

**City of Talladega
Water and Sewer Department**

FINANCIAL STATEMENTS

September 30, 2019



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City of Talladega Water and Sewer Department
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September 30, 2019

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INDEPENDENT AUDITORS' REPORT

To the Manager and City Council
City of Talladega, Alabama

We have audited the accompanying financial statements of the City of Talladega Water and Sewer Department of the City of Talladega, Alabama (the "Water and Sewer Department"), as of and for the year ended September 30, 2019, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 auditors' 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 Water and Sewer Department'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 Water and Sewer Department's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water and Sewer Department as of September 30, 2019, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Water and Sewer Department and do not purport to, and do not present fairly the financial position of the City of Talladega, Alabama, as of September 30, 2019, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the schedules listed in the table of contents as required supplementary information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require supplementing the basic financial statements. Such missing information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2020 on our consideration of the Water and Sewer Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Water and Sewer Department'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 Department's internal control over financial reporting and compliance.

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, L.L.C.
Enterprise, Alabama

September 15, 2020

**City of Talladega Water and Sewer Department
Statement of Net Position**

September 30,

2019

Assets and deferred outflows of resources

Current assets

Cash and cash equivalents	\$	6,025,457
Accounts receivable (net of allowance for doubtful accounts of \$668,035)		664,137
Unbilled revenue		888,985
Prepaid expenses		19,068
Inventory of supplies		256,466

Total current assets		7,854,113
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Noncurrent assets

Noncurrent restricted assets

Investments		4,336,194
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Capital assets

Land		279,326
Land improvements		312,564
Buildings and improvements		46,206,709
Machinery and equipment		6,056,820
Construction in progress		863,543

		53,718,962
Less accumulated depreciation		27,133,526

Total capital assets, net of accumulated depreciation		26,585,436
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Total noncurrent assets		30,921,630
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Deferred outflows of resources

Deferred outflows of resources - pension		332,036
Deferred outflows of resources - OPEB		163,588
Deferred charges from refunding		106,434

Total deferred outflows of resources		602,058
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Total assets and deferred outflows of resources	\$	39,377,801
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-Continued-

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

**City of Talladega Water and Sewer Department
Statement of Net Position (Continued)**

September 30,

2019

Liabilities, deferred inflows of resources and net position

Liabilities

Current liabilities

Accounts payable and accrued expenses	\$	634,797
Interfund payable		104,917
Current portion of long-term debt		465,000

Total current liabilities		1,204,714
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Noncurrent liabilities

Compensated absences		124,359
Customer meter deposits		230,867
Revenue warrants payable, net		19,710,389
Net pension liability		1,461,271
Net OPEB Liability		826,748

Total noncurrent liabilities		22,353,634
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Total liabilities		23,558,348
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Deferred inflows of resources

Deferred inflows of resources - pension		234,946
Deferred inflows of resources - OPEB		40,092

Total deferred inflows of resources		275,038
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Net position

Net investment in capital assets		9,383,351
Restricted for:		
Debt service		37,049
Capital improvements		4,222,379
Unrestricted		1,901,636

Total net position		15,544,415
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Total liabilities, deferred outflows of resources, and net position	\$	39,377,801
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The accompanying notes are an integral part of these financial statements.

City of Talladega Water and Sewer Department
Statement of Revenues, Expenses and Changes in Fund Net Position

<i>Year ended September 30,</i>	2019
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Operating revenues	
Water revenues	\$ 3,995,732
Sewer revenues	2,732,041
Garbage revenues	1,059,735
Other operating revenues	416,941
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Total operating revenues	8,204,449
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Operating expenses	
Water and sewer department expenses	1,016,803
Waste water plants	1,532,661
Water filters and wells	949,774
Garbage collection expenses	1,028,322
General and administrative expenses	1,519,313
Depreciation expense	1,491,455
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Total operating expenses	7,538,328
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Operating income	666,121
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Nonoperating revenues (expenses)	
Interest income	94,452
Grant revenue	62,593
Proceeds from sale of property	73,682
Interest expense	(929,628)
<hr/>	
Total nonoperating revenues (expenses)	(698,901)
<hr/>	
Income Before Transfers	(32,780)
Transfers in	29,223
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Change in net position	(3,557)
<hr/>	
Net position - beginning	15,547,972
<hr/>	
Net position - end	\$ 15,544,415
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The accompanying notes are an integral part of these financial statements.

City of Talladega Water and Sewer Department
Statement of Cash Flows

<i>For the year ended September 30,</i>	2019
Cash Flows From Operating Activities	
Cash received from customers	\$ 7,879,519
Cash paid to suppliers	(4,352,960)
Cash paid to employees	(1,897,959)
Net cash provided by operating activities	1,628,600
Cash Flows From Non-Capital Financing Activities	
Grant revenue	62,593
Transfers from other departments	29,223
Net cash provided by non-capital financing activities	91,816
Cash Flows From Capital and Related Financing Activities	
Acquisition and construction of capital assets	(2,737,512)
Proceeds from sale of capital assets	73,682
Principal paid on long-term debt	(445,000)
Interest paid on long-term debt	(895,325)
Net cash used in capital and related financing activities	(4,004,155)
Cash Flows From Investing Activities	
Interest received	94,452
Net Decrease in Cash and Cash Equivalents	(2,189,287)
Cash and cash equivalents - Beginning	12,550,938
Cash and cash equivalents - Ending	\$ 10,361,651
Reconciliation of Cash and cash equivalents to the Statement of Net Position	
Cash and cash equivalents	\$ 6,025,457
Investments	4,336,194
Total	\$ 10,361,651

-Continued-

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

**City of Talladega Water and Sewer Department
Statement of Cash Flows (Continued)**

For the year ended September 30,

2019

**Reconciliation of Operating Income to Net Cash Provided
by Operating Activities:**

Operating income	\$	666,121
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		1,491,455
Change in operating assets and liabilities:		
Decrease in accounts receivable		6,667
Increase in unbilled revenue		(331,597)
Decrease in prepaid expenses		5,032
Decrease in inventory of supplies		20,004
Increase in deferred outflows of resources		(153,186)
Decrease in accounts payable and accrued expenses		(249,709)
Increase in interfund payable		58,506
Decrease in customer deposits		(243)
Decrease in net pension liability		(106,545)
Increase in net OPEB liability		164,443
Increase in deferred inflows of resources		57,652
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Net cash provided by operating activities	\$	1,628,600

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

City of Talladega Water and Sewer Department

Notes to Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Talladega Water and Sewer Department (the “Water and Sewer Department”) have been prepared in accordance with accounting principles generally accepted in the United States of America and reporting guidelines established by the Governmental Accounting Standards Board (“GASB”). The following notes to the financial statements are an integral part of the Water and Sewer Department’s financial statements.

Reporting Entity

The Water and Sewer Department is a department of the City of Talladega, Alabama (the “City”) and its governing body is the City Council of the City. The Water and Sewer Department, a proprietary fund, serves the entire geographic area of the City and is defined as a component unit of the City.

Proprietary 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 for 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, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Basis of Accounting

The Water and Sewer Department is reported as a proprietary fund and uses the economic resources measurement focus and the accrual basis of accounting. The accrual basis of accounting recognizes revenues when earned and expenses when incurred. Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Water and Sewer Department’s enterprise fund are charges to customers for sales and services. The Water and Sewer Department also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash and Cash Equivalents

The Water and Sewer Department’s cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

The Water and Sewer Department's investments consist of mutual funds which are invested in short-term U.S. Treasury obligations. Investments are reported at fair market value.

Accounts Receivable

Provisions for credit losses are charged to income in amounts sufficient to maintain the allowance at a level considered adequate to cover current losses, as deemed necessary by management. Bad debt expense was \$0 for the year ended September 30, 2019, and the allowance for doubtful accounts was \$668,035 at September 30, 2019.

Inventories

Inventories of unused supplies and pipe are physically counted at the end of each fiscal year and recorded at the lower of average cost or market, with cost being determined by the first-in, first-out method. Inventories expended for repairs are recorded as expenditures when consumed. Inventories expended for capital improvements are capitalized.

Prepaid Expenses

Insurance premiums are paid annually, recorded as prepaid expense and amortized each month.

Restricted Assets

Certain assets of the Water and Sewer Department are reported as restricted in the statement of net position. Restricted assets consist of cash deposited in restricted trust department accounts with banks. Debt service funds set aside for the payment of debt service on the Water and Sewer Department's debt are restricted by contractual provisions contained in the corresponding debt agreements and total \$113,815 at September 30, 2019. Additional funds are set aside for capital improvements in accordance with contractual provisions of debt agreements and total \$4,222,379 at September 30, 2019.

Capital Assets

Capital assets are recorded at cost when purchased or constructed. The Water and Sewer Department records water and sewer lines constructed by sub-dividers as a part of capital assets, upon completion of subdivision. Contributed assets are recorded at the estimated fair value at the date of donation. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized. Interest has not been capitalized during the construction of assets. The Water and Sewer Department capitalizes assets with a useful life of one year or more. Depreciation is recorded using the straight-line method over the estimated service lives of the assets, ranging from five to forty years.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Unbilled Revenues

Estimated unbilled revenues are recognized at the end of each fiscal year on a pro rata basis. The estimated amount is based on billings during the month following the close of the fiscal year.

Long-term Obligations and Costs

Long-term obligations are reported at face value, net of applicable premiums and discounts. Premiums, discounts, and gains or losses on advance refunding and defeasances are amortized over the life of the bonds. In accordance with GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, issuance costs are expensed in the reporting period in which the costs are incurred.

Compensated Absences

The Water and Sewer Department follows GASB Statement No. 16, *Accounting for Compensated Absences*, which requires that accrued liabilities for compensated absences be recorded to the extent the future leaves (1) relate to rights attributable to employee services already rendered, (2) relate to rights that vest or accumulate, (3) where payment is probable, and (4) where amounts can be reasonably estimated. The current portion of this debt is estimated based on historical trends.

Vacation pay is earned based on length of service (one year-one week; two years-two weeks; after ten years-three weeks; after twenty years-four weeks). Unused vacation pay must be taken in the year following the year it is earned.

Full time employees who work more than eight years of continuous service with the City may accrue sick leave up to a maximum of one hundred and fifty (150) working days.

Upon retirement or separation in good standing, the employee may be paid for unused sick leave based on the following percentage:

- 8-10 years of service – 1/5 of unused sick leave
- 10-12 years of service – 1/4 of unused sick leave
- 12-18 years of service – 1/3 of unused sick leave
- 18-25 years of service – 1/2 of unused sick leave

The number of sick leave days for any employee who meets the above criteria shall be a maximum of thirty days. If termination of employment is due to death, the employee's beneficiary or estate will receive his/her compensation.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pensions

The Employees' Retirement System of Alabama (the "Plan") financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Contributions are recognized as revenues when earned, pursuant to the plan requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan. Expenses are recognized when the corresponding liability is incurred, regardless of when the payment is made. Investments are reported at fair value. Financial statements are prepared in accordance with requirements of the GASB. Under these requirements, the Plan is considered a component unit of the State of Alabama and is included in the State's Comprehensive Annual Financial Report. See also Note 8.

Other Post-employment Benefits (OPEB)

The fiduciary net position of the Water and Sewer Department's retiree benefit plan (the "OPEB Plan") has been determined using the flow of economic resources measurement focus and full accrual basis of accounting. This includes for purposes of measuring the net OPEB liability, deferred outflow of resources and deferred inflows of resources related to OPEB, OPEB expense, and information about assets, liabilities and additions to/deductions from the OPEB Plan's fiduciary net position. Benefit payments are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value. See also Note 9.

Customer Meter Deposits

The Water and Sewer Department requires customers to pay a one-time deposit for water service, with the exception of customers who provide proof of home ownership. When a customer terminates service, the deposit is applied to the last bill and any remaining balance is refunded.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Water and Sewer Department has three items that qualify for reporting in this category, the deferred charge on refunding, deferred outflows related to pension and deferred outflows related to OPEB. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt. Deferred outflows related to pension and OPEB result from contributions related to normal and accrued employer liability (net of any refunds or error service payments) subsequent to the measurement date, the net difference between projected and actual earnings on plan investments, changes in assumptions, and differences between actual and expected experience.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period and so will *not* be recognized as an inflow of resources (revenue) until that time. The Water and Sewer Department has two items that qualify for reporting in this category, the deferred inflows related to pension and deferred inflows related to OPEB. Deferred inflows related to pension and OPEB result from differences between expected and actual experience, changes in assumptions, and the net difference between projected and actual earnings on plan investments.

Net Position

The Water and Sewer Department's net position is divided into three components:

- *Net investment in capital assets* - This component of net position consists of the historical cost of capital assets, net of accumulated depreciation, and is reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt should also be included in this component of net position.
- *Restricted* - This component of net position consists of assets that are restricted by contributors, contractual provisions, or enabling legislation, reduced by liabilities and deferred inflows of resources related to those assets. The Water and Sewer Department's restricted net position as reported in the statement of net position consist of cash and investments which are restricted for debt service and capital improvements.
- *Unrestricted* - This component of net position is the net amount of the assets, liabilities, and deferred inflows/outflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position.

Budgetary Control

The Water and Sewer Department's manager submits a budget of estimated revenues and expenses to the City Council for the fiscal year beginning October 1. The City Council approves this original budget and modifications as needed during the year.

Operating Revenues and Expenses

The Water and Sewer Department's Statements of Revenues, Expenses and Changes in Net Position distinguish between operating and non-operating revenues and expenses. Operating revenues results from transactions associated with water, sewer and garbage services – the Water and Sewer Department's principal activities. Non-operating revenues include interest income and gain or loss on the sale of plant, property or equipment.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimates

Management uses estimates and assumptions in preparing these financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

New Accounting Standards Adopted

In fiscal year 2019, the Water and Sewer Department adopted two new statements of financial accounting standards issued by the GASB:

- Statement No. 83, *Certain Asset Retirement Obligations* (GASB 83)

- Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements* (GASB 88)

GASB 83 establishes standards of accounting and financial reporting requirements for legally enforceable liabilities associated with the retirement of certain tangible capital assets. State and local governments that have legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the regulation of GASB 83. The requirements of GASB 83 are effective for reporting periods beginning after June 15, 2018. GASB 83 had no impact on the Water and Sewer Department's financial statements.

GASB 88 defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. GASB 88 requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant subjective acceleration clauses. GASB 88 also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of GASB 88 are effective for reporting periods beginning after June 15, 2018. Details of the Water and Sewer Department's implementation with respect to GASB 88 is included in the long-term debt note (see Note 7).

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pronouncements Issued But Not Yet Effective

The GASB has issued the following pronouncements that may affect future financial position, results of operations, cash flows, or financial presentation of the Water and Sewer Department upon implementation. Management has not yet evaluated the effect of implementation of these standards.

GASB Statement No.	GASB Accounting Standard	Effective Fiscal Year
84	<i>Fiduciary Activities</i>	2020
87	<i>Leases</i>	2021
89	<i>Accounting for Interest Cost Incurred before the End of a Construction Period</i>	2021
90	<i>Majority Equity Interests – An Amendment of GASB Statements No. 14 and No. 61</i>	2020
91	<i>Conduit Debt Obligations</i>	2022

Interfund transactions

During the course of normal operations, there are numerous transactions between the Water and Sewer Department and the City’s general fund, including expenditures and transfers or resources for providing services. Interfund transfers are reported after nonoperating income and expenses.

Subsequent Events

Management has evaluated subsequent events through the date that the financial statements were available to be issued, September 15, 2020. See Note 14 for relevant disclosures. No subsequent events occurring after this date have been evaluated for inclusion in these financial statements.

Note 2: CASH AND CASH EQUIVALENTS

As of September 30, 2019, all of the Water and Sewer Department’s bank deposits were either covered by federal depository insurance or secured by collateral through the Security for Alabama Funds Enhancement Program (SAFE Program). Under the SAFE program all public deposits are protected through a collateral pool administered by the Alabama State Treasurer's office.

Public deposits include the funds of any covered public entity or covered public official placed on deposit in a qualified depository, including time and demand deposit accounts and certificates of deposit but excluding bonds, notes, money market mutual funds, repurchase agreements and similar investment instruments. Covered public entities include the state and its political subdivisions. In the past, the bank pledged collateral directly to each public entity. Under SAFE,

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 2: CASH AND CASH EQUIVALENTS (Continued)

which is mandatory, each qualified public depository (QPD) is required to hold collateral for all of its public deposits on a pooled basis in a custody account (SAFE Custody Account) established for the State Treasurer as SAFE administrator. In the unlikely event a public entity should suffer a deposit loss due to QPD insolvency or default, a claim form would be filed with the State Treasurer, who would use the SAFE pool collateral or other means to reimburse the loss. The SAFE program is classified as a category 1 credit risk.

Due to the requirements of the SAFE program, the City has no formal custodial risk or interest rate risk rating policy. State statute requirements for investments are followed.

Note 3: RECEIVABLES AND UNBILLED REVENUE

The Water and Sewer Department uses cycle billing and customers are billed at various times during each month. Income and unbilled receivables are recorded for the portion of customers' usage of water and sewage from the time of their last billing until September 30. Receivables consist of the following:

September 30,	2019
Accounts receivable	\$ 1,332,172
Less: allowance for doubtful accounts	(668,035)
<u>Accounts receivable, net</u>	<u>\$ 664,137</u>

Unbilled revenues at September 30, 2019 was \$888,985.

Note 4: INVESTMENTS

Restricted assets consist of investments held in trust by Regions Bank to cover warrant indenture expenses and repayment of warrants. These assets are held at fair value.

Fair Value – GASB Codification Section 3100: *Fair Value Measurements* establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under the codification are described as follows:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the City has the ability to access.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 4: INVESTMENTS (Continued)

Level 2: Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following table sets forth by level, within the fair value hierarchy, the Water and Sewer Department's assets at fair value as of September 30, 2019:

	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Money Market Treasury Portfolio	\$ 4,336,194	\$ 4,336,194	\$ -	\$ -

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2019.

Mutual funds – Mutual funds classified in Level 1 of the fair value hierarchy are valued using quoted market prices for those investments.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Water and Sewer Department believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 5: CAPITAL ASSETS

The following is a summary of changes in capital assets during the year ended September 30, 2019:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	\$ 279,326	\$ -	\$ -	\$ 279,326
Construction progress	2,478,274	2,296,334	(3,911,065)	863,543
Total capital assets not being depreciated	2,757,600	2,296,334	(3,911,065)	1,142,869
Capital assets being depreciated:				
Land improvements	110,564	202,000	-	312,564
Building and improvements	42,810,384	3,396,325	-	46,206,709
Machinery and equipment	5,302,902	753,918	-	6,056,820
Total capital assets being depreciated	48,223,850	4,352,243	-	52,576,093
Less accumulated depreciation for:				
Land improvements	38,685	5,004	-	43,689
Building and improvements	22,351,462	1,159,630	-	23,511,092
Machinery and equipment	3,251,924	326,821	-	3,578,745
Total accumulated depreciation	25,642,071	1,491,455	-	27,133,526
Total capital assets being depreciated, net	22,581,779	2,860,788	-	25,442,567
Total capital assets, net	\$ 25,339,379	\$ 5,157,122	\$ (3,911,065)	\$ 26,585,436

Depreciation expense for the year ended September 30, 2019 was \$1,491,455.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 6: ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at September 30:

		2019
Accounts payable	\$	462,629
Payroll liabilities		54,879
Accrued interest payable		76,766
Accrued salaries and wages		40,523
Total	\$	634,797

Note 7: LONG-TERM DEBT

Revenue Warrants Payable

Revenue warrants payable consists of Subordinated Water and Sewer Revenue warrants issued as special obligations of the Water and Sewer Department secured by the net revenues of the water and sewer system. This debt is not a general obligation of the City. The principal and interest is paid by revenue earned by the system and trust restricted assets. The following schedule summarizes the changes in revenue warrants for the year ended September 30, 2019:

Description	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due Within One Year	Interest Paid
2010 Warrants	\$ 15,272,915	\$ -	\$ (445,000)	\$ 14,827,915	\$ 465,000	\$ 668,387
Premium	192,692	-	(8,760)	183,932	-	-
2015 Warrants	4,700,000	-	-	4,700,000	-	226,938
Premium	482,082	-	(18,540)	463,542	-	-
Total	\$ 20,647,689	\$ -	\$ (472,300)	\$ 20,175,389	\$ 465,000	\$ 895,325

Revenue warrants outstanding at September 30, 2019:

Series 2010 Warrants

On November 1, 2010, the Water and Sewer Department issued revenue warrants totaling \$18,435,000 with interest rates ranging from 2.00% to 5.00%. The proceeds were used for the following:

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 7: LONG-TERM DEBT (Continued)

- 1) To make improvements to the system.
- 2) To provide funds to prepay on an advance refunding basis, all of the warrants now outstanding that were heretofore issued by The Water and Sewer department of the City of Talladega.
- 3) To fund a Debt Service reserve fund for the benefit of the Series 2010 Warrants.
- 4) To pay expenses for issuing the warrants.

The Series 2010 warrants are limited obligation warrants of the Water and Sewer Department, payable solely out of revenues of the system.

Cash in the amount of \$7,162,734 was deposited with an escrow agent pursuant to an escrow agreement. The maturities of these securities and related earnings thereon are expected to provide sufficient cash flow to meet the debt service requirements of the defeased Series 2003 and Series 2004 Bonds as they mature. This transaction effectively released the City from its obligation to repay the defeased Series 2003 and Series 2004 Bonds and constitutes an in-substance defeasance. Accordingly, the escrow account assets and the liability for the defeased bonds are not included in the City's financial statements.

The following schedule shows the future debt service requirements for the 2010 Warrants:

Fiscal Years Ending September 30,	Principal	Interest	Total
2020	\$ 465,000	\$ 668,850	\$ 1,133,850
2021	480,000	651,050	1,131,050
2022	500,000	616,850	1,116,850
2023	515,000	599,350	1,114,350
2024	540,000	578,750	1,118,750
2025 – 2029	3,010,000	2,554,350	5,564,350
2030 – 2034	3,675,000	1,890,875	5,565,875
2035 – 2039	4,585,000	975,250	5,560,250
2040	1,057,915	53,000	1,110,915
Total	\$ 14,827,915	\$ 8,588,325	\$ 23,416,240

Series 2015 Warrants

On April 8, 2015, the Water and Sewer Department issued revenue warrants totaling \$4,700,000 with an interest rate of 5.00%. The proceeds were used for the following:

- 1) To make improvements to the system.
- 2) To fund a debt service reserve fund for the benefit of the Series 2015 Warrants.
- 3) To pay expenses for issuing the warrants.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 7: LONG-TERM DEBT (Continued)

The Series 2015 warrants are limited obligation warrants of the Water and Sewer Department, payable solely out of revenues of the system.

The following schedule shows the future debt service requirements for the 2015 Warrants:

Fiscal Years Ending September 30,	Principal	Interest	Total
2020	\$ -	\$ 235,000	\$ 235,000
2021	-	235,000	235,000
2022	-	235,000	235,000
2023	-	235,000	235,000
2024	-	235,000	235,000
2025 – 2029	-	1,175,000	1,175,000
2030 – 2034	-	1,175,000	1,175,000
2035 – 2039	-	1,175,000	1,175,000
2040 – 2044	4,700,000	830,250	5,530,250
Total	\$ 4,700,000	\$ 5,530,250	\$ 10,230,250

The Water and Sewer Department is required to maintain certain financial ratios relating to debt service coverage. At September 30, 2019, the City was in compliance with the provisions of the Department’s 2010 and 2015 Water and Sewer bond covenants that require the Water and Sewer Department make and maintain rates and charges for the water and other services supplied from the water and sewer system and make collections from the users thereof in such manner that shall produce revenues during each fiscal year at least equal to the sum of a) operation and maintenance expenses during such fiscal year plus b) 1.25 times the annual debt service requirements.

Note 8: EMPLOYEE RETIREMENT PLAN

As described in Note 1, the Water and Sewer Department is a department of the City; the following information is based on the City as a whole, which includes the Water and Sewer Department’s portion of retirement benefits.

General Information about the Pension Plan

Plan description. The Employees’ Retirement System of Alabama (“ERS”), an agent multiple-employer plan, was established as of October 1, 1945, pursuant to the *Code of Alabama 1975, Title 36, Chapter 27* (Act 515 of the Legislature of 1945). The purpose of the ERS is to provide retirement allowances and other specified benefits for state employees, State Police, and on an elective basis, to all cities, counties, towns and quasi-public organizations. The responsibility for the general administration and operation of ERS is vested in its Board of Control which consists of 13 trustees.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 8: EMPLOYEE RETIREMENT PLAN (Continued)

The Plan is administered by the Retirement Systems of Alabama (“RSA”). The *Code of Alabama, Title 36, Chapter 27* grants the authority to establish and amend the benefit terms to the ERS Board of Control. The Plan issues a publicly available financial report that can be obtained at www.rsa-al.gov.

The ERS Board of Control consists of 13 trustees as follows:

- 1) The Governor, ex officio.
- 2) The State Treasurer, ex officio.
- 3) The State Personnel Director, ex officio.
- 4) The State Director of Finance, ex officio.
- 5) Three vested members of ERS appointed by the Governor for a term of four years, no two of whom are from the same department of state government nor from any department of which an ex officio trustee is the head.
- 6) Six members of ERS who are elected by members from the same category of ERS for a term of four years as follows:
 - a. Two retired members with one from the ranks of retired state employees and one from the ranks of retired employees of a city, county or a public agency each of whom is an active beneficiary of ERS.
 - b. Two vested active state employees.
 - c. Two vested active employees of an employer participating in ERS pursuant to the *Code of Alabama 1975, Section 36-27-6*.

Benefits provided. State law establishes retirement benefits as well as death and disability benefits and any ad hoc increase in postretirement benefits for the ERS. Benefits for ERS members vest after 10 years of creditable service. State employees who retire after age 60 (52 for State Police) with 10 years or more of creditable service or with 25 years of service (regardless of age) are entitled to an annual retirement benefit, payable monthly for life. Local employees who retire after age 60 with 10 years or more of creditable service or with 25 or 30 years of service (regardless of age), depending on the particular entity’s election, are entitled to an annual retirement benefit, payable monthly for life. Service and disability retirement benefits are based on a guaranteed minimum or a formula method, with the member receiving payment under the method that yields the highest monthly benefit. Under the formula method, members of the ERS (except State Police) are allowed 2.0125% of their average final compensation (highest 3 of the last 10 years) for each year of service. State Police are allowed 2.875% for each year of State Police service in computing the formula method.

Act 377 of the Legislature of 2012 established a new tier of benefits (Tier 2) for members hired on or after January 1, 2013. Tier 2 ERS members are eligible for retirement after age 62 (56 for State Police) with 10 years or more of creditable service and are entitled to an annual retirement benefit, payable monthly for life. Service and disability retirement benefits are based on a guaranteed minimum or a formula method, with the member receiving payment under the method that yields the highest monthly benefit. Under the formula method, Tier 2 members of the ERS (except State Police) are allowed 1.65% of their average final compensation (highest 5 of the last 10 years) for each year of service. State Police are allowed 2.375% for each year of State Police service in computing the formula method.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 8: EMPLOYEE RETIREMENT PLAN (Continued)

Members are eligible for disability retirement if they have 10 years of credible service, are currently in-service, and determined by the RSA Medical Board to be permanently incapacitated from further performance of duty. Preretirement death benefits equal to the annual earnable compensation of the member as reported to the Plan for the preceding year ending September 30 are paid to the beneficiary.

The ERS serves approximately 909 local participating employers. The ERS membership includes approximately 90,999 participants. As of September 30, 2018, membership consisted of:

Retirees and beneficiaries currently receiving benefits	24,818
Terminated employees entitled to but not yet receiving benefits	1,426
Terminated employees not entitled to a benefit	7,854
Active members	56,760
Post-DROP participants who are still in active service	<u>141</u>
Total	<u>90,999</u>

Contributions. Covered members of the ERS contributed 5% of earnable compensation to the ERS as required by statute until September 30, 2011. From October 1, 2011 to September 30, 2012, covered members of the ERS were required by statute to contribute 7.25% of earnable compensation. Effective October 1, 2012, covered members of the ERS are required by statute to contribute 7.50% of earnable compensation. Certified law enforcement, correctional officers, and firefighters of the ERS contributed 6% of earnable compensation as required by statute until September 30, 2011. From October 1, 2011 to September 30, 2012, certified law enforcement, correctional officers, and firefighters of the ERS were required by statute to contribute 8.25% of earnable compensation. Effective October 1, 2012, certified law enforcement, correctional officers, and firefighters of the ERS are required by statute to contribute 8.50% of earnable compensation. State Police of the ERS contribute 10% of earnable compensation. ERS local participating employers are not required by statute to increase contribution rates for their members.

Tier 2 covered members of the ERS contribute 6% of earnable compensation to the ERS as required by statute. Tier 2 certified law enforcement, correctional officers, and firefighters of the ERS are required by statute to contribute 7% of earnable compensation. Tier 2 State Police members of the ERS contribute 10% of earnable compensation. These contributions rates are the same for Tier 2 covered members of ERS local participating employers.

The ERS establishes rates based upon an actuarially determined rate recommended by an independent actuary. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with additional amounts to finance any unfunded accrued liability, the pre-retirement death benefit and administrative expenses of the Plan. For the year ended September 30, 2019, the City's active employee contribution rate was 5% of covered employee payroll for normal Tier 1 employees and 6% of covered employee payroll for normal Tier 2 employees, and the City's average contribution rate to fund the normal and accrued liability costs was 11.07% of pensionable payroll for Tier 1 employees and 7.84% for Tier 2 employees.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 8: EMPLOYEE RETIREMENT PLAN (Continued)

The City's contractually required contribution rate for the year ended September 30, 2019 was 11.44% of pensionable pay for Tier 1 employees, and 8.21% of pensionable pay for Tier 2 employees. These required contribution rates are based upon the actuarial valuation as of September 30, 2016, a percent of annual pensionable payroll, and actuarially determined as an amount that, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year, with an additional amount to finance any unfunded accrued liability. Total employer contributions to the pension plan were \$783,367 for the year ended September 30, 2019, and \$164,507 (21%) were related to Water and Sewer Department employees.

Net Pension Liability. The City's net pension liability was measured as of September 30, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as September 30, 2017 rolled forward to September 30, 2018 using standard roll-forward techniques as shown in the following table:

	Expected	Actual
(a) TPL as of September 30, 2017	\$ 27,583,215	\$ 27,287,360
(b) Discount Rate	7.75%	7.75%
(c) Entry Age Normal Cost for the period October 1, 2017 – September 30, 2018	593,659	593,659
(d) Transfers Among Employers	-	(98,079)
(e) Actual Benefit Payments and Refunds for the period October 1, 2017 – September 30, 2018	(1,784,053)	(1,784,053)
(f) TPL as of September 30, 2018 [[a] x (1+(b))] + (c) + (d) + [(e) x (1 + 0.5*(b))]	<u>\$ 28,461,388</u>	<u>\$ 28,044,525</u>
(g) Difference between Expected and Actual		\$ (416,863)
(h) Less Liability Transferred for Immediate Recognition		(98,079)
(i) Experience (Gain)/Loss = (g) - (h)		<u>\$ (318,784)</u>

Actuarial assumptions. The total pension liability as of September 30, 2018 was determined based on the annual actuarial funding valuation report prepared as of September 30, 2017. The key actuarial assumptions are summarized below:

Inflation	2.75%
Salary increases	3.25% - 5.00%
Investment rate of return*	7.70%

*Net of pension plan investment expense

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 8: EMPLOYEE RETIREMENT PLAN (Continued)

Mortality rates were based on the sex distinct RP-2000 Blue Collar Mortality Table Projected with Scale BB to 2020 with an adjustment of 125% at all ages for males and 120% for females at ages 78 and older. The rates of mortality for the period after disability retirement are according to the sex distinct RP-2000 Disabled Retiree Mortality Table Projected with Scale BB to 2020 with an adjustment of 130% at all ages for females.

The actuarial assumptions used in the September 30, 2017 valuation were based on the results of an investigation of the economic and demographic experience for the ERS based upon participant data as of September 30, 2015. The Board of Control accepted and approved these changes in September 2016, which became effective at the beginning of fiscal year 2016. The long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis 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 weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target asset allocation and best estimates of geometric real rates of return for each major asset class are as follows:

	Target Allocation	Long-Term Expected Rate of Return *
Fixed Income	17.00%	4.40%
U. S. Large Stocks	32.00%	8.00%
U. S. Mid Stocks	9.00%	10.00%
U. S. Small Stocks	4.00%	11.00%
International Developed Market Stocks	12.00%	9.50%
International Emerging Market Stocks	3.00%	11.00%
Alternatives	10.00%	10.10%
Real Estate	10.00%	7.50%
Cash	3.00%	1.50%
Total	100.00%	

* Included assumed rate of Inflation of 2.50%

Discount rate. The discount rate used to measure the total pension liability was the long-term rate of return, 7.70%. 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 employer contributions will be made in accordance with the funding policy adopted by the ERS Board of Control. Based on those assumptions, components of the pension plan's fiduciary net position were projected to be available to make all projected 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.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 8: EMPLOYEE RETIREMENT PLAN (Continued)

Changes in Net Pension Liability

	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (Asset) (a)-(b)
Balances at September 30, 2017	\$ 27,583,215	\$ 20,456,779	\$ 7,126,436
Changes for the year:			
Service cost	593,659	-	593,659
Interest	2,068,567	-	2,068,567
Changes in assumptions	146,665	-	146,665
Difference between expected and actual experience	(318,784)	-	(318,784)
Contributions – employer	-	726,979	(726,979)
Contributions – employee	-	411,668	(411,668)
Net investment income	-	1,858,814	(1,858,814)
Benefit payments, including refunds of employee contributions	(1,784,053)	(1,784,053)	-
Administrative expense	-	-	-
Transfers among employers	(98,079)	(98,079)	-
Net changes	607,975	1,115,329	(507,354)
Balances at September 30, 2018	\$ 28,191,190	\$ 21,572,108	\$ 6,619,082

The above net pension liability is shared between the City’s general fund and Water and Sewer Department. The City has allocated 21% or \$ 1,461,271 to the Water and Sewer Department. The allocation is based on the fund’s relative share of employee and employer pension contributions.

Sensitivity of the net pension liability to changes in the discount rate. The following table presents the City’s net pension liability calculated using the discount rate of 7.70%, as well as what the City’s proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.70%) or 1-percentage point higher (8.70%) than the current rate:

	1% Decrease (6.70%)	Current Discount Rate (7.70%)	1% Increase (8.70%)
City’s Net Pension Liability	\$ 9,866,600	\$ 6,619,082	\$ 3,878,428

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 8: EMPLOYEE RETIREMENT PLAN (Continued)

Pension plan fiduciary net position. Detailed information about the pension plan’s fiduciary net position is available in the separately issued RSA Comprehensive Annual Report for the fiscal year ended September 30, 2018. The supporting actuarial information is included in the GASB Statement No. 68 Report for the ERS prepared as of September 30, 2018. The auditor’s report dated August 17, 2019 on the Schedule of Changes in Fiduciary Net Position by Employer and accompanying notes is also available. The additional financial and actuarial information is available at <http://www.rsa-al.gov/index.php/employers/financial-reports/gasb-68-reports/>.

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions. For the year ended September 30, 2019, the City recognized pension expense of \$583,202, \$122,472 of which was related to Water and Sewer Department employees. At September 30, 2019, the reported deferred outflows of resources and deferred inflows of resources related to pensions are from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 121,152	\$ 407,489
Changes of assumptions	676,607	-
Net difference between projected and actual earnings on plan investments	-	711,301
Employer contributions subsequent to the measurement date	783,367	-
Total	\$ 1,581,126	\$ 1,118,790

Amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

For Years Ending September 30	
2020	\$ 854,286
2021	(168,720)
2022	(138,936)
2023	(39,062)
2024	(37,039)
Thereafter	(8,193)
Total	\$ 462,336

The above deferred outflows and inflows of resources are shared between the City’s general fund and Water and Sewer Department. The City has allocated 21%, or \$332,036 of the above deferred outflows of resources and \$234,946 of the above deferred inflows of resources, to the Water and Sewer Department. The allocation is based on the fund’s relative share of employee and employer pension contributions. The deferred outflows and inflows of resources will be recognized in each fund’s pension expense account in future periods.

City of Talladega Water and Sewer Department Notes to Financial Statements

Note 9: OTHER POST-EMPLOYMENT BENEFITS

As described in Note 1, the Water and Sewer Department is a department of the City; the following information is based on the City as a whole, which includes the Water and Sewer Department's portion of OPEB.

Plan Description. The City, through its substantive commitment to provide OPEB, maintains a single-employer defined benefit plan to provide certain post-retirement healthcare benefits to all former employees who have 25 years of continuous service, regardless of age, or who have 10 years of continuous service and are age 62. Such benefits are also available to retirees' spouses or dependents, but the cost of that coverage is the retiree's responsibility. Specific details of the OPEB Plan include coverage offered through the Alabama Local Government Health Insurance Program. Retirees with 25 years of continuous service have 100% of their health and life insurance coverage paid for by the City. Retirees with 10 years of continuous service must pay the entire cost of the premium and are not eligible for life insurance through the City. Medical, drug, dental, and life benefits are offered for pre-Medicare retirees.

Management of the OPEB Plan is invested in the City's elected council members, who may vary from time to time and who may designate certain administration officials as signatories on the trust's investment accounts.

Plan Membership. At September 30, 2019, the OPEB Plan's membership consisted of 159 active employees receiving benefits and 18 retirees receiving benefits.

Benefits Provided. Medical plan benefits are provided through Local Government Health Insurance Programs (LGHIP) which is administered by the Alabama State Employee Insurance Board. The City contributes the full monthly premium for single retiree medical coverage for retirees with 24 or more years of service at retirement. The retiree is responsible for the cost of dependent coverage in excess of this amount. The subsidy continues until the retiree reaches age 65. Dental benefits are included in the medical contribution. The City also provides certain life insurance benefits for retirees.

Contribution Rates. Employees do not contribute to their post-employment benefits costs until they become retirees and begin receiving those benefits. The plan provisions and contribution rates are contained in the official OPEB plan documents.

Investment Policy. The OPEB Plan's policy regarding the allocation of invested assets is established and may be amended by the City. It is the City's policy to invest public funds in a manner that will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City and conforming to all state and local statutes governing the investment of public funds. As of September 30, 2019, the City's investments are weighted as follows:

Asset Class	Allocation
Domestic Equity	83%
Certificates of Deposit	17%

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 9: OTHER POST-EMPLOYMENT BENEFITS (Continued)

Concentrations. The plan has three investments each exceeding 5% of total assets. The funds and corresponding allocations are: First Trust 60/40 Strategic Allocation 3rd Quarter 2016, 23%; First Trust 60/40 Strategic Allocation 1st Quarter 2019, 38%; and First Trust 60/40 Strategic Allocation 3rd Quarter 2019, 28%.

Rate of Return. For the year ended September 30, 2019, the annual money-weighted rate of return on investments, net of investment expense was 12.87%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Net OPEB Liability. The components of the City's OPEB liability as of September 30, 2019 were as follows:

Total OPEB liability	\$	5,197,115
Plan fiduciary net position		1,260,219
Net OPEB liability (asset)	\$	3,936,896

Plan fiduciary net position as a percentage of the total OPEB liability	24.25%
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The above net OPEB liability is shared between the City and the Water and Sewer Department. The City has allocated 21%, or \$826,748, to the Water and Sewer Department. The allocation is based on the relative share of employer OPEB contributions.

Actuarial Assumptions. The total OPEB liability was measured as of September 30, 2019 based on an actuarial valuation as of October 1, 2018, rolled forward to September 30, 2019 using standard roll-forward techniques and the following actuarial assumptions applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.50%
Healthcare cost trend rates	Level 5.50% annually
Salary increases	4.00%
Investment rate of return	4.18%, beginning of year 2.66%, end of year

Mortality rates were based on the RP-2000 Total without projection with 50%/50% unisex blend.

The long-term expected rate of return on OPEB plan investments was determined using a building block method in which best-estimate ranges of expected future real rates of return (expected returns, net of 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 weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation as of September 30, 2019 are summarized in the following table:

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 9: OTHER POST-EMPLOYMENT BENEFITS (Continued)

Asset Class	Long-term Expected Real Rate of Return
Domestic Equity	6%
Certificates of Deposit	1%

Changes in the Net OPEB Liability

	Increases (Decreases)		
	Total OPEB Liability (a)	Plan Fiduciary Net Position (b)	Net OPEB Liability (a)-(b)
Balances at September 30, 2018	\$ 4,290,138	\$ 1,136,303	\$ 3,153,835
Service cost	115,706	-	115,706
Interest cost at 4.18%	174,629	-	174,629
Changes of benefit terms	-	-	-
Difference between expected and actual experience	223,346	-	223,346
Employer contributions	-	80,847	(80,847)
Net investment income	-	46,321	(46,321)
Changes of assumptions	618,136	-	618,136
Benefit payments			
a. From trust	-	-	-
b. Direct	(224,840)	-	(224,840)
Administrative expenses			
a. From trust	-	(3,252)	3,252
b. Direct	-	-	-
Net changes	906,977	123,916	783,061
Balance at September 30, 2019	\$ 5,197,115	\$ 1,260,219	\$ 3,936,896

Discount Rate. The discount rate used to measure the total OPEB liability was 2.66%, which is the value of the Bond Buyer's 20 year general obligation municipal bond index as of September 30, 2019.

Sensitivity of the Net OPEB Liability to Changes in the Discount Rate. The following represents the City's net OPEB liability, as well as what the City's net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (1.66%) or 1-percentage-point higher (3.66%) than the current discount rate:

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

NOTE 9: OTHER POST-EMPLOYMENT BENEFITS (Continued)

	1% Decrease (1.66%)	Current Discount Rate (2.66%)	1% Increase (3.66%)
Net OPEB Liability	\$ 4,425,465	\$ 3,936,896	\$ 3,514,467

Sensitivity of the Net OPEB Liability to Changes in Healthcare Cost Trend Rates. The following represents the City's net OPEB liability, as well as what the City's net OPEB liability would be if it were calculated using a healthcare cost trend rate that is 1-percentage-point lower (4.50%) or 1-percentage-point higher (6.50%) than the current healthcare cost trend rate:

	Decrease (4.50%)	Discount Rate (5.50%)	Increase (6.50%)
Net OPEB Liability	\$ 3,490,846	\$ 3,936,896	\$ 4,450,267

OPEB Expense and Deferred Inflows of Resources Related to OPEB. For the year ended September 30, 2019, the City recognized OPEB expense of \$293,800, 21% or \$61,698 of which was allocated to the Water and Sewer Department. At September 30, 2019, the City reported deferred outflows and inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between projected and actual earnings on OPEB investments	\$ 2,238	\$ 4,955
Differences between expected and actual experience	206,166	7,226
Changes in assumption	570,587	178,733
Total	\$ 778,991	\$ 190,914

The above deferred outflows and inflows of resources is shared between the City and the Water and Sewer Department. The City has allocated 21%, or \$163,588 in deferred outflows and \$40,092 in deferred inflows, to the Water and Sewer Department. The allocation is based on the relative share of employer OPEB contributions.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 9: OTHER POST-EMPLOYMENT BENEFITS (Continued)

Amounts will be reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Fiscal Years Ending September 30,	Net Amount to be Recognized	
2020	\$	49,332
2021		49,332
2022		49,332
2023		50,984
2024		50,424
Thereafter		338,673
Total	\$	588,077

Note 10: DEFERRED CHARGES FROM REFUNDING

The defeasance of series 2003 and 2004 revenue bonds resulted in a difference of \$507,384 between the reacquisition price and the net carrying amount of the old debt. This difference is amortized through 2022 and is reported in the accompanying financial statements as a deferred outflow of resources. The unamortized portion of the deferred charges at September 30, 2019 was \$106,434.

Note 11: RISK MANAGEMENT

The Water and Sewer Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees and natural disasters. The Water and Sewer Department has entered into an agreement with other municipalities and governmental units to pool their liabilities in a fund for the purpose of self-insuring worker's compensation risk.

This fund has satisfied the Alabama Department of Industrial Relations of its financial ability to pay compensation direct and in the manner due, as provided by law, and has filed with the Department an acceptable bond or made deposit of security as required. The Water and Sewer Department has no joint or several liabilities with other members of the fund, except that the total sum of premiums over and above fixed costs paid by all members are available for payment of worker's compensation claims of all members.

**City of Talladega Water and Sewer Department
Notes to Financial Statements**

Note 12: COMMITMENTS AND CONTINGENCIES

At September 30, 2019, there is outstanding litigation involving the Water and Sewer Department. In the opinion of management and the City attorney, these matters are either covered by insurance or involve amounts that would not have a material adverse effect on the financial statements.

Note 13: CONTRACTS AND AGREEMENTS

The Department has entered into contracts to provide water to three governmental entities. The terms are as follows:

<u>Entity</u>	<u>Expiration Date</u>	<u>Minimum Usage</u>	<u>Maximum Usage</u>
City of Lincoln	May 31, 2006 with option to renew for up to eight two year periods	150 million gallons yearly	32 million gallons monthly
Central Talladega County Water District	Verbal contract-non-specified	None	6 million gallons monthly
City of Waldo	When notice is given by either party expressing the desire to terminate the contract	None	As required from month-to-month

Note 14: SUBSEQUENT EVENTS

In March 2020, the World Health Organization made the assessment that the outbreak of a novel coronavirus (COVID-19) can be characterized as a pandemic. As a result, uncertainties have arisen that may have a significant negative impact on the operating activities and results of the Water and Sewer Department. The occurrence and extent of such an impact will depend on future developments, including (i) the duration and spread of the virus, (ii) government quarantine measures, (iii) voluntary and precautionary restrictions on travel or meetings, (iv) the effects on the financial markets, and (v) the effects on the economy overall, all of which are uncertain.

Required Supplementary Information

**City of Talladega Water and Sewer Department
Schedule of Changes in Net Pension Liability**

September 30,	2018	2017	2016	2015	2014
Total pension liability					
Service cost	\$ 593,659	\$ 583,545	\$ 602,738	\$ 608,309	\$ 592,326
Interest	2,068,567	2,013,859	1,928,337	1,832,623	1,761,806
Changes in benefit terms	-	-	-	-	-
Differences between expected and actual experience	(318,784)	(204,100)	26,895	309,855	-
Changes of assumptions	146,665	-	1,027,411	-	-
Benefit payments, including refunds of employee contributions	(1,784,053)	(1,654,058)	(1,585,868)	(1,522,852)	(1,414,985)
Transfers among employers	(98,079)	31,663	(84,352)	-	-
Net change in total pension liability	607,975	770,909	1,915,161	1,227,935	939,147
Total pension liability - beginning	27,583,215	26,812,306	24,897,145	23,669,210	22,730,063
Total pension liability - ending (a)	\$ 28,191,190	\$ 27,583,215	\$ 26,812,306	\$ 24,897,145	\$ 23,669,210
Plan Fiduciary Net Position					
Contributions - employer	\$ 726,979	\$ 635,966	\$ 640,034	\$ 699,653	\$ 740,892
Contributions - employee	411,668	374,226	365,914	404,420	360,594
Net investment income	1,858,814	2,356,733	1,760,239	208,626	1,917,819
Benefit payments, including refunds of employee contributions	(1,784,053)	(1,654,058)	(1,585,868)	(1,522,852)	(1,414,985)
Transfers among employers	(98,079)	31,663	(84,352)	63,907	(3,971)
Net change in plan fiduciary net position	1,115,329	1,744,530	1,095,967	(146,246)	1,600,349
Plan net position - beginning	20,456,779	18,712,249	17,616,282	17,762,528	16,162,179
Plan net position - ending (b)	\$ 21,572,108	\$ 20,456,779	\$ 18,712,249	\$ 17,616,282	\$ 17,762,528
Net pension liability (asset) - ending (a) - (b)	\$ 6,619,082	\$ 7,126,436	\$ 8,100,057	\$ 7,280,863	\$ 5,906,682
Plan fiduciary net position as a percentage of total pension liability	76.52%	74.16%	69.79%	70.76%	75.04%
Covered payroll*	\$ 7,606,318	\$ 6,911,019	\$ 6,713,736	\$ 6,313,716	\$ 6,643,729
Net pension liability as a percentage of covered payroll	87.02%	103.12%	120.65%	115.32%	88.91%

The schedule above represents the changes in net pension liability for the City of Talladega. The City has allocated 21% of the net pension liability to the Water and Sewer Department. This schedule is intended to cover 10 fiscal years. As each year ensues in the future, the information will be added until the schedule covers 10 years.

*Employer's covered payroll during the measurement period is the total covered payroll. For FY 2019, the measurement period is October 1, 2017 – September 30, 2018.

**City of Talladega Water and Sewer Department
Schedule of Employer Contributions - Pension**

Fiscal Year	Actuarially Determined Contribution* (a)	Employer Contributions to Pension Plan* (b)	Annual Contribution Deficiency (Excess) (b-a)	Covered Payroll** (c)	Employer Contributions to Pension Plan as a % of Covered Payroll (b/c)
2019	\$ 783,368	\$ 783,367	\$ -	\$ 8,248,435	9.50%
2018	697,135	697,135	-	7,606,318	9.17%
2017	632,981	632,981	-	6,911,019	9.16%
2016	642,492	642,492	-	6,713,736	9.57%
2015	718,888	718,888	-	6,313,716	11.39%
2014	595,409	595,409	-	6,643,729	8.96%
2013	616,154	616,154	-	6,313,746	9.76%
2012	506,870	506,870	-	5,922,110	8.56%
2011	550,188	550,188	-	6,688,593	8.23%
2010	507,653	507,653	-	6,586,748	7.71%

The table above represents the schedule of funding progress for the City of Talladega, which includes the Water and Sewer Department.

*The amount of employer contributions related to normal and accrued liability components of employer rate net of any refunds or error service payments. The Schedule of Employer Contributions is based on the 12 month period of the underlying financial statement.

**Employer's covered payroll for FY 2019 is the total covered payroll for the 12 month period of the underlying financial statement.

Notes to Schedule

Actuarially determined contribution rates are calculated as of September 30, three years prior to the end of the fiscal year in which contributions are reported. Contributions for fiscal year 2019 were based on the September 30, 2016 actuarial valuation.

Methods and assumptions used to determine contribution rates for the period October 1, 2018 to September 30, 2019:

Actuarial cost method	Entry Age
Amortization method	Level percent closed
Remaining amortization period	25.8 years
Asset valuation method	Five year smoothed market
Inflation	2.875%
Salary increases	3.375 – 5.125%, including inflation
Investment rate of return	7.875%, net of pension plan investment expense, including inflation

**City of Talladega Water and Sewer Department
Schedule of Changes in Net OPEB Liability**

September 30,	2019	2018
Total OPEB liability		
Service cost	\$ 115,706	\$ 122,473
Interest	174,629	154,929
Changes in benefit terms	-	-
Difference between expected and actual experience	223,346	(8,338)
Changes of assumptions	618,136	(206,231)
Benefit payments	(224,840)	(200,664)
Net change in total OPEB liability	906,977	(137,831)
Total OPEB liability, beginning of year	4,290,138	4,427,969
Total OPEB liability, end of year	\$ 5,197,115	\$ 4,290,138
Plan Fiduciary net position		
Contributions - employer	80,847	-
Contributions - other	-	-
Net investment income	46,321	47,296
Benefit payments and net transfers	-	-
Administrative expense	(3,252)	(2,808)
Net change in fiduciary net position	123,916	44,488
Plan fiduciary net position, beginning of year	1,136,303	1,091,815
Plan fiduciary net position, end of year	\$ 1,260,219	\$ 1,136,303
Net OPEB liability, end of year	\$ 3,936,896	\$ 3,153,835
Plan fiduciary net position as a percentage of the total OPEB liability	24.25%	26.49%
Covered employee payroll in year ending September 30	\$ 6,015,944	\$ 5,784,562
Net OPEB liability as a percentage of covered-employee payroll	65.44%	54.52%

The schedule above represents the changes in net pension liability for the City of Talladega. The City has allocated 21% of the net pension liability to the Water and Sewer Department.

This schedule is intended to cover 10 fiscal years. As each year ensues in the future, the information will be added until the schedule covers 10 years.

**City of Talladega Water and Sewer Department
Schedule of Employer Contributions - OPEB**

September 30,	2019	2018
Actuarially determined contribution	\$ 302,100	\$ 305,687
Contributions in relation to the actuarially determined contribution		
Employer contributions to the trust	80,847	-
Employer-paid retiree premiums	224,840	200,664
Employer-paid expenses	-	-
Contribution deficiency (excess)	\$ (3,587)	\$ 105,023
Covered annual payroll	\$ 6,015,944	\$ 5,784,562
Contributions as a percentage of covered employee payroll	5.08%	3.47%

The table above represents the schedule of funding progress for the City of Talladega, which includes the Water and Sewer Department.

This schedule is intended to cover 10 fiscal years. As each year ensues in the future, the information will be added until the schedule covers 10 years.

Notes to Schedule:

Valuation date	10/1/2018
	Actuarially determined contributions are calculated as of the last day of the fiscal year in which contributions are reported
Actuarial cost method	Individual Entry Age Normal
Amortization method	Level dollar, open
Amortization period	30 years
Asset valuation method	Market value
Inflation	2.5% annually
Healthcare trend	Flat 5.5% annually
Salary increases	4.0% annually
Investment return	4.18% annually (Beginning of Year to Determine ADC) 2.66% annually (As of End of Year Measurement Date)
Retirement age	Attainment of 25 years or service at any age; or, attainment of age 60 and 10 years of service; employees hired on and after January 1, 2013 are not eligible to retire until age 62 (age 56 for Fire and Police).
Mortality	RP-2000 without projection, 50% unisex blend

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

To the Manager and City Council
Water and Sewer Department
Talladega, Alabama

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Water and Sewer Department of the City of Talladega, Alabama (the "Water and Sewer Department"), an enterprise fund of the City of Talladega, Alabama, as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the Water and Sewer Department's basic financial statements and have issued our report thereon dated September 15, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Water and Sewer Department'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 Water and Sewer Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Water and Sewer Department's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or 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 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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Water and Sewer Department's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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.

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, L.L.C.

Enterprise, Alabama

September 15, 2020