

# **TOWN OF HERMOSA, SOUTH DAKOTA**

INDEPENDENT AUDITOR'S REPORTS,  
FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

DECEMBER 31, 2018

**CASEY  PETERSON**  
*Leading the Way.*

RAPID CITY, SOUTH DAKOTA  
GILLETTE, WYOMING



**Town of Hermosa, South Dakota**  
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**December 31, 2018**

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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, each major fund, and the aggregate remaining fund information of the Town of Hermosa, South Dakota, as of and for the year ended December 31, 2018, 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 April 4, 2019.

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 questioned costs, 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 2018-001 and 2018-002 described in the accompanying Schedule of Findings and Management's Responses 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 2018-003 described in the accompanying Schedule of Findings and Management's Responses to be a significant deficiency.

### 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 no instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards*.

### 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.

A handwritten signature in blue ink that reads "Casey Peterson, LTD." The signature is written in a cursive, flowing style.

Casey Peterson, Ltd.

Rapid City, South Dakota  
April 4, 2019

**Town of Hermosa, South Dakota**  
**Schedule of Findings and Management's Responses**  
**December 31, 2018**

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Material Weakness

Internal Controls Related to Drafting Financial Statements

2018-001 *Condition:* As the auditor, we were requested to draft the financial statements and the accompanying notes to the financial statements and an audit adjustment was proposed to convert the accounting records to the modified cash basis.

*Criteria:* Establishing internal controls over the preparation of the financial statements is the responsibility of management.

*Cause:* Due to the limited number of employees, the Town does not have an internal control system designed to provide for the preparation of the financial statements being audited.

*Effect:* The Town engages its auditor to draft the financial statements and assist in the conversion to the modified cash basis of accounting for financial statement presentation.

*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 auditor to prepare the financial statements and notes to the financial statements.

Material Weakness

Internal Controls Related Reviewing Cash Receipts and Adequate Segregation of Duties

2018-002 *Condition:* The lack of accounting experience among the few staff members does not allow the Town to perform oversight over the cash receipt process 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 Clerk performs the billing, receives payments and enters data into the system 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 Clerk billing, receiving payments and entering data without proper oversight, because of cost or other considerations. The Finance Officer should review payments received and payments posted on a regular basis and also review accounts receivable aging summaries 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.

**Town of Hermosa, South Dakota**  
**Schedule of Findings and Management's Responses (Continued)**  
**December 31, 2018**

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*Management's Response:* The Town accepts the risk related to segregation of duties as there is no possibility of hiring additional staff.

Significant Deficiency  
Internal Control over Compliance

2018-003 *Condition:* We noted instances of noncompliance with the Fair Labor Standards Act and state statute. The Fair Labor Standards Act requires employers to have records of hours worked by employees for each day. We noted no timecards were available to support the hours worked by the meter reader. We also noted the meter reader is a member of the Board of Trustees. Per SDCL 6-1-2, certain conditions must be met in order for the Town to contract with an officer.

*Criteria:* The Town should have an internal control system designed to verify that state statutes and other laws and regulations are followed, conflicts of interest are documented, and consideration for services to related parties is reasonable and just.

*Cause:* Timecards were not available to support the hours worked and paid to an employee. The Town does not have documentation proving the contract with a Town officer meets the requirements of SDCL 6-1-2.

*Effect:* Although immaterial to the financial statements, this is a non-compliance issue with South Dakota Codified Law and the Fair Labor Standards Act.

*Auditor's Recommendation:* We recommend that the Town review statutory requirements and consult with their attorney concerning this issue.

*Management's Response:* The Town will obtain documentation of hours worked by each employee prior to processing payroll. The Board and attorney will evaluate contracts and employment relationships for possible conflicts that may violate state statutes.

## 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, each major fund, and aggregate remaining fund information of the Town of Hermosa, South Dakota, as of and for the year ended December 31, 2018, 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, each major fund, and the aggregate remaining fund information of the Town of Hermosa, South Dakota, as of December 31, 2018, 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 34 - 36 and list of Town Officials on page 37, 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 April 4, 2019, 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 the effectiveness of the Town's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Town of Hermosa, South Dakota's internal control over financial reporting and compliance.



Casey Peterson, Ltd.

Rapid City, South Dakota  
April 4, 2019

## BASIC FINANCIAL STATEMENTS

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**Town of Hermosa, South Dakota**  
**Statement of Net Position – Modified Cash Basis**  
**December 31, 2018**

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
<b>ASSETS</b>			
Cash and Cash Equivalents	\$ 320,227	\$ 429,333	\$ 749,560
Investments	17,895	-	17,895
Restricted Assets:			
Customer Deposit Reserve	<u>-</u>	<u>13,994</u>	<u>13,994</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 338,122</u></u>	<u><u>\$ 443,327</u></u>	<u><u>\$ 781,449</u></u>
<b>NET POSITION</b>			
Restricted for:			
Debt Service	\$ 198,384	\$ 26,727	\$ 225,111
Construction	1,500	-	1,500
Customer Deposits	-	13,994	13,994
Unrestricted	<u>138,238</u>	<u>402,606</u>	<u>540,844</u>
<b>TOTAL NET POSITION</b>	<u><u>\$ 338,122</u></u>	<u><u>\$ 443,327</u></u>	<u><u>\$ 781,449</u></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, 2018**

Functions/Programs	Disbursements	Program Receipts	
		Charges for Services	Capital Grants, Loans and Contributions
<b>PRIMARY GOVERNMENT</b>			
Governmental Activities:			
General Government	\$ 156,628	\$ 9,353	\$ -
Public Safety	33,694	-	-
Public Works	108,797	63,313	6,190
Conservation and Development	2,118	-	-
Total Governmental Activities	<u>301,237</u>	<u>72,666</u>	<u>6,190</u>
Business-type Activities:			
Water	236,710	114,120	134,500
Sewer	96,885	68,543	-
Total Business-type Activities	<u>333,595</u>	<u>182,663</u>	<u>134,500</u>
Total Primary Government	<u>\$ 634,832</u>	<u>\$ 255,329</u>	<u>\$ 140,690</u>
<b>GENERAL RECEIPTS</b>			
Taxes:			
Property Taxes			
Sales Tax			
State Shared Receipts			
Unrestricted Investment Earnings			
Miscellaneous Receipts			
Transfers			
Total General Receipts			
<b>CHANGE IN NET POSITION</b>			
<b>NET POSITION - BEGINNING</b>			
<b>NET POSITION - ENDING</b>			

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
\$ (147,275)	\$ -	\$ (147,275)
(33,694)	-	(33,694)
(39,294)	-	(39,294)
(2,118)	-	(2,118)
(222,381)	-	(222,381)
-	11,910	11,910
-	(28,342)	(28,342)
-	(16,432)	(16,432)
(222,381)	(16,432)	(238,813)
99,554	-	99,554
181,841	-	181,841
15,482	-	15,482
2,215	-	2,215
10,182	-	10,182
11,803	(11,803)	-
321,077	(11,803)	309,274
98,696	(28,235)	70,461
239,426	471,562	710,988
\$ 338,122	\$ 443,327	\$ 781,449

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, 2018**

	General Fund	Tax Increment District #1 - Debt Service Fund	Nonmajor Funds	Total Governmental Funds
<b>ASSETS</b>				
Cash and Cash Equivalents	\$ 116,477	\$ 198,384	5,366	\$ 320,227
Investments	<u>17,895</u>	<u>-</u>	<u>-</u>	<u>17,895</u>
<b>TOTAL ASSETS</b>	<u>\$ 134,372</u>	<u>\$ 198,384</u>	<u>\$ 5,366</u>	<u>\$ 338,122</u>
<b>FUND BALANCES</b>				
Restricted for:				
Debt Service	\$ -	\$ 198,384	\$ -	\$ 198,384
Construction	-	-	1,500	1,500
Committed for:				
City Promotion	-	-	3,866	3,866
Unassigned	<u>134,372</u>	<u>-</u>	<u>-</u>	<u>134,372</u>
<b>TOTAL FUND BALANCES</b>	<u>\$ 134,372</u>	<u>\$ 198,384</u>	<u>\$ 5,366</u>	<u>\$ 338,122</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, 2018**

	General Fund	Tax Increment District #1 - Debt Service Fund	Nonmajor Funds	Total Governmental Funds
<b>RECEIPTS</b>				
Taxes:				
General Property Taxes	\$ 45,084	\$ 53,828	\$ -	\$ 98,912
General Sales and Use Taxes	177,975	-	3,866	181,841
Penalties and Interest on Delinquent Taxes	330	312	-	642
Licenses and Permits	9,353	-	-	9,353
Intergovernmental Receipts:				
State Grants	6,190	-	-	6,190
State Shared Receipts:				
Other	5,245	-	-	5,245
County Road Tax	10,237	-	-	10,237
Charges for Goods and Services:				
General Government	63,313	-	-	63,313
Fines and Forfeits:				
Court Fines and Costs	390	-	-	390
Miscellaneous Revenue:				
Investment Earnings	2,215	-	-	2,215
Other	9,792	-	-	9,792
<b>TOTAL RECEIPTS</b>	<b>330,124</b>	<b>54,140</b>	<b>3,866</b>	<b>388,130</b>

The accompanying notes are an integral part of this statement.

	General Fund	Tax Increment District #1 - Debt Service Fund	Nonmajor Funds	Total Governmental Funds
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>DISBURSEMENTS</b>				
General Government:				
Legislative	22,653	-	-	22,653
Elections	300	-	-	300
Financial Administration	109,179	-	-	109,179
Other	21,354	-	3,142	24,496
Public Safety:				
Police	32,694	-	-	32,694
Protective Inspection	1,000	-	-	1,000
Public Works:				
Highways and Streets	52,347	-	-	52,347
Sanitation	33,905	-	-	33,905
Conservation and Development:				
Planning and Zoning	2,118	-	-	2,118
Debt Service	-	22,545	-	22,545
<b>TOTAL DISBURSEMENTS</b>	<u>275,550</u>	<u>22,545</u>	<u>3,142</u>	<u>301,237</u>
<b>OTHER FINANCING SOURCES</b>				
Transfers In	11,803	-	3,142	14,945
Transfers (Out)	<u>(3,142)</u>	<u>-</u>	<u>-</u>	<u>(3,142)</u>
<b>TOTAL OTHER FINANCING SOURCES</b>	<u>8,661</u>	<u>-</u>	<u>3,142</u>	<u>11,803</u>
<b>NET CHANGE IN FUND BALANCE</b>	63,235	31,595	3,866	98,696
<b>FUND BALANCE - BEGINNING</b>	<u>71,137</u>	<u>166,789</u>	<u>1,500</u>	<u>239,426</u>
<b>FUND BALANCE - ENDING</b>	<u>\$ 134,372</u>	<u>\$ 198,384</u>	<u>\$ 5,366</u>	<u>\$ 338,122</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, 2018**

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total Proprietary Funds</u>
<b>ASSETS</b>			
Current Assets:			
Cash and Cash Equivalents	\$ 205,844	\$ 223,489	\$ 429,333
Customer Deposit Reserve	<u>13,994</u>	<u>-</u>	<u>13,994</u>
<b>TOTAL ASSETS</b>	<u>\$ 219,838</u>	<u>\$ 223,489</u>	<u>\$ 443,327</u>
<b>NET POSITION</b>			
Restricted for:			
Revenue Bond Debt Service	\$ 23,300	\$ 3,427	\$ 26,727
Customer Deposits	13,994	-	13,994
Unrestricted	<u>182,544</u>	<u>220,062</u>	<u>402,606</u>
<b>TOTAL NET POSITION</b>	<u>\$ 219,838</u>	<u>\$ 223,489</u>	<u>\$ 443,327</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, 2018**

	Water Fund	Sewer Fund	Total Proprietary Funds
<b>OPERATING RECEIPTS</b>			
Revenue Dedicated to Servicing Debt	\$ 114,120	\$ 68,543	\$ 182,663
<b>OPERATING DISBURSEMENTS</b>			
Operations Disbursements	61,457	90,751	152,208
Capital Expenditures	126,294	-	126,294
Total Operating Disbursements	187,751	90,751	278,502
<b>OPERATING INCOME (LOSS)</b>	(73,631)	(22,208)	(95,839)
<b>NONOPERATING RECEIPTS (DISBURSEMENTS)</b>			
Debt Service Payments	(48,959)	(6,134)	(55,093)
Debt Proceeds	134,500	-	134,500
Total Nonoperating Disbursements	85,541	(6,134)	79,407
<b>TRANSFERS</b>			
Transfers Out	-	(11,803)	(11,803)
<b>CHANGE IN NET POSITION</b>	11,910	(40,145)	(28,235)
<b>NET POSITION - BEGINNING</b>	207,928	263,634	471,562
<b>NET POSITION - ENDING</b>	\$ 219,838	\$ 223,489	\$ 443,327

The accompanying notes are an integral part of this statement.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**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% 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% 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, 2018**

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**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 trusts for individuals, private organizations, or other governments or for major capital projects) that are legally restricted to expenditures for specified purposes. The Town has the following special revenue funds:

*Liquor, Lodging and Dining Gross Receipts Tax Fund* - The fund is used to account for the collection of a 1% tax on the gross receipts of lodgings, alcoholic beverages, prepared food and admissions which tax shall 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 promotion and advertising of the city (SDCL 10-52A-2). This fund may be established at the direction of the governing body through local ordinance. This is not a major fund.

*FEMA Relocation Fund* - The fund is used to accept grant receipts and make disbursements related to the FEMA relocation project. This is not 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 construction and 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, 2018.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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.

The Town’s basis of accounting is the modified cash basis, which is a basis of accounting other than GAAP. Under GAAP, transactions are recorded in the accounts when revenues are earned and liabilities are incurred. Under the modified cash basis, transactions are recorded when cash is received or disbursed.

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.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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.

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.

**E. RESTRICTED CASH DEPOSITS**

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

**F. 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.

**G. 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.

**H. 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.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**I. 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.
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.

**J. 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.

**K. 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 position that do not meet the definition of Restricted Net Position.

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 either because it is not in spendable form or because of legal or contractual constraints.

*Restricted* - Includes 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 amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the Board of Trustees and does not lapse at year-end.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Assigned* - Includes 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* - Includes positive amounts within the General Fund which has not been classified within the above-mentioned categories and negative fund balances in other governmental funds.

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.

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% 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.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)**

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, SDCL4-5-9 requires investments to be in the physical custody of the political subdivision or deposited in a safekeeping account with any banker or trust company designated by the political subdivision as its fiscal agent. The investments held by the Town at December 31, 2018 were as follows:

	Credit Rating	Maturities	Initial Cost
Investment:			
FNMA Pool	AA+	3 - 15 yrs	\$ 1,408
GNMA Pool	AAA	10 - 15 yrs	574
FHLMC Pool	AA+	7 - 17 yrs	214
Total Bonds:			2,196
Mutual Funds			15,601
Cash Held in Money Market			98
Total Investments			\$ 17,895

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, 2018 was \$134,642, 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, 2018, 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.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

**NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)**

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.

**NOTE 4 - COMMITMENTS**

The following is a summary of changes in long-term debt commitments for the year ended December 31, 2018:

	Beginning Balance 01/01/18	Additions	Payments	Ending Balance 12/31/18	Due in One Year
Rural Development Bond 2005	\$ 241,208	\$ -	\$ (5,490)	\$ 235,718	\$ 5,207
Rural Development Bond 2009	86,571	-	(1,351)	85,220	1,380
Rural Development Bond 2010	46,261	-	(829)	45,432	788
Installment Sale	5,925	-	(2,061)	3,864	2,061
State Revolving Fund Loan #1	50,418	-	(27,312)	23,106	23,106
State Revolving Fund Loan #2	-	134,500	-	134,500	-
Consolidated Loan 2012L-109	96,148	-	(4,410)	91,738	4,544
Tax Incremental District Loan #1	272,403	-	(6,508)	265,895	6,722
	<u>\$ 798,934</u>	<u>\$ 134,500</u>	<u>\$ (47,961)</u>	<u>\$ 885,473</u>	<u>\$ 43,808</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 expense on the three notes paid for the year ended December 31, 2018 was \$15,336. Payments are financed exclusively from proceeds earned by the Water Fund and Sewer Fund, 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 the initial down payment of \$72,000 and a donation of \$30,000 by the seller, the total principal due at the origination of the loan was \$18,000. The contract requires annual 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 expense for the year ended December 31, 2018 was \$239. 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%. Interest expense for the year ended December 31, 2018 was \$2,477. This debt is paid by the Water Fund.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 4 - COMMITMENTS (CONTINUED)**

The Town entered into a State Revolving Fund Loan in September of 2017 in the amount of \$199,000 in order to fund water system repairs. For the year ended December 31, 2018, the Town had drawn a total of \$134,500. Repayment does not begin until all funds are drawn or November 2019. The loan requires quarterly payments including 2% interest.

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. Interest expense for the year ended December 31, 2018 was \$8,774.

During 2014, the Town entered into a State Consolidated Water Facilities Loan for the 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 bi-annual payments of \$3,631. Interest expense for the year ended December 31, 2018 was \$2,851.

The Town was in compliance with debt covenants for the year ending December 31, 2018. The debt covenants consist of a bond reserves maintained for the purposes of servicing the debt. Deposits are maintained in savings accounts.

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 and Water Fund for the retirement of its Tax Increment Financing Note and State Consolidated loans 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>77,638</u>
Pledged Revenue:	
Tax Increment Receipts	53,828
Water Fund Receipts	114,120
Sewer Fund Receipts	<u>68,543</u>
Total Pledged Revenue	<u>\$ 236,491</u>

**Town of Hermosa, South Dakota  
Notes to the Financial Statements  
December 31, 2018**

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**NOTE 4 - COMMITMENTS (CONTINUED)**

The annual requirements to amortize all debt outstanding as of December 31, 2018 are as follows:

	Principal	Interest	Total
2019	\$ 43,808	\$ 30,965	\$ 74,773
2020	24,421	29,017	53,438
2021	23,379	28,142	51,521
2022	24,166	27,355	51,521
2023	24,981	26,539	51,520
2024 - 2028	138,176	119,426	257,602
2029 - 2033	163,349	94,253	257,602
2034 - 2038	162,730	65,828	228,558
2039 - 2043	185,352	35,943	221,295
2044 - 2048	85,207	8,010	93,217
2049 - 2050	9,904	204	10,108
	\$ 885,473	\$ 465,682	\$ 1,351,155

**NOTE 5 - PENSION 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 hybrid 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 general members, Class B public safety and Class B judicial members, and Class C Cement Plant Retirement Fund members.

Members hired before July 1, 2017 are Foundation members. Class A Foundation members and Class B Foundation members who retire after age 65 with three years of contributory service are entitled to an unreduced annual retirement benefit. An unreduced annual retirement benefit is also available after age 55 for Class A Foundation members where the sum of age and credited service is equal to or greater than 85, or after age 55 for Class B Foundation judicial members where the sum of age and credited service is equal to or greater than 80. Class B Foundation public safety members can retire with an unreduced annual retirement benefit after age 55 with three years of contributory service. An unreduced annual retirement benefit is also available after age 45 for Class B Foundation public safety members where the sum of age and credited service is equal to or greater than 75. All Foundation retirements that do not meet the above criteria may be payable at a reduced level.

**Town of Hermosa, South Dakota  
Notes to the Financial Statements  
December 31, 2018**

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**NOTE 5 - PENSION PLAN (CONTINUED)**

Members hired on/after July 1, 2017, are Generational members. Class A Generational members and Class B Generational judicial members who retire after age 67 with three years of contributory service are entitled to an unreduced annual retirement benefit. Class B Generational public safety members can retire with an unreduced annual retirement benefit after age 57 with three years of contributory service. At retirement, married Generational members may elect a single-life benefit, a 60% joint and survivor benefit, or a 100% joint and survivor benefit. All Generational retirement benefits that do not meet the above criteria may be payable at a reduced level. Generational members will also have a variable retirement account (VRA) established, in which they will receive up to 1.5% of compensation funded by part of the employer contribution. VRAs will receive investment earnings based on investment returns.

Legislation enacted in 2017 established the current COLA process. At each valuation date:

- Baseline actuarial accrued liabilities will be calculated assuming the COLA is equal to the long-term inflation assumption of 2.25%.
- If the fair value of assets is greater or equal to the baseline actuarial accrued liabilities, the COLA will be:
  - The increase in the 3<sup>rd</sup> quarter CPI-W, no less than 0.5% and no greater than 3.5%
- If the fair of assets is less than the baseline actuarial accrued liabilities, the COLA will be:
  - The increase in the 3<sup>rd</sup> quarter CPI-W, no less than 0.5% and no greater a restricted maximum such that, that if the restricted maximum is assumed for future COLAs, the fair value of assets will be greater or equal to the accrued liabilities.

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. The Town's share of contributions to the SDRS for the calendar years ended December 31, 2018, 2017, and 2016 were \$3,318, \$2,676, and \$2,054 respectively, and were equal to the required contributions each year.

Pension Assets and Pension Expense.

At June 30, 2018, SDRS was 100.02% funded and accordingly, has a net pension asset. The proportionate share of the components of the net pension asset of South Dakota Retirement System, for the Town as of this measurement period ending June 30, 2018 and reported by the Town as of December 31, 2018 are as follows:

Proportionate Share of Total Pension Liability	\$	302,470
Less: Proportionate Share of Net Position Restricted for Pension Benefits		<u>302,528</u>
Proportionate Share of Net Pension Liability (Asset)	\$	<u>(58)</u>

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**NOTE 5 - PENSION PLAN (CONTINUED)**

The net pension liability (asset) was measured as of June 30, 2018 and the total pension liability (asset) used to calculate the net pension liability (asset) was based on a projection of the Town's share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2018, the Town's proportion was 0.0024725%, which is an increase of 0.0003389% from its proportion measured as of June 30, 2017.

Actuarial Assumptions

The total pension liability (asset) in the June 30, 2018 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.25%
Salary Increases	Graded by years of service, from 6.50% at entry to 3.00% after 25 years of service
Investment Rate of Return	6.50% net of plan investment expense

Mortality rates were based on 97% of the RP-2014 Mortality Table, projected generationally with Scale MP-2016, white color rates for females and total dataset rates for males.

Mortality rates for disabled members were based on the RP-2014 Disabled Retiree Mortality Table projected generationally with Scale MP-2016.

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, 2018 (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%
Total	<u>100.0%</u>	

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
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**NOTE 5 - PENSION PLAN (CONTINUED)**

Discount Rate

The discount rate used to measure the total pension liability (asset) was 6.50%. 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 6.50%, 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 (5.50%) or 1-percentage point higher (7.50%) than the current rate:

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
Town's Proportionate Share of Net Pension Liability (Asset)	\$ 43,553	\$ (58)	\$ (35,532)

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, 2018, 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, 2018, no claims were paid for unemployment benefits. At December 31, 2018, 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.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
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**NOTE 6 - RISK ASSESSMENT (CONTINUED)**

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 accrued based on the ultimate cost of the experience to date of the SDPAA member, based on their exposure or type of coverage. The Town pays an annual premium 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, 2018, 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.

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 in the amount of \$13,994.

**Town of Hermosa, South Dakota**  
**Notes to the Financial Statements**  
**December 31, 2018**

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**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.

<u>Purpose</u>	<u>Restricted By</u>	<u>Amount</u>
Major Purposes:		
Debt Service	Debt Covenants	\$ 225,111
Customer Deposits	State Law	13,994
Construction	Grant Agreement	1,500
		<u>\$ 240,605</u>

**NOTE 9 - INTERFUND TRANSFERS**

Interfund transfers for the year ended December 31, 2017 were as follows:

<u>Transfer From:</u>	<u>Transfer To:</u>	
	<u>General Fund</u>	<u>Nonmajor Funds</u>
General Fund	\$ -	\$ 3,142
Sewer Fund	11,803	-
	<u>\$ 11,803</u>	<u>\$ 3,142</u>

All transfers were made to help fund operations.

**NOTE 10 - SUBSEQUENT EVENTS**

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

SUPPLEMENTARY INFORMATION

**Town of Hermosa, South Dakota**  
**Budgetary Comparison Schedule - Budgetary Basis - General Fund**  
**For the Year Ended December 31, 2018**

	<u>Budgeted Amounts</u>		<u>Budgetary Basis - Actual Amounts</u>	<u>Positive (Negative) Variance</u>
	<u>Original</u>	<u>Final</u>		
<b>RECEIPTS</b>				
Taxes:				
General Property Taxes	\$ 55,150	\$ 55,150	\$ 45,084	\$ (10,066)
General Sales and Use Taxes	150,000	150,000	177,975	27,975
Penalties and Interest on Delinquent Taxes	300	300	330	30
Licenses and Permits	5,640	5,640	9,353	3,713
Intergovernmental Revenue:				
State Grants	1,310	1,310	6,190	4,880
Intergovernmental Receipts:				
State Shared Revenue:				
Liquor Tax Reversion	2,200	2,200	2,503	303
State Highway/Bridge Revenue	1,900	1,900	1,907	7
Motor Vehicle Comm Prorate	850	850	595	(255)
Bank Franchise Tax	180	180	180	-
Other	-	-	60	60
County Motor Vehicle License	8,500	8,500	10,236	1,736
County Wheel Tax	-	-	1	1
Charges for Goods and Services:				
Liquor Revenue	24,500	24,500	23,872	(628)
Garbage Service Revenue	35,320	35,320	39,441	4,121
Fines and Forfeits:				
Court Fines and Costs	250	250	390	140
Miscellaneous Revenue:				
Investment Earnings	450	450	2,215	1,765
Other	7,500	7,500	9,792	2,292
<b>TOTAL RECEIPTS</b>	<u>294,050</u>	<u>294,050</u>	<u>330,124</u>	<u>36,074</u>

See independent auditor's report.

	Budgeted Amounts		Budgetary Basis - Actual Amounts	Positive (Negative) Variance
	Original	Final		
<b>DISBURSEMENTS</b>				
General Government:				
Legislative	32,259	32,259	22,653	9,606
Elections	978	978	300	678
Financial Administration	120,864	120,864	109,179	11,685
Other	20,000	23,160	21,354	1,806
Public Safety:				
Police	34,942	34,942	32,694	2,248
Protective Inspection	1,000	1,000	1,000	-
Public Works:				
Highways and Streets	44,483	65,232	52,347	12,885
Sanitation	31,250	33,905	33,905	-
Conservation and Development:				
Planning and Zoning	4,784	4,784	2,118	2,666
<b>TOTAL DISBURSEMENTS</b>	<u>290,560</u>	<u>317,124</u>	<u>275,550</u>	<u>41,574</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Contingency	(15,293)	-	-	-
Transfers in	11,803	11,803	11,803	-
Transfers (Out)	-	(3,143)	(3,142)	1
<b>TOTAL OTHER FINANCING SOURCES (USES)</b>	<u>(3,490)</u>	<u>8,660</u>	<u>8,661</u>	<u>1</u>
<b>NET CHANGE IN FUND BALANCE</b>	-	(14,414)	63,235	77,649
<b>FUND BALANCE - BEGINNING</b>	<u>71,137</u>	<u>71,137</u>	<u>71,137</u>	-
<b>FUND BALANCE - ENDING</b>	<u>\$ 71,137</u>	<u>\$ 56,723</u>	<u>\$ 134,372</u>	<u>\$ 77,649</u>

See independent auditor's report.

**Town of Hermosa, South Dakota**  
**Notes to Supplementary Information**  
**For the Year Ended December 31, 2018**

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**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 Board of Trustees, 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% of the total municipal budget and may be transferred by resolution of the Board of Trustees 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 Board of Trustees. The Town did not encumber any amounts at December 31, 2018.

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, 2018**

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BOARD OF TRUSTEES

Dan Holsworth

Vicki Henrichsen

Robert King

Kathy Saulton

Linda Kramer

FINANCE OFFICER

Bobbie Johnson

See independent auditor's report.