

TOWN OF HERMOSA, SOUTH DAKOTA

INDEPENDENT AUDITOR'S REPORT,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

DECEMBER 31, 2016

CASEY  PETERSON
Leading the Way.

RAPID CITY, SOUTH DAKOTA
GILLETTE, WYOMING

Town of Hermosa, South Dakota
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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*

Town Board of Trustees
Town of Hermosa, South Dakota
Hermosa, 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 modified cash basis financial statements of the governmental activities, the business-type activities, and each major fund of the Town of Hermosa, South Dakota, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Town of Hermosa, South Dakota's basic financial statements and have issued our report thereon dated August 18, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Town of Hermosa, South Dakota'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 Town of Hermosa, South Dakota's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town of Hermosa, South Dakota'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 and management's responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and management's responses as items 2016-001 through 2016-003 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 deficiencies described in the accompanying schedule of findings and management's responses as items 2016-004 and 2016-005 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Town of Hermosa, South Dakota'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 instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards* and which are described in the accompanying schedule of findings and management's response as 2015-003 through 2016-005.

Town of Hermosa, South Dakota's Response to Findings

The Town of Hermosa, South Dakota's response to the findings identified in our audit is described in the accompanying schedule of findings and management's responses. The Town of Hermosa, South Dakota's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Casey Peterson, Ltd.

Rapid City, South Dakota
August 18, 2017

Town of Hermosa, South Dakota
Schedule of Findings and Management's Responses
December 31, 2016

Material Weakness

Internal Controls Related to Drafting Financial Statements

2016-001 *Condition:* The small size of the Town limits the ability of the Finance Office to prepare financial statements being audited.

Criteria: The Town should have an internal control system designed to provide for drafting the financial statements being audited.

Cause: The Town Office has a small staff size and there is a limited number of people in the Town's governance with an accounting background.

Effect: The Town engages their auditor to draft the financial statements and the notes to the financial statements.

Auditor's Recommendation: It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with the Town's auditors drafting the financial statements because of cost or other considerations. If the Town chooses not to accept this risk, training should be provided to those employees responsible for drafting the financial statements and related notes.

Management's Response: The Town accepts the risk related to hiring the auditors to prepare the financial statements and notes to the financial statements.

Material Weakness

Internal Controls Related Reviewing Journal Entries and Adequate Segregation of Duties

2016-002 *Condition:* The lack of accounting experience among the few staff members does not allow the Town to perform oversight over adjusting journal entries as well as separate incompatible accounting functions or processes which would be necessary under a properly designed system of internal controls.

Criteria: The Town should have safeguards in place to separate accounting functions which is fundamental in a good system of internal controls. Adjusting entries should be reviewed by someone other than the individual responsible for their preparation.

Cause: The Town office has a small staff size and there is a limited number of people in the Town's governance with an accounting background.

Effect: The Finance Officer performs adjusting journal entries and other functions with limited oversight. The possibility of fraud or errors occurring and not being detected or corrected is present. There is a potential that intentional or unintentional errors could be made and not be detected.

Auditor's Recommendation: It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with Finance Officer posting entries without proper oversight, because of cost or other considerations. The Town Board of Trustees should review all journal entries on a regular basis to safeguard against risks. The Town Board should hire additional staff to remediate having individual staff persons perform processes and functions that should be separated.

Management's Response: The Town has hired another staff person and the former Finance Officer is now the Town Trustee which will help improve oversight of accounting functions.

Town of Hermosa, South Dakota
Schedule of Findings and Management's Responses
December 31, 2016

Material Weakness - Internal Control over Compliance with State Statute
Noncompliance

2016-003 *Condition:* The Town did not legally adopt a budget for the FEMA Special Revenue Fund as required by state statute.

Criteria: The Town must budget for each major fund and legally adopt and publish the legally adopted budget in accordance with SDCL 9-21-2.

Cause: Lack of oversight during audit year as well as the Town's inexperience with the new project that was undertaken.

Effect: The Town failed to budget for a major fund required as by state statute.

Recommendation: The Town should consult with a third party to determine if they are complying with budgetary requirements.

Management's Response: The Town Board agrees with the finding and related recommendations. The Town will adopt a supplemental budget for the FEMA Fund for Fiscal Year 2017.

Significant Deficiency - Internal Control over Compliance with State Statute
Noncompliance

2016-004 *Condition:* We noted an instance of wage increases not being published in the Board minutes. The total was published once during the year, but wage changes, new contracts and employee names were not published.

Criteria: The Town should have an internal control system designed to verify that any officer or employee who has been added or whose salary has increased is published per SDCL 6-1-10.

Cause: The Town did not publish increased wages in a timely manner.

Effect: Although immaterial to the financial statements, this is a non-compliance issue with South Dakota Codified Law.

Auditor's Recommendation: We recommend that the Town review statutory requirements concerning this issue.

Management's Response: Management will review the requirements and implement procedures to verify the requirements are met.

Significant Deficiency - Internal Control over Compliance with State Statute
Noncompliance

2016-005 *Condition:* We noted that utility billing adjustments were not being reviewed by Board members.

Criteria: The Town must have approval by the Board before uncollectables are removed from the records in accordance with SDCL 9-22-4.

Cause: The Town was unaware of the state statute requiring this process.

Effect: The Town did not obtain Board approval of utility adjustments required by state statute.

Town of Hermosa, South Dakota
Schedule of Findings and Management's Responses
December 31, 2016

Recommendation: The Town should have the Board approve all utility adjustments.

Management's Response: The Council agrees with the finding and related recommendations. The Town will set up a tracking system for all utility billing adjustments and have board member sign off after review of all adjustments.

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Independent Auditor's Report

Town Board of Trustees
Town of Hermosa, South Dakota
Hermosa, South Dakota

Report on the Financial Statements

We have audited the accompanying modified cash basis financial statements of the governmental activities, the business-type activities, and each major fund of the Town of Hermosa, South Dakota, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Town'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 the modified cash basis of accounting described in Note 1; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for 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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Town'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 - modified cash basis of the governmental activities, the business-type activities, and each major fund of the Town of Hermosa, South Dakota, as of December 31, 2016, and the respective changes in financial position - modified cash basis for the year then ended in accordance with the basis of accounting described in Note 1.

Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

Disclaimer of Opinion on Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Town of Hermosa, South Dakota's basic financial statements. The budgetary comparison information on pages 36 - 38 and schedule of Town officials on page 39, which are the responsibility of management, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated August 18, 2017, on our consideration of the Town of Hermosa, South Dakota'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 Town of Hermosa, South Dakota's internal control over financial reporting and compliance.



Casey Peterson, Ltd.

Rapid City, South Dakota
August 18, 2017

BASIC FINANCIAL STATEMENTS

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Town of Hermosa, South Dakota
Statement of Net Position - Modified Cash Basis
December 31, 2016

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
ASSETS			
Cash and Cash Equivalents	\$ 132,615	\$ 427,437	\$ 560,052
Investments	17,541	-	17,541
Restricted Assets:			
Customer Deposit Reserve	<u>-</u>	<u>13,053</u>	<u>13,053</u>
TOTAL ASSETS	<u>\$ 150,156</u>	<u>\$ 440,490</u>	<u>\$ 590,646</u>
NET POSITION			
Restricted for:			
Debt Service	\$ 137,479	\$ 22,193	\$ 159,672
Construction	1,500	-	1,500
Customer Deposits	-	13,053	13,053
Unrestricted	<u>11,177</u>	<u>405,244</u>	<u>416,421</u>
TOTAL NET POSITION	<u>\$ 150,156</u>	<u>\$ 440,490</u>	<u>\$ 590,646</u>

The accompanying notes are an integral part of this statement.

Town of Hermosa, South Dakota
Statement of Activities - Modified Cash Basis
For the Year Ended December 31, 2016

<u>Functions/Programs</u>	<u>Disbursements</u>	<u>Program Receipts</u>	
		<u>Charges for Services</u>	<u>Capital Grants, Loans and Contributions</u>
PRIMARY GOVERNMENT			
Governmental Activities:			
General Government	\$ 207,145	\$ 6,848	\$ -
Public Safety	90,395	-	-
Public Works	100,097	61,848	1,309
Conservation and Development	30,056	-	-
Total Governmental Activities	<u>427,693</u>	<u>68,696</u>	<u>1,309</u>
Business-type Activities:			
Water	105,353	115,357	-
Sewer	30,091	71,874	-
Total Business-type Activities	<u>135,444</u>	<u>187,231</u>	<u>-</u>
Total Primary Government	<u>\$ 563,137</u>	<u>\$ 255,927</u>	<u>\$ 1,309</u>

GENERAL RECEIPTS

Taxes:

Property Taxes

Sales Tax

State Shared Receipts

Unrestricted Investment Earnings

Miscellaneous Receipts

Sale of Municipal Property

Total General Receipts

CHANGE IN NET POSITION

NET POSITION - BEGINNING

NET POSITION - ENDING

The accompanying notes are an integral part of this statement.

Net (Disbursements) Receipts and
Changes in Net Position

Primary Government		
Governmental Activities	Business-type Activities	Total
\$ (200,297)	\$ -	\$ (200,297)
(90,395)	-	(90,395)
(36,940)	-	(36,940)
(30,056)	-	(30,056)
(357,688)	-	(357,688)
-	10,004	10,004
-	41,783	41,783
-	51,787	51,787
(357,688)	51,787	(305,901)
109,941	-	109,941
155,803	-	155,803
16,169	-	16,169
474	-	474
3,784	-	3,784
-	-	-
286,171	-	286,171
(71,517)	51,787	(19,730)
221,673	388,703	610,376
\$ 150,156	\$ 440,490	\$ 590,646

The accompanying notes are an integral part of this statement.

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Town of Hermosa, South Dakota
Balance Sheet - Modified Cash Basis - Governmental Funds
December 31, 2016

	General Fund	Tax Increment District #1 - Debt Service Fund	FEMA Relocation Special Revenue Fund	Total Governmental Funds
ASSETS				
Cash and Cash Equivalents	\$ (6,364)	\$ 137,479	\$ 1,500	\$ 132,615
Investments	<u>17,541</u>	<u>-</u>	<u>-</u>	<u>17,541</u>
TOTAL ASSETS	<u>\$ 11,177</u>	<u>\$ 137,479</u>	<u>\$ 1,500</u>	<u>\$ 150,156</u>
FUND BALANCES				
Restricted for Debt Service	\$ -	\$ 137,479	\$ -	\$ 137,479
Restricted for Construction	-	-	1,500	1,500
Unassigned	<u>11,177</u>	<u>-</u>	<u>-</u>	<u>11,177</u>
TOTAL FUND BALANCES	<u>\$ 11,177</u>	<u>\$ 137,479</u>	<u>\$ 1,500</u>	<u>\$ 150,156</u>

The accompanying notes are an integral part of this statement.

Town of Hermosa, South Dakota
Statement of Revenues, Expenditures and Changes in Fund Balances -
Modified Cash Basis - Governmental Funds
For the Year Ended December 31, 2016

	General Fund	Tax Increment District #1 - Debt Service Fund	FEMA Relocation Special Revenue Fund	Total Governmental Funds
RECEIPTS				
Taxes:				
General Property Taxes	\$ 55,202	\$ 53,543	\$ -	\$ 108,745
General Sales and Use Taxes	155,803	-	-	155,803
Penalties and Interest on				
Delinquent Taxes	564	632	-	1,196
Licenses and Permits	6,848	-	-	6,848
Intergovernmental Receipts:				
State Grants	1,309	-	-	1,309
State Shared Receipts:				
Other	6,441	-	-	6,441
County Road Tax	9,728	-	-	9,728
Charges for Goods and Services:				
General Government	61,848	-	-	61,848
Fines and Forfeits:				
Court Fines and Costs	-	-	-	-
Miscellaneous Receipts:				
Investment Earnings	474	-	-	474
Other	3,784	-	-	3,784
TOTAL RECEIPTS	302,001	54,175	-	356,176

The accompanying notes are an integral part of this statement.

	General Fund	Tax Increment District #1 - Debt Service Fund	FEMA Relocation Special Revenue Fund	Total Governmental Funds
DISBURSEMENTS				
General Government:				
Legislative	23,240	-	-	23,240
Elections	14	-	-	14
Financial Administration	99,346	-	-	99,346
Other	16,462	-	68,083	84,545
Public Safety:				
Police	45,756	-	-	45,756
Protective Inspection	535	-	-	535
Public Works:				
Highways and Streets	39,776	-	-	39,776
Sanitation	32,778	-	-	32,778
Conservation and Development:				
Planning and Zoning	2,166	-	-	2,166
Capital Outlays	71,994	-	-	71,994
Debt Service	-	27,544	-	27,544
TOTAL DISBURSEMENTS	<u>332,067</u>	<u>27,544</u>	<u>68,083</u>	<u>427,694</u>
OTHER FINANCING SOURCES				
Transfers In (Out)	<u>(69,583)</u>	-	<u>69,583</u>	-
NET CHANGE IN FUND BALANCE	(99,649)	26,631	1,500	(71,518)
FUND BALANCE - BEGINNING	<u>110,826</u>	<u>110,848</u>	-	<u>221,674</u>
FUND BALANCE - ENDING	<u>\$ 11,177</u>	<u>\$ 137,479</u>	<u>\$ 1,500</u>	<u>\$ 150,156</u>

The accompanying notes are an integral part of this statement.

Town of Hermosa, South Dakota
Balance Sheet - Modified Cash Basis - Proprietary Funds
December 31, 2016

	Water Fund	Sewer Fund	Total Proprietary Funds
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 181,877	\$ 245,560	\$ 427,437
Customer Deposit Reserve	<u>13,053</u>	<u>-</u>	<u>13,053</u>
TOTAL ASSETS	<u>\$ 194,930</u>	<u>\$ 245,560</u>	<u>\$ 440,490</u>
NET POSITION			
Restricted for:			
Revenue Bond Debt Service	\$ 19,532	\$ 2,661	\$ 22,193
Customer Deposits	13,053	-	13,053
Unrestricted	<u>162,345</u>	<u>242,899</u>	<u>405,244</u>
TOTAL NET POSITION	<u>\$ 194,930</u>	<u>\$ 245,560</u>	<u>\$ 440,490</u>

The accompanying notes are an integral part of this statement.

Town of Hermosa, South Dakota
Statement of Revenues, Expenses and Changes in Fund Net Position -
Modified Cash Basis - Proprietary Funds
For the Year Ended December 31, 2016

	Water Fund	Sewer Fund	Total Proprietary Funds
OPERATING RECEIPTS			
Revenue Dedicated to Servicing Debt	\$ 115,357	\$ 71,874	\$ 187,231
OPERATING DISBURSEMENTS			
Other Current Disbursements	56,982	26,257	83,239
OPERATING INCOME	58,375	45,617	103,992
NONOPERATING DISBURSEMENTS			
Capital Expenditures	5,370	-	5,370
Debt Service Payments	43,001	3,834	46,835
Total Nonoperating Disbursements	48,371	3,834	52,205
CHANGE IN NET POSITION	10,004	41,783	51,787
NET POSITION - BEGINNING	184,926	203,777	388,703
NET POSITION - ENDING	\$ 194,930	\$ 245,560	\$ 440,490

The accompanying notes are an integral part of this statement.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As discussed further in Note 1.C., these financial statements are presented on the modified cash basis of accounting. The modified cash basis of accounting differs from accounting principles generally accepted in the United States of America (GAAP) as described within this note. Generally accepted accounting principles include all relevant Governmental Accounting Standards Board (GASB) pronouncements.

A. REPORTING ENTITY

The reporting entity of the Town of Hermosa, South Dakota (the Town) consists of the primary government which includes all of the funds, organizations, institutions, agencies, departments, and offices that make up the legal 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 Town as a whole. These statements include all funds of the overall government except for fiduciary funds. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental receipts, and other non-exchange receipts. 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 disbursements and program receipts for each segment of the business-type activities of the Town and for each function of the Town's governmental activities. Direct disbursements are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program receipts include (a) charges paid by recipients of goods and services offered by the programs and (b) grants and contributions and loan proceeds that are restricted to meeting the operational or capital requirements of a particular program. Receipts that are not classified as program receipts, including all taxes, are presented as general receipts.

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, receipts, and disbursements. Funds are organized into three major categories: governmental, proprietary and fiduciary. 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 Town, or it meets the following criteria:

1. Total assets, liabilities, receipts, or disbursements 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, receipts, or disbursements 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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The funds of the Town are described below:

Governmental Funds:

General Fund - The General Fund is the general operating fund of the Town. 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 Fund - Special revenue funds are used to account for and report the proceeds of specific receipt sources (other than expendable trusts or major capital projects) that are restricted or committed to disbursements for specified purposes other than debt service or capital projects. The City has the following special revenue funds:

FEMA Relocation Fund - The fund is used to accept grant receipts and make disbursements related to the FEMA relocation project the city had undertaken in the current year. This 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 costs.

Tax Increment District #1 - The fund is used to account for the accumulation of property tax receipts received on the tax increment district and the payment of long-term debt principal and interest as related to the tax increment district. This 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 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.

Water Fund - Financed primarily by user charges, this fund accounts for the operation of the municipal waterworks system and related facilities (SDCL 9-47-1). This fund is a major fund.

Sewer Fund - Financed primarily by user charges, this fund accounts for the construction and operation of the municipal sanitary sewer system and related facilities (SDCL 9-48-2). This fund is a major fund.

Fiduciary Funds:

Fiduciary funds are never considered to be major funds and are used to account for resources held by the Town in a purely custodial capacity (assets equal liabilities). The Town did not have fiduciary funds as of December 31, 2016.

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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 within the limitations of the modified cash basis of accounting.

Fund Financial Statements:

In the fund financial statements, the current financial resources measurement focus or the economic resources measurement focus is used, applied within the limitations of the modified cash basis of accounting.

Basis of Accounting

The government-wide Statement of Net Position and Statement of Activities and the fund financial statements, governmental, and business-type activities are presented using the modified cash basis of accounting.

The modified cash basis of accounting involves the measurement of cash and cash equivalents and changes in cash and cash equivalents resulting from cash receipt and disbursement transactions. Under the modified cash basis of accounting, the balance sheet reports only cash and cash equivalents (those investments with terms to maturity of 90 days or less at the date of acquisition). Under the modified cash basis of accounting, transactions are recorded in the accounts when cash and/or cash equivalents are received or disbursed and assets and liabilities are recognized to the extent that cash has been received or disbursed.

Acceptable modifications to the cash basis of accounting implemented by the Town in these financial statements include the recording of investments arising from cash transactions.

As a result of the use of this modified cash basis of accounting, certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, and accrued expenses and liabilities) are not recorded in these financial statements.

If the Town applied accounting principles generally accepted in the United States, the fund financial statements for governmental funds would use the modified accrual basis of accounting, while the fund financial statements for proprietary fund types would use the accrual basis of accounting. All government-wide financial statements would be presented on the accrual basis of accounting.

D. CASH AND CASH EQUIVALENTS

The Town pools its cash resources for deposit purposes. The proprietary funds have access to their cash resources on demand.

E. RESTRICTED CASH DEPOSITS

The Town maintains restricted cash deposits for utility customer account deposits.

F. DEPOSITS AND INVESTMENTS

For the purpose of financial reporting, "cash and cash equivalents" includes all demand and savings accounts and certificates of deposit or short-term investments with a term to maturity at date of acquisition of three months or less.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. INTERFUND ELIMINATIONS AND RECLASSIFICATIONS

Government-wide Financial Statements

In the process of aggregating data for the government-wide financial statements, some amounts reported as interfund activity and balances in the fund financial statements have been eliminated or reclassified.

H. CAPITAL ASSETS

Government-wide Financial Statements

Under the modified cash basis of accounting, the Town's capital assets are considered a cost of the program for which they were acquired, for the amount paid in cash. In the Statement of Activities, cash payments for capital assets are recorded in the program category for which they were acquired. Allocations between programs are made, where necessary, to match the cost with the program that benefits from the use of the capital assets.

Fund Financial Statements

In the fund financial statements, capital assets arising from cash transactions acquired for use in governmental fund operations are accounted for as expenditures of the governmental fund when paid for in cash. Capital assets acquired for use in proprietary fund operations are accounted for in the same manner in the government-wide financial statements.

I. LONG-TERM LIABILITIES

Long-term liabilities include, but are not limited to, a contract for deed and financing notes.

As discussed in Note 1.C. above, the government-wide Statement of Net Position and Statement of Activities and the fund financial statements, governmental and business-type activities are presented using a modified cash basis of accounting. The Town has not elected to modify their cash basis presentation by recording long-term debt arising from cash transactions so any outstanding indebtedness is not reported on the financial statements of the Town. The Town does report the principal and interest payments on long-term debt as Debt Service expenditures on the Statement of Revenues, Expenditures and Changes in Fund Balances. On the Statement of Activities, the principal and interest on these debt service payments is reported within the appropriate expense function.

J. REVENUE RECEIVED IN ADVANCE

Under the modified cash basis of accounting, cash may have been received in advance of the Town's providing a good or service to a customer. These amounts are reported in the financial statements at the time of receipt, as applicable.

K. PROGRAM RECEIPTS

Program receipts derive directly from the program itself or from parties other than the Town's taxpayers or citizenry as a whole. Program receipts are classified into three categories as follows:

1. Charges for Services - These arise from charges to customers, applicants or other who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2. Program-specific Operating Grants and Contributions - These arise from mandatory and voluntary non-exchange transactions with other governments, organizations or individuals that are restricted for use in a particular program.
3. Program-specific Capital Grants and Contributions - These arise from mandatory and voluntary non-exchange transactions with other governments, organizations or individuals that are restricted for the acquisition of capital assets for use in a particular program.

L. PROPRIETARY FUNDS RECEIPTS AND DISBURSEMENTS CLASSIFICATION

Operating receipts and disbursements for proprietary funds result from providing services and producing and delivering goods and services. They also include all receipts and disbursements not related to capital and related financing, noncapital financing, or investing activities.

M. EQUITY CLASSIFICATIONS

Government-Wide Financial Statements:

Equity is classified as net position and is displayed in two components under the modified cash basis:

1. 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) law through constitutional provisions or enabling legislation.
2. Unrestricted Net Position - All other net assets that do not meet the definition of "restricted."

It is the Town's policy to first use restricted net position prior to the use of unrestricted net position when a disbursement is made for purposes for which both restricted and unrestricted net position are available.

Fund Financial Statements

Governmental fund equity is classified as fund balance, which is distinguished between the following classifications:

Nonspendable - Includes amounts that cannot be spent because they are either not in spendable form or are legally or contractually required to be maintained intact.

Restricted - Constraints are placed on the use of resources by either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or (b) imposed by law through constitutional provisions or enabling legislation.

Committed - Amounts that can only be used for specific purposes pursuant to constraints imposed by resolutions of the Town Board of Trustees.

Assigned - Amounts that are constrained by the Town management and are intended to be used for specific purposes but are neither restricted nor committed. The Town Board of Trustees has given management the authority to create assignments of fund equity.

Unassigned - Represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned.

The Town uses restricted amounts first when both restricted and unrestricted fund balance is available unless there are legal documents or contracts that prohibit doing this, such as a grant agreement requiring dollar for dollar spending. Additionally, the Town would first use committed, then assigned, and lastly unassigned amounts of unrestricted fund balance when expenditures are made.

**Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Town does not have a formal minimum fund balance policy.

Proprietary fund equity is classified the same as in the government-wide financial statements.

NOTE 2 - DEPOSITS AND INVESTMENTS

The Town 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 as follows:

Deposits

The Town'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 authorized to do business in South Dakota.

Investments

In general, SDCL 4-5-6 permits Town funds to be invested only in (a) securities of the United States and securities guaranteed by the United States Government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load fund administered by an investment company whose investments are in securities described in (a) above and repurchase agreements described in (b) above. Also, SDCL 4-5-9 requires investments to be in the physical custody of the political subdivision or deposited in a safekeeping account with any banker trust company designated by the political subdivision as its fiscal agent. The investments held by the Town at December 31, 2016 were as follows:

	<u>Credit Rating</u>	<u>Maturities</u>	<u>Initial Cost</u>
Investment:			
FNMA Pool	AA+	3-15 Yrs	\$ 1,639
GNMA Pool	AAA	10-15 Yrs	1,043
FHLMC Pool	AA+	7-17 Yrs	<u>359</u>
Total Bonds:			3,041
Mutual Funds			14,402
Cash Held in Money Market			<u>98</u>
Total Investments			<u>\$ 17,541</u>

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)

Fair Value Measurement

The Town reports its investments based on cash paid for such investments and not the fair market value. If the Town reported its investments at fair market value, each investment would be evaluated in accordance with generally accepted accounting principles and reported in a fair value hierarchy. The hierarchy is based on valuation inputs used to measure fair value of the asset. The investments held by the Town would be considered Level 2, which includes significant observable inputs other than quoted prices in active markets.

Additionally the Town holds funds in the South Dakota Public Fund Investment Trust (SDFIT), which 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 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. The balance in the SD FIT investment pool is recognized as cash equivalents on the Balance Sheet and the Statement of Net Position. The balance at December 31, 2016 was \$132,266, which is allocated among the General, Water, and Sewer Funds.

Custodial Credit Risk - The risk that, in the event of a depository failure, the Town's deposits may not be returned to it. The Town does not have a deposit policy for custodial credit risk. As of December 31, 2016, the Town's deposits were adequately secured by FDIC Insurance and collateralized with pledged securities.

Interest Rate Risk - The Town does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from interest rates.

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

State law allows income from deposits and investments to be credited to either the General Fund of the fund making the investment. The Town's policy is to credit all income from deposits and investments to the fund making the investment.

NOTE 3 - PROPERTY TAXES

Property taxes are levied on or before October 1 of the year preceding the start of the fiscal year. They attach as an enforceable lien on property and become due and payable as of January 1, the first day of the fiscal year. Taxes are payable in two installments on or before April 30 and October 31 of the fiscal year. The Town is permitted by several state statutes to levy varying amounts of taxes per \$1,000 of taxable valuation on taxable real property in the Town.

**Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016**

NOTE 4 - COMMITMENTS

The following is a summary of changes in long-term debt commitments for the year ended December 31, 2016:

	Beginning Balance 01/01/16	Additions	Payments	Ending Balance 12/31/16	Due in One Year
Rural Development Bond 2005	\$ 251,532	\$ -	\$ (5,056)	\$ 246,476	\$ 4,796
Rural Development Bond 2009	89,106	-	(1,241)	87,865	1,268
Rural Development Bond 2010	47,822	-	(765)	47,057	728
Installment Sale	9,490	-	(1,731)	7,759	1,834
State Revolving Fund Loan #1	90,738	-	(19,659)	71,079	20,661
Consolidated Loan 2012L-109	104,583	-	(4,155)	100,428	4,280
Tax Incremental District Loan #1	284,804	-	(6,100)	278,704	6,301
	<u>\$ 878,075</u>	<u>\$ -</u>	<u>\$ (38,707)</u>	<u>\$ 839,368</u>	<u>\$ 39,868</u>

The Town holds three Water and Sewer Financing Bonds with USDA Rural Development for the purpose of paying project costs associated with construction of water and sewer systems. The notes were issued in years 2005, 2009 and 2010 for an aggregate total original principal amount of \$449,000. The Bonds mature in various years until 2050. Monthly payments totaling \$1,917 are made including interest at rates between 4.0% and 4.5%. Interest on the three notes paid for the year ended December 31, 2015 was \$15,942. Payments are financed exclusively from proceeds earned by the water and sewer funds, in accordance with debt covenants.

An installment sale was entered into in June 2010. The contract allows for the purchase of six acres of land for construction of a lagoon. After initial down payment of \$72,000 and donation of \$30,000 by the seller, the total principal due at origination of the loan was \$18,000. The contract requires monthly payments of \$2,300 until June 2020, at which time a balloon payment of remaining principal and interest is due. All payments include interest at 6%. Interest paid for the year ended December 31, 2015 was \$569. This debt is paid by the sewer fund.

The Town entered into a Drinking Water State Revolving Fund Loan in February 1999 in order to fund the establishment of a water system. The original principal due on the loan was \$300,000 due in quarterly payments of \$5,958 over a period of twenty years beginning September 1, 2000. Interest is accrued at a rate of 5%. Current year interest paid on the loan was \$4,172. This debt is paid by the water fund.

The Town was awarded a second \$300,000 State Revolving Fund Loan (de-obligated to \$292,156) for the purpose of financing improvements in the Tax Increment District #1. The repayment period of thirty years begins January 1, 2015 at 3.25% interest with quarterly payments of \$3,821 due every January, April, July, and October 15th. The fund balance of the Tax Increment District #1 Fund is restricted to the purpose of paying this debt. Current year interest paid on the loan was \$9,182.

During 2014 the Town entered into a State Consolidated Water Facilities loan for their Hwy 79 Water Main Expansion Project, which is funded with proceeds from the Tax Increment District #1. The loan has a term of 20 years at 3% interest with biannual payments of \$3,631. Current year interest paid on the loan was \$3,107.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 4 - COMMITMENTS (CONTINUED)

The Town was in compliance with debt covenants for the year ending December 31, 2016. The debt covenants consist of a bond reserves maintained for the purposes of servicing the debt. Deposits are maintained in a savings account.

Pledged Revenues

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 Town pledges future tax revenues generated by the tax increment district to acquire public improvements within the established district.

The Town has pledged future tax revenues generated by Tax Increment District #1 - Debt Service Fund and future revenues of the Sewer Fund for the retirement of its Tax Increment Financing Note and State Consolidated loan listed in the table above. This debt was used to fund capital projects. The current principal balance plus interest at the stated applicable rate over the life of the debt represents the amount of future revenue pledged. Below is a comparison of principal and interest payments and total pledged revenue for the current year:

Current Year Principal and Interest	\$ <u>72,946</u>
Pledged Revenue:	
Tax Increment Receipts	53,543
Sewer Fund Receipts	<u>71,874</u>
Total Pledged Revenue	\$ <u>125,417</u>

The annual requirements to amortize all debt outstanding as of December 31, 2016 are as follows:

	Principal	Interest	Total
2017	\$ 39,868	\$ 33,078	\$ 72,946
2018	41,653	31,811	73,464
2019	43,522	30,026	73,548
2020	27,115	28,157	55,272
2021	20,004	26,425	46,429
2022-2026	111,354	141,927	253,281
2027-2031	132,950	94,787	227,737
2032-2036	143,984	69,232	213,216
2037-2041	148,637	42,793	191,430
2042-2049	130,281	14,938	145,219
	\$ 839,368	\$ 513,174	\$ 1,352,542

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 5 - RETIREMENT PLAN

All employees, working more than 20 hours per week during the year, participate in the South Dakota Retirement System (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 survivor 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://sdrs.sd.gov/publications.aspx> 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.

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% of salary; Class B Judicial Members, 9.0% of salary; and Class B Public Safety Members, 8.0% 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 Town's share of contributions to the SDRS for the years ended December 31, 2016, 2015, and 2014 were \$2,054, \$3,300, and \$4,863 respectively, and were equal to the required contributions each year.

**Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016**

NOTE 5 - RETIREMENT PLAN (CONTINUED)

Pension Liabilities (Assets)

At June 30, 2016, SDRS was 96.89% funded and accordingly, has a net pension liability. The proportionate shares of the components of the net pension asset of South Dakota Retirement System, for the Town as of December 31, 2016 were as follows:

Less: Proportionate Share of Total Pension Liability	\$ 298,127
Proportionate Share of Net Position Restricted for Pension Benefits	<u>288,847</u>
Proportionate Share of Net Pension Liability (Asset)	<u><u>\$ 9,280</u></u>

The net pension liability (asset) was measured as of June 30, 2016 and the total pension liability (asset) used to calculate the net pension liability (asset) 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 December 31, 2016, the City's proportion was 0.00274740%, which is a decrease of 0.00150480% from its proportion measured as of June 30, 2015.

Actuarial Assumptions - The total pension liability (asset) 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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 5 - RETIREMENT PLAN (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	<u>2.0%</u>	0.7%
Total	<u>100.0%</u>	

Discount Rate

The discount rate used to measure the total pension liability (asset) was 7.25 percent through 2017 and 7.50 percent thereafter. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that matching employer contributions from 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 (asset).

Sensitivity of Liability (Asset) to Changes in the Discount Rate

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

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
Town's Proportionate Share of the Net Pension Liability (Asset)	\$ 51,933	\$ 9,280	\$ (25,508)

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 5 - RETIREMENT PLAN (CONTINUED)

Pension Plan Fiduciary Net Position

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

NOTE 6 - RISK ASSESSMENT

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

Unemployment Benefits

The Town has coverage for unemployment benefits by paying into the Unemployment Compensation Fund established by State law and managed by the State of South Dakota. During the year ended December 31, 2015, no claims were paid for unemployment benefits. At July 31, 2017, no claims had been filed for unemployment benefits and none are anticipated in the next fiscal year.

Health Insurance

The Town 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 Town 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 Town'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 Town. The Town pays an annual premium, to provide liability coverage detailed below, under a claims-made policy, and the premiums are based on their exposure or type of coverage to the pool to provide coverage for general liability, officials' liability, automobile liability and damage, property damage and law enforcement liability.

The agreement with the SDPAA provides that the above coverage will be provided to a \$3,000,000 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 Town would be eligible to receive a refund of the full amount allocated to the cumulative reserve fund.

As of the December 31, 2016, the Town has a vested balance in the cumulative reserve fund of \$5,533, which is not recorded in the cash basis financial statements of the Town. The Town 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 during the past three years.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2016

NOTE 6 - RISK ASSESSMENT (CONTINUED)

Worker's Compensation:

The Town 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 the 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 Town'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 Town pays an annual premium, 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 an additional \$2,000,000 per individual per incident.

The Town 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 during the past three years.

NOTE 7 - RESTRICTED ASSETS

The City is obligated for customer deposits in the Water Fund.

NOTE 8 - RESTRICTED NET POSITION

The following table shows restricted net position and the purpose for such restrictions as shown in the statement of net position - modified cash basis.

Purpose	Restricted By	Amount
Major Purposes:		
Debt Service	Debt Covenants	\$ 22,193
Debt Service	State Law	137,479
Construction	Grant Agreement	1,500
		\$ 159,672

NOTE 9 - SUBSEQUENT EVENTS

Subsequent to year-end, the City approved Resolution 2017-04 approving loan agreement and revenue bond issuance. The bond will allow the Town to finance improvements to the drinking water facilities within its System up to \$199,000. The Town will be obligated to repay the principal, interest, and an administrative expense surcharge on the loan. The Town will implement an additional surcharge to water customers that benefit from the improvements to repay the loan. Funds have not yet been received by the Town at the time of audit report.

Management has evaluated subsequent events through the date of the independent auditor's report, which is the date the financial statements were available to be issued.

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SUPPLEMENTARY INFORMATION

Town of Hermosa, South Dakota
Budgetary Comparison Schedule - Budgetary Basis - General Fund
For the Year Ended December 31, 2016

	<u>Budgeted Amounts</u>		Budgetary	Positive
	<u>Original</u>	<u>Final</u>	Basis - Actual Amounts	(Negative) Variance
RECEIPTS				
Taxes:				
General Property Taxes	\$ 57,000	\$ 57,000	\$ 55,202	\$ (1,798)
General Sales and Use Taxes	140,000	140,000	155,803	15,803
Penalties and Interest on Delinquent Taxes	2,450	2,450	564	(1,886)
Licenses and Permits	5,640	5,640	6,848	1,208
Intergovernmental Revenue:				-
State Grants	240,191	240,191	1,309	(238,882)
Intergovernmental Receipts:				
State Shared Revenue:				
Liquor Tax Reversion	2,000	2,000	2,597	597
State Highway/Bridge Revenue	1,900	1,900	2,022	122
Motor Vehicle Comm Prorate	850	850	1,655	805
Bank Franchise Tax	180	180	167	(13)
County Motor Vehicle License	7,000	7,000	8,682	1,682
County Wheel Tax	-	-	1,046	1,046
Charges for Goods and Services:				
Liquor Revenue	23,500	23,500	25,314	1,814
Garbage Service Revenue	37,450	37,450	36,534	(916)
Fines and Forfeits:				
Court Fines and Costs	250	250	-	(250)
Miscellaneous Revenue:				
Investment Earnings	780	780	474	(306)
Rentals	-	-	3,500	3,500
Other	-	-	284	284
TOTAL RECEIPTS	<u>519,191</u>	<u>519,191</u>	<u>302,001</u>	<u>(217,190)</u>

See independent auditor's report.

	<u>Budgeted Amounts</u>		<u>Budgetary Basis - Actual Amounts</u>	<u>Positive (Negative) Variance</u>
	<u>Original</u>	<u>Final</u>		
DISBURSEMENTS				
General Government:				
Legislative	32,258	32,258	23,240	9,018
Elections	978	978	14	964
Financial Administration	102,178	106,926	99,346	7,580
Other	17,000	17,000	16,462	538
Public Safety:				
Police	35,941	45,756	45,756	-
Protective Inspection	1,000	1,000	535	465
Public Works:				
Highways and Streets	43,382	43,382	39,776	3,606
Sanitation	31,250	32,762	32,778	(16)
Conservation and Development:				
Planning and Zoning	4,784	4,784	2,166	2,618
Capital Outlay	261,347	261,347	71,994	189,353
Miscellaneous	10,229	10,229	-	10,229
TOTAL DISBURSEMENTS	<u>540,347</u>	<u>556,422</u>	<u>332,067</u>	<u>224,355</u>
OTHER FINANCING SOURCES				
Transfers Out	<u>(37,809)</u>	<u>(69,883)</u>	<u>(69,583)</u>	<u>300</u>
TOTAL OTHER FINANCING SOURCES	<u>(37,809)</u>	<u>(69,883)</u>	<u>(69,583)</u>	<u>300</u>
NET CHANGE IN FUND BALANCE	(58,965)	(107,114)	(99,649)	7,465
FUND BALANCE - BEGINNING	<u>110,826</u>	<u>110,826</u>	<u>110,826</u>	<u>-</u>
FUND BALANCE - ENDING	<u>\$ 51,861</u>	<u>\$ 3,712</u>	<u>\$ 11,177</u>	<u>\$ 7,465</u>

See independent auditor's report.

Town of Hermosa, South Dakota
Notes to Supplementary Information
For the Year Ended December 31, 2016

NOTE 1 - BASIS OF PRESENTATION

The Budgetary Comparison Schedules have been prepared on the modified cash basis of accounting and present capital outlay and debt service expenditures within each department rather than as separate functions similar to the Statement of Revenues, Expenditures and Changes in Fund Balances - Modified Cash Basis.

NOTE 2 - BUDGETS AND BUDGETARY ACCOUNTING

The Town follows these procedures in establishing the budgetary data reflected in the required supplementary information:

1. At the regular Board meeting in September each year, the governing Board introduces the annual appropriations ordinance for the ensuing fiscal year.
2. After adoption by the governing Board, the operating budget is legally binding and actual expenditures for each purpose cannot exceed the amounts budgeted, except as indicated in number 4.
3. A line item for contingencies may be included in the annual budget. Such line item may not exceed 5 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. The Town did not encumber any amounts at December 31, 2016.

The budget for the general fund is adopted on a basis consistent with that which is presented in the financial statements.

See independent auditor's report.

**Town of Hermosa, South Dakota
Town Officials
December 31, 2016**

BOARD OF TRUSTEES

Linda Kramer

Dan Holsworth

Bernhard Flug

Robert King

FINANCE OFFICER

Shanna Harris

See independent auditor's report.