

NATURAL GAS UTILITY DISTRICT  
OF HAWKINS COUNTY

Financial Statements  
With Supplementary Information

March 31, 2017 and 2016

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With Supplementary Information  
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## Independent Auditors' Report

Board of Commissioners  
Natural Gas Utility District of Hawkins County  
Rogersville, Tennessee

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

We have audited the accompanying financial statements of Natural Gas Utility District of Hawkins County (the "District") as of and for the years ended March 31, 2017 and 2016, and the related notes to the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 District'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 District'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 District as of March 31, 2017 and 2016, and the respective changes in financial position, and cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents, 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audits were conducted for the purpose of forming an opinion on the financial statements of the District. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements.

The supplementary 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. Such information has been subjected to the auditing procedures applied in the audits 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 supplementary information is fairly stated in all material respects in relation to the financial statements as a whole.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated July 12, 2017, on our consideration of the District'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 District's internal control over financial reporting and compliance.

*Roderic Messer & Co, PLLC*

Greeneville, Tennessee

July 12, 2017

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Management's Discussion and Analysis  
March 31, 2017 and 2016

Our discussion and analysis of the financial performance of Natural Gas Utility District of Hawkins County (the "District") provides an overview of the District's financial activities for the fiscal years ended March 31, 2017 and 2016. Please read it in conjunction with the District's financial statements, which begin on page 6.

FINANCIAL HIGHLIGHTS

- The District's net position increased \$481,295, or more than 2 percent, which compared to an increase of \$713,196, or more than 3 percent for the prior fiscal year.
- During the year, the District had operating revenues that were \$43,962 less than last year and operating expenses that were \$186,227 more than last year.
- The District's non-operating revenues decreased by \$1,712.
- It has been increasingly difficult in recent years to project operating costs due to the extreme volatility of natural gas and propane prices. Both revenue and cost have been based on historical averages adjusted for estimated gas costs. Effective October 1, 2004, the District instituted a Purchase Gas Adjustment (PGA) rate. The retail rates are adjusted each month based on the District's cost of gas for that month.

DESCRIPTION OF BASIC FINANCIAL STATEMENTS

The District operates as a utility enterprise and its annual report consists of a series of financial statements presented on the full accrual basis of accounting. The Statements of Net Position, Statements of Revenue, Expenses, and Changes in Net Position and Statements of Cash Flows (on pages 6-8) provide information about the District as a whole and present a longer-term view of the District's finances.

CONDENSED FINANCIAL INFORMATION

The following condensed financial information provides an overview of the District's financial activities for the years ended March 31, 2017 and 2016.

NET POSITION

	<u>2017</u>	<u>2016</u>
Capital assets, net	\$10,225,459	\$10,144,239
Other assets, net	<u>10,473,607</u>	<u>10,115,159</u>
Total assets	20,699,066	20,259,398
Long-term liabilities	96,288	94,087
Other liabilities	<u>554,463</u>	<u>598,291</u>
Total liabilities	650,751	692,378
Net invested in capital assets	10,225,459	10,144,239
Unrestricted	<u>9,822,856</u>	<u>9,422,781</u>
Total net position	<u>\$20,048,315</u>	<u>\$19,567,020</u>

Capital and other assets - The change in capital assets is a net increase of \$81,220, due to the extension of lines and replacement of obsolete equipment. Depreciation also increased. Other assets increased \$358,448, primarily due to an increase in certificates of deposit.

Long-term and other liabilities - Long-term liabilities decreased due to payments made on copier leases. Other liabilities decreased due to a decrease in other payables and accrued liabilities.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Management's Discussion and Analysis (Continued)

CONDENSED FINANCIAL INFORMATION (Continued)

CHANGES IN NET POSITION

	<u>2017</u>	<u>2016</u>
Total operating revenues	\$ 9,711,641	\$ 9,755,603
Total non-operating revenues	<u>31,503</u>	<u>33,215</u>
Total revenues	\$ 9,743,144	\$ 9,788,818
Total operating expense	5,126,793	5,020,859
Total other operating expense	<u>4,135,056</u>	<u>4,054,763</u>
Total expenses	<u>9,261,849</u>	<u>9,075,622</u>
Change in net position	481,295	713,196
Net position, beginning of year	<u>19,567,020</u>	<u>18,853,824</u>
Net position, end of year	<u>\$20,048,315</u>	<u>\$19,567,020</u>

Revenues - The District's operating revenues consist primarily of natural gas sales. The main source of the District's other operating revenues are connection charges and forfeited discounts.

Expenses - The District's total expenses increased by \$186,227.

CAPITAL ASSET

Capital Assets - At March 31, 2017 and 2016, the District had \$24.4 and \$23.6 million invested in distribution plant, intangible plant, propane plant, land, buildings, equipment, furniture and fixtures and automobiles (see table below), respectively. The 2017 amount represents an increase of \$785,244 over the 2016 amount.

	<u>2017</u>	<u>2016</u>
Distribution plant	\$17,336,545	\$16,776,555
Intangible plant	16,958	16,958
Propane plant	2,546,978	2,518,998
Land and right-of-ways	181,191	181,191
Buildings	1,433,053	1,433,053
Equipment	884,975	873,041
Furniture and fixtures	845,468	815,248
Automobiles and trucks	<u>1,178,618</u>	<u>1,023,498</u>
Totals	<u>\$24,423,786</u>	<u>\$23,638,542</u>

The 2016-2017 capital improvements include progress on Automated Meter Reading for meters and new computer system, and new service trucks. The District will continue to extend mains as needed for future development.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Management's Discussion and Analysis (Continued)

RESULTS AND OUTLOOK

The District experienced another mild winter during 2016-2017 resulting in lower natural gas sales. Sales were down to about equal to the 10-year average. Propane sales were also down considerably but still profitable. Despite the average gas sales, the District was still able to end its fiscal year in a net positive position. By the District basing its budget on average sales instead of assuming a hard winter, the District is able to maintain itself in a good financial position. The District also saw its net growth of customers increase from the previous year and the District maintained strong equipment sales. This combination of customer growth and equipment sales should result in a slow but positive increase in gas sales in the future.

Natural Gas prices rebounded from the previous year but still remained reasonable and did not negatively affect customer growth. Prices ranged from the low \$3 per dekatherm to highs of just over \$4 per dekatherm. If the prices continue to hold in those ranges, the District believes that the growth in consumption of natural gas will continue. Propane pricing also continued to hold around the \$0.75 per gallon delivered cost. However, the worldwide consumption of propane saw a huge uptick resulting in near record low storage volumes. This will put considerable upward pressure on pricing. Although the District can store approximately half its annual sales in on-site storage, there could be a chance for a needed rate increase if wholesale prices of propane climb considerably.

The District continues to re-invest in its distribution system both by new main line extensions and line replacements. This year there is a continued emphasis on old-steel line replacement. Some of the oldest lines, installed about 50 years ago, are being replaced with new polyethylene pipe. Over 23,000 feet of pipe was replaced last fiscal year. As this program continues, another 20,000 feet of pipe is projected to be replaced. In addition, the District continues to upgrade the meter stations and pressure regulator stations.

Engineering work has begun on a new 3-mile 8-inch steel main extension with an accompanying new City Gate station. The new gas receiving point will be located just south of Rogersville. This new station will provide two feeds into the District's main distribution system providing a much desired secondary feed. This extension done in conjunction with the planned purchase of the former TENGASCO pipeline from Rogersville to Church Hill will provide a circular feed loop for the system enhancing security and reliability. This project has caught the attention of BAE, the contractor operating the Holsten Army Ammunition Plant (HAAP) for the U.S. Army. Although HAAP is directly served off the East Tennessee Natural Gas transmission line, HAAP will be needing additional supplies not available on the transmission lateral that serves them. The District is in talks with BAE about providing needed projected volumes of gas in the near future for HAAP's planned expansion. These volumes are projected to be around 1,500 to 2,000 dekatherms per day which would make HAAP the District's largest volume customer.

The District finally implemented its new software system at the beginning of April. This software package is from LOGICS and was customized to meet the needs of the District. As with any new customized software package there have been "hiccups" in the transition to the new system. However, both the IT manager and the accountant have put in long hours working with the LOGICS to identify and correct the errors found in the system. Management is confident that once this teething period is over with the new system will provide not only better reporting and accounting, but customer service enhancements like on-line bill pay.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our purveyors, taxpayers, customers, investors and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have any questions about this report, or need additional financial information, contact the District at 202 Park Boulevard, Rogersville, Tennessee 37857.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Statements of Net Position  
March 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
Current Assets		
Cash	\$ 2,515,294	\$ 3,091,768
Certificates of deposit	5,792,582	4,768,937
Accounts receivable, net	766,478	548,788
Inventories	1,092,022	1,438,254
Unbilled revenues	163,607	139,998
Prepaid expenses	39,469	35,555
Interest receivable	<u>16,813</u>	<u>10,446</u>
Total current assets	<u>10,386,265</u>	<u>10,033,746</u>
Designated Funds		
Gas meter deposits - cash	<u>87,342</u>	<u>81,413</u>
Total designated funds	<u>87,342</u>	<u>81,413</u>
Utility Plant		
Utility plant	24,423,786	23,638,542
Less accumulated depreciation	<u>(14,198,327)</u>	<u>(13,494,303)</u>
Total utility plant, net	<u>10,225,459</u>	<u>10,144,239</u>
Total assets	<u>\$ 20,699,066</u>	<u>\$ 20,259,398</u>
<b>LIABILITIES AND NET POSITION</b>		
Current Liabilities		
Accounts payable	\$ 345,971	\$ 341,294
Capital lease payable, due within one year	3,729	3,729
Other payables and accrued liabilities	<u>204,763</u>	<u>253,268</u>
Total current liabilities	<u>554,463</u>	<u>598,291</u>
Non-Current Liabilities		
Capital lease payable, less amount due within one year	8,946	12,674
Payable from designated funds - gas meter deposits	<u>87,342</u>	<u>81,413</u>
Total non-current liabilities	<u>96,288</u>	<u>94,087</u>
Total liabilities	<u>650,751</u>	<u>692,378</u>
Net investment in capital assets	10,225,459	10,144,239
Unrestricted	<u>9,822,856</u>	<u>9,422,781</u>
Total net position	<u>\$ 20,048,315</u>	<u>\$ 19,567,020</u>

See accompanying notes to financial statements.



NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
 Statements of Revenues, Expenses, and Changes in Net Position  
 Years Ended March 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>OPERATING REVENUES</b>		
Sales	\$ 9,605,293	\$ 9,638,603
Cost of sales	<u>5,126,793</u>	<u>5,020,859</u>
	4,478,500	4,617,744
Other operating revenues	<u>106,348</u>	<u>117,000</u>
	<u>4,584,848</u>	<u>4,734,744</u>
<b>OPERATING EXPENSES</b>		
Transmission and distribution	581,197	564,531
Customer accounting and collection	219,839	122,940
Sales promotion	82,122	78,457
General and administrative	2,547,874	2,592,514
Depreciation	<u>704,024</u>	<u>696,321</u>
	<u>4,135,056</u>	<u>4,054,763</u>
Operating income	<u>449,792</u>	<u>679,981</u>
<b>OTHER INCOME</b>		
Gain on sale of capital assets	-	16,237
Interest income	<u>31,503</u>	<u>16,978</u>
	<u>31,503</u>	<u>33,215</u>
Change in net position	481,295	713,196
Net position at the beginning of the year	<u>19,567,020</u>	<u>18,853,824</u>
Net position at the end of the year	<u>\$ 20,048,315</u>	<u>\$ 19,567,020</u>

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Statements of Cash Flows  
Years Ended March 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash receipts from customers	\$ 9,363,556	\$ 10,050,203
Cash paid to suppliers	(5,254,221)	(5,882,417)
Cash paid to employees including benefits	(3,008,842)	(2,841,847)
Other operating receipts	<u>106,348</u>	<u>117,000</u>
Net cash flows from operating activities	<u>1,206,841</u>	<u>1,442,939</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition and construction of utility plant	<u>(785,244)</u>	<u>(698,690)</u>
Net cash flows from capital and related financing activities	<u>(785,244)</u>	<u>(698,690)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Maturities of investments	4,768,937	3,768,937
Purchases of investments	(5,792,582)	(4,744,584)
Interest collected	<u>31,503</u>	<u>16,978</u>
Net cash flows from investing activities	<u>(992,142)</u>	<u>(958,669)</u>
Net change in cash	(570,545)	(214,420)
Cash at the beginning of the year	<u>3,173,181</u>	<u>3,387,601</u>
Cash at the end of the year	<u>\$ 2,602,636</u>	<u>\$ 3,173,181</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES</b>		
Operating income	\$ 449,792	\$ 679,981
Adjustments to reconcile operating income to cash flows from operating activities		
Depreciation	704,024	696,321
Loss (gain) on sale of capital assets	-	(16,237)
Decrease (increase) in:		
Accounts receivable	(217,690)	375,123
Inventories	346,232	(129,501)
Unbilled revenues	(23,609)	45,302
Prepaid expenses and interest receivable	(10,281)	(5,382)
Increase (decrease) in:		
Accounts payable	4,677	(220,672)
Accrued liabilities	(48,505)	14,305
Capital lease payable	(3,728)	5,591
Gas meter deposits	<u>5,929</u>	<u>(1,892)</u>
Net cash flows from operating activities	<u>\$ 1,206,841</u>	<u>\$ 1,442,939</u>

See accompanying notes to financial statements.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Notes to Financial Statements  
March 31, 2017 and 2016

NOTE 1 - NATURE OF ORGANIZATION

Natural Gas Utility District of Hawkins County (the "District") was created under the Utility District Act of 1937 to provide natural gas and propane gas services to residents and businesses of Hawkins County, Tennessee.

The District receives the majority of its natural gas supply through East Tennessee Natural Gas, a division of Enbridge and Tennessee Gas Pipeline interstate pipelines. The District has firm transportation and storage contracts with these pipelines. The District purchases its natural gas supply from two marketing companies, CenterPoint Energy and Tennessee Energy Acquisition Corporation, ("TEAC"). The TEAC natural gas supply is a firm long term supply contract.

The District is operated under the control of a three-member Board of Commissioners ("Board"). The District's operations alone constitute the reporting entity since the Board is not financially accountable for any other entities and the District has no relationships with any other entities where the nature and significance of the relationships would require inclusion in the financial statements of the District. Operating revenues are based on rates approved by the Board of Commissioners. No other board or commission has jurisdiction over the District in the management and control of its operations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** - The District is an enterprise fund. An enterprise fund is a proprietary type fund used to account for operations 1) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or 2) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. The District has implemented Governmental Accounting Standards Board Statement No. 62, "*Codification of Accounting and Financial Reporting Guidance contained in Pre-November 30, 1989 FASB and AICPA pronouncements.*"

**Measurement Focus, Basis of Accounting, and Financial Statement Presentation** - Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements. Basis of accounting refers to "when" transactions are recorded regardless of the measurement focus applied.

The accompanying financial statements are reported using the "economic resources management focus," and the "accrual basis of accounting". Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

**Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Cash Equivalents** - For purposes of reporting cash flows, cash includes highly liquid investments (including restricted assets) purchased with a maturity of three months or less.

**Accounts Receivable** - The District extends unsecured credit to its customers in the ordinary course of business but mitigates the associated credit risk by actively pursuing past due accounts. Management has established an allowance for doubtful accounts of approximately \$158,000 in 2017 and \$138,000 in 2016. Based on subsequent collections, historical performance, and experience with the District's customers, management believes that the allowance is adequate.

**Inventories** - Materials, which include appliances, supplies and gas in storage, are valued at average cost.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Notes to Financial Statements (Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

**Utility Plant** - is stated at the historical cost of construction. Such costs include direct construction costs and payroll related costs. Depreciation is provided by the straight-line method over the estimated useful lives of the related assets ranging from three to thirty-three years. Interest is capitalized, net of interest earned on interest-bearing investments acquired with the proceeds of tax-exempt borrowings, in connection with the construction of significant utility plant. The construction period interest is recorded as part of the cost of the asset to which it relates and is amortized over the asset's estimated useful life. No interest was capitalized in 2017 or 2016. The cost of normal repairs of property and the replacements and renewal of items considered being less than units of property are charged to maintenance expense. Units of property replaced or retired are credited to the utility plant accounts and charged to accumulated depreciation.

**Revenues and Expenses** - The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and delivering gas in connection with ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**Date of Management Review** - Management has evaluated events and transactions occurring subsequent to the statement of net position for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date of the report, which is the date these financial statements were available to be issued.

NOTE 3 - CASH AND INVESTMENTS

State statutes require that all deposits with financial institutions must be collateralized by securities whose market value is equal to 105 percent of the value of the deposits, less so much of such amount as is insured by federal deposit insurance. The collateral must be held by the District or its agent in the District's name, or by the Federal Reserve in the District's name.

Statutes also authorize the District to invest in bonds, notes or treasury bills of the United States or any of its agencies, certificates of deposit at Tennessee state chartered banks and savings and loan associations and federally chartered banks and savings and loan associations, repurchase agreements utilizing obligations of the United States or its agencies as the underlying securities, state pooled investment fund, and money market mutual funds. Statutes also require that securities underlying repurchase agreements must have a market value at least equal to the amount of funds invested in the repurchase transaction.

Following are the components of the District's cash on hand and bank deposits at March 31, 2017 and 2016:

<u>March 31, 2017</u>	<u>Undesignated</u>	<u>Designated</u>	<u>Total</u>
Cash on hand	\$ 900	\$ -	\$ 900
Bank deposits -			
Non-interest bearing demand	68,783	-	68,783
Interest bearing demand	<u>2,445,611</u>	<u>87,342</u>	<u>2,532,953</u>
Total cash	2,515,294	87,342	2,602,636
Investments in certificates of deposit	<u>5,792,582</u>	-	<u>5,792,582</u>
Total	<u>\$ 8,307,876</u>	<u>\$ 87,342</u>	<u>\$ 8,395,218</u>

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Notes to Financial Statements (Continued)

NOTE 3 - CASH AND INVESTMENTS (Continued)

<u>March 31, 2016</u>	<u>Undesignated</u>	<u>Designated</u>	<u>Total</u>
Cash on hand	\$ 900	\$ -	\$ 900
Bank deposits -			
Non-interest bearing demand	142,244	-	142,244
Interest bearing demand	<u>2,948,624</u>	<u>81,413</u>	<u>3,030,037</u>
Total cash	3,091,768	81,413	3,173,181
Investments in certificates of deposit	<u>4,768,937</u>	<u>-</u>	<u>4,768,937</u>
Total	<u>\$ 7,860,705</u>	<u>\$ 81,413</u>	<u>\$ 7,942,118</u>

The carrying amounts of the District's deposits were \$8,395,218 and \$7,942,118 and the bank balances were \$8,643,289 and \$7,992,775 as of March 31, 2017 and 2016. Of the bank balances, \$906,842 for 2017 and \$1,000,000 for 2016 were covered by federal depository insurance, \$2,329,798 and \$2,199,619 were covered by collateral held by the District's agent in the District's name, and \$5,406,649 and \$4,793,156 were covered through the banks' participation in the Tennessee Bank Collateral Pool.

NOTE 4 - INVENTORIES

Inventory is valued at average cost. Inventories consisted of:

	<u>2017</u>	<u>2016</u>
Natural gas storage	\$ 300,898	\$ 594,173
Appliances, parts and supplies	756,604	707,461
Propane	<u>34,520</u>	<u>136,620</u>
	<u>\$ 1,092,022</u>	<u>\$ 1,438,254</u>

NOTE 5 - MAJOR SUPPLIERS

For the year ended March 31, 2017 and 2016, three suppliers comprised greater than ten percent of the District's gas purchases. These purchases totaled approximately \$3.4 million and \$3.3 million or 100% of gas purchases, respectively.

NOTE 6 - MAJOR CUSTOMER

For the year ended March 31, 2017 and 2016, one customer comprised greater than ten percent of the District's gas sales. These sales totaled \$0.9 million and \$1 million, respectively.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Notes to Financial Statements (Continued)

NOTE 7 - UTILITY PLANT

Utility plant activity for the year ended March 31, 2017 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated				
Land and land rights	\$ 181,191	\$ -	\$ -	\$ 181,191
Total capital assets not being depreciated	<u>181,191</u>	<u>-</u>	<u>-</u>	<u>181,191</u>
Capital assets being depreciated				
Buildings and permanent improvements	1,433,053	-	-	1,433,053
Equipment and gas distribution system	<u>22,024,298</u>	<u>785,244</u>	<u>-</u>	<u>22,809,542</u>
Total capital assets being depreciated	23,457,351	785,244	-	24,242,595
Less accumulated depreciation	<u>13,494,303</u>	<u>704,024</u>	<u>-</u>	<u>14,198,327</u>
Total capital assets being depreciated, net	<u>9,963,048</u>	<u>81,220</u>	<u>-</u>	<u>10,044,268</u>
Total capital assets, net	<u>\$10,144,239</u>	<u>\$ 81,220</u>	<u>\$ -</u>	<u>\$10,225,459</u>

Utility plant activity for the year ended March 31, 2016 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated				
Land and land rights	\$ 181,191	\$ -	\$ -	\$ 181,191
Total capital assets not being depreciated	<u>181,191</u>	<u>-</u>	<u>-</u>	<u>181,191</u>
Capital assets being depreciated				
Buildings and permanent improvements	1,431,452	1,601	-	1,433,053
Equipment and gas distribution system	<u>21,412,563</u>	<u>697,090</u>	<u>85,355</u>	<u>22,024,298</u>
Total capital assets being depreciated	22,844,015	698,691	85,355	23,457,351
Less accumulated depreciation	<u>12,883,073</u>	<u>696,321</u>	<u>(85,091)</u>	<u>13,494,303</u>
Total capital assets being depreciated, net	<u>9,960,942</u>	<u>2,370</u>	<u>264</u>	<u>9,963,048</u>
Total capital assets, net	<u>\$10,142,133</u>	<u>\$ 2,370</u>	<u>\$ 264</u>	<u>\$10,144,239</u>

Depreciation charged to income was \$704,024 and \$696,321 for the years ended March 31, 2017 and 2016, respectively.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Notes to Financial Statements (Continued)

NOTE 8 - DEFERRED COMPENSATION PLAN

Employees of the District are offered a deferred compensation plan through Natural Gas Utility District of Hawkins County (the "Plan") created in accordance with Internal Revenue Code Section 457. The plan permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseen emergency. The assets of the plan are held in a trust for the exclusive benefit of the participants and their beneficiaries. Presently, the District does not match any employee deferrals.

NOTE 9 - DEFINED CONTRIBUTION PLAN

Employees of the District are provided a contributory target benefit defined contribution retirement plan covering substantially all of its employees through Natural Gas Utility District of Hawkins County Employees' Pension Trust (the "Plan"). The Plan provisions and contribution requirements are established by and may be amended by the District's Board of Commissioners. Employees are eligible to participate in the plan after completion of six months of service and attainment of their 24<sup>th</sup> birthday. Employees participate in the plan on September 1 after the eligibility requirements are met. The plan allows employees to contribute up to 2% of their annual salary to the plan. The District's contributions to the plan are actuarially calculated based on age, salary, and date of employment, using a target benefit of 25% of the employee's annual average compensation. The District's contributions for each employee and earnings allocated to each employee's account are vested on a graded schedule of 20% increments for 2-6 years of service. The employee is vested 100% at all times for employee contributions. Forfeitures of the Plan may be used to satisfy any contribution paid by the District or to pay any administrative expenses of the Plan. No forfeitures were used during the years ended March 31, 2017 and 2016. The balances of forfeitures available at March 31, 2017 and 2016 were \$2,875 and \$1,896. The District's contributions to the plan totaled \$82,161 for 2017 and \$84,938 for 2016. Employees' contributions to the plan totaled \$28,751 for 2017 and \$28,975 for 2016.

NOTE 10 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District obtains commercial insurance to cover general liability claims, errors or omissions liability, auto liability, property damage, and workers' compensation. The District is covered by the Tennessee Governmental Tort Liability Act, which generally limits the District's tort liability to \$350,000 per claim. Settled claims resulting from these risks have not exceeded commercial insurance coverage in the past three years.

NOTE 11 - CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the District to concentrations of credit risk consist primarily of cash, certificates of deposit and customer accounts receivable. The District's cash deposits and investments in certificates of deposit are in financial institutions and are federally insured or collateralized. Credit evaluation and account monitoring procedures are utilized to minimize the risk of loss. Management does not believe significant credit risk existed at March 31, 2017.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The District has firm gas supply and firm gas transportation contracts some of which do not expire until 2026. These contracts typically contain minimum demand or storage obligations on the part of the District.

The District is involved in litigation and claims arising principally in the normal course of business. In the opinion of management the outcomes of these claims will not have a material adverse effect on the accompanying financial statements and accordingly, no provisions have been recorded.

SUPPLEMENTARY INFORMATION



NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedules of Operating Revenues  
Years Ended March 31, 2017 and 2016

	<u>Sales</u>	<u>Cost of Sales</u>	<u>Gross Profit</u>	<u>Gross Profit Percentage</u>
Year Ended March 31, 2017				
Natural gas	\$ 7,293,754	\$ 3,357,094	\$ 3,936,660	54.0%
Propane	906,617	440,530	466,087	51.4%
Appliances and service	<u>1,404,922</u>	<u>1,329,169</u>	<u>75,753</u>	<u>5.4%</u>
	<u>\$ 9,605,293</u>	<u>\$ 5,126,793</u>	<u>\$ 4,478,500</u>	46.6%
Year Ended March 31, 2016				
Natural gas	\$ 7,298,841	\$ 3,346,208	\$ 3,952,633	54.2%
Propane	948,801	415,639	533,162	56.2%
Appliances and service	<u>1,390,961</u>	<u>1,259,012</u>	<u>131,949</u>	<u>9.5%</u>
	<u>\$ 9,638,603</u>	<u>\$ 5,020,859</u>	<u>\$ 4,617,744</u>	47.9%

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedules of Other Operating Revenues  
Years Ended March 31, 2017 and 2016

	<u>2017</u>		<u>2016</u>	
	<u>Amount</u>	<u>Percent of Sales</u>	<u>Amount</u>	<u>Percent of Sales</u>
Connection charges	\$ 43,380	0.5%	\$ 45,130	0.5%
Forfeited discounts	58,670	0.6%	68,745	0.7%
Miscellaneous revenues	2,110	0.0%	1,620	0.0%
Discounts taken	<u>2,188</u>	<u>0.0%</u>	<u>1,505</u>	<u>0.0%</u>
	<u>\$ 106,348</u>	1.1%	<u>\$ 117,000</u>	1.2%

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedules of Other Operating Expenses  
Years Ended March 31, 2017 and 2016

	<u>2017</u>		<u>2016</u>	
	<u>Amount</u>	<u>Percent of Sales</u>	<u>Amount</u>	<u>Percent of Sales</u>
Transmission and distribution expense				
Supervision	\$ 150,573	1.6%	\$ 141,606	1.5%
Engineering	9,000	0.1%	19,043	0.2%
Maintenance:				
Distribution and service lines	227,123	2.4%	220,067	2.3%
Meters and regulators	9,202	0.1%	9,809	0.1%
Other distribution plant and equipment	<u>185,299</u>	<u>1.9%</u>	<u>174,006</u>	<u>1.8%</u>
	<u>581,197</u>	<u>6.1%</u>	<u>564,531</u>	<u>5.9%</u>
Customer accounting and collection expense				
Meter reading labor	102,403	1.1%	84,103	0.9%
Supplies and expenses	57,312	0.6%	58,183	0.6%
Uncollectible accounts	55,390	0.6%	(25,151)	-0.3%
Billing and collecting labor	<u>4,734</u>	<u>0.0%</u>	<u>5,805</u>	<u>0.1%</u>
	<u>219,839</u>	<u>2.3%</u>	<u>122,940</u>	<u>1.3%</u>
Sales promotions	<u>82,122</u>	<u>0.9%</u>	<u>78,457</u>	<u>0.8%</u>
General and administrative expense				
Employee benefits	1,007,445	10.5%	1,012,648	10.5%
Salaries	863,987	9.0%	876,451	9.1%
Insurance	196,013	2.0%	201,033	2.1%
Office supplies and expense	154,359	1.6%	157,246	1.6%
Repairs and maintenance	94,078	1.0%	93,259	1.0%
Personnel training and expense	64,165	0.7%	79,698	0.8%
Transportation	59,929	0.6%	61,247	0.6%
Utilities and telephone	49,366	0.5%	59,016	0.6%
Warehouse labor	41,206	0.4%	31,278	0.3%
Professional fees	35,411	0.4%	37,294	0.4%
Other general and administrative expense	22,435	0.2%	20,178	0.2%
Commissioners expense	18,000	0.2%	18,000	0.2%
Freight	14,790	0.2%	15,753	0.2%
Overhead capitalized to plant	<u>(73,310)</u>	<u>-0.8%</u>	<u>(70,587)</u>	<u>-0.7%</u>
	<u>2,547,874</u>	<u>26.5%</u>	<u>2,592,514</u>	<u>26.9%</u>
Depreciation	<u>704,024</u>	<u>7.3%</u>	<u>696,321</u>	<u>7.2%</u>
	<u>\$ 4,135,056</u>	<u>43.0%</u>	<u>\$ 4,054,763</u>	<u>42.1%</u>

See accompanying independent auditors' report.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedule of Utility Plant in Service  
March 31, 2017

	Cost April 1, 2016	Additions	Retirements	Cost March 31, 2017
Distribution plant				
Mains	\$ 11,516,849	\$ 350,787	\$ -	\$ 11,867,636
Service lines	3,551,402	94,201	-	3,645,603
Meters	1,708,304	115,002	-	1,823,306
	<u>16,776,555</u>	<u>559,990</u>	<u>-</u>	<u>17,336,545</u>
Intangible plant	<u>16,958</u>	<u>-</u>	<u>-</u>	<u>16,958</u>
Propane plant	<u>2,518,998</u>	<u>27,980</u>	<u>-</u>	<u>2,546,978</u>
General plant				
Land and right-of-ways	181,191	-	-	181,191
Buildings	1,433,053	-	-	1,433,053
Equipment	873,041	11,934	-	884,975
Furniture and fixtures	815,248	30,220	-	845,468
Automobiles and trucks	1,023,498	155,120	-	1,178,618
	<u>4,326,031</u>	<u>197,274</u>	<u>-</u>	<u>4,523,305</u>
	<u>\$ 23,638,542</u>	<u>\$ 785,244</u>	<u>\$ -</u>	<u>\$ 24,423,786</u>

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedule of Utility Rates  
March 31, 2017

Residential  
Base Tariff Rates Excluding Gas Cost

Customer service charge	\$5.95
Standard gas charge	0.637 per therm
Summer reduced rate	.310 per therm
Supplemental service rate	1.610 per therm

Commercial  
Base Tariff Rates Excluding Gas Cost

Customer service charge	\$6.95
Standard gas charge	0.647 per therm
Summer reduced rate	.340 per therm
Supplemental service rate	1.610 per therm

Public Authority and Religious  
Base Tariff Rates Excluding Gas Cost

Customer service charge	\$5.95
Standard gas charge	0.600 per therm
Summer reduced rate	.340 per therm
Supplemental service rate	1.610 per therm

Small Industrial  
Base Tariff Rates Excluding Gas Cost

Customer service charge	\$60.00
Standard gas charge	0.620 per therm

Large Industrial  
Base Tariff Rates Excluding Gas Cost

Customer service charge	\$100.00
Next 40,000 therms	0.590 per therm
For all over 40,000 therms each month	0.530 per therm

Interruptible  
Base Tariff Rates Excluding Gas Cost

For the first 40,000 therms each month	.382 per therm
For all over 40,000 therms each month	.312 per therm

The average cost of gas for the current month will be added to the above base tariff rates for the current month billing.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedule of Utility Rates (Continued)

A 10% penalty is added to all amounts not paid by the discount date. Summer reduced rates apply to gas used for space cooling from May through September. Supplemental service rates apply to gas used for supplemental and/or auxiliary fuel in automatically controlled heating equipment where gas is not the primary heat source from November through March.

The number of natural gas customers at March 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Residential	6,573	6,478
Commercial	468	474
Public authority and religious	382	381
Industrial and interruptible	<u>33</u>	<u>33</u>
	<u>7,456</u>	<u>7,366</u>

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Roster of Officials and Commissioners  
March 31, 2017

Officials

Mr. Patrick Lund

General Manager

Commissioners

Mr. Fred Montgomery

Chairman

Mr. Reed Matney

Vice-Chairman

Mr. Tommy Young

Secretary

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

Board of Commissioners  
Natural Gas Utility District  
of Hawkins County

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 Natural Gas Utility District of Hawkins County (the "District") as of and for the year ended March 31, 2017, and the related notes to the financial statements, and have issued our report thereon dated July 12, 2017.

### **Internal Control Over Financial Reporting**

In planning and performing our audits of the financial statements, we considered the District'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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 District's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses as item 2017-001 that we consider to be a significant deficiency.

### **Compliance and Other Matters**

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

### **District's Response to Finding**

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

Roderick Messer & Co, PLLC

Greeneville, Tennessee  
July 12, 2017



NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedule of Findings and Responses  
Year Ended March 31, 2017

Findings - Financial Statement Audit

Significant Deficiencies - Internal Control Over Financial Reporting

**2016-001 - Segregation of Duties (repeated from prior year)**

Due to the small size of the accounting staff, segregation of duties is inadequate. This was also a finding in the prior year.

Criteria

Ideally, duties should be segregated so that one person is performing only one of the following functions in relation to a specific aspect of the District:

- 1) Custody
- 2) Recording
- 3) Authorization

Effect

Inadequate segregation of duties leaves room for error and fraud to occur.

Recommendation

Internal control procedures should be in place to segregate the duties of custody, recording, and authorization of the accounting records to prevent error and fraud.

Management's Response

Management acknowledges that segregation of duties is not ideal; however, management continues to study the most efficient ways to eliminate or mitigate this weakness.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY  
Schedule of Disposition of Prior Year Findings  
Year Ended March 31, 2017

Prior Year Financial Statement Findings

<u>Finding Number</u>	<u>Finding Title</u>	<u>Status</u>
2016-001	Segregation of Duties	Repeated