



CITY OF CUSTER

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT
DECEMBER 31, 2016



Ketel Thorstenson, LLP
Certified Public Accountants/Business & Personal Consultants

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CITY OF CUSTER

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INDEPENDENT AUDITOR'S REPORT

City Council
City of Custer
Custer, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the **CITY OF CUSTER** (the City), as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of the City, as of December 31, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

City Council

Other Matters - Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3 through 11, budgetary comparison information on pages 41 through 44, pension information on pages 45 and 46, and notes to required supplementary information on page 47 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 1, 2017 on our consideration of the City'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 City's internal control over financial reporting and compliance.



KETEL THORSTENSON, LLP
Certified Public Accountants

May 1, 2017

CITY OF CUSTER

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2016

This section of the City of Custer (the City) annual financial report presents our discussion and analysis of the City's financial performance during the year ended December 31, 2016. Please read it in conjunction with the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

The City's net position from governmental and business-type activities decreased by \$574,815, primarily due to the sewer fund assets being moved to the governmental fund. Golf Course and Cemetery assets totaling \$429,860 were moved. In addition, the hospital subsidy that was previously being held for payment was paid in full during 2016.

During the year, the City's revenues generated from charges for services, taxes and other revenues of the governmental programs were \$3,424,664, and the governmental program expenditures were \$3,772,802.

The City's proprietary funds' expenses including transfers exceeded revenues by \$648,317 primarily due to the sewer fund assets being moved to the governmental fund. In addition, expenditures in the water and sewer fund were higher, with personal services being the largest portion of that increase.

The general fund reported a \$120,329 current year decrease due to the 2014 and 2015 hospital sales tax subsidy that was previously being held in addition to the 2016 payments totaling \$1,041,000 being paid.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial report is presented in a format consistent with the presentation requirements of the Governmental Accounting Standards Board (GASB) Statement 34.

This annual report consists of three parts – management's discussion and analysis (this section), the basic financial statements, including related notes, and required supplementary information. The basic financial statements include two kinds of statements that present different views of the City:

The first two statements are government-wide financial statements that provide both long-term and short-term information about the City's overall financial status.

The remaining statements are fund financial statements that focus on individual parts of the City government, reporting the City's operations in more detail than the government-wide statements.

The governmental funds statements tell how general government services, like public safety, were financed in the short-term, as well as what remains for future spending.

Proprietary fund statements offer short- and long-term financial information about the activities that the City operates like businesses. The City has three proprietary funds – the Water Fund, the Sewer Fund, and the Solid Waste Fund.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements.

CITY OF CUSTER

**MANAGEMENT’S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

The figure below summarizes the major features of the City’s financial statements, including the portion of the City government they cover and the types of information they contain. The remainder of the overview section of the management’s discussion and analysis explains the structure and contents of each of the statements.

	Government-wide Statements	Fund Statements	
		Governmental Funds	Proprietary Funds
Scope	Entire City government (except fiduciary funds)	The activities of the City that are not proprietary or fiduciary, such as finance office, police, fire and parks	Activities the City operates similar to private businesses, the water and sewer systems
Required Financial Statements	Statement of Net Position and Statement of Activities	Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances	Statement of Net Position; Statement of Revenues, Expenses and Changes in Net Position; and Statement of Cash Flows
Accounting Basis and Measurement Focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of Asset/ Liability Information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term
Type of Inflow/ Outflow Information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during the year or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid

CITY OF CUSTER

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) DECEMBER 31, 2016

OVERVIEW OF THE FINANCIAL STATEMENTS (CONCLUDED)

Government-wide Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net position includes all of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the City's net position and how they have changed. Net position – the difference between the City's assets and liabilities – are one way to measure the City's financial health.

Increases or decreases in the City's net position are an indicator of whether its financial health is improving or deteriorating, respectively.

To assess the overall health of the City, you need to consider additional non-financial factors, such as changes in the City's property tax base and changes in the sales tax revenue base.

The government-wide financial statements of the City are reported in two categories:

Governmental Activities -- This category includes most of the City's basic services, such as police, fire, public works, parks department and general administration. Property taxes, sales taxes, charges for services, state grants and interest earnings finance most of these activities.

Business-type Activities -- The City charges a fee to customers to help cover the costs of certain services it provides. The City's water, sewer, and solid waste program are included here.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds – not the City as a whole. Funds are accounting devices that the City uses to keep track of specific sources of funding and spending for particular purposes.

State law requires some of the funds. The City Council establishes other funds to control and manage money for particular purposes or to show that it is properly using certain taxes and grants.

The City has two kinds of funds:

Governmental Funds – Most of the City's basic services are included in the governmental funds, which focus on (1) how cash and other financial assets that can be readily converted to cash flow in and out and (2) the balances left at the end of the year that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statements, or on the subsequent page, that explains the relationship (or differences) between them.

Proprietary Funds – Services for which the City charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both short- and long-term financial information. The City's proprietary funds are the same as its business-type activities, but provide more detail and additional information, such as cash flows.

CITY OF CUSTER

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

The City's combined net position decreased by 2.88 percent between 2015 and 2016 – decreasing by \$574,815.

Table A-1 Statement of Net Position						
	Governmental Activities		Business-Type Activities		Total	
	2015	2016	2015	2016	2015	2016
Current & Other Assets	\$ 3,929,253	\$ 3,746,401	\$ 3,060,796	\$ 2,779,643	\$ 6,990,049	\$ 6,526,044
Capital Assets	9,714,889	9,879,231	10,704,245	9,909,704	20,419,134	19,788,935
Total Assets	\$ 13,644,142	\$ 13,625,632	\$ 13,765,041	\$ 12,689,347	\$ 27,409,183	\$ 26,314,979
Pension Related Deferred Outflows	\$ 197,133	\$ 192,203	\$ 68,163	\$ 63,086	\$ 265,296	\$ 255,289
Long-Term Debt	\$ 4,230,879	\$ 4,222,691	\$ 3,206,521	\$ 2,763,149	\$ 7,437,400	\$ 6,985,840
Other Liabilities	26,044	92,979	48,247	112,997	74,291	205,976
Total Liabilities	\$ 4,256,923	\$ 4,315,670	\$ 3,254,768	\$ 2,876,146	\$ 7,511,691	\$ 7,191,816
Pension Related Deferred Inflows	\$ 155,689	\$ -	\$ 53,832	\$ -	\$ 209,521	\$ -
Net Position:						
Net Investment in Capital Assets	\$ 5,523,354	\$ 5,702,843	\$ 7,558,564	\$ 7,225,302	\$ 13,081,918	\$ 12,928,145
Restricted	403,329	432,956	157,735	112,295	561,064	545,251
Unrestricted	3,501,980	3,366,366	2,808,305	2,538,690	6,310,285	5,905,056
Total Net Position	\$ 9,428,663	\$ 9,502,165	\$ 10,524,604	\$ 9,876,287	\$ 19,953,267	\$ 19,378,452
Beginning Net Position	\$ 8,607,326	\$ 9,428,663	\$ 10,585,072	\$ 10,524,604	\$ 19,192,398	\$ 19,953,267
Change in Accounting Principle	129,877	-	44,906	-	174,783	-
Change in Net Position	691,460	73,502	(105,374)	(648,317)	586,086	(574,815)
Percentage of Change Net Position	8.03%	0.78%	-1.00%	-6.16%	3.05%	-2.88%

The Statement of Net Position reports all financial and capital resources. The statement presents the assets and liabilities in order of relative liquidity. The liabilities with average maturities greater than one year are reported in two components – the amount due within one year and the amount due in more than one year. The long-term liabilities of the City have been reported in this manner on the Statement of Net Position. The difference between the City's assets and liabilities is its net position.

CITY OF CUSTER

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

The City's revenues totaled \$4,823,568. See Figure A-1 below for various sources of revenue. The total revenue decreased while the expenditures increased. The City's expenses cover a range of services, including public works, general government, and utility services for water, sewer, and sanitation (See Figure A-2).

Figure A-1: Revenue Sources for 2016

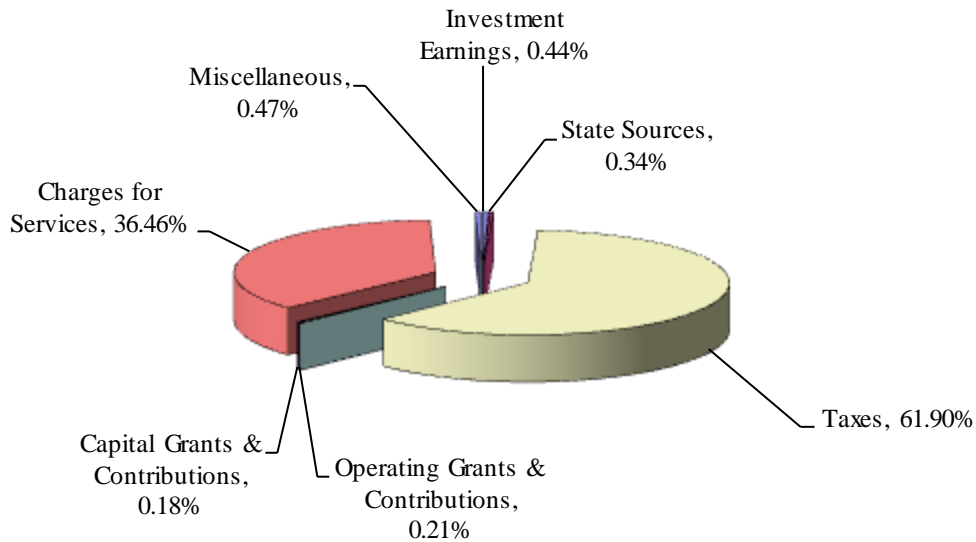
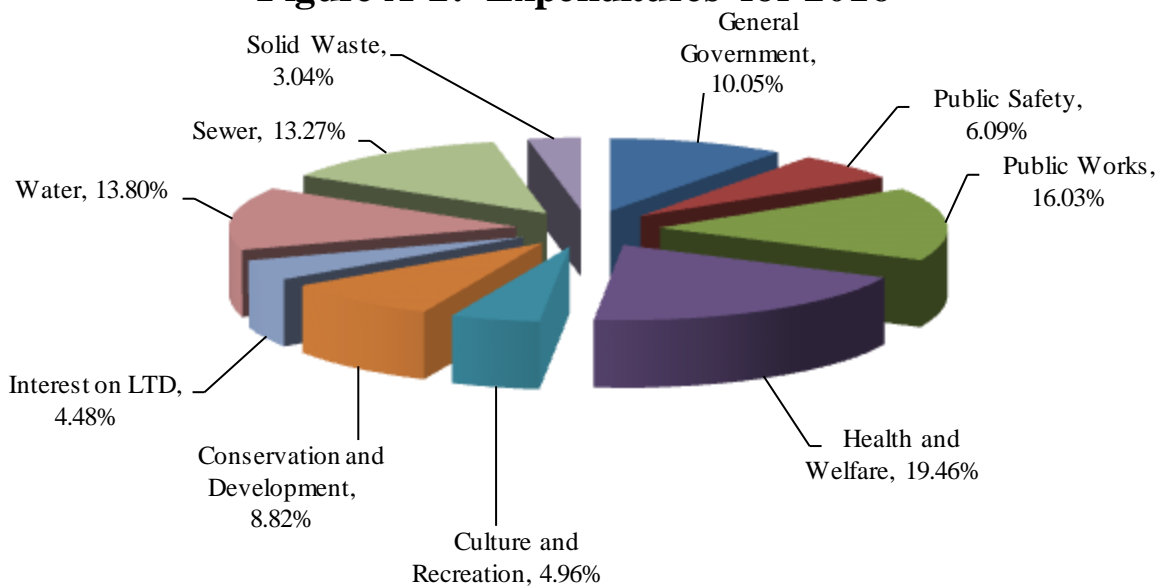


Figure A-2: Expenditures for 2016



CITY OF CUSTER

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Table A-2						
Statement of Activities						
	Total Governmental Activities		Total Business-Type Activities		Grand Total	
	2015	2016	2015	2016	2015	2016
Revenues						
<i>Program Revenues</i>						
Charges for Services	\$ 402,477	\$ 376,270	\$ 1,381,369	\$ 1,382,532	\$ 1,783,846	\$ 1,758,802
Capital Grants and Contributions	3,797	8,788	4,100	-	7,897	8,788
Operating Grants and Contributions	-	10,000	-	-	-	10,000
<i>General Revenues</i>						
Taxes	3,031,976	2,985,666	-	-	3,031,976	2,985,666
Revenue State Sources	15,460	16,347	-	-	15,460	16,347
Unrestricted Investment Earnings	10,968	12,780	9,998	8,572	20,966	21,352
Other	13,092	14,813	-	7,800	13,092	22,613
Total Revenues	\$ 3,477,770	\$ 3,424,664	\$ 1,395,467	\$ 1,398,904	\$ 4,873,237	\$ 4,823,568
Expenses						
General Government	\$ 507,931	\$ 542,449	\$ -	\$ -	\$ 507,931	\$ 542,449
Public Safety	350,583	328,867	-	-	350,583	328,867
Public Works	938,373	865,125	-	-	938,373	865,125
Health and Welfare	10,602	1,050,740	-	-	10,602	1,050,740
Culture and Recreation	247,372	267,772	-	-	247,372	267,772
Conservation and Development	477,311	475,969	-	-	477,311	475,969
Interest on Long-Term Debt	254,138	241,880	-	-	254,138	241,880
Water Services	-	-	686,471	745,113	686,471	745,113
Sewer Services	-	-	644,108	716,208	644,108	716,208
Solid Waste	-	-	170,262	164,260	170,262	164,260
Total Expenses	\$ 2,786,310	\$ 3,772,802	\$ 1,500,841	\$ 1,625,581	\$ 4,287,151	\$ 5,398,383
Transfers	\$ -	\$ 421,640	\$ -	\$ (421,640)	\$ -	\$ -
Increase (Decrease) in Net Position						
Net Position	\$ 691,460	\$ 73,502	\$ (105,374)	\$ (648,317)	\$ 586,086	\$ (574,815)
Net Position - Beginning	\$ 8,607,326	\$ 9,428,663	\$ 10,585,072	\$ 10,524,604	\$ 19,192,398	\$ 19,953,267
Change in Accounting Principle	129,877	-	44,906	-	174,783	-
Net Position - Ending	\$ 9,428,663	\$ 9,502,165	\$ 10,524,604	\$ 9,876,287	\$ 19,953,267	\$ 19,378,452

CITY OF CUSTER

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONCLUDED)

Governmental Activities

Revenues and transfers of the City's governmental activities exceeded expenses by \$73,502. Factors contributing to these results included:

- Golf Course and Cemetery assets were transferred from the sewer fund to the governmental fund.

Business-Type Activities

Expenses and transfers of the City's business-type activities exceeded revenues by \$648,317. The factor contributing to these results included that golf course and cemetery assets that were previously recorded in the sewer fund were transferred to the governmental fund.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

The financial analysis of the City's funds mirror those highlighted in the analysis of governmental and business-type activities presented above. The City maintains several governmental funds and three business-type funds.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the City Council revised the City budget three times. The amendments increased appropriations by contingency transfer to prevent budget overruns.

CITY OF CUSTER

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

CAPITAL ASSET ADMINISTRATION

By the end of 2016, the City had invested \$19,788,935 in a broad range of capital assets, including land, buildings, and various machinery and equipment. (See Table A-3.) This amount represents a net decrease (including additions and deductions) of \$630,199. This decrease was due to the increase in annual depreciation from sewer projects completed in the last couple years as well as a number of disposals in 2016.

	Governmental Activities		Business-type Activities	
	2015	2016	2015	2016
Land	\$ 1,070,706	\$ 1,412,978	\$ 568,035	\$ 146,395
Buildings	1,447,090	1,408,960	613,298	600,679
Improvements	6,398,656	5,946,595	9,098,275	8,768,788
Machinery and Equipment	418,390	404,644	405,619	393,842
Construction Work in Progress	380,047	706,054	19,018	-
Total	\$ 9,714,889	\$ 9,879,231	\$ 10,704,245	\$ 9,909,704

LONG-TERM DEBT

	Governmental Activities		Business-type Activities	
	2015	2016	2015	2016
Compensated Absences	\$ 39,344	\$ 46,303	\$ 60,840	\$ 78,747
TIF #1 - Boothill	665,465	665,465	-	-
Accrued Interest - TIF #1	33,965	20,302	-	-
TIF #2 - Stonehill	1,569,901	1,569,901	-	-
Accrued Interest - TIF #2	680,526	754,284	-	-
TIF #4 - Downtown	968,441	903,730	-	-
TIF #5 - Pamida	273,237	262,706	-	-
Water Revenue Bonds	-	-	2,260,351	1,834,820
Sewer Revenue Bonds	-	-	885,330	849,582
Total	\$ 4,230,879	\$ 4,222,691	\$ 3,206,521	\$ 2,763,149

The City made scheduled payments on long-term debt.

CITY OF CUSTER

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED) DECEMBER 31, 2016

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's current economic position has shown continued improvement. The City did experience an increase in total property valuation of \$7,991,015, up 5.9 percent from the prior year, thus increasing total property tax revenue by approximately \$45,000. The increase in property valuation also allows the City to reduce the property tax mill levy from \$6.50 per \$1,000 assessed valuation to \$5.78. Under the state-mandated property tax freeze, property taxes from one year to the next may increase three percent or an amount based on the CPI, whichever is lower.

One of the primary sources of revenue to the City is based on taxable retail sales in the community (sales tax). The City has experienced a decrease in sales tax of 3.22 percent over the prior year and has budgeted for a \$135,000 increase in sales tax revenue from the 2016 actual for the next year.

The City's adopted General Fund budget for the next fiscal year will decrease to \$3,534,920. The largest portion of this decrease is due to the hospital sales tax subsidy that has been previously on hold was remitted in 2016 and only the yearly payment of \$347,000 will be made next year.

The City's adopted business-type budget for the next fiscal year will increase to \$2,773,946. This increase is mainly due to the water treatment upgrade project and purchase of a jetter truck replacement.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional information, contact the City of Custer Finance Office, 622 Crook Street, Custer, SD 57730.

CITY OF CUSTER

**STATEMENT OF NET POSITION
DECEMBER 31, 2016**

	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTAL
ASSETS			
Cash and Investments (Note 2)	\$ 3,497,515	\$ 2,493,146	\$ 5,990,661
Restricted Investments (Notes 3 and 7)	-	106,920	106,920
Receivables	206,099	179,577	385,676
Other Assets (Note 9)	42,787	-	42,787
Capital Assets (Note 6):			
Land and Construction in Progress	2,119,032	146,395	2,265,427
Other Capital Assets, Net of Depreciation	7,760,199	9,763,309	17,523,508
TOTAL ASSETS	13,625,632	12,689,347	26,314,979
DEFERRED OUTFLOWS OF RESOURCES			
Pension Related Deferred Outflows of Resources (Note 8)	192,203	63,086	255,289
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES			
	\$ 13,817,835	\$ 12,752,433	\$ 26,570,268
LIABILITIES			
Accounts Payable	\$ 19,761	\$ 10,907	\$ 30,668
Other Current Liabilities	17,174	44,379	61,553
Net Pension Liability (Note 8)	56,044	57,711	113,755
Long-Term Liabilities (Note 7):			
Due Within One Year	236,235	147,106	383,341
Due in More Than One Year	3,986,456	2,616,043	6,602,499
TOTAL LIABILITIES	4,315,670	2,876,146	7,191,816
NET POSITION			
Net Investment in Capital Assets	5,702,843	7,225,302	12,928,145
Restricted for:			
Debt Service	-	106,920	106,920
Business Improvement District	72,551	-	72,551
Promoting the City	105,892	-	105,892
SDPAA (Note 9)	32,595	-	32,595
SDRS Pension (Note 8)	136,159	5,375	141,534
Permanently Restricted Purposes:			
Expendable	35,759	-	35,759
Nonexpendable	50,000	-	50,000
Unrestricted	3,366,366	2,538,690	5,905,056
TOTAL NET POSITION	9,502,165	9,876,287	19,378,452
TOTAL LIABILITIES AND NET POSITION	\$ 13,817,835	\$ 12,752,433	\$ 26,570,268

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

CITY OF CUSTER

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2016

Functions/Programs	--- Program Revenues ---				Net (Expense) Revenue and ----- Changes in Net Position -----		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Primary Government							
Governmental Activities:							
General Government	\$ 542,449	\$ 80,482	\$ -	\$ -	\$ (461,967)	\$ -	\$ (461,967)
Public Safety	328,867	1,724	-	-	(327,143)	-	(327,143)
Public Works	865,125	90,882	-	-	(774,243)	-	(774,243)
Health and Welfare	1,050,740	-	-	-	(1,050,740)	-	(1,050,740)
Culture and Recreation	267,772	11,982	-	8,788	(247,002)	-	(247,002)
Conservation and Development	475,969	-	10,000	-	(465,969)	-	(465,969)
Miscellaneous	-	191,200	-	-	191,200	-	191,200
Interest on Long-Term Debt	241,880	-	-	-	(241,880)	-	(241,880)
Total Governmental Activities	3,772,802	376,270	10,000	8,788	(3,377,744)	-	(3,377,744)
Business-Type Activities:							
Water	745,113	639,203	-	-	-	(105,910)	(105,910)
Sewer	716,208	553,888	-	-	-	(162,320)	(162,320)
Solid Waste	164,260	189,441	-	-	-	25,181	25,181
Total Business-Type Activities	1,625,581	1,382,532	-	-	-	(243,049)	(243,049)
Total Primary Government	\$ 5,398,383	\$ 1,758,802	\$ 10,000	\$ 8,788	(3,377,744)	(243,049)	(3,620,793)
General Revenues:							
Taxes:							
Property Taxes					1,104,520	-	1,104,520
Sales Taxes					1,881,146	-	1,881,146
State Shared Revenue					16,347	-	16,347
Unrestricted Investment Earnings					12,780	8,572	21,352
Miscellaneous Revenue					14,813	7,800	22,613
Transfers					421,640	(421,640)	-
Total General Revenue					3,451,246	(405,268)	3,045,978
Change in Net Position					73,502	(648,317)	(574,815)
Net Position, Beginning					9,428,663	10,524,604	19,953,267
Net Position, Ending					\$ 9,502,165	\$ 9,876,287	\$ 19,378,452

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

CITY OF CUSTER

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2016**

	General Fund	Third Penny (Promotion) Fund	BID Fund
Assets			
101 Cash and Cash Equivalents (Note 2)	\$ 2,160,400	\$ 101,307	\$ 68,537
105 Investments (Note 2)	1,076,378	2,797	-
108 Property Taxes Receivable - Delinquent	31,344	-	-
110 Sales Taxes Receivable	121,160	8,939	-
115 Accounts Receivable	40,308	-	4,014
135 Interest Receivable	232	-	-
154.1 Restricted Deposits (Note 9)	32,595	-	-
155 Prepaid Expenses	10,192	-	-
Total Assets	\$ 3,472,609	\$ 113,043	\$ 72,551
Liabilities, Deferred Inflows of Resources and Fund Balances			
<i>Liabilities</i>			
202 Accounts Payable	\$ 10,171	\$ 7,151	\$ -
216 Accrued Wages Payable	12,791	-	-
220 Customer Deposits	500	-	-
Total Liabilities	23,462	7,151	-
<i>Deferred Inflows of Resources (Note 4)</i>			
245 Unavailable Revenue - Property Taxes	16,593	-	-
<i>Fund Balances</i>			
<i>263 Nonspendable:</i>			
263.51 Perpetual Care Cemetery	-	-	-
263.02 Prepaid Expenses	10,192	-	-
263.49 SDPAA Reserve (Note 9)	32,595	-	-
<i>264 Restricted:</i>			
264.03 Perpetual Care Cemetery	-	-	-
264.04 Promoting the City	-	105,892	-
264.09 Business Improvement District	-	-	72,551
<i>265 Committed:</i>			
265.99 Capital Reserve Fund	250,000	-	-
<i>266 Assigned:</i>			
266.02 Hospital Sales Tax	2,664,417	-	-
267 Unassigned	475,350	-	-
Total Fund Balances	3,432,554	105,892	72,551
Total Liabilities, Deferred Inflows of Resources and Fund Balances	\$ 3,472,609	\$ 113,043	\$ 72,551

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

TIF Debt Service Fund	Cemetery Perpetual Care Fund	Total Governmental Funds
\$ 2,439	\$ 4,184	\$ 2,336,867
-	81,473	1,160,648
-	-	31,344
-	-	130,099
-	-	44,322
-	102	334
-	-	32,595
-	-	10,192
\$ 2,439	\$ 85,759	\$ 3,746,401

\$ 2,439	\$ -	\$ 19,761
-	-	12,791
-	-	500
2,439	-	33,052

-	-	16,593
---	---	--------

-	50,000	50,000
-	-	10,192
-	-	32,595
-	35,759	35,759
-	-	105,892
-	-	72,551
-	-	250,000
-	-	2,664,417
-	-	475,350
-	85,759	3,696,756

\$ 2,439	\$ 85,759	\$ 3,746,401
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CITY OF CUSTER

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE
GOVERNMENT-WIDE STATEMENT OF NET POSITION
DECEMBER 31, 2016**

Total Fund Balances - Governmental Funds \$ 3,696,756

Amounts reported for governmental activities in the Statement of Net Position
are different because:

Capital assets used in governmental activities are not financial resources and
therefore are not reported in the funds. 9,879,231

Long-term liabilities are not due and payable in the current period and therefore
not reported in the funds. (4,222,691)

Net pension liability is not due and payable in the current period and therefore
is not reported in the funds. (56,044)

Pension related deferred outflows are components of pension asset and therefore
are not reported in the funds. 192,203

Accrued interest is not due and payable in the current period and therefore is
not reported in the funds. (3,883)

Assets such as delinquent taxes receivable and grants receivable are not available
to pay for current period expenditures and therefore are deferred in the funds. 16,593

Total Net Position - Governmental Funds \$ 9,502,165

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

CITY OF CUSTER

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2016**

Revenue	General Fund	Third Penny (Promotion) Fund	BID Fund	TIF Debt Service Fund
<i>Taxes:</i>				
311 General Property Taxes	\$ 852,628	\$ -	\$ -	\$ 251,948
313 General Sales and Use Taxes	1,469,229	243,473	168,444	-
315 Amusement Taxes	480	-	-	-
319 Penalties and Interest on Delinquent Taxes	1,935	-	-	-
320 Licenses and Permits	61,330	-	-	-
<i>State Shared Revenue:</i>				
334 State Grants	10,000	-	-	-
335.01 Bank Franchise Tax	2,867	-	-	-
335.03 Liquor Tax Reversion	13,480	-	-	-
335.04 Motor Vehicle Licenses (5%)	38,683	-	-	-
335.08 Local Government Highway and Bridge Fund	31,862	-	-	-
<i>County Shared Revenue:</i>				
338.02 County HBR Tax	8,792	-	-	-
<i>Charges for Goods and Services:</i>				
341 General Government	8,776	-	-	-
346 Culture and Recreation	11,982	-	-	-
348 Cemeteries	5,300	-	-	-
350 Fines and Forfeits	1,724	-	-	-
<i>Miscellaneous Revenue:</i>				
361 Earnings on Deposits and Investments	12,323	207	-	-
362 Rentals	8,570	-	-	-
367 Contributions and Donations	1,806	-	-	-
368 Liquor Operating Agreement Income	191,200	-	-	-
369 Other	5,417	-	-	-
Total Revenue	2,738,384	243,680	168,444	251,948

Cemetery Perpetual Care Fund	Total Governmental Funds
\$ -	\$ 1,104,576
-	1,881,146
-	480
-	1,935
-	61,330
-	10,000
-	2,867
-	13,480
-	38,683
-	31,862
-	8,792
-	8,776
-	11,982
6,245	11,545
-	1,724
250	12,780
-	8,570
-	1,806
-	191,200
-	5,417
6,495	3,408,951

CITY OF CUSTER

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (CONTINUED)
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2016**

	General Fund	Third Penny (Promotion) Fund	BID Fund	TIF Debt Service Fund
Expenditures				
<i>General Government:</i>				
411 Legislative	85,211	-	-	-
413 Elections	20	-	-	-
414 Financial Administration	146,430	-	-	-
419 Other	243,043	-	-	-
<i>Public Safety:</i>				
421 Police	328,867	-	-	-
<i>Public Works:</i>				
431 Highways and Streets	335,339	-	-	-
437 Cemeteries	27,503	-	-	-
<i>Health and Welfare:</i>				
444 Humane Society	9,740	-	-	-
447 Hospital Subsidy	1,041,000	-	-	-
<i>Culture and Recreation:</i>				
451 Custer Cruisin'	14,292	-	-	-
451 Swimming	42,278	-	-	-
452 Parks	117,158	-	-	-
<i>Conservation and Development:</i>				
465 Economic Development and Assistance	97,000	230,235	148,734	-
470 Debt Service	-	-	-	257,382
485 Capital Outlay	399,586	-	-	-
Total Expenditures	2,887,467	230,235	148,734	257,382
Other Financing Sources				
391 Sale of Capital Assets	22,012	-	-	-
391 Compensation for Loss or Damage to Capital Assets	6,742	-	-	-
Total Other Financing Sources	28,754	-	-	-
Net Change in Fund Balances	(120,329)	13,445	19,710	(5,434)
Fund Balances - December 31, 2015	3,552,883	92,447	52,841	5,434
Fund Balances - December 31, 2016	\$ 3,432,554	\$ 105,892	\$ 72,551	\$ -

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

Cemetery Perpetual Care Fund	Total Governmental Funds
-	85,211
-	20
-	146,430
-	243,043
-	328,867
-	335,339
-	27,503
-	9,740
-	1,041,000
-	14,292
-	42,278
-	117,158
-	475,969
-	257,382
-	399,586
-	<u>3,523,818</u>
-	22,012
-	6,742
-	<u>28,754</u>
6,495	<u>(86,113)</u>
79,264	<u>3,782,869</u>
\$ 85,759	\$ <u>3,696,756</u>

CITY OF CUSTER

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES TO THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED DECEMBER 31, 2016

Net Change in Fund Balances - Total Government Funds \$ (86,113)

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report capital outlays as expenditures; however, in the Statement of Activities the cost of those assets is allocated over their estimated lives and reported as depreciation expense.

Capital Asset Purchases Capitalized	399,586
Depreciation Expense	(586,304)

Capital assets contributed to the City, which are included in the Statement of Activities.	8,788
--	-------

Assets transferred and to and from Water and Sewer Funds.	421,640
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The governmental funds reflect proceeds from capital asset sales, if any, while the Statement of Activities reports a loss on sale or disposal of capital assets.	(79,368)
---	----------

The governmental fund financial statement property tax accruals differ from the government-wide statement property tax accruals in that the fund financial statements require the amounts to be "available."	(2,471)
--	---------

Payment of principal on long-term debt and accrued interest on TIFs #1 and #2 is an expenditure in the governmental funds but the payment reduces long-term liabilities in the Statement of Net Position.	191,897
---	---------

Increases to the interest accrual on TIFs #1 and #2 does not require the use of current financial resources and therefore is not reported as expenditures in governmental funds.	(176,750)
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Accrued interest expense, excluding TIFs #1 and #2, reported in the Statement of Activities does not require the use of current financial resources and therefore is not reported as expenditures in governmental funds.	355
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Pension expense reported in the Statement of Activities does not require the use of current financial resources and are not reported as expenditures in the governmental funds.	(30,547)
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Changes in the pension related deferred outflows/inflows are direct components of pension asset and are not reflected in the governmental funds.	19,748
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Governmental funds do not reflect the change in accrued leave, but the Statement of Activities reflects the change in accrued leave through expenditures.	(6,959)
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Change in Net Position of Governmental Activities	\$ 73,502
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The accompanying notes are an integral part of the financial statements.

CITY OF CUSTER

**STATEMENT OF NET POSITION
 PROPRIETARY FUNDS
 DECEMBER 31, 2016**

	Water Fund	Sewer Fund	Solid Waste Fund	Total Proprietary Funds
Assets				
Current Assets				
101 Cash and Cash Equivalents (Note 2)	\$ 584,569	\$ 367,928	\$ 30,583	\$ 983,080
105 Investments (Note 2)	507,174	927,892	75,000	1,510,066
115 Accounts Receivable, Net	73,513	76,123	29,578	179,214
135 Interest Receivable	156	200	7	363
Total Current Assets	1,165,412	1,372,143	135,168	2,672,723
Noncurrent Assets				
107 Restricted Investments (Notes 3 and 7)	106,920	-	-	106,920
Capital Assets (Note 6)				
160 Land	54,482	91,913	-	146,395
162 Buildings	920,269	570,305	-	1,490,574
163 Accumulated Depreciation (AD) - Buildings	(542,907)	(346,988)	-	(889,895)
164 Improvements Other Than Buildings	7,876,053	6,309,611	-	14,185,664
165 AD - Improvements Other Than Buildings	(2,896,376)	(2,520,500)	-	(5,416,876)
166 Machinery and Equipment	379,333	1,173,760	-	1,553,093
167 AD - Machinery and Equipment	(328,790)	(830,461)	-	(1,159,251)
Total Noncurrent Assets	5,568,984	4,447,640	-	10,016,624
Total Assets	6,734,396	5,819,783	135,168	12,689,347
Deferred Outflows of Resources				
196 Pension Related Deferred Outflows (Note 8)	30,649	32,437	-	63,086
Total Assets and Deferred Outflows of Resources	\$ 6,765,045	\$ 5,852,220	\$ 135,168	\$ 12,752,433

	Water Fund	Sewer Fund	Solid Waste Fund	Total Proprietary Funds
Liabilities and Net Position				
Current Liabilities				
202 Accounts Payable	\$ 3,936	\$ 5,951	\$ 1,020	\$ 10,907
205 Current Portion of Long-Term Debt (Note 7)	31,526	36,833	-	68,359
215 Accrued Interest Payable	3,940	5,984	-	9,924
216 Accrued Wages	3,986	4,084	-	8,070
220 Customer Deposits	26,385	-	-	26,385
233 Accrued Leave Payable (Note 7)	39,247	39,500	-	78,747
Total Current Liabilities	109,020	92,352	1,020	202,392
Long-Term Liabilities				
237 Long-Term Debt, Net of Current Portion (Note 7)	1,803,294	812,749	-	2,616,043
239 Net Pension Liability (Note 8)	28,289	29,422	-	57,711
Total Long-Term Liabilities	1,831,583	842,171	-	2,673,754
Total Liabilities	1,940,603	934,523	1,020	2,876,146
Net Position				
253.1 Net Investment in Capital Assets	3,627,244	3,598,058	-	7,225,302
253.21 Restricted for Debt Service	106,920	-	-	106,920
235.29 Restricted for SDRS Pension (Note 8)	2,360	3,015	-	5,375
262.0 Unrestricted	1,087,918	1,316,624	134,148	2,538,690
Total Net Position	4,824,442	4,917,697	134,148	9,876,287
Total Liabilities and Net Position	\$ 6,765,045	\$ 5,852,220	\$ 135,168	\$ 12,752,433

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

CITY OF CUSTER

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
 PROPRIETARY FUNDS
 FOR THE YEAR ENDED DECEMBER 31, 2016**

	Water Fund	Sewer Fund	Solid Waste Fund	Total Proprietary Funds
Operating Revenue				
380 Charges for Goods and Services	\$ 639,203	\$ 553,888	\$ 189,441	\$ 1,382,532
Operating Expenses				
410 Personal Services	259,817	263,271	-	523,088
420 Other Current Expenses	188,157	149,180	164,260	501,597
457 Depreciation	214,923	277,848	-	492,771
Total Operating Expenses	662,897	690,299	164,260	1,517,456
Operating Income (Loss)	(23,694)	(136,411)	25,181	(134,924)
Non-Operating Income (Expense)				
361 Earnings on Deposits and Investments	3,734	4,648	190	8,572
470 Interest Expense	(82,216)	(25,909)	-	(108,125)
492 Gain (Loss) on Disposition of Assets for Transfer	3,900	(425,960)	-	(422,060)
Total Non-Operating Income (Expense)	(74,582)	(447,221)	190	(521,613)
Income before Contributions	(98,276)	(583,632)	25,371	(656,537)
391.07 Capital Contributions	8,220	-	-	8,220
Change in Net Position	(90,056)	(583,632)	25,371	(648,317)
Net Position - December 31, 2015	4,914,498	5,501,329	108,777	10,524,604
Net Position - December 31, 2016	\$ 4,824,442	\$ 4,917,697	\$ 134,148	\$ 9,876,287

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

CITY OF CUSTER

**STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2016**

	Water Fund	Sewer Fund	Solid Waste Fund	Total Proprietary Funds
Cash Flows from Operating Activities:				
Receipts from Customers	\$ 633,351	\$ 547,956	\$ 187,351	\$ 1,368,658
Payments to Suppliers	(184,513)	(149,061)	(164,175)	(497,749)
Payments to Employees	(227,273)	(229,756)	-	(457,029)
Net Cash Flows Provided by Operating Activities	221,565	169,139	23,176	413,880
Cash Flows from Capital and Related Financing Activities:				
Purchase of Capital Assets	(8,768)	(111,102)	-	(119,870)
Proceeds from Sale of Capital Assets	3,900	3,900	-	7,800
Principal Paid on Capital Debt	(425,531)	(35,748)	-	(461,279)
Interest Paid	(82,876)	(26,160)	-	(109,036)
Net Cash Flows Used in Capital and Related Financing Activities	(513,275)	(169,110)	-	(682,385)
Cash Flows Provided by Investing Activities:				
Interest Received	3,676	4,575	183	8,434
Change in Cash and Investments	(288,034)	4,604	23,359	(260,071)
Cash and Investments - December 31, 2015	1,486,697	1,291,216	82,224	2,860,137
Cash and Investments - December 31, 2016	\$ 1,198,663	\$ 1,295,820	\$ 105,583	\$ 2,600,066
Reconciliation of Operating Income to Net Cash Flows Provided by Operating Activities				
Operating Income (Loss)	\$ (23,694)	\$ (136,411)	\$ 25,181	\$ (134,924)
<i>Adjustments to Reconcile Operating Income (Loss) to Net Cash Flows Provided by Operating Activities:</i>				
Depreciation Expense	214,923	277,848	-	492,771
Change in Assets and Liabilities:				
Change in Receivables	(7,242)	(5,932)	(2,090)	(15,264)
Change in Pension Asset	17,737	18,747	-	36,484
Change in Pension Related Deferred Outflows	2,489	2,588	-	5,077
Change in Accounts Payable	3,644	119	85	3,848
Change in Accrued Wages	1,373	1,339	-	2,712
Change in Customer Deposits	1,390	-	-	1,390
Change in Accrued Leave Payable	8,827	9,080	-	17,907
Change in Pension Liability	28,289	29,422	-	57,711
Change in Pension Related Deferred Inflows	(26,171)	(27,661)	-	(53,832)
Net Cash Flows Provided by Operating Activities	\$ 221,565	\$ 169,139	\$ 23,176	\$ 413,880
Noncash Capital and Related Financing Activities				
Capital Assets Contributed	\$ 8,220	\$ -	\$ -	\$ 8,220
Gain (Loss) on Sale of Capital Assets for Transfer	3,900	(425,960)	-	(422,060)

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

CITY OF CUSTER

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies

a. Reporting Entity

The reporting entity of the City of Custer (the City), consists of the primary government (which includes all of the funds, organizations, institutions, agencies, departments, and offices that make up the legal entity, plus those funds for which the primary government has a fiduciary responsibility, even though those fiduciary funds may represent organizations that do not meet the criteria for inclusion in the financial reporting entity); those organizations for which the primary government is financially accountable; and other organizations for which the nature and significance of their relationship with the primary government are such that their exclusion would cause the financial reporting entity's financial statements to be misleading or incomplete.

b. Basis of Presentation

Government-wide Financial Statements:

The Statement of Net Position and Statement of Activities display information about the reporting entity as a whole. They include all funds of the reporting entity. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The Statement of Activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by recipients of goods and services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements:

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into two major categories: governmental and proprietary. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the City or it meets the following criteria:

1. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type, and
2. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined, or
3. Management has elected to classify one or more governmental or enterprise funds as major for consistency in reporting from year to year, or because of public interest in the fund's operations.

CITY OF CUSTER

NOTES TO FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies (Continued)

b. Basis of Presentation (Continued)

Fund Financial Statements (Continued):

The funds of the City financial reporting entity are described below:

Governmental Funds:

General Fund – the General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund. The General Fund is always considered to be a major fund.

Special Revenue Funds – special revenue funds are used to account for the proceeds of specific revenue sources (other than trusts for individuals, private organizations, or other governments or for major capital projects) that are legally restricted to expenditures for specified purposes.

Third Penny Sales Tax Fund – A fund allowed by SDCL 10-52-8 to be used for the purpose of land acquisition, architectural fees, construction costs, payments for civic center, auditorium or athletic facility buildings, including the maintenance, staffing and operations of such facilities, and the staffing and operation of the Custer Chamber of Commerce. This fund is a major fund.

Business Improvement District (BID) Fund – A fund allowed by SDCL 9-55 to account for a \$2 per night occupancy fee charged to motel guests. Motel operators determine how the proceeds are to be spent, usually on advertising to promote the city. This fund is a major fund.

Debt Service Funds – debt service funds are used to account for the accumulation of resources for, and the payment of general long-term debt principal, interest, and related cost. The City has the following debt service fund:

TIF Debt Service Fund – TIF funds are Tax Increment Financing Districts allowed by SDCL 11-9-24 to account for the proceeds of incremental property taxes, restricted for the payment of principal and interest on debt issued to finance a public improvement. Separate accounts are maintained for TIF District #1, #2, #4, and #5 revenues and expenditures. This fund is a major fund.

Permanent Funds – permanent funds are used to account for assets that are permanently set aside and from which only the income from its investments can be used for its stated legal purpose. The City has the following permanent fund:

Cemetery Perpetual Care Fund – A fund allowed by SDCL 9-31-18 to account for payments received for perpetual care of cemeteries. The payments are permanently set aside and only the income from the investments can be used for the care and maintenance of the cemetery. The Cemetery Perpetual Care Fund is a major fund.

Proprietary Funds:

Enterprise Funds – Enterprise funds are used to account for operations (a) 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 (b) 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.

CITY OF CUSTER

NOTES TO FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies (Continued)

b. Basis of Presentation (Concluded)

Fund Financial Statements (Concluded):

The City has the following enterprise funds:

Water Fund – A fund established by SDCL 9-47-1 to account for the operation of the City of Custer’s waterworks systems and related facilities and is financed primarily by user charges. The water fund is a major fund.

Sewer Fund – A fund established by SDCL 9-48-2 to account for the operation of the City of Custer’s sanitary sewer system and related facilities and is financed primarily by user charges. The sewer fund is a major fund.

Solid Waste Fund – A fund established by SDCL 9-32-11 and 34A-6 to account for the City of Custer’s collection and disposal of solid waste and is financed primarily by user charges. The solid waste collection fund is a major fund.

Fiduciary Funds:

Fiduciary fund types are used to account for assets held by a governmental unit in a trustee capacity or as an agent for individuals, private organizations, or other governmental units. Fiduciary funds are never considered major funds. The City has no fiduciary funds.

c. Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe how transactions are recorded within the various financial statements. Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus.

Measurement Focus:

Government-wide Financial Statements:

In the government-wide Statement of Net Position and Statement of Activities, both governmental and business-type activities are presented using the economic resources measurement focus, applied on the accrual basis of accounting.

Fund Financial Statements:

In the fund financial statements, the current financial resources measurement focus and the modified-accrual basis of accounting are applied to governmental fund types, while the economic resources measurement focus and the accrual basis of accounting are applied to the proprietary fund types.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

c. Measurement Focus and Basis of Accounting (Continued)

Basis of Accounting:

Government-wide Financial Statements:

In the government-wide Statement of Net Position and Statement of Activities, governmental and business-type activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues and related assets are recorded when earned (usually when the right to receive cash vests); and, expenses and related liabilities are recorded when an obligation is incurred (usually when the obligation to pay cash in the future vests).

Fund Financial Statements:

All governmental funds are accounted for using the modified-accrual basis of accounting. Their revenues, including property taxes, are recognized when they become measurable and available. Available means resources are collected or to be collected soon enough after the end of the fiscal year that they can be used to pay the bills of the current period. The accrual period does not exceed one bill-paying cycle, and for the City, the length of that cycle is 30 days. The revenues which are accrued at December 31, 2016, are property and sales tax.

d. Cash and Cash Equivalents

The City pools the cash and investment resources of its funds for cash management purposes. The proprietary funds essentially have access to the entire amount of cash and investment resources on hand. Accordingly, each proprietary fund's equity in the cash management pool, including restricted investments, is considered to be cash and cash equivalents for the purposes of the Statement of Cash Flows.

e. Capital Assets

Capital assets include land, buildings, machinery and equipment, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Infrastructure assets are long-lived capital assets that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets.

The accounting treatment over capital assets depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

Government-wide Financial Statements:

Capital assets are recorded at historical cost, or estimated cost, where actual cost could not be determined. Donated capital assets are valued at their estimated fair value on the donation date. Reported cost values include ancillary charges necessary to place the asset into its intended location and condition for use. Subsequent to initial capitalization, improvements or betterments that are significant and which extend the useful life of a capital asset are also capitalized.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

e. Capital Assets (Continued)

Government-wide Financial Statements (Continued):

Infrastructure assets used in general government operations, consisting of certain improvements other than buildings, including roads, bridges, sidewalks, drainage systems, and lighting systems, acquired prior to January 1, 2004, were not required to be capitalized by the City. Infrastructure assets acquired since January 1, 2004, are recorded at cost, and classified as Improvements Other Than Buildings.

Construction-period interest for capital assets used in governmental activities is not capitalized in accordance with USGAAP; however, construction period interest for capital assets used in business-type activities/proprietary fund's operations, is capitalized in accordance with USGAAP. There was no capitalized interest for the year ended December 31, 2016.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the government-wide Statement of Activities, with net capital assets reflected in the Statement of Net Position. Accumulated depreciation is reported on the government-wide Statement of Net Position and on each proprietary fund's Statement of Net Position.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods, and estimated useful lives of capital assets reported in the government-wide statements and proprietary funds are as follows:

	<u>Capitalization Threshold</u>	<u>Depreciation Method</u>	<u>Estimated Useful Life</u>
Land	\$ -0-	----N/A----	----N/A----
Improvements Other Than Buildings	\$ 5,000	Straight-line	15-100 years
Buildings	\$ 5,000	Straight-line	33-50 years
Machinery and Equipment	\$ 5,000	Straight-line	5-25 years

Land is an inexhaustible capital asset and is not depreciated.

Fund Financial Statements:

In the governmental fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the appropriate governmental fund upon acquisition. Capital assets used in proprietary fund operations are accounted for on the accrual basis, the same as in the government-wide statements.

f. Long-Term Liabilities

The accounting treatment of long-term liabilities depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

All long-term liabilities to be repaid from governmental and business-type resources are reported as liabilities in the government-wide statements. The long-term liabilities primarily consist of TIF obligations, water and sewer revenue bonds, compensated absences, and a net pension liability.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

f. Long-Term Liabilities (Continued)

In the governmental fund financial statements, debt proceeds are reported as revenues (other financing sources), while payments of principal and interest are reported as expenditures when they become due. The accounting for proprietary fund long-term debt is on the accrual basis for both the fund statements and the government-wide statements.

g. Program Revenues

Program revenues are derived directly from the program itself or from parties other than the City's taxpayers or citizenry, as a whole. Program revenues are classified into three categories, as follows:

1. Charges for services – arise from charges to customers, applicants, or others who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services.
2. Program-specific operating grants and contributions – arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals and are restricted for use in a particular program.
3. Program-specific capital grants and contributions – arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals and are restricted for the acquisition of capital assets for use in a particular program.

h. Proprietary Funds Revenue and Expense Classifications

In the proprietary fund's Statement of Activities, revenues and expenses are classified in a manner consistent with how they are classified in the Statement of Cash Flows. That is, transactions for which related cash flows are reported as capital and related financing activities, non-capital financing activities, or investing activities are not reported as components of operating revenues or expenses.

i. Equity Classifications

Government-wide Financial Statements:

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

1. Net Investment in Capital Assets – consists of capital assets, including restricted capital assets, net of accumulated depreciation (if applicable) and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
2. Restricted Net Position– consists of net position with constraints placed on their use either by (a) external groups such as creditors, grantors, contributors, or laws and regulations of other governments; or (b) laws through constitutional provisions or enabling legislation.
3. Unrestricted Net Position – all other net position that do not meet the definition of restricted or net investment in capital assets.

CITY OF CUSTER

NOTES TO FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies (Concluded)

i. Equity Classifications (Continued)

Fund Financial Statements:

The City classifies governmental fund balance as follows:

Nonspendable – includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.

Restricted – includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.

Committed – includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end. The City has one committed fund balance for the year ended December 31, 2016. The General Fund created a Capital Reserve Replacement by the City Council passing Ordinance #722. The commitment was established to set funds aside for future capital asset replacements exceeding a cost of \$30,000, up to a maximum commitment of \$250,000. The City Council is the highest decision-making authority and would have to pass an ordinance to remove the commitment.

Assigned – includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed. Fund balance may be assigned by the City Council, Mayor, or Finance Officer. The Hospital Sales Tax Subsidy was established by the City Council when it passed Resolution #02-01-16A and is assigned for future funds (\$347,000 per year, not to exceed \$4,000,000) to be set aside for the new Regional Health building.

Unassigned – includes positive fund balance within the General Fund which has not been classified within the above-mentioned categories and negative fund balances in other governmental funds.

With regard to the City's governmental funds, the City uses restricted amounts first when both restricted and unrestricted fund balances are available unless there are legal documents/contracts that prohibit doing this, such as a grant agreement requiring dollar-for-dollar spending. Additionally, the City would first use committed, then assigned, and lastly unassigned amounts of unrestricted fund balance when expenditures are made. The City does not have a formal minimum fund balance policy.

Proprietary fund equity is classified the same as in the government-wide financial statements. With regard to the City's proprietary funds, it is the City's policy to first use restricted net position, prior to the use of unrestricted net position, when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

j. Compensated Absences

Eligible employees earn sick leave and after ten years of employment are entitled to a payout percentage based on years of service upon termination. Eligible employees can earn vacation leave based on years of service, and will be paid upon termination, up to a maximum of 240 hours for end of year carry over.

k. Accounts Receivable

Included in utility accounts receivable at December 31, 2016, are unbilled accounts receivable totaling approximately \$45,000, \$40,000, and \$16,000 for the water, wastewater, and solid waste funds, respectively.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(2) Deposits and Investments

The City follows the practice of aggregating the cash assets of various funds to maximize cash management efficiency and returns. Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits – The City’s cash deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 9-22-6, 9-22-6.1 and 9-22-6.2, and may be in the form of demand or time deposits. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by Federal Home Loan Banks accompanied by written evidence of that bank’s public debt rating which may not be less than “AA”, or a qualified public depository may furnish a corporate surety bond of a corporation duly authorized to do business in South Dakota.

Investments – In General, SDCL 4-5-6 permits City funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly including, without limitation, United States treasury bills, notes, bonds, and other obligations issued or directly or indirectly guaranteed by the United States government, or otherwise directly or indirectly backed by the full faith and credit of the United States government; provided that, for other than permanent, trust, retirement, building, and depreciation reserve funds, such securities shall either mature within eighteen months from the date of purchase or be redeemable at the option of the holder within eighteen months from the date of purchase; or (b) repurchase agreements fully collateralized by securities described in (a) and meeting the requirements of § 4-5-9, if the repurchase agreements are entered into only with those primary reporting dealers that report to the Federal Reserve Bank of New York and with the one hundred largest United States commercial banks, as measured by domestic deposits; or (c) in shares of an open-end, no-load fund administered by an investment company registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933 and whose only investments are in securities described in (a) and repurchase agreements described in (b).

Also, SDCL 4-5-9 requires investments to be in the physical custody of the City or deposited with any bank or trust account designated by the City as its fiscal agent.

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

As of December 31, 2016, the City had the following investments:

Investment	Credit Rating	Maturity	Fair Value
Money Market	Unrated	N/A	\$ 237,299
U.S. Government Securities			
US Treasury Strips - 0%	AAA	3-6 years	863,045
US Treasury Notes - 0.75% - 1.375%	AAA	2-6 years	174,800
External Investment Pools:			
SDFIT	Unrated	N/A	177,223
			<u>1,452,367</u>
Nonnegotiable Certificates of Deposit			1,739,789
Total Investments			\$ 3,192,156

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(2) Deposits and Investments (Continued)

The South Dakota Public Fund Investment Trust (SDFIT) is an external investment pool created for South Dakota local government investing. It is regulated by a nine-member board with representation from municipalities, school districts, and counties. The net asset value of the SDFIT money market account (GCR) is kept at one dollar per share by adjusting the rate of return on a daily basis. Earnings are credited to each account on a monthly basis. SDFIT, as well as the U.S. Government Securities, are measured as level 2 recurring fair value measurements according to the fair value hierarchy.

Interest Rate Risk:

The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by structuring the portfolio to meet the cash requirements of ongoing operations, thereby mitigating the need to liquidate securities at a loss prior to maturity.

Credit Risk:

State law limits eligible investments for the City, as discussed above. The City has no investment policy that would further limit its investment choices.

Custodial Credit Risk:

The risk that, in the event of a depository failure, the City’s deposits may not be returned to it. The City has a policy to follow state law depository requirements. As of December 31, 2016, none of the City’s deposits were exposed to custodial credit risk. The bank balances at December 31, 2016 are as follows, excluding SDFIT, described below:

	<u>Bank Balance</u>
Insured - FDIC	\$ 1,250,000
Uninsured, collateralized in accordance with SDCL 4-6A-3	3,327,701
Total Deposits	\$ 4,577,701

Concentration of Credit Risk

The City does not allow more than 75 percent be invested in any one issuer. Additionally, investment maturities will be staggered in such a manner that all investments will not come due at the same time. Unless matched with specific cash flow, the City will not directly invest in securities maturing more than eight years from the date of purchase. The City only has cash, certificates of deposit, money market funds, and government securities.

State law allows income from deposits and investments to be credited to either the General Fund or the fund making the investment. The City’s policy is to credit all income from investments to the fund making the investment, except for the Cemetery Perpetual Care Fund income, which is credited to the General Fund as required by SDCL 9-32-18.

(3) Restricted Investments

Assets restricted to use for a specific purpose through segregation of balances in separate accounts are as follows:

<u>Amount</u>	<u>Purpose:</u>
\$106,920	Water Fund Debt Service, by debt covenants (Note 7)

(4) Deferred Inflows and Outflows of Resources

In addition to assets, the statement of net position reports a separate section for deferred outflows of resources. Deferred outflows of resources represent consumption of net position that applies to a future period or periods. These items will not be recognized as an outflow of resources until the applicable future period. Deferred outflows consist of pension activity.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(4) Deferred Inflows and Outflows of Resources (Continued)

In addition to liabilities, the statement of net position and governmental funds balance sheet report a separate section for deferred inflows of resources. Deferred inflows of resources represent acquisitions of net position that applies to a future period or periods. These items will not be recognized as an inflow of resources until the applicable future period. Deferred inflows of resources consist of property taxes on the governmental funds balance sheet.

(5) Property Taxes

Property taxes attach as an enforceable lien on property as of January 1 of each year. Taxes are levied on or before October 1 and payable in two installments before April 30 and October 31 of the following year. The county bills and collects the taxes and remits them to the City. The City is permitted by several state statutes to levy varying amounts of taxes per \$1,000 of taxable valuation on taxable real property in the City.

(6) Changes in Capital Assets

A summary of changes in capital assets for the year ending December 31, 2016 is as follows:

<i>Governmental Activities:</i>	Balance 12/31/2015	Additions	Transfers/ Deletions	Balance 12/31/2016
Capital Assets, not being Depreciated:				
Land	\$ 1,070,706	\$ -	\$ 342,272	\$ 1,412,978
Construction Work in Progress	380,047	326,007	-	706,054
Total Capital Assets, not being Depreciated	1,450,753	326,007	342,272	2,119,032
Capital Assets, being Depreciated:				
Buildings	1,978,550	-	-	1,978,550
Improvements Other Than Buildings	8,831,126	-	-	8,831,126
Machinery and Equipment	1,420,149	82,367	(51,027)	1,451,489
Total Capital Assets, being Depreciated	12,229,825	82,367	(51,027)	12,261,165
Less Accumulated Depreciation for:				
Buildings	531,460	38,130	-	569,590
Improvements Other Than Buildings	2,432,470	452,061	-	2,884,531
Machinery and Equipment	1,001,759	96,113	(51,027)	1,046,845
Total Accumulated Depreciation	3,965,689	586,304	(51,027)	4,500,966
Total Governmental Activities Capital Assets, being Depreciated, Net	8,264,136	(503,937)	-	7,760,199
Total Governmental Capital Assets, Net	\$ 9,714,889	\$ (177,930)	\$ 342,272	\$ 9,879,231

Depreciation expense was charged to functions as follows:

Public Works	\$ 437,050
Culture and Recreation	92,289
General Government	56,965
Total Depreciation Expense - Governmental	\$ 586,304

As of December 31, 2016, there are approximately \$61,000 of commitments associated with construction projects in progress. Completion of such projects will be funded through cash reserves.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(6) Changes in Capital Assets (Continued)

	Balance 12/31/2015	Additions	Transfers/ Deletions	Balance 12/31/2016
<i>Business-Type Activities:</i>				
Capital Assets, not being Depreciated:				
Land	\$ 568,035	\$ -	\$ (421,640)	\$ 146,395
Construction Work in Progress	19,018	102,335	(121,353)	-
Total Capital Assets, not being Depreciated	587,053	102,335	(542,993)	146,395
Capital Assets, being Depreciated:				
Buildings	1,473,024	-	17,550	1,490,574
Improvements Other Than Buildings	14,185,664	-	-	14,185,664
Machinery and Equipment	1,457,928	17,535	77,630	1,553,093
Total Capital Assets, being Depreciated	17,116,616	17,535	95,180	17,229,331
Less Accumulated Depreciation for:				
Buildings	859,726	30,169	-	889,895
Improvements Other Than Buildings	5,087,389	329,487	-	5,416,876
Machinery and Equipment	1,052,309	133,115	(26,173)	1,159,251
Total Accumulated Depreciation	6,999,424	492,771	(26,173)	7,466,022
Total Business-Type Activities Capital Assets, being Depreciated, Net				
	10,117,192	(475,236)	121,353	9,763,309
Total Business-Type Capital Assets, Net	\$ 10,704,245	\$ (372,901)	\$ (421,640)	\$ 9,909,704

Depreciation expense was charged to functions as follows:

Sewer	\$ 277,848
Water	214,923
Total Depreciation Expense - Business-Type	\$ 492,771

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(7) Long-Term Debt

The following is a summary of the long-term debt activity for the year ending December 31, 2016:

	Balance 12/31/2015	Earned/ Borrowings	Used/ Repayments	Balance 12/31/2016	Due Within One Year
Primary Government:					
Governmental Activities:					
TIF #1 - Boothill	\$ 665,465	\$ -	\$ -	\$ 665,465	\$ -
Accrued Interest - TIF #1	33,965	38,943	52,606	20,302	53,989
TIF #2 - Stonehill	1,569,901	-	-	1,569,901	-
Accrued Interest - TIF #2	680,526	137,807	64,049	754,284	55,333
TIF #4 - Downtown (2011 Bonds)	968,441	-	64,711	903,730	69,110
TIF #5 - Pamida	273,237	-	10,531	262,706	11,500
Compensated Absences	39,344	45,216	38,257	46,303	46,303
Total Governmental Activities	4,230,879	221,966	230,154	4,222,691	236,235
Business-Type Activities:					
2003 SRF Water Revenue Bond	394,981	-	394,981	-	-
2007 USDA Water Revenue Bond	1,865,370	-	30,550	1,834,820	31,526
2012 SRF Sewer Revenue Bond	885,330	-	35,748	849,582	36,833
Compensated Absences	60,840	52,793	34,886	78,747	78,747
	3,206,521	52,793	496,165	2,763,149	147,106
Total Primary Government	\$ 7,437,400	\$ 274,759	\$ 726,319	\$ 6,985,840	\$ 383,341

Tax Increment Financing Obligations

Tax increment financing is a method of financing improvements and development in an area which has been determined to be blighted according to the criteria set forth in SDCL 11-9. In some instances, the City pledges future tax revenues generated by the tax increment district to acquire public improvements within the established Tax Increment District which were constructed by a private developer.

It is a specific condition of the developer's agreement and a condition of the City's obligation that all sums payable shall be limited to the proceeds of the positive tax increment. It is also specifically agreed that the City has made no representation that the proceeds from such funds shall be sufficient to retire the indebtedness incurred by the developer to construct the public improvements.

During the year ended December 31, 2016, property tax revenues were \$49,612, \$64,049, \$108,863, and \$29,424 for TIFs #1, #2, #4, and #5, respectively. Interest expenditures, excluding corresponding accruals, related to TIF obligations totaled \$182,140 for the year ended December 31, 2016.

Business-type Activities

The City has pledged future revenues of the Water and Sewer Funds for the retirement of debt issues associated with those funds through the maturity dates listed below. All debt secured by pledged revenues funded capital projects and improvements. The current principal balance plus interest at the stated applicable rate over the life of the debt represents the amount of future revenue pledged.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(7) Long-Term Debt (Continued)

Business-type Activities (Continued)

Below is a comparison by fund of principal and interest payments and total pledged revenue for the current year.

	<u>Water Fund</u>	<u>Sewer Fund</u>
Current Year Principal and Interest (Including Early Pay-off of 2003 Bonds)	\$ 507,747	\$ 61,657
Pledged Revenue	639,203	553,888

Long-term debt at December 31, 2016, is comprised of the following:

Revenue Bonds

2007 USDA Water Loan, matures in January 2047, interest at 4.13 percent, due in monthly installments of \$8,910. Financed through the Water Fund. \$ 1,834,820

Series 2012 SRF Sewer Revenue Bonds, matures in July 2034, interest at 3.00 percent, due in quarterly installments of \$15,477. Financed through the Sewer Fund. 849,582

Total Revenue Bonds 2,684,402

Tax Increment Financing Obligations

TIF #1, including interest at 6.00 percent, due in varying semi-annual installments of incremental property taxes collected through 2018. Partial interest payments only were paid in 2016. Financed through the TIF Debt Service Fund. 665,465

TIF #2, including interest at 9.00 percent, due in varying installments within 30 days of property tax collection from the county through 2023. Partial interest payments only were paid in 2016. Financed through the TIF Debt Service Fund. 1,569,901

TIF #4, Series 2011, including variable interest at not less than 4.50 percent, and not to exceed 7.00 percent, due in semi-annual installments of \$56,903 through 2027. Financed through the TIF Debt Service Fund. 903,730

TIF #5, including interest at 7.00 percent, due in varying semi-annual installments of incremental property taxes collected through 2021. Financed through the TIF Debt Service Fund. 262,706

Total Tax Increment Financing Obligations 3,401,802

Compensated Absences

General Fund 46,303

Water Fund 39,247

Sewer Fund 39,500

Total Compensated Absences 125,050

Accrued Interest (TIFs #1 and #2) 774,586

Total Long-Term Debt \$ 6,985,840

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(7) Long-Term Debt (Concluded)

The annual requirements to amortize long-term debt outstanding as of December 31, 2016, except for compensated absences and accrued interest on TIFs #1 and #2, are as follows:

	Revenue Bonds		TIF Obligations		Total	
	Interest	Principal	Interest	Principal	Interest	Principal
2017	\$ 100,478	\$ 68,359	\$ 170,412	\$ 80,610	\$ 270,890	\$ 148,969
2018	98,034	70,803	154,558	748,558	252,592	819,361
2019	95,499	73,338	109,528	87,505	205,027	160,843
2020	92,872	75,965	105,021	92,012	197,893	167,977
2021	90,148	78,689	99,984	97,049	190,132	175,738
2022-2026	431,087	437,950	1,820,933	2,205,553	2,252,020	2,643,503
2027-2031	321,368	522,817	-	90,515	321,368	613,332
2032-2036	223,807	481,083	-	-	223,807	481,083
2037-2041	143,530	391,113	-	-	143,530	391,113
2042-2046	53,992	480,651	-	-	53,992	480,651
2047	31	3,634	-	-	31	3,634
Total	\$ 1,650,846	\$ 2,684,402	\$ 2,460,436	\$ 3,401,802	\$ 4,111,282	\$ 6,086,204

(a) TIF Obligation maturities are based on projected future property tax increments. Actual repayments will vary dependent on property tax increments received.

The City has bond reserves of \$106,920 at December 31, 2016, in accordance with debt covenants on the 2007 USDA Water Revenue bonds. Additionally, the 2012 SRF Sewer Revenue bonds have a covenant requiring the City to keep net sewer revenue available for debt service at 110 percent of debt service expenses each year. The City is in compliance with such covenant at December 31, 2016.

(8) Pension Plan

All employees, working more than 20 hours per week during the year, participate in the SDRS, a cost sharing, multiple employer defined benefit pension plan administered by SDRS to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability, and survivors' benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in SDCL 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained at <http://www.sdrs.sd.gov/publications/> or by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

Benefits Provided:

SDRS has three different classes of employees, Class A, Class B public safety and Class B judicial. Class A retirement benefits are determined as 1.7 percent prior to 2008 and 1.55 percent thereafter of the employee's final 3-year average compensation times the employee's years of service. Employees with 3 years of service are eligible to retire at age 55. Class B public safety benefits are determined as 2.4 percent for service prior to 2008 and 2.0 percent thereafter of employee final average compensation. Class B judicial benefits are determined as 3.733 percent for service prior to 2008 and 3.333 percent thereafter of employee final average compensation. All Class B employees with 3 years of service are eligible to retire at age 45. Employees are eligible for service-related disability benefits regardless of length of service. Three years of service is required for nonservice-related disability eligibility. Disability benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits are a percent of the employee's final average salary.

CITY OF CUSTER

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(8) Pension Plan (Continued)

The annual increase in the amount of the SDRS benefits payable on each July 1st is indexed to the consumer price index (CPI) based on SDRS funded status:

- If the SDRS market value funded ratio is 100% or more - 3.1% COLA
- If the SDRS market value funded ratio is 80.0% to 99.9%, index with the CPI
 - 90.0% to 99.9% funded - 2.1% minimum and 2.8% maximum COLA
 - 80.0% to 90.0% funded - 2.1% minimum and 2.4% maximum COLA
- If the SDRS market value funded ratio is less than 80% - 2.1% COLA

All benefits except those depending on the Member’s Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

Contributions:

Per SDCL 3-12, contribution requirements of the active employees and the participating employers are established and may be amended by the SDRS Board. Covered employees are required by state statute to contribute the following percentages of their salary to the plan; Class A Members, 6.0 percent of salary; Class B Judicial Members, 9.0 percent of salary; and Class B Public Safety Members, 8.0 percent of salary. State statute also requires the employer to contribute an amount equal to the employee’s contribution. State statute also requires the employer to make an additional contribution in the amount of 6.2 percent for any compensation exceeding the maximum taxable amount for social security for general employees only. The City’s share of contributions to the SDRS for the fiscal years ended December 31, 2016, 2015, and 2014 were **\$38,826**, \$38,488, and \$37,180, respectively, equal to the required contributions each year.

Pension Assets (Liabilities), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources to Pensions:

At June 30, 2016, SDRS is 96.89 percent funded and accordingly has a net pension liability. The proportionate shares of the components of the net pension liability of South Dakota Retirement System, for the City as of June 30, 2016 are as follows:

	Governmental Activities	Business-Type Activities	Total
Proportionate Share of Net Position Restricted for Pension Benefits	\$ 1,744,307	\$ 1,796,203	\$ 3,540,510
Less: Proportionate Share of Total Pension Liability	(1,800,351)	(1,853,914)	(3,654,265)
Proportionate Share of Net Pension Liability	\$ (56,044)	\$ (57,711)	\$ (113,755)

At December 31, 2016, the City reported a liability of (\$113,755) for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016 and the total pension liability used to calculate the net pension liability was based on a projection of the City’s share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2016, the City’s proportion was .0336760 percent, which is an increase of .000196 percent from its proportion measured as of June 30, 2015.

**CITY OF CUSTER
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(8) Pension Plan (Continued)

For the year ended December 31, 2016, the City recognized pension expense of \$96,321. At December 31, 2016, the City reported deferred outflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between Expected and Actual Experience	\$ 39,600	\$ -
Changes in Assumption	68,133	-
Net Difference between Projected and Actual Earnings on Pension Plan Investments	127,870	-
Changes in Proportion and Difference between City Contributions and Proportionate Share of Contributions	-	-
City Contributions Subsequent to the Measurement Date	19,686	-
Total	\$ 255,289	\$ -

Deferred outflow of resources includes \$19,686 resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense (revenue) as follows:

2017	\$ 63,213
2018	38,237
2019	80,121
2020	54,032
	\$ 235,603

Actuarial Assumptions:

The total pension liability in the June 30, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25 percent
Salary Increases	5.83 percent at entry to 3.87 percent after 30 years of service
Investment Rate of Return	7.25 percent through 2017 and 7.50 percent thereafter, net of pension plan investment expense

Mortality rates were based on the RP-2000 Employee Mortality Table for males and females, as appropriate.

The actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2005 through June 30, 2011. The mortality assumptions were revised based on an extension of the experience study including mortality experience through June 30, 2013.

**CITY OF CUSTER
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(8) Pension Plan (Concluded)

Actuarial Assumptions (Continued):

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. SDIC is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current SDIC investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016 (see the discussion of the pension plan's investment policy) are summarized in the following table using geometric means:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global Equity	58.0%	4.8%
Fixed Income	30.0%	1.8%
Real Estate	10.0%	4.6%
Cash	2.0%	0.7%
	<u>100.0%</u>	

Discount Rate:

The discount rate used to measure the total pension liability was 7.25 percent through 2017 and 7.50 percent thereafter. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that matching employer contributions will be made at rates equal to the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of Asset to Changes in the Discount Rate:

The following presents the City's proportionate share of net pension liability calculated using the discount rate of 7.25 percent through 2017 and 7.50 percent thereafter, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.25/6.50 percent) or 1-percentage point higher (8.25/8.50 percent) than the current rate:

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
City's Proportionate Share of the Net Pension Liability	\$ (636,567)	\$ (113,755)	\$ (312,656)

Pension Plan Fiduciary Net Position:

Detailed information about the plan's fiduciary net position is available in the separately issued SDRS financial report.

**CITY OF CUSTER
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(9) Risk Management

The City is exposed to various risks of loss related to torts; theft; damage or destruction of assets; errors or omissions; injuries to employees; and natural disasters. During the year ending December 31, 2016, the City managed its risks as follows:

Employee Health Insurance:

The City purchases health insurance for its employees from a commercial insurance carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

Liability Insurance:

The City joined the South Dakota Public Assurance Alliance (SDPAA), a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The objective of the SDPAA is to administer and provide risk management services and risk sharing facilities to the members and to defend and protect the members against liability, to advise members on loss control guidelines and procedures, and provide them with risk management services, loss control and risk reduction information and to obtain lower costs for that coverage. The City's responsibility is to promptly report to and cooperate with the SDPAA to resolve any incident which could result in a claim being made by or against the City. The City pays an annual premium to provide general liability, automobile liability, and officials' liability.

The agreement with the SDPAA provides that the above coverages will be provided to a \$2,000,000 limit. Member premiums are used by the pool for payment of claims and to pay for reinsurance for claims in excess of \$250,000 for property coverage and \$500,000 for liability coverage to the upper limit. A portion of the member premiums are also allocated to a cumulative reserve fund. The City would be eligible to receive a refund for a percentage of the amount allocated to the cumulative reserve fund on the following basis:

End of City's First Full Year	50%
End of City's Second Full Year	60%
End of City's Third Full Year	70%
End of City's Fourth Full Year	80%
End of City's Fifth Full Year	90%
End of City's Sixth Full Year and Thereafter	100%

As of December 31, 2016, the City has a vested balance in the cumulative reserve fund of **\$32,595**.

The City does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have not exceeded the liability coverage over the past three years.

**CITY OF CUSTER
NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)
DECEMBER 31, 2016**

(9) Risk Management (Continued)

Worker's Compensation:

The City joined the South Dakota Municipal League Worker's Compensation Fund (the Fund), a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The objective of the Fund is to formulate, develop, and administer, on behalf of member organizations, a program of worker's compensation coverage, to obtain lower costs for that coverage, and to develop a comprehensive loss control program. The City's responsibility is to initiate and maintain a safety program to give its employees safe and sanitary working conditions and to promptly report to and cooperate with the Fund to resolve any worker's compensation claims. The City pays an annual premium to the pool to provide worker's compensation coverage for its employees, under a self-funded program, and the premiums are accrued based on the ultimate cost of the experience to date of the Fund members. Coverage limits are set by state statute. The pool pays the first \$650,000 of any claim per individual. The pool has reinsurance which covers up to statutory limits in addition to a separate combined employer liability of \$2,000,000 per incident.

The City does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have not exceeded the liability coverage over the past three years.

Unemployment Benefits:

The City provides coverage for unemployment benefits by paying into the Unemployment Compensation Fund established by state law and managed by the State of South Dakota.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF CUSTER

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND - BUDGETARY BASIS
FOR THE YEAR ENDED DECEMBER 31, 2016**

Revenue	Original Budget	Final Budget	Actual - Budgetary Basis	Variance
<i>Taxes:</i>				
311 General Property Taxes	\$ 836,373	\$ 836,373	\$ 852,628	\$ 16,255
313 General Sales and Use Taxes	1,387,500	1,387,500	1,469,229	81,729
315 Amusement Taxes	500	500	480	(20)
319 Penalties and Interest on Delinquent Taxes	3,500	3,500	1,935	(1,565)
320 Licenses and Permits	47,350	47,350	61,330	13,980
<i>Intergovernmental Revenue:</i>				
<i>State Shared Revenue:</i>				
334 State Grant	-	10,000	10,000	-
335.01 Bank Franchise Tax	1,800	1,800	2,867	1,067
335.02 Motor Vehicle Commercial Prorate	5,500	5,500	-	(5,500)
335.03 Liquor Tax Reversion	12,500	12,500	13,480	980
335.04 Motor Vehicle Licenses (5%)	30,000	30,000	38,683	8,683
335.08 Local Government Highway and Bridge Fund	31,000	31,000	31,862	862
<i>County Shared Revenue:</i>				
338.02 County HBR Tax	-	-	8,792	8,792
<i>Charges for Goods and Services:</i>				
341 General Government	7,100	7,100	8,776	1,676
346 Culture and Recreation	13,500	13,500	11,982	(1,518)
348 Cemeteries	3,000	3,000	5,300	2,300
350 Fines and Forfeits	400	400	1,724	1,324
352 Animal Control Fines	1,100	1,100	-	(1,100)
<i>Miscellaneous Revenue:</i>				
361 Earnings on Deposits and Investments	7,000	7,000	12,323	5,323
362 Rentals	4,820	4,820	8,570	3,750
367 Contributions and Donations	-	-	1,806	1,806
368 Liquor Operating Agreement Income	190,000	190,000	191,200	1,200
369 Other	19,000	19,000	5,417	(13,583)
Total Revenue	2,601,943	2,611,943	2,738,384	126,441

CITY OF CUSTER

**BUDGETARY COMPARISON SCHEDULE (CONTINUED)
GENERAL FUND - BUDGETARY BASIS
FOR THE YEAR ENDED DECEMBER 31, 2016**

	Original Budget	Final Budget	Actual - Budgetary Basis	Variance
Expenditures				
<i>General Government:</i>				
411 Legislative	122,590	122,590	85,211	37,379
413 Elections	1,200	1,200	20	1,180
414 Financial Administration	152,340	153,340	146,430	6,910
419 Other	385,855	484,555	361,094	123,461
<i>Public Safety:</i>				
421 Police	581,800	581,800	328,867	252,933
<i>Public Works:</i>				
431 Highways and Streets	1,183,180	1,145,080	616,798	528,282
437 Cemeteries	29,310	29,310	27,503	1,807
<i>Health and Welfare:</i>				
444 Humane Society	10,330	10,330	9,740	590
447 Hospitals, Nursing Homes, and Rest Homes	1,041,000	1,041,000	1,041,000	-
<i>Culture and Recreation:</i>				
451 Custer Cruisin'	13,500	15,000	14,292	708
451 Swimming	52,000	61,500	42,278	19,222
452 Parks	190,750	196,825	117,234	79,591
<i>Conservation and Development:</i>				
465 Economic Development and Assistance	91,000	101,000	97,000	4,000
Total Expenditures	3,854,855	3,943,530	2,887,467	1,056,063
Other Financing Sources				
391 Sale of Capital Assets	-	-	22,012	22,012
391 Compensation for Loss or Damage to Capital Assets	-	-	6,742	6,742
Total Other Financing Sources	-	-	28,754	28,754
Net Change in Fund Balance	(1,252,912)	(1,331,587)	(120,329)	1,211,258
Fund Balance - December 31, 2015	3,552,883	3,552,883	3,552,883	-
Fund Balance - December 31, 2016	\$ 2,299,971	\$ 2,221,296	\$ 3,432,554	\$ 1,211,258

The accompanying notes to required supplementary information are an integral part of this statement.

CITY OF CUSTER

**BUDGETARY COMPARISON SCHEDULE
THIRD PENNY (PROMOTION) FUND - BUDGETARY BASIS
FOR THE YEAR ENDED DECEMBER 31, 2016**

	Original Budget	Final Budget	Actual - Budgetary Basis	Variance
Revenue				
<i>Taxes:</i>				
313 General Sales and Use Taxes	\$ 205,000	\$ 238,500	\$ 243,473	\$ 4,973
<i>Miscellaneous Revenue:</i>				
361 Investment Earnings	200	200	207	7
Total Revenue	205,200	238,700	243,680	4,980
Expenditures				
<i>Conservation and Development:</i>				
465 Economic Development and Assistance	205,200	238,700	230,235	8,465
Net Change in Fund Balance	-	-	13,445	13,445
Fund Balance - December 31, 2015	92,447	92,447	92,447	-
Fund Balance - December 31, 2016	\$ 92,447	\$ 92,447	\$ 105,892	\$ 13,445

The accompanying notes to required supplementary information are an integral part of this statement.

CITY OF CUSTER

**BUDGETARY COMPARISON SCHEDULE
 BID DISTRICT FUND - BUDGETARY BASIS
 FOR THE YEAR ENDED DECEMBER 31, 2016**

	Original Budget	Final Budget	Actual - Budgetary Basis	Variance
Revenue				
<i>Taxes:</i>				
313 General Sales and Use Taxes	\$ 148,000	\$ 153,000	\$ 168,444	\$ 15,444
Expenditures				
<i>Conservation and Development:</i>				
465 Economic Development and Assistance	148,000	153,000	148,734	4,266
Net Change in Fund Balance	-	-	19,710	19,710
Fund Balance - December 31, 2015	52,841	52,841	52,841	-
Fund Balance - December 31, 2016	\$ 52,841	\$ 52,841	\$ 72,551	\$ 19,710

The accompanying notes to required supplementary information are an integral part of this statement.

CITY OF CUSTER

**SCHEDULE OF THE CITY'S PROPORTIONATE SHARE OF THE NET PENSION ASSET (LIABILITY)
DECEMBER 31, 2016**

	<u>2016</u>	<u>2015</u>
City's Proportion of the Net Pension Asset (Liability)	0.03367600%	0.03348000%
City's Proportionate Share of Net Pension Asset (Liability)	\$ (113,755)	\$ 141,998
City's Covered-Employee Payroll (Plan's Fiscal Year)	\$ 641,667	\$ 635,252
City's Proportionate Share of the Net Pension Asset (Liability) as a Percentage of its Covered-Employee Payroll	-17.73%	22.35%
Plan Fiduciary Net Position as a Percentage of the Total Pension Asset (Liability)	96.89%	104.10%

CITY OF CUSTER

**SCHEDULE OF THE CITY'S PENSION CONTRIBUTIONS
DECEMBER 31, 2016**

	<u>2016</u>	<u>2015</u>
Contractually Required Contribution	\$ 38,826	\$ 38,488
Contributions in Relation to the Contractually Required Contribution	<u>38,826</u>	<u>38,488</u>
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>
City's Covered-Employee Payroll (Calendar Year)	\$ 647,098	\$ 641,477
Contributions as a Percentage of Covered- Employee Payroll	6.0%	6.0%

CITY OF CUSTER

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION DECEMBER 31, 2016

(1) Budgets and Budgetary Accounting

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. At the first regular board meeting in September of each year or within ten days thereafter, the governing board introduces the annual appropriation ordinance for the ensuing fiscal year.
2. After adoption by the governing board, the operating budget is legally binding and actual disbursements for each purpose cannot exceed the amounts budgeted, except as indicated in item number four.
3. A line item for contingencies may be included in the annual budget. Such a line item may not exceed five percent of the total municipal budget and may be transferred by resolution of the governing board to any other budget category that is deemed insufficient during the year.
4. If it is determined during the year that sufficient amounts have not been budgeted, state statute allows the adoption of supplemental budgets.
5. Unexpended appropriations lapse at year-end unless encumbered by resolution of the governing board.
6. The City did not encumber any amounts at December 31, 2016.
7. Formal budgetary integration is employed as a management control device during the year for the general fund and major special revenue funds.
8. Budgets for the general fund and major special revenue funds are adopted on a basis consistent with the modified-cash basis of accounting, except for the following:

The financial statements prepared in conformity with USGAAP present capital outlay expenditure information in a separate category of expenditures. Under the budgetary basis of accounting, capital outlay expenditures are reported within the function to which they relate. For example, the purchase of a new vehicle would be reported as a capital outlay expenditure on the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances; however, in the Budgetary RSI Schedule, the purchase of that vehicle would be reported as an expenditure of the Public Safety function of government, along with all other current Public Safety related expenditures.

OTHER REPORTS



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

City Council
City of Custer
Custer, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, and each major fund of City of Custer (the City) as of and for the year ended December 31, 2016 and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated May 1, 2017.

Internal Control over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and a significant deficiency.

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 City's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings as #2016-001 and #2016-002 to be material weaknesses.

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. We consider the deficiency described in the accompanying Schedule of Findings as #2016-003 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City'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 matter that is required to be reported under *Government Auditing Standard*.

City Council

City's Response to Findings

The City's response to the findings identified in our audit is described in the accompanying Corrective Action Plan. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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 City'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 City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, as required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



KETEL THORSTENSON, LLP
Certified Public Accountants

May 1, 2017

CITY OF CUSTER

**SCHEDULE OF FINDINGS
DECEMBER 31, 2016**

Current Year Audit Findings and Recommendations

MATERIAL WEAKNESSES

#2016-001 FINDING: Financial Statement Preparation

Condition and Cause: We were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Auditing standards require auditors to communicate this situation to the City Council as an internal control deficiency. Ultimately, it is management's responsibility to provide for the preparation of the City's statements and footnotes, and the responsibility of the auditor to determine the fairness and presentation of those statements. From a practical standpoint, we do both for the City at the same time in connection with our audit. This is not unusual for municipalities of your size.

Criteria and Effect: It is our responsibility to inform the City Council that this deficiency could result in a material misstatement to the financial statements that would not have been prevented or detected by the City's management.

Recommendation: As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for their accuracy; we have answered any questions they might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification and disclosure in the City's financial statements. We are satisfied that the appropriate steps have been taken to provide the City with the completed financial statements. It is the responsibility of management and the City Council to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

Views of Responsible Officials: See City's Corrective Action Plan.

#2016-002 FINDING: Audit Adjustments

Condition and Cause: During the course of the engagement, we proposed material audit adjustments. Additionally, other entries were proposed as a part of the audit, but were not recorded due to the overall insignificance on the financial statements.

Criteria and Effect: These adjustments would not have been identified as a result of the City's existing internal controls, and therefore, could have resulted in a material misstatement of the City's financial statements.

Recommendation: We recommend the following:

- When transferring capital assets between funds, do not record the transfer against net position. Rather, if the enterprise fund is receiving the assets, record them as capital contribution revenue. If the enterprise fund is transferring the assets, record the transfer as non-operating expense. Then, the transaction will be presented as a transfer on the Statement of Activities.
- When recording pension activity, cash should not be affected. Additionally, review the General Capital Asset and Long-Term Debt funds and verify no cash accounts were erroneously created.

Views of Responsible Officials: See City's Corrective Action Plan.

CITY OF CUSTER

**SCHEDULE OF FINDINGS (CONTINUED)
DECEMBER 31, 2016**

Current Year Audit Findings and Recommendations (Continued)

SIGNIFICANT DEFICIENCY

#2015-003 FINDING: Controls over Payroll

Condition and Cause: Through our payroll testing process, we noted an employee within public works was paid at a rate of \$0.30 per hour greater than the approved rate. Total overpayment was approximately \$700. This increased pay rate was due to the employee taking on more responsibilities with turnover in another position. The increased pay rate was not changed back or reviewed in comparison to the approved pay rate throughout the rest of the year.

Criteria and Effect: This error was not caught in a timely manner by the City's existing internal controls, and therefore, resulted in an overpayment for a majority of the year to this employee. This was the only instance noted in our testing of the payroll process.

Recommendation: The Finance Officer should review approved pay rates prior to payment of payroll.

Views of Responsible Officials: See City's Corrective Action Plan.

CITY OF CUSTER

**STATUS OF PRIOR FINDINGS
DECEMBER 31, 2016**

#2015-001 FINDING: Financial Statement Preparation

The City has accepted the risk associated with Finding #2015-001 regarding the preparation of the financial statements. The finding, originally issued years ago, is repeated Finding #2016-001 in the Schedule of Findings. The finding will continue to be repeated due to the City accepting the risk associated with such finding.

#2015-002 FINDING: Audit Adjustments

Although Finding #2015-002 will be repeated as Finding #2016-002, it's due to different journal entries in the current year. See Corrective Action Plan.

#2015-003 FINDING: Compliance with Debt Covenants

The City is in compliance with the debt covenant for the 2012 Sewer Revenue Bonds that require revenues of the sewer fund to be at least 110 percent of debt service requirements as of December 31, 2016. Thus, Finding #2015-003 will not be repeated.

CITY OF CUSTER

**CORRECTIVE ACTION PLAN
DECEMBER 31, 2016**

#2016-001 FINDING: Financial Statement Preparation

The City has accepted the risk associated with Finding #2016-001 regarding the preparation of the financial statements which was originally issued years ago. The Finance Officer, Laurie Woodward, is responsible for the corrective action plan for this finding, and there is no anticipated completion date.

#2016-002 FINDING: Internal Control over Significant Accounts

The year-end process is cumbersome and with the quick turnaround with the audit timeframe, sometimes things are not caught by staff until the documents have been sent to the auditors and sometimes things are overlooked. The Finance Officer, Laurie Woodward, is responsible for the corrective action plan for this finding. She will try to pay closer attention to all the details when doing the year-end entries, especially those entries that are not routinely made.

#2016-003 FINDING: Controls over Payroll

This error was the result of a transposed number being entered into the payroll software. The error was caught by the Finance Officer while doing the preparation work for the audit. The Finance Officer, Laurie Woodward, and Deputy Finance Officer, Lisa Trana, will check the entries more carefully to try and avoid errors. In addition, payroll analytical will be done on a more regular basis versus annually before the audit.