

NATURAL GAS UTILITY DISTRICT
OF HAWKINS COUNTY

Financial Statements
With Supplementary Information

March 31, 2019 and 2018

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
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With Supplementary Information
March 31, 2019 and 2018

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INTRODUCTORY SECTION (UNAUDITED)

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Roster of Officials and Commissioners
March 31, 2019 and 2018

Officials

Mr. Patrick Lund

General Manager

Commissioners

Mr. Reed Matney

Chairman

Mr. Tommy Young

Vice-Chairman

Mr. Eugene Christian

Secretary

FINANCIAL SECTION

- Certified Public Accountants
 - Business Advisors

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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, 2019 and 2018, 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, 2019 and 2018, and the respective changes in financial position, and cash flows, thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

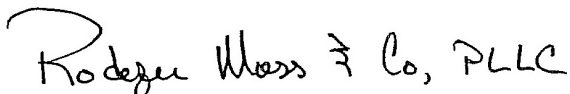
Our audits were conducted for the purpose of forming an opinion on the financial statements of the District. The introductory section and the supplementary information as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the financial statements.

The supplementary information listed in the table of contents 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.

The introductory section has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2019, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's 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.



Greeneville, Tennessee
June 24, 2019

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Management's Discussion and Analysis
March 31, 2019 and 2018

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, 2019 and 2018. Please read it in conjunction with the District's financial statements, which begin on page 7.

FINANCIAL HIGHLIGHTS

- The District's net position increased \$714,782, or more than 3 percent, which compared to an increase of \$866,328, or more than 4 percent for the prior fiscal year.
- During the year, the District had operating revenues that were \$341,052 more than last year and operating expenses that were \$313,022 more than last year.
- The District's non-operating revenues increased by \$34,219.
- 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 7-9) 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, 2019 and 2018.

NET POSITION

| | <u>2019</u> | <u>2018</u> |
|--------------------------------|---------------------|---------------------|
| Capital assets, net | \$10,761,531 | \$10,541,791 |
| Other assets, net | <u>11,767,605</u> | <u>11,093,222</u> |
| Total assets | 22,529,136 | 21,635,013 |
| Long-term liabilities | 96,025 | 95,058 |
| Other liabilities | <u>803,686</u> | <u>625,312</u> |
| Total liabilities | 899,711 | 720,370 |
| Net invested in capital assets | 11,093,222 | 10,541,791 |
| Unrestricted | <u>10,536,203</u> | <u>10,372,852</u> |
| Total net position | <u>\$21,629,425</u> | <u>\$20,914,643</u> |

Capital and other assets - The change in capital assets is a net increase of \$219,740, due to the extension of lines and replacement of obsolete equipment. Depreciation also increased. Other assets increased \$674,383, primarily due to increases in certificates of deposit and accounts receivable.

Long-term and other liabilities - Long-term liabilities decreased due to payments made on copier leases. Other liabilities increased due to an increase 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>2019</u> | <u>2018</u> |
|---------------------------------|---------------------|---------------------|
| Total operating revenues | \$11,195,429 | \$10,854,377 |
| Total non-operating revenues | <u>77,176</u> | <u>42,957</u> |
| Total revenues | \$11,272,605 | \$10,897,334 |
| | | |
| Total operating expense | 6,003,778 | 5,690,756 |
| Total other operating expense | <u>4,554,045</u> | <u>4,340,250</u> |
| | | |
| Total expenses | <u>10,557,823</u> | <u>10,031,006</u> |
| | | |
| Change in net position | 714,782 | 866,328 |
| | | |
| Net position, beginning of year | <u>20,914,643</u> | <u>20,048,315</u> |
| Net position, end of year | <u>\$21,629,425</u> | <u>\$20,914,643</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 \$526,817 due to an increase in cost of goods sold and an increase in maintenance expenses.

CAPITAL ASSET

Capital Assets - At March 31, 2019 and 2018, the District had \$25.5 and \$25.5 million, respectively, invested in distribution plant, intangible plant, propane plant, land, buildings, equipment, furniture and fixtures and automobiles (see table below), respectively. The 2019 amount represents a decrease of \$20,087 over the 2018 amount.

| | <u>2019</u> | <u>2018</u> |
|------------------------|---------------------|---------------------|
| Distribution plant | \$18,819,656 | \$18,173,244 |
| Intangible plant | 16,958 | 16,958 |
| Propane plant | 2,668,713 | 2,576,661 |
| Land and right-of-ways | 186,206 | 181,191 |
| Buildings | 1,433,053 | 1,433,053 |
| Equipment | 511,231 | 931,412 |
| Furniture and fixtures | 560,226 | 871,777 |
| Automobiles and trucks | <u>1,262,957</u> | <u>1,294,791</u> |
| Totals | <u>\$25,459,000</u> | <u>\$25,479,087</u> |

The 2018-2019 capital improvements include progress on Automated Meter Reading for meters and new trucks and equipment. 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's gas sales for the first nine months of the fiscal year started out very strong. The cumulative sales were on track to be the highest in the past eleven years. Then two events occurred in December that changed that. First, East Tennessee Natural Gas, who transports natural gas from Tennessee Gas Pipeline to the District, had a pipeline rupture on their 3100 line in middle Tennessee on December 5th, 2018. The majority of the District's pipeline capacity contracts are on the 3100 line. Second, the weather changed and a warmer than normal winter set in.

The pipeline rupture cut-off all supplies of natural gas from the west for all shippers with capacity on the 3100 line. The District had to rely solely on supplies from the east. As a result, the District quickly drained its gas stored in Early Grove and Saltville, and could pull no gas from storage in Bear Creek or TGP. In fact, the daily contracted supply of the District's pre-pay gas contracts were diverted to its TGP storage. But within a week, the weather began to warm which eased pressure on gas demand. The ruptured line was repaired and placed back in service at on December 29th, 2018 restoring gas flows from the west although at a reduced capacity for several months. During the entire time CenterPoint Energy, who manages the District's natural gas, was able to supply the all the gas needed. None of the District's customers saw any reduced gas supply or interruption of service.

The warm winter continued for the rest of the fiscal year and the District saw its gas sales go from the highest in eleven years to finish just above the average for the past eleven years. The pipeline rupture also prevented the usual draw down of gas supplies from storage in Bear Creek and TGP. Therefore, the District began the new fiscal year with much higher gas storage totals.

Natural Gas prices continue to remain reasonable which help with a positive customer growth. As long as prices continue to remain reasonable, the District believes that the growth in consumption of natural gas will continue. The District did see its customer growth double compared to the previous fiscal year, with the percentage increase of propane customer out performing the natural gas growth. The District saw an approximate growth rate of 2% in propane customers compared to 1% for natural gas.

The District continues to re-invest in its distribution system both by new main line extensions and line replacements for the third year in a row. 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 15,000 feet of pipe was replaced last fiscal year. As this program continues, another 15,000 to 20,000 feet of pipe is projected to be replaced in 2019-2020 fiscal year. In addition, the District continues to upgrade the meter stations and pressure regulator stations. The replacement of gas meters or conversion of newer meters to automated meter reading (AMR) continues. The District currently has over 60% of its meters that are AMR's. The resulting enhancements have considerably reduced meter reading times to less than fifteen (15) working days for the meter reading employees with a corresponding drop in mis-reads.

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, 2019 and 2018

| | <u>2019</u> | <u>2018</u> |
|--|----------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash | \$ 2,368,708 | \$ 2,217,838 |
| Certificates of deposit | 6,394,302 | 6,325,553 |
| Accounts receivable, net | 918,870 | 1,031,653 |
| Inventories | 1,729,115 | 1,148,034 |
| Unbilled revenues | 188,088 | 209,973 |
| Prepaid expenses | 44,904 | 45,115 |
| Interest receivable | <u>29,948</u> | <u>25,215</u> |
| Total current assets | <u>11,673,935</u> | <u>11,003,381</u> |
| Designated Funds | | |
| Gas meter deposits - cash | <u>93,670</u> | <u>89,841</u> |
| Total designated funds | <u>93,670</u> | <u>89,841</u> |
| Utility Plant | | |
| Utility plant | 25,459,000 | 25,479,087 |
| Less accumulated depreciation | <u>(14,697,469)</u> | <u>(14,937,296)</u> |
| Total utility plant, net | <u>10,761,531</u> | <u>10,541,791</u> |
| Total assets | <u>\$ 22,529,136</u> | <u>\$ 21,635,013</u> |
| LIABILITIES AND NET POSITION | | |
| Current Liabilities | | |
| Accounts payable | \$ 572,125 | \$ 401,291 |
| Capital lease payable, due within one year | 2,862 | 3,729 |
| Other payables and accrued liabilities | <u>228,699</u> | <u>220,292</u> |
| Total current liabilities | <u>803,686</u> | <u>625,312</u> |
| Non-Current Liabilities | | |
| Capital lease payable, less amount due within one year | 2,355 | 5,217 |
| Payable from designated funds - gas meter deposits | <u>93,670</u> | <u>89,841</u> |
| Total non-current liabilities | <u>96,025</u> | <u>95,058</u> |
| Total liabilities | <u>899,711</u> | <u>720,370</u> |
| Net investment in capital assets | 10,761,531 | 10,541,791 |
| Unrestricted | <u>10,867,894</u> | <u>10,372,852</u> |
| Total net position | <u>\$ 21,629,425</u> | <u>\$ 20,914,643</u> |

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
 Statements of Revenues, Expenses, and Changes in Net Position
 Years Ended March 31, 2019 and 2018

| | <u>2019</u> | <u>2018</u> |
|---|----------------------|----------------------|
| OPERATING REVENUES | | |
| Sales | \$ 11,076,972 | \$ 10,744,396 |
| Cost of sales | <u>6,003,778</u> | <u>5,690,756</u> |
| | 5,073,194 | 5,053,640 |
| Other operating revenues | <u>118,457</u> | <u>109,981</u> |
| Total operating revenues | <u>5,191,651</u> | <u>5,163,621</u> |
| OPERATING EXPENSES | | |
| General and administrative | 2,685,643 | 2,353,844 |
| Transmission and distribution | 868,904 | 924,911 |
| Depreciation | 757,170 | 738,969 |
| Customer accounting and collection | 169,738 | 247,578 |
| Sales promotion | 94,143 | 74,948 |
| Gain on disposal of utility plant | <u>(21,553)</u> | <u>-</u> |
| Total operating expenses | <u>4,554,045</u> | <u>4,340,250</u> |
| Operating income | <u>637,606</u> | <u>823,371</u> |
| OTHER INCOME | | |
| Interest income | <u>77,176</u> | <u>42,957</u> |
| Total other income | <u>77,176</u> | <u>42,957</u> |
| Change in net position | 714,782 | 866,328 |
| Net position at the beginning of the year | <u>20,914,643</u> | <u>20,048,315</u> |
| Net position at the end of the year | <u>\$ 21,629,425</u> | <u>\$ 20,914,643</u> |

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Statements of Cash Flows
Years Ended March 31, 2019 and 2018

| | <u>2019</u> | <u>2018</u> |
|---|---------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash receipts from customers | \$ 11,210,736 | \$ 10,426,952 |
| Cash paid to suppliers | (6,916,581) | (6,259,781) |
| Cash paid to employees including benefits | (3,310,983) | (3,026,794) |
| Other operating receipts | <u>118,457</u> | <u>109,981</u> |
| Net cash flows from operating activities | <u>1,101,629</u> | <u>1,250,358</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Proceeds from disposal of equipment | 4,553 | - |
| Acquisition and construction of utility plant | <u>(959,910)</u> | <u>(1,055,301)</u> |
| Net cash flows from capital and related financing activities | <u>(955,357)</u> | <u>(1,055,301)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Maturities of investments | 6,379,290 | 5,792,582 |
| Purchases of investments | (6,448,039) | (6,325,553) |
| Interest collected | <u>77,176</u> | <u>42,957</u> |
| Net cash flows from investing activities | <u>8,427</u> | <u>(490,014)</u> |
| Net change in cash | 154,699 | (294,957) |
| Cash at the beginning of the year | <u>2,307,679</u> | <u>2,602,636</u> |
| Cash at the end of the year | <u>\$ 2,462,378</u> | <u>\$ 2,307,679</u> |
| RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES | | |
| Operating income | \$ 637,606 | \$ 823,371 |
| Adjustments to reconcile operating income to cash flows from operating activities | | |
| Depreciation | 757,170 | 738,969 |
| Gain from disposal of equipment | (21,553) | - |
| Decrease (increase) in: | | |
| Accounts receivable | 112,783 | (265,175) |
| Inventories | (581,081) | (56,012) |
| Unbilled revenues | 21,885 | (46,366) |
| Prepaid expenses and interest receivable | (4,522) | (14,048) |
| Increase (decrease) in: | | |
| Accounts payable | 170,834 | 55,320 |
| Accrued liabilities | 8,407 | 15,529 |
| Capital lease payable | (3,729) | (3,729) |
| Gas meter deposits | <u>3,829</u> | <u>2,499</u> |
| Net cash flows from operating activities | <u>\$ 1,101,629</u> | <u>\$ 1,250,358</u> |

See accompanying notes to financial statements.

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Notes to Financial Statements
March 31, 2019 and 2018

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 \$186,000 in 2019 and \$203,000 in 2018. 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 2019 or 2018. 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, 2019 and 2018:

| <u>March 31, 2019</u> | <u>Undesignated</u> | <u>Designated</u> | <u>Total</u> |
|--|---------------------|-------------------|---------------------|
| Cash on hand | \$ 1,000 | \$ - | \$ 1,000 |
| Bank deposits - | | | |
| Non-interest bearing demand | 283,203 | - | 283,203 |
| Interest bearing demand | <u>2,084,505</u> | <u>93,670</u> | <u>2,178,175</u> |
| Total cash | 2,368,708 | 93,670 | 2,462,378 |
| Investments in certificates of deposit | <u>6,394,302</u> | <u>-</u> | <u>6,394,302</u> |
| Total | <u>\$ 8,763,010</u> | <u>\$ 93,670</u> | <u>\$ 8,856,680</u> |

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

NOTE 3 - CASH AND INVESTMENTS (Continued)

| <u>March 31, 2018</u> | <u>Undesignated</u> | <u>Designated</u> | <u>Total</u> |
|--|---------------------|-------------------|---------------------|
| Cash on hand | \$ 1,000 | \$ - | \$ 1,000 |
| Bank deposits - | | | |
| Non-interest bearing demand | 190,224 | - | 190,224 |
| Interest bearing demand | <u>2,026,614</u> | <u>89,841</u> | <u>2,116,455</u> |
| Total cash | 2,217,838 | 89,841 | 2,307,679 |
| Investments in certificates of deposit | <u>6,325,553</u> | <u>-</u> | <u>6,325,553</u> |
| Total | <u>\$ 8,543,391</u> | <u>\$ 89,841</u> | <u>\$ 8,633,232</u> |

The carrying amounts of the District's deposits were \$8,856,680 and \$8,633,232 and the bank balances were \$7,812,419 and \$8,814,984 as of March 31, 2019 and 2018. Of the bank balances, \$1,166,170 for 2019 and \$1,000,000 for 2018 were covered by federal depository insurance, \$0 and \$972,717 were covered by collateral held by the District's agent in the District's name, and \$7,812,419 and \$6,842,267 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>2019</u> | <u>2018</u> |
|--------------------------------|---------------------|---------------------|
| Natural gas storage | \$ 654,629 | \$ 294,994 |
| Appliances, parts and supplies | 885,195 | 794,441 |
| Propane | <u>189,291</u> | <u>58,599</u> |
| | <u>\$ 1,729,115</u> | <u>\$ 1,148,034</u> |

NOTE 5 - MAJOR SUPPLIERS

For the years ended March 31, 2019 and 2018 there were two suppliers that comprised greater than ten percent of the District's gas purchases. These purchases totaled approximately \$3.8 million for 2019 and 2018 or 100% of gas purchases, respectively.

NOTE 6 - MAJOR CUSTOMER

For the years ended March 31, 2019 and 2018, one customer comprised greater than ten percent of the District's gas sales. These sales totaled approximately \$900,000 for both years.

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, 2019 was as follows:

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|----------------------|-------------------|------------------|---------------------|
| Capital assets not being depreciated | | | | |
| Land and land rights | \$ 181,191 | \$ 5,015 | \$ - | \$ 186,206 |
| Total capital assets not being depreciated | <u>181,191</u> | <u>5,015</u> | <u>-</u> | <u>186,206</u> |
| Capital assets being depreciated | | | | |
| Buildings and permanent improvements | 1,433,053 | - | - | 1,433,053 |
| Equipment and gas distribution system | 23,864,843 | 971,895 | 996,996 | 23,839,742 |
| Total capital assets being depreciated | 25,297,896 | 971,895 | 996,996 | 25,272,795 |
| Less accumulated depreciation | <u>14,937,296</u> | <u>757,170</u> | <u>(996,996)</u> | <u>14,697,470</u> |
| Total capital assets being depreciated, net | <u>10,360,600</u> | <u>214,725</u> | <u>-</u> | <u>10,575,325</u> |
| Total capital assets, net | <u>\$10,541,791</u> | <u>\$ 219,740</u> | <u>\$ -</u> | <u>\$10,761,531</u> |

Utility plant activity for the year ended March 31, 2018 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 | 22,809,542 | 1,055,301 | - | 23,864,843 |
| Total capital assets being depreciated | 24,242,595 | 1,055,301 | - | 25,297,896 |
| Less accumulated depreciation | <u>14,198,327</u> | <u>738,969</u> | <u>-</u> | <u>14,937,296</u> |
| Total capital assets being depreciated, net | <u>10,044,268</u> | <u>316,332</u> | <u>-</u> | <u>10,360,600</u> |
| Total capital assets, net | <u>\$10,225,459</u> | <u>\$ 316,332</u> | <u>\$ -</u> | <u>\$10,541,791</u> |

Depreciation charged to income was \$757,170 and \$738,969 for the years ended March 31, 2019 and 2018, 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 24th 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. Forfeitures used during the year ended March 31, 2019 were \$2,886 and \$0 during 2018. The balances of forfeitures available at March 31, 2019 and 2018 were \$0 and \$2,875. The District's contributions to the plan totaled \$109,895 for 2019 and \$95,701 for 2018. Employees' contributions to the plan totaled \$32,162 for 2019 and \$30,699 for 2018.

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, 2019.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The District has firm gas supply and firm gas transportation contracts some of which do not expire until September 2049. 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, 2019 and 2018

| | <u>Sales</u> | <u>Cost of Sales</u> | <u>Gross Profit</u> | <u>Gross Profit Percentage</u> |
|---------------------------|----------------------|--------------------------|-------------------------|--|
| Year Ended March 31, 2019 | | | | |
| Natural gas | \$ 8,222,251 | \$ 3,786,895 | \$ 4,435,356 | 53.9% |
| Propane | 1,502,158 | 752,287 | 749,871 | 49.9% |
| Appliances and service | <u>1,352,563</u> | <u>1,464,596</u> | <u>(112,033)</u> | <u>-8.3%</u> |
| | <u>\$ 11,076,972</u> | <u>\$ 6,003,778</u> | <u>\$ 5,073,194</u> | 45.8% |
| Year Ended March 31, 2018 | | | | |
| Natural gas | \$ 8,120,432 | \$ 3,736,413 | \$ 4,384,019 | 54.0% |
| Propane | 1,331,123 | 620,676 | 710,447 | 53.4% |
| Appliances and service | <u>1,292,841</u> | <u>1,333,667</u> | <u>(40,826)</u> | <u>-3.2%</u> |
| | <u>\$ 10,744,396</u> | <u>\$ 5,690,756</u> | <u>\$ 5,053,640</u> | 47.0% |

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Schedules of Other Operating Revenues
Years Ended March 31, 2019 and 2018

| | 2019 | | 2018 | |
|------------------------|-------------------|---------------------|-------------------|---------------------|
| | Amount | Percent of Sales | Amount | Percent of Sales |
| Connection charges | \$ 43,920 | 0.4% | \$ 37,140 | 0.3% |
| Forfeited discounts | 66,228 | 0.6% | 68,411 | 0.6% |
| Miscellaneous revenues | 2,040 | 0.0% | 2,100 | 0.0% |
| Discounts taken | <u>6,269</u> | <u>0.1%</u> | <u>2,330</u> | <u>0.0%</u> |
| | <u>\$ 118,457</u> | 1.1% | <u>\$ 109,981</u> | 0.9% |

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Schedules of Other Operating Expenses
Years Ended March 31, 2019 and 2018

| | <u>2019</u> | | <u>2018</u> | |
|--|---------------------|-----------------------------|---------------------|-----------------------------|
| | <u>Amount</u> | <u>Percent of Sales</u> | <u>Amount</u> | <u>Percent of Sales</u> |
| Transmission and distribution expense | | | | |
| Salaries | \$ 443,451 | 4.0% | \$ 539,739 | 5.0% |
| Repair and Maintenance | 378,630 | 3.4% | 327,432 | 3.0% |
| Engineering | <u>46,823</u> | <u>0.4%</u> | <u>57,740</u> | <u>0.5%</u> |
| | <u>868,904</u> | <u>7.8%</u> | <u>924,911</u> | <u>8.6%</u> |
| Customer accounting and collection expense | | | | |
| Salaries | 89,557 | 0.8% | 108,741 | 1.0% |
| Uncollectible accounts | 17,358 | 0.2% | 79,482 | 0.7% |
| Supplies and expenses | <u>62,823</u> | <u>0.6%</u> | <u>59,355</u> | <u>0.6%</u> |
| | <u>169,738</u> | <u>1.5%</u> | <u>247,578</u> | <u>2.3%</u> |
| Sales promotions | <u>94,143</u> | <u>0.8%</u> | <u>74,948</u> | <u>0.7%</u> |
| General and administrative expense | | | | |
| Employee benefits | 1,146,300 | 10.3% | 971,477 | 9.0% |
| Salaries | 1,076,705 | 9.7% | 895,856 | 8.3% |
| Insurance | 208,158 | 1.9% | 202,703 | 1.9% |
| Office supplies and expense | 107,674 | 1.0% | 171,236 | 1.6% |
| Utilities and telephone | 69,453 | 0.6% | 65,748 | 0.6% |
| Repairs and maintenance | 65,488 | 0.6% | 56,893 | 0.5% |
| Other general and administrative expense | 49,311 | 0.4% | 51,133 | 0.5% |
| Professional fees | 53,493 | 0.5% | 43,527 | 0.4% |
| Commissioners expense | 20,317 | 0.2% | 18,506 | 0.2% |
| Transportation | 2,319 | 0.0% | 5,185 | 0.0% |
| Freight | 283 | 0.0% | 497 | 0.0% |
| Overhead capitalized to plant | <u>(113,858)</u> | <u>-1.0%</u> | <u>(128,917)</u> | <u>-1.2%</u> |
| | <u>2,685,643</u> | <u>24.2%</u> | <u>2,353,844</u> | <u>21.9%</u> |
| Gain on disposal of utility plant | (21,553) | -0.2% | - | 0.0% |
| Depreciation | <u>757,170</u> | <u>6.8%</u> | <u>738,969</u> | <u>6.9%</u> |
| | <u>\$ 4,554,045</u> | <u>41.1%</u> | <u>\$ 4,340,250</u> | <u>40.4%</u> |

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Schedule of Utility Plant in Service
March 31, 2019

| | Cost April 1, 2018 | Additions | Retirements | Cost March 31, 2019 |
|------------------------|--------------------------|-------------------|-------------------|---------------------------|
| Distribution plant | | | | |
| Mains | \$ 12,324,632 | \$ 365,464 | \$ - | \$ 12,690,096 |
| Service lines | 3,751,163 | 94,746 | - | 3,845,909 |
| Meters | 2,097,449 | 186,202 | - | 2,283,651 |
| | <u>18,173,244</u> | <u>646,412</u> | <u>-</u> | <u>18,819,656</u> |
| Intangible plant | <u>16,958</u> | <u>-</u> | <u>-</u> | <u>16,958</u> |
| Propane plant | <u>2,576,661</u> | <u>92,052</u> | <u>-</u> | <u>2,668,713</u> |
| General plant | | | | |
| Land and right-of-ways | 181,191 | 5,015 | - | 186,206 |
| Buildings | 1,433,053 | - | - | 1,433,053 |
| Equipment | 931,412 | 100,081 | 520,262 | 511,231 |
| Furniture and fixtures | 871,777 | 111,927 | 423,478 | 560,226 |
| Automobiles and trucks | 1,294,791 | 21,422 | 53,256 | 1,262,957 |
| | <u>4,712,224</u> | <u>238,445</u> | <u>996,996</u> | <u>3,953,673</u> |
| | <u>\$ 25,479,087</u> | <u>\$ 976,909</u> | <u>\$ 996,996</u> | <u>\$ 25,459,000</u> |

NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Schedule of Utility Rates
March 31, 2019

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, 2019 and 2018 is as follows:

| | <u>2019</u> | <u>2018</u> |
|--------------------------------|--------------|--------------|
| Residential | 6,646 | 6,569 |
| Commercial | 480 | 482 |
| Public authority and religious | 390 | 388 |
| Industrial and interruptible | <u>35</u> | <u>35</u> |
| | <u>7,551</u> | <u>7,474</u> |

COMPLIANCE REPORTS

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, 2019, and the related notes to the financial statements, and have issued our report thereon dated June 24, 2019.

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 2019-001 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.

Rodger Mess & Co, PLLC

Greeneville, Tennessee
June 24, 2019



NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Schedule of Findings and Responses
Year Ended March 31, 2019

Findings - Financial Statement Audit

Significant Deficiencies - Internal Control Over Financial Reporting

2019-001 - Segregation of Duties (repeated from 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

Condition

Due to the small size of the bookkeeping staff, segregation of duties is inadequate.

Effect of Condition

One person in control of all aspects of accounting leaves greater potential for error or fraud to occur.

Cause of Condition

The District only employs one individual in the accounting department.

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, 2019

Prior Year Financial Statement Findings

| <u>Prior Year Finding Number</u> | <u>Finding Title</u> | <u>Status/ Current Year Finding Number</u> |
|----------------------------------|---|--|
| 2018-001 | Segregation of Duties (original finding #2016-001) | Repeated/2019-001 |



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NATURAL GAS UTILITY DISTRICT OF HAWKINS COUNTY
Management's Corrective Action Plan
March 31, 2019

2019-001 - Segregation of Duties (Repeated from prior year)

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.

Action Taken

Currently the general ledger is maintained by the accountant with the Board reviewing financial statements at meetings. The accounting process does not lend itself to an appropriate segregation of duties and oversight of transactions. Due to the small size of the organization and cost efficiency, the current accounting process is the most beneficial. The Board will add levels of duties if the District increases in transactions and size.

Name of Contact Person: Patrick Lund
Anticipated Completion Date: Ongoing

Sincerely,

A handwritten signature in black ink, appearing to read "Patrick Lund".

Patrick Lund
General Manager