

TOWN OF HERMOSA, SOUTH DAKOTA

INDEPENDENT AUDITOR'S REPORTS,
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

DECEMBER 31, 2019

CASEY  PETERSON
Leading the Way.

RAPID CITY, SOUTH DAKOTA
GILLETTE, WYOMING

Town of Hermosa, South Dakota
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December 31, 2019

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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, 2019, 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 September 10, 2020.

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.

A *deficiency in internal control* exists when the design of the 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 statement will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not identified. However, we consider the deficiencies 2019-001, 2019-002, and 2019-003 described in the accompanying Schedule of Findings and Management's Responses to be material weaknesses.

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 an instance of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards* and which is described in the accompanying Schedule of Findings and Management's Responses as item 2019-003.

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
September 10, 2020

Town of Hermosa, South Dakota
Schedule of Findings and Management's Responses
December 31, 2019

Material Weakness

Internal Controls Related to Drafting Financial Statements

2019-001 *Condition:* As the auditor, we were requested to draft the financial statements and the accompanying notes to the financial statements.

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 decide 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 Lack of Segregation of Duties

2019-002 *Condition:* The lack of accounting experience among the few staff members does not allow the Town to perform oversight and have separate incompatible accounting functions or processes that 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. Accounting transactions 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: With the turnover in the Finance Officer position in the current year, there were times during the year in which there was only one person in the office. There are also other areas; cash receipts and journal entries where there is a lack of oversight and review. 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 decide 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.

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

Town of Hermosa, South Dakota
Schedule of Findings and Management's Responses (Continued)
December 31, 2019

Material Weakness
Internal Control over Compliance
Statutory Noncompliance

2019-003 *Condition:* During our review of statutory compliance, we noted that the Town was not in compliance with state statute SDLC 9-21-9, which requires municipalities to refrain from spending in excess of the amount appropriated for any purpose or any department during the fiscal year.

Criteria: Expenditures by department should be limited to the amounts appropriated by the Board of Trustees and approved in the annual budget.

Cause: Budgets were not adequately monitored and supplemental appropriations were not made. Therefore, budgeted expenditures were exceeded in several departments.

Effect: The Town is not in compliance with SDCL 9-21-9

Auditor's Recommendation: We recommend that the Town review statutory requirements and review approved budgets versus expenditures on a timely basis.

Management's Response: The Town will familiarize itself with budgetary requirements and review the budget timely.

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, 2019, 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 modified cash basis financial position 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, 2019, and the respective changes in modified cash basis financial position for the year then ended in accordance with the modified cash 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.

Other Matters

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole that collectively comprise the Town of Hermosa, South Dakota's basic financial statements. The budgetary comparison information on pages 36 - 37, Schedule of Net Pension Liability (Asset) on page 38, Schedule of Pension Contributions on page 39, and Notes to the Supplementary Information on page 40, and list of Town Officials on page 41, 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 September 10, 2020, 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 the Town of Hermosa, South Dakota's internal control over financial reporting and compliance.



Casey Peterson, Ltd.

Rapid City, South Dakota
September 10, 2020

BASIC FINANCIAL STATEMENTS

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Town of Hermosa, South Dakota
Statement of Net Position – Modified Cash Basis
December 31, 2019

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
ASSETS			
Cash and Cash Equivalents	\$ 425,132	\$ 470,083	\$ 895,215
Investments	18,766	-	18,766
Restricted Assets:			
Customer Deposit Reserve	<u>-</u>	<u>13,161</u>	<u>13,161</u>
TOTAL ASSETS	<u>\$ 443,898</u>	<u>\$ 483,244</u>	<u>\$ 927,142</u>
NET POSITION			
Restricted for:			
Debt Service	\$ 234,798	\$ 23,004	\$ 257,802
Construction	1,500	-	1,500
Customer Deposits	-	13,161	13,161
Unrestricted	<u>207,600</u>	<u>447,079</u>	<u>654,679</u>
TOTAL NET POSITION	<u>\$ 443,898</u>	<u>\$ 483,244</u>	<u>\$ 927,142</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, 2019

Functions/Programs	Disbursements	Program Receipts	
		Charges for Services	Capital Grants, Loans and Contributions
PRIMARY GOVERNMENT			
Governmental Activities:			
General Government	\$ 179,160	\$ 15,713	\$ -
Public Safety	41,313	-	-
Public Works	109,389	63,922	1,099
Conservation and Development	<u>3,267</u>	<u>-</u>	<u>-</u>
Total Governmental Activities	<u>333,129</u>	<u>79,635</u>	<u>1,099</u>
Business-type Activities:			
Water	91,669	119,132	-
Sewer	<u>52,870</u>	<u>74,931</u>	<u>-</u>
Total Business-type Activities	<u>144,539</u>	<u>194,063</u>	<u>-</u>
Total Primary Government	<u>\$ 477,668</u>	<u>\$ 273,698</u>	<u>\$ 1,099</u>

GENERAL RECEIPTS

Taxes:

Property Taxes

Sales Tax

State Shared Receipts

Unrestricted Investment Earnings

Miscellaneous Receipts

Insurance Proceeds on Damaged Assets

Transfers

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
\$ (163,447)	\$ -	\$ (163,447)
(41,313)	-	(41,313)
(44,368)	-	(44,368)
(3,267)	-	(3,267)
(252,395)	-	(252,395)
-	27,463	27,463
-	22,061	22,061
-	49,524	49,524
(252,395)	49,524	(202,871)
109,575	-	109,575
187,043	-	187,043
21,007	-	21,007
3,986	-	3,986
10,034	-	10,034
16,919	-	16,919
9,607	(9,607)	-
358,171	(9,607)	348,564
105,776	39,917	145,693
338,122	443,327	781,449
\$ 443,898	\$ 483,244	\$ 927,142

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, 2019

	General Fund	Tax Increment District #1 - Debt Service Fund	Nonmajor Funds	Total Governmental Funds
ASSETS				
Cash and Cash Equivalents	\$ 173,830	\$ 234,798	16,504	\$ 425,132
Investments	<u>18,766</u>	<u>-</u>	<u>-</u>	<u>18,766</u>
TOTAL ASSETS	<u>\$ 192,596</u>	<u>\$ 234,798</u>	<u>\$ 16,504</u>	<u>\$ 443,898</u>
FUND BALANCES				
Restricted for:				
Debt Service	\$ -	\$ 234,798	\$ -	\$ 234,798
Construction	-	-	1,500	1,500
Committed for:				
City Promotion	-	-	15,004	15,004
Unassigned	<u>192,596</u>	<u>-</u>	<u>-</u>	<u>192,596</u>
TOTAL FUND BALANCES	<u>\$ 192,596</u>	<u>\$ 234,798</u>	<u>\$ 16,504</u>	<u>\$ 443,898</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, 2019

	General Fund	Tax Increment District #1 - Debt Service Fund	Nonmajor Funds	Total Governmental Funds
RECEIPTS				
Taxes:				
General Property Taxes	\$ 50,350	\$ 58,578	\$ -	\$ 108,928
General Sales and Use Taxes	175,905	-	11,138	187,043
Penalties and Interest on Delinquent Taxes	267	380	-	647
Licenses and Permits	15,713	-	-	15,713
Intergovernmental Receipts:				
State Grants	1,099	-	-	1,099
State Shared Receipts:				
Other	11,909	-	-	11,909
County Road Tax	10,024	-	-	10,024
Charges for Goods and Services:				
General Government	63,922	-	-	63,922
Fines and Forfeits:				
Court Fines and Costs	320	-	-	320
Miscellaneous Revenue:				
Investment Earnings	3,986	-	-	3,986
Other	8,788	-	-	8,788
TOTAL RECEIPTS	342,283	58,958	11,138	412,379

The accompanying notes are an integral part of this statement.

	General Fund	District #1 - Debt Service Fund	Nonmajor Funds	Total Governmental Funds
DISBURSEMENTS				
General Government:				
Legislative	40,418	-	-	40,418
Elections	844	-	-	844
Financial Administration	118,535	-	-	118,535
Other	19,363	-	-	19,363
Public Safety:				
Police	37,103	-	-	37,103
Protective Inspection	510	-	-	510
Public Works:				
Highways and Streets	54,979	-	-	54,979
Sanitation	31,866	-	-	31,866
Conservation and Development:				
Planning and Zoning	2,389	-	-	2,389
Debt Service	-	22,544	-	22,544
Capital Outlay	4,578	-	-	4,578
TOTAL DISBURSEMENTS	<u>310,585</u>	<u>22,544</u>	<u>-</u>	<u>333,129</u>
OTHER FINANCING SOURCES				
Transfers In	9,607	-	-	9,607
Compensation for Loss or Damage to Capital Assets	16,919	-	-	16,919
TOTAL OTHER FINANCING SOURCES	<u>26,526</u>	<u>-</u>	<u>-</u>	<u>26,526</u>
NET CHANGE IN FUND BALANCE	58,224	36,414	11,138	105,776
FUND BALANCE - BEGINNING	<u>134,372</u>	<u>198,384</u>	<u>5,366</u>	<u>338,122</u>
FUND BALANCE - ENDING	<u>\$ 192,596</u>	<u>\$ 234,798</u>	<u>\$ 16,504</u>	<u>\$ 443,898</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, 2019

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total Proprietary Funds</u>
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 234,140	\$ 235,943	\$ 470,083
Restricted Assets:			
Customer Deposit Reserve	<u>13,161</u>	<u>-</u>	<u>13,161</u>
TOTAL ASSETS	<u><u>\$ 247,301</u></u>	<u><u>\$ 235,943</u></u>	<u><u>\$ 483,244</u></u>
NET POSITION			
Restricted for:			
Revenue Bond Debt Service	\$ 19,170	\$ 3,834	\$ 23,004
Customer Deposits	13,161	-	13,161
Unrestricted	<u>214,970</u>	<u>232,109</u>	<u>447,079</u>
TOTAL NET POSITION	<u><u>\$ 247,301</u></u>	<u><u>\$ 235,943</u></u>	<u><u>\$ 483,244</u></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, 2019

	Water Fund	Sewer Fund	Total Proprietary Funds
OPERATING RECEIPTS			
Revenue Dedicated to Servicing Debt	\$ 119,132	\$ 74,931	\$ 194,063
OPERATING DISBURSEMENTS			
Operations Disbursements	50,496	44,817	95,313
Capital Expenditures	1,343	-	1,343
Total Operating Disbursements	51,839	44,817	96,656
OPERATING INCOME	67,293	30,114	97,407
NONOPERATING DUSBURSEMENTS			
Debt Service Payments	(39,830)	(8,053)	(47,883)
TRANSFERS			
Transfers Out	-	(9,607)	(9,607)
CHANGE IN NET POSITION	27,463	12,454	39,917
NET POSITION - BEGINNING	219,838	223,489	443,327
NET POSITION - ENDING	\$ 247,301	\$ 235,943	\$ 483,244

The accompanying notes are an integral part of this statement.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

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 each function of the Town's governmental activities. Direct disbursements are those that are specifically associated with a program or function and, therefore, are 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 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, 2019

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 the civic center, auditorium, or athletic facility buildings, including the maintenance, staffing, and operations of such facilities; and the promotion and advertising of the Town (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 may be used to report any activity for which a fee is charged to external users for goods or services. Activities required to be reported as enterprise funds if any one of the following criteria is met. Governments should apply each of these criteria in the context of the activity's principal revenue sources. A) The activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of activity. Debt that is secured by a pledge of net revenues from fees and charges and the full faith and credit of a related primary government or component unit – even if that government is not expected to make any payments – is not payable solely from fees and charges of the activity. (Some debt may be secured, in part, by a portion of its own proceeds but should be considered as payable “solely” from the revenues of the activity. B) Laws or regulations require that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues. C) The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service)

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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2019.

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 as defined below.

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 statement of financial position 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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

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 the modified cash basis of accounting. The Town has not elected to modify their cash basis presentation by recording capital assets arising from cash transactions and depreciating those assets where appropriate so any capital assets owned by the Town and the related depreciation are not reported on the financial statements of the Town.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. LONG-TERM LIABILITIES

Long-term liabilities include, but are not limited to, 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 are 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.

I. PROGRAM RECEIPTS

Program receipts derive directly from the program itself or 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 others who purchase, use or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services.
2. *Program-specific Operating Grants and Contributions* - 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

In the proprietary fund's Statement of Revenues, Expenses, and Changes in Net Position, receipts and disbursements are classified as operating or non-operating receipts and disbursements. Operating receipts and disbursements directly relate to the purpose of the fund.

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 does not meet the definition of Restricted Net Position.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 that 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 do not lapse at year-end.

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 - VIOLATIONS OF FINANCE-RELATED LEGAL AND CONTRACTUAL PROVISIONS

The Town is prohibited by statute from spending in excess of appropriated amounts at the department level. The following represents the significant overdrafts of the expenditures compared to appropriations:

<u>General Fund</u>	<u>Appropriations</u>	<u>Total Spent</u>	<u>Overdraft of Expenditures</u>
General Government:			
Legislative / Executive	\$ 27,173	\$ 40,418	\$ (13,245)
Public Safety:			
Police	33,832	37,103	(3,271)
Public Works:			
Highways and Streets	45,628	54,979	(9,351)
Conservation and Development:			
Planning and Zoning	-	2,389	(2,389)
	<u>\$ 106,633</u>	<u>\$ 134,889</u>	<u>\$ (28,256)</u>

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 3 - 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.

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 or trust company designated by the political subdivision as its fiscal agent. The investments held by the Town at December 31, 2019 were as follows:

	<u>Credit Rating</u>	<u>Maturities</u>	<u>Initial Cost</u>
Investment:			
FNMA Pool	AA+	3 - 15 yrs	\$ 1,306
GNMA Pool	AAA	10 - 15 yrs	445
FHLMC Pool	AA+	7 - 17 yrs	<u>172</u>
Total Bonds:			1,923
Mutual Funds			16,744
Cash Held in Money Market			<u>99</u>
Total Investments			<u>\$ 18,766</u>

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 the 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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 3 - DEPOSITS AND INVESTMENTS (CONTINUED)

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, 2019 was \$137,136, 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, 2019, 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 or 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 4 - 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 5 - COMMITMENTS

The following is a summary of changes in long-term debt commitments for the year ended December 31, 2019:

	Beginning Balance 01/01/19	Additions	Payments	Ending Balance 12/31/19	Due in One Year
Rural Development Bond 2005	\$ 235,718	\$ -	\$ (5,720)	\$ 229,998	\$ 5,426
Rural Development Bond 2009	85,220	-	(1,410)	83,810	1,440
Rural Development Bond 2010	45,432	-	(863)	44,569	821
Installment Sale	3,864	-	(3,864)	-	-
State Revolving Fund Loan #1	23,105	-	(17,220)	5,885	5,885
State Revolving Fund Loan #2	134,500	-	-	134,500	3,308
Consolidated Loan 2012L-109	91,738	-	(4,543)	87,195	4,680
Tax Incremental District Loan #1	265,895	-	(6,722)	259,173	6,943
	<u>\$ 885,472</u>	<u>\$ -</u>	<u>\$ (40,342)</u>	<u>\$ 845,130</u>	<u>\$ 28,503</u>

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 5 - COMMITMENTS (CONTINUED)

The Town holds three Water and Sewer Financing Bonds with USDA Rural Development for the purpose of paying project costs associated with the 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 4.25%. Interest expense on the three notes paid for the year ended December 31, 2019 was \$15,012. 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 the 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 required annual payments of \$2,300 until June 2020 and was paid off during the year ended December 31, 2019. All payments included interest at 6%. Interest expense for the year ended December 31, 2019 was \$355. This debt was 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 twenty years beginning September 1, 2000. Interest is accrued at a rate of 5%. Interest expense for the year ended December 31, 2019 was \$653. This debt is paid by the Water Fund.

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, 2019 the Town had drawn down a total of \$134,500. The loan has a term of 30 years at 2% interest with quarterly payments of \$1,493. Interest expense for the year ended December 31, 2019 was \$2,787. 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 loan has a term of 30 years at 3.25% interest with quarterly payments of \$3,821. 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, 2019 was \$8,560.

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. 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, 2019 was \$2,718.

The Town was in compliance with debt covenants for the year ending December 31, 2019. The debt covenants consist of a bond reserve 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 that 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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 5 - COMMITMENTS (CONTINUED)

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>70,427</u>
Pledged Revenue:	
Tax Increment Receipts	\$ 58,578
Water Fund Receipts	119,132
Sewer Fund Receipts	<u>74,931</u>
Total Pledged Revenue	<u>\$ 252,641</u>

The annual requirements to amortize all debt outstanding as of December 31, 2019 are as follows:

	Principal	Interest	Total
2020	\$ 28,503	\$ 28,975	\$ 57,478
2021	23,379	28,142	51,521
2022	24,166	27,355	51,521
2023	24,981	26,539	51,520
2024	25,825	25,696	51,521
2025 - 2029	142,865	114,737	257,602
2030 - 2034	168,936	88,668	257,604
2035 - 2039	161,147	60,149	221,296
2040 - 2044	185,858	29,068	214,926
2045 - 2049	59,470	5,132	64,602
	<u>\$ 845,130</u>	<u>\$ 434,461</u>	<u>\$ 1,279,591</u>

NOTE 6 - 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.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 6 - PENSION PLAN (CONTINUED)

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.

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 3rd 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 3rd 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, 2019, 2018, and 2017 were \$4,101, \$3,084, and \$2,601 respectively, and were equal to the required contributions each year.

**Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019**

NOTE 6 - PENSION PLAN (CONTINUED)

Pension Assets and Pension Expense.

At June 30, 2019, SDRS was 100.09% 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, 2019 and reported by the Town as of December 31, 2019 are as follows:

Proportionate Share of Total Pension Liability	\$ 400,610
Less: Proportionate Share of Net Position Restricted for Pension Benefits	<u>400,951</u>
Proportionate Share of Net Pension Liability (Asset)	<u>\$ (341)</u>

At December 31, 2019, the Town reported a liability (asset) of \$(341) for its proportionate share of the net pension liability (asset). The net pension liability (asset) was measured as of June 30, 2019 and the total pension liability (asset) used to calculate the net pension liability (asset) was based on the projection of the Town's share of contributions to the pension plan relative to the contributions of all participating entities. As of June 30, 2019, the Town's proportion was .0032146% which is an increase of .0007421% from its proportion measured as of June 30, 2018.

Actuarial Assumptions

The total pension liability (asset) in the June 30, 2019 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
Future COLAs	1.88%

Mortality rates were based on 97% of the RP-2014 Mortality Table, adjusted to 2006 and projected generationally with Scale MP-2016, white-collar rates for females and total dataset rates for males. Mortality rates for disabled members were based on the RP-2014 Disabled Retiree Mortality Table, adjusted to 2006 and projected generationally with Scale MP-2016.

The actuarial assumptions used in the June 30, 2019 valuation were based on the results of an actuarial experience study for the period of July 1, 2011 to June 30, 2016.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 6 - PENSION 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 the 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, 2019 (see the discussion of the pension plan's investment policy) are summarized in the following table using geometric means:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
Global Equity	58.0%	4.7%
Fixed Income	30.0%	1.7%
Real Estate	10.0%	4.3%
Cash	2.0%	0.9%
Total	100.0%	

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 one percentage point lower (5.50%) or 1-percentage point higher (7.50%) than the current rate:

	1% Decrease	Current Discount Rate	1% Increase
Town's Proportionate Share of Net Pension Liability (Asset)	\$ 56,543	\$ (341)	\$ (46,690)

Pension Plan Fiduciary Net Position

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

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 7 - 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, 2019, 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, 2019, no claims were paid for unemployment benefits. At December 31, 2019, 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 a Members' Annual Operating Contribution, 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, auto liability, auto damage, law enforcement, and property.

Effective January 1, 2018, the SDPAA revised the method of calculating the amount available to be refunded to a withdrawing member. Upon giving proper written notice to the SDPAA a member may withdraw. With 120 days following withdrawal, or as soon thereafter as the next Annual Budget is completed, the SDPAA will advise the withdrawing member of its total calculated portion of contributions made to the SDPAA that shall be refunded. Refunds are calculated based on the pool's total contributions along with the member's total contributions, current losses, unpaid losses, and loss expenses, the member's loss ratio, and number of membership years.

A member who withdraws from the SDPAA shall receive a calculated portion of their contributions refunded for unpaid casualty losses, based on the following schedule:

<u>Years</u>	<u>Percentage</u>
1	55%
2	50%
3	40%
4	35%
5	30%
6+	20%

All refunds shall be paid to the withdrawing Member over a five-year term.

Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019

NOTE 7 - RISK ASSESSMENT (CONTINUED)

As of December 31, 2019, the Town's balance available to be refunded per the SDPAA was \$7,673, which was an increase of \$2,140 from the previous year. The deposit is not recorded in the Town's financial statements due to the modified cash basis of accounting elected by the Town.

The Town carries a \$500 deductible for the property damage coverage and \$100/\$250 deductible for auto damage coverage.

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 8 - RESTRICTED ASSETS

The City is obligated for customer deposits in the Water Fund in the amount of \$13,161.

NOTE 9 - 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	\$ 257,802
Customer Deposits	State Law	13,161
Construction	Grant Agreement	1,500
		<u>\$ 272,463</u>

**Town of Hermosa, South Dakota
Notes to the Financial Statements
December 31, 2019**

NOTE 10 - INTERFUND TRANSFERS

Interfund transfers for the year ended December 31, 2019 were as follows:

<u>Transfer From:</u>	<u>Transfer To:</u>
	<u>General Fund</u>
Sewer Fund	<u>\$ 9,607</u>

All transfers were made to help fund operations.

NOTE 11 - SUBSEQUENT EVENTS

Subsequent to year-end, the World Health Organization declared the novel coronavirus (COVID-19) outbreak a public health emergency. There have been mandates from state and local authorities requiring a forced closure of schools, businesses, and other facilities and organizations. The extent of the impact COVID-19 on the Town's operation and financial performance will depend on certain developments, including the duration and spread of the outbreak, and the impact on the Town's customers, employees, and vendors, all of which is uncertain and cannot be predicted. The financial impact cannot be estimated at this time.

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.

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SUPPLEMENTARY INFORMATION

Town of Hermosa, South Dakota
Budgetary Comparison Schedule - Budgetary Basis - General Fund
For the Year Ended December 31, 2019

	<u>Budgeted Amounts</u>		<u>Budgetary</u>	<u>Positive</u>
	<u>Original</u>	<u>Final</u>	<u>Basis - Actual</u>	<u>(Negative)</u>
			<u>Amounts</u>	<u>Variance</u>
RECEIPTS				
Taxes:				
General Property Taxes	\$ 53,000	\$ 53,000	\$ 50,350	\$ (2,650)
General Sales and Use Taxes	150,800	150,800	175,905	25,105
Penalties and Interest on				
Delinquent Taxes	2,450	2,450	267	(2,183)
Licenses and Permits	5,750	5,750	15,713	9,963
Intergovernmental Revenue:				
State Grants	1,200	1,200	1,099	(101)
Intergovernmental Receipts:				
State Shared Revenue:				
Liquor Tax Reversion	2,200	2,200	2,594	394
State Highway/Bridge Revenue	1,900	1,900	1,959	59
Motor Vehicle Comm Prorate	850	850	760	(90)
Bank Franchise Tax	180	180	185	5
Other	-	-	6,411	6,411
County Motor Vehicle License	8,500	8,500	10,024	1,524
Charges for Goods and Services:				
Liquor Revenue	24,500	24,500	23,517	(983)
Garbage Service Revenue	39,000	39,000	40,405	1,405
Fines and Forfeits:				
Court Fines and Costs	250	250	320	70
Miscellaneous Revenue:				
Investment Earnings	950	950	3,986	3,036
Other	7,890	7,890	8,788	898
TOTAL RECEIPTS	<u>299,420</u>	<u>299,420</u>	<u>342,283</u>	<u>42,863</u>

See independent auditor's report.

	Budgeted Amounts		Budgetary Basis - Actual Amounts	Positive (Negative) Variance
	Original	Final		
DISBURSEMENTS				
General Government:				
Legislative	27,173	27,173	40,418	(13,245)
Elections	978	978	844	134
Financial Administration	127,395	127,395	118,535	8,860
Other	20,000	20,000	19,363	637
Public Safety:				
Police	33,832	33,832	37,103	(3,271)
Protective Inspection	2,000	2,000	510	1,490
Public Works:				
Highways and Streets	45,628	45,628	54,979	(9,351)
Sanitation	32,400	32,400	31,866	534
Conservation and Development:				
Planning and Zoning	-	-	2,389	(2,389)
Capital Outlay	4,946	4,946	4,578	368
TOTAL DISBURSEMENTS	<u>294,352</u>	<u>294,352</u>	<u>310,585</u>	<u>(16,233)</u>
OTHER FINANCING SOURCES (USES)				
Contingency	(14,675)	-	-	-
Compensation for Damage to Capital Assets	-	-	16,919	16,919
Transfers in	9,607	9,607	9,607	-
TOTAL OTHER FINANCING SOURCES (USES)	<u>(5,068)</u>	<u>9,607</u>	<u>26,526</u>	<u>16,919</u>
NET CHANGE IN FUND BALANCE	-	14,675	58,224	43,549
FUND BALANCE - BEGINNING	<u>134,372</u>	<u>134,372</u>	<u>134,372</u>	<u>-</u>
FUND BALANCE - ENDING	<u>\$ 134,372</u>	<u>\$ 149,047</u>	<u>\$ 192,596</u>	<u>\$ 43,549</u>

See independent auditor's report.

**Town of Hermosa, South Dakota
Schedule of the Town's Proportionate Share
of the Net Pension Liability (Asset)
South Dakota Retirement System**

Year*	Town's Proportion of Net Pension Liability/Asset	Town's Proportionate Share of Net Pension Liability (Asset) (a)	Town's Covered- employee Payroll (b)	Town's Proportionate Share of Net Pension Liability (Asset) as a Percentage of its Covered- employee Payroll (a/b)	Plan Fiduciary Net Pension as a Percentage of its Total Pension Liability/Asset
6/30/19	0.0032146%	\$ (341)	\$ 68,350	0.50%	100.09%
6/30/18	0.0024743%	(58)	51,400	0.11%	100.02%
6/30/17	0.0021336%	(194)	43,350	0.45%	100.10%
6/30/16	0.0027474%	9,280	52,250	17.76%	96.89%
6/30/15	0.0042522%	(18,035)	77,633	23.23%	104.10%

*The amounts presented for each fiscal year were determined as of the measurement date of the collective net pension liability (asset) which is 6/30. Until a full 10-year trend is compiled, the Town will present information for those years for which information is available.

See independent auditor's report.

**Town of Hermosa, South Dakota
Schedule of Pension Contributions
South Dakota Retirement System**

Year*	Contractually- required Contribution (a)	Contributions in Relation to the Contractually- required Contribution (b)	Contribution Deficiency (Excess) (a-b)	Town's Covered- employee Payroll (c)	Contributions as a Percentage of Covered- employee Payroll (b/c)
12/31/19	\$ 4,101	\$ 4,101	-	\$ 68,350	6.0%
12/31/18	3,084	3,084	-	51,400	6.0%
12/31/17	2,601	2,601	-	43,350	6.0%
12/31/16	3,135	3,135	-	52,250	6.0%
12/31/15	4,658	4,658	-	77,633	6.0%

* Until a full 10-year trend is compiled, the Town will present information for those years for which information is available.

See independent auditor's report.

Town of Hermosa, South Dakota
Notes to Supplementary Information
For the Year Ended December 31, 2019

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 or within ten days thereafter, the Board of Trustees 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 a 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, 2019.

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

NOTE 3 - SCHEDULE OF PENSION CONTRIBUTIONS

Changes in Benefit Terms:

No significant changes.

Changes of Assumptions:

Legislation enacted in 2017 modified the SDRS COLA. For COLAs first applicable in 2018, the SDRS COLA will equal the percentage increase in the most recent third calendar quarter CPI-W over the prior year, no less than 0.5% and not greater than 3.5%. However, if the FVFR assuming the long-term COLA is equal to the baseline COLA assumption (currently 2.25%) is less than 100%, the maximum COLA payable will be limited to the increase that if assumed on a long-term basis, results in a FVFR equal to or exceeding 100%. That condition existed as of June 30, 2018 and exists again this year as of June 30, 2019. Future COLAs are assumed to equal the current restricted maximum COLA which was 2.03% as of June 30, 2018 and is 1.88% as of June 30, 2019.

The changes in actuarial assumptions decreased the Actuarial Accrued Liability by 1.5% of the Actuarial Accrued Liability based on the 2.03% COLA, reflecting the current and assumed future restricted maximum COLA of 1.88%.

Actuarial assumptions are reviewed in depth periodically, with the next experience analysis anticipated before the June 30, 2022 Actuarial Valuation and any recommended changes anticipated to be first implemented in the June 30, 2022 Actuarial Valuation.

See independent auditor's report.

**Town of Hermosa, South Dakota
Town Officials
December 31, 2019**

BOARD OF TRUSTEES

Vicki Henrichsen

Robert King

Berni Flug

Dan Holsworth

Terry Schumack

FINANCE OFFICER

Gail Boddicker

See independent auditor's report.