Fiscal Years

| | <u>June 30, 2015</u> <u>Non-Hazardous</u> | <u>June 30, 2016</u> <u>Non-Hazardous</u> | <u>June 30, 2017</u> <u>Non-Hazardous</u> | <u>June 30, 2018</u> <u>Non-Hazardous</u> | <u>June 30, 2019</u> <u>Non-Hazardous</u> |
|--|--|--|--|--|--|
| Contractually required contribution | \$ 138,064 | \$ 134,229 | \$ 159,235 | \$ 181,205 | \$ 205,985 |
| Contributions in relation to the contractually required contribution | <u>\$ (138,064)</u> | <u>\$ (134,229)</u> | <u>\$ (159,235)</u> | <u>\$ (181,205)</u> | <u>\$ (205,985)</u> |
| Contribution deficiency (excess) | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |
| Commission's covered-employee payroll | \$1,042,996 | \$1,080,750 | \$1,141,499 | \$1,250,688 | \$1,269,947 |
| Contributions as a percentage of covered employee | 13.24% | 12.42% | 13.95% | 14.49% | 16.22% |

Shelbyville Municipal Water and Sewer Commission
Schedule of the Commission's OPEB Contributions
County Employees' Retirement System
Last Two Fiscal Years

| | <u>Non-Hazardous</u> <u>June 30, 2018</u> | <u>Non-Hazardous</u> <u>June 30, 2019</u> |
|---|--|--|
| Contractually required contribution | \$ 58,817 | \$ 66,799 |
| Contributions in relation to the contractually required contribution | <u>(58,817)</u> | <u>(66,799)</u> |
| Contribution deficiency (excess) | <u>\$ -</u> | <u>\$ -</u> |
| Commission's covered-employee payroll | \$1,250,688 | \$1,269,947 |
| Contributions as a percentage of covered-employee payroll | 4.70% | 5.26% |

Shelbyville Municipal Water and Sewer Commission
Schedule of Changes in the Commission's OPEB Liability
County Employees' Retirement System
Last Two Fiscal Years
(\$ in thousands)

| | Non-Hazardous June 30, 2018 | Non-Hazardous June 30, 2019 |
|--|--------------------------------|--------------------------------|
| Change in the Net OPEB Liability | <u> </u> | <u> </u> |
| Total OPEB liability | | |
| Service Cost | \$ 40 | \$ 62 |
| Interest | 113 | 122 |
| Benefit Changes | - | 2 |
| Difference between actual and expected experience | (3) | (122) |
| Assumption Changes | 244 | (2) |
| Benefit Payments | <u>(66)</u> | <u>(79)</u> |
| Net Change on Total OPEB Liability | 328 | (17) |
| Total OPEB Liability - Beginning | <u>1,650</u> | <u>2,135</u> |
| Total OPEB Liability - Ending | <u>\$ 1,978</u> | <u>\$ 2,118</u> |
| Plan Fiduciary Net Position | | |
| Contributions - Employer | \$ 62 | \$ 74 |
| Contributions - Member | 4 | 5.5 |
| Benefit Payments | (66) | (79.1) |
| Net Investment Income | 124 | 102.1 |
| Administrative Expense | (0) | (0.4) |
| Other | <u>-</u> | <u>0.0</u> |
| Net Change in Plan Fiduciary Net Position | 125 | 102 |
| Plan Fiduciary Net Position - Beginning | <u>911</u> | <u>1,118</u> |
| Plan Fiduciary Net Position - Ending | <u>\$ 1,036</u> | <u>\$ 1,220</u> |
| Net OPEB Liability - Ending | \$ 941 | \$ 898 |
| Plan Fiduciary Net Position as a Percentage of the Total OPEB Liability | 52.4% | 57.6% |
| Covered Payroll | \$1,251 | \$1,270 |
| Net OPEB Liability as a Percentage of Covered Payroll | 75.3% | 70.7% |

OTHER SUPPLEMENTARY INFORMATION

Shelbyville Municipal Water and Sewer Commission
Schedule of Revenues, Expenses and Changes in Net Position - Budget to Actual
For the Year Ended June 30, 2019

| | Budget | | Actual | Variance - Over (Under) |
|--|---------------|---------------|---------------|----------------------------|
| | Original | Final | | |
| Operating Revenue | | | | |
| Water sales | \$ 3,505,375 | \$ 3,505,375 | \$ 3,869,315 | \$ 363,940 |
| Sewer sales | 2,872,932 | 2,872,932 | 3,272,207 | 399,275 |
| Other revenues | 134,148 | 134,148 | 117,585 | (16,563) |
| Total Operating Revenue | 6,512,455 | 6,512,455 | 7,259,107 | 746,652 |
| Operating Expenses | | | | |
| Direct water expenses | 1,339,370 | 1,339,370 | 1,371,490 | 32,120 |
| Direct sewer expenses | 1,104,996 | 1,104,996 | 1,085,409 | (19,587) |
| Administrative expenses | 1,504,178 | 1,504,178 | 1,839,381 | 335,203 |
| Depreciation - water plant | 725,004 | 725,004 | 757,208 | 32,204 |
| Depreciation - sewer plant | 849,996 | 849,996 | 1,018,263 | 168,267 |
| Depreciation - office building | 16,596 | 16,596 | 35,565 | 18,969 |
| Total Operating Expenditures | 5,540,140 | 5,540,140 | 6,107,315 | 567,175 |
| Operating Income | 972,315 | 972,315 | 1,151,792 | 179,477 |
| Non-operating revenues (expenses): | | | | |
| Interest income | 99,996 | 99,996 | 233,574 | 133,578 |
| Interest expense | (635,537) | (635,537) | (630,415) | 5,122 |
| Capital contributions | - | - | 165,871 | 165,871 |
| Tap on fees | - | - | 206,752 | 206,752 |
| Debt administration fees | (75,000) | (75,000) | (71,183) | 3,817 |
| Total Non-Operating Revenues (Expenses): | (610,541) | (610,541) | (95,402) | 515,139 |
| Income Before Transfers | 361,774 | 361,774 | 1,056,390 | 694,616 |
| Transfers out- City of Shelbyville | (150,000) | (150,000) | (150,139) | (139) |
| Net Change in Net Position | 211,774 | 211,774 | 906,251 | \$ 694,477 |
| Net Position, June 30, 2018 | 28,489,820 | 28,489,820 | 28,489,820 | |
| Net Position, June 30, 2019 | \$ 28,701,594 | \$ 28,701,594 | \$ 29,396,071 | |

See accompanying notes to the financial statements.

Shelbyville Municipal Water and Sewer Commission
Schedule of Operating Revenues - Budget to Actual
For the Year Ended June 30, 2019

| | Budget | | Actual | Variance - Over (Under) |
|-------------------------------------|---------------------|---------------------|---------------------|----------------------------|
| | Original | Final | | |
| Water Sales: | | | | |
| Industrial sales | \$ 400,499 | \$ 400,499 | \$ 432,777 | \$ 32,278 |
| Residential sales | 2,186,910 | 2,186,910 | 2,344,330 | 157,420 |
| Commercial sales | 299,048 | 299,048 | 343,074 | 44,026 |
| Sales to West Shelby Water District | 140,000 | 140,000 | 189,886 | 49,886 |
| Sales to Noth Shelby Water District | 215,000 | 215,000 | 239,891 | 24,891 |
| Sales to East US 60 Water District | 125,000 | 125,000 | 161,936 | 36,936 |
| Private fire protection | 89,004 | 89,004 | 109,833 | 20,829 |
| Public fire protection | 5,418 | 5,418 | 5,418 | - |
| Other water sales | 44,496 | 44,496 | 42,170 | (2,326) |
| Total Water Sales | \$ 3,505,375 | \$ 3,505,375 | \$ 3,869,315 | \$ 363,940 |
| Sewer Service | | | | |
| Industrial service | \$ 515,003 | \$ 515,003 | \$ 570,844 | \$ 55,841 |
| Residential service | 1,839,207 | 1,839,207 | 1,919,344 | 80,137 |
| Commercial service | 412,220 | 412,220 | 553,227 | 141,007 |
| Sewer pretreatment program | 24,000 | 24,000 | 26,923 | 2,923 |
| Other sewer service | 82,502 | 82,502 | 201,869 | 119,367 |
| Total Sewer Service | \$ 2,872,932 | \$ 2,872,932 | \$ 3,272,207 | \$ 399,275 |
| Other Revenues | | | | |
| Water meter turn ons | \$ 39,000 | \$ 39,000 | \$ 36,725 | \$ (2,275) |
| Miscellaneous income | 24,996 | 24,996 | 17,919 | (7,077) |
| Handling late fee | 51,996 | 51,996 | 42,977 | (9,019) |
| Rental income | 18,156 | 18,156 | 19,965 | 1,809 |
| Total Other Revenues | \$ 134,148 | \$ 134,148 | \$ 117,585 | \$ (16,562) |

Shelbyville Municipal Water and Sewer Commission
Schedule of Operating Expenses - Budget to Actual
For the Year Ended June 30, 2019

| | Budget | | Actual | Variance - Over (Under) |
|--|-------------------------|-------------------------|-------------------------|----------------------------|
| | Original | Final | | |
| Direct Water Expenses: | | | | |
| Operation, supervision and engineering | \$ 15,000 | \$ 15,000 | \$ 5,482 | \$ (9,519) |
| Source of supply and pumping labor | 219,999 | 219,999 | 202,225 | (17,774) |
| Laboratory expense | 98,004 | 98,004 | 79,905 | (18,099) |
| Operating supplies | 230,004 | 230,004 | 287,739 | 57,735 |
| Maintenance - structures | 80,000 | 80,000 | 92,816 | 12,816 |
| Maintenance - pumping and filtering | 83,003 | 83,003 | 110,595 | 27,592 |
| Power | 210,000 | 210,000 | 200,306 | (9,694) |
| Maintenance - water mains | 96,000 | 96,000 | 76,974 | (19,026) |
| Maintenance - services and meters | 86,798 | 86,798 | 85,116 | (1,682) |
| Maintenance - hydrants | 12,665 | 12,665 | 6,499 | (6,166) |
| Meter readings | 79,997 | 79,997 | 89,027 | 9,030 |
| Sludge removal | 8,400 | 8,400 | 15,499 | 7,099 |
| Misc. labor | 45,000 | 45,000 | 49,682 | 4,682 |
| Vacation, holiday and sick-pay | 74,500 | 74,500 | 69,624 | (4,876) |
| | <u>74,500</u> | <u>74,500</u> | <u>69,624</u> | <u>(4,876)</u> |
| Total Direct Water Expenses | <u>\$ 1,339,370</u> | <u>\$ 1,339,370</u> | <u>\$ 1,371,490</u> | <u>\$ 32,120</u> |

Shelbyville Municipal Water and Sewer Commission
Schedule of Operating Expenses - Budget to Actual
For the Year Ended June 30, 2019

| | Budget | | Actual | Variance - Over (Under) |
|--|---------------------|---------------------|---------------------|----------------------------|
| | Original | Final | | |
| Direct Sewer Expenses: | | | | |
| Operation, supervision and engineering | \$ 2,600 | \$ 2,600 | \$ 11,647 | \$ 9,047 |
| Sewer plant labor | 125,470 | 125,470 | 132,491 | 7,021 |
| Laboratory expense | 32,500 | 32,500 | 41,933 | 9,433 |
| Operating supplies | 187,500 | 187,500 | 184,819 | (2,681) |
| Maintenance - structures | 28,688 | 28,688 | 26,999 | (1,689) |
| Maintenance - disposal plant equipment | 60,946 | 60,946 | 67,619 | 6,673 |
| Power | 218,002 | 218,002 | 183,186 | (34,816) |
| Power - SD pump station | 88,800 | 88,800 | 83,063 | (5,737) |
| Maintenance - sewer mains | 31,587 | 31,587 | 29,784 | (1,803) |
| Maintenance - sewer manholes | 5,500 | 5,500 | 11,742 | 6,242 |
| Maintenance - pump stations | 38,512 | 38,512 | 24,244 | (14,268) |
| Maintenance - SD pump stations | 24,414 | 24,414 | 292 | (24,122) |
| Maintenance - flow monitoring | 6,752 | 6,752 | 6,072 | (680) |
| Pretreatment expense | 26,000 | 26,000 | 44,139 | 18,139 |
| Chronic tox testing | 7,500 | 7,500 | 7,942 | 442 |
| Sludge removal | 125,000 | 125,000 | 81,254 | (43,746) |
| Vacation, holiday and sick-pay | 36,000 | 36,000 | 44,778 | 8,778 |
| Labor - comm pump station | 23,082 | 23,082 | 37,376 | 14,294 |
| Pretreatment outside lab expense | 18,000 | 18,000 | 17,069 | (932) |
| Materials comm pump station | 15,996 | 15,996 | 48,289 | 32,293 |
| Maintenance - SD mains | 2,147 | 2,147 | 673 | (1,474) |
| Total Direct Sewer Expenses | \$ 1,104,996 | \$ 1,104,996 | \$ 1,085,409 | \$ (19,587) |

Shelbyville Municipal Water and Sewer Commission
Schedule of Operating Expenses - Budget to Actual
For the Year Ended June 30, 2019

| | Budget | | Actual | Variance - Over (Under) |
|-----------------------------------|-------------------------|-------------------------|-------------------------|----------------------------|
| | Original | Final | | |
| Administrative Expenses: | | | | |
| Office salaries | \$ 123,564 | \$ 123,564 | \$ 121,133 | \$ (2,431) |
| Office supplies and expenses | 72,000 | 72,000 | 75,420 | 3,420 |
| Uncollectible revenue | 9,996 | 9,996 | 27,718 | 17,722 |
| Management salaries | 144,997 | 144,997 | 138,544 | (6,453) |
| Management training | 2,400 | 2,400 | 10,468 | 8,068 |
| Legal and accounting | 60,000 | 60,000 | 50,133 | (9,867) |
| Commission member fees | 35,300 | 35,300 | 34,040 | (1,260) |
| Insurance | 160,000 | 160,000 | 160,921 | 921 |
| Employee insurance | 231,996 | 231,996 | 139,704 | (92,292) |
| Employee retirement | 262,248 | 262,248 | 665,882 | 403,634 |
| Miscellaneous expenses | 87,996 | 87,996 | 118,607 | 30,611 |
| Maintenance - general properties | 9,600 | 9,600 | 12,286 | 2,686 |
| Maintenance - safety equipment | 15,000 | 15,000 | 21,206 | 6,206 |
| Safety training | 3,600 | 3,600 | 3,247 | (353) |
| Truck and equipment expenses | 105,000 | 105,000 | 86,596 | (18,404) |
| Distribution shop supplies | 21,000 | 21,000 | 27,746 | 6,746 |
| Cash short over | 803 | 803 | 759 | (44) |
| Office utilities | 8,400 | 8,400 | 7,108 | (1,292) |
| Payroll taxes | 100,002 | 100,002 | 103,076 | 3,074 |
| Vacation, holiday and sick-pay | 31,076 | 31,076 | 15,790 | (15,286) |
| Office janitorial | 12,000 | 12,000 | 12,500 | 500 |
| Office maintenance | 7,200 | 7,200 | 6,496 | (704) |
| | <u>7,200</u> | <u>7,200</u> | <u>6,496</u> | <u>(704)</u> |
| Total Administrative Expenses | <u>\$ 1,504,178</u> | <u>\$ 1,504,178</u> | <u>\$ 1,839,381</u> | <u>\$ 335,203</u> |

Shelbyville Municipal Water and Sewer Commission
Board of Commissioners
June 30, 2019

| | <u>Term Expires</u> |
|-------------------|---------------------|
| Mayor David Eaton | December 31, 2020 |
| Wayne Stratton | June 30, 2020 |
| Gil Tucker | June 30, 2021 |
| Danny Eades | June 30, 2021 |
| Val Owens | June 30, 2020 |
| Al Andrews | June 30, 2020 |
| Jon Swindler | December 31, 2019 |

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance
And Other Matters based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

To the Board of Commissioners
Shelbyville Municipal Water and Sewer Commission

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", as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise Commission's basic financial statements and have issued our report thereon dated February 12, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered 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 Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. 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.

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.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Commission's internal control or on compliance. This report is an integral 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.

Baldwin CPAs, PLLC

Richmond, Kentucky
February 12, 2020