

THE SOUTHEAST MORRIS COUNTY  
MUNICIPAL UTILITIES AUTHORITY  
COUNTY OF MORRIS  
FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
TABLE OF CONTENTS  
YEAR ENDED DECEMBER 31, 2016

	<u>Page</u>
<u>PART I - INTRODUCTORY SECTION (UNAUDITED)</u>	
Letter of Transmittal	1-2
Organizational Chart	3
Roster of Officials	4
Consultants and Advisors	5
<u>PART II - FINANCIAL SECTION</u>	
Independent Auditors' Report	6-8
Management's Discussion and Analysis (Unaudited)	9-16
<u>Financial Statements</u>	
Statement of Net Position	17-18
Statement of Revenue, Expenses and Changes in Net Position	19
Statement of Cash Flows	20
Notes to Financial Statements	21-38
<u>REQUIRED SUPPLEMENTARY INFORMATION</u>	
Schedules Related to Accounting and Reporting for Pensions (GASB 68) (Unaudited)	
Schedule of Authority's Proportionate Share of the Net Pension Liability- Public Employees Retirement System	39
Schedule of Authority Contributions – Public Employees Retirement System	40
Notes to Required Supplementary Information (Unaudited)	41
<u>SUPPLEMENTARY INFORMATION</u>	
Schedule 1 - Statement of Revenue, Expenses and Changes in Net Position	42
Schedule 2 - Schedule of Revenue and Expenditures Compared to Budget	43-44
Schedule 3 - Schedule of Revenue Serial Bonds Payable	45
<u>PART III – GOVERNMENT AUDITING STANDARDS SECTION</u>	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	46-47
Schedule of Findings and Responses	48
Summary Schedule of Prior Audit Findings	49
<u>PART IV – COMMENTS AND RECOMMENDATIONS</u>	
Comments and Recommendations	50-53
Summary of Recommendations	54

PART I - INTRODUCTORY SECTION



# Southeast Morris County Municipal Utilities Authority

19 SADDLE ROAD • CEDAR KNOLLS, NEW JERSEY 07927 • TEL 973-326-6880 • FAX 973-326-6864

April 11, 2017

The Honorable Chairman and Members  
of The Southeast Morris County  
Municipal Utilities Authority  
Cedar Knolls, NJ 07927

Dear Authority Members:

The annual financial report of The Southeast Morris County Municipal Utilities Authority (the “Authority”) for the year ended December 31, 2016 is hereby submitted. Responsibility for both the accuracy of the data and completeness and fairness of the presentation, including all disclosures, rests with the management of the Authority. To the best of our knowledge and belief, the data presented in this report is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the Authority. All disclosures necessary to enable the reader to gain an understanding of the Authority's financial activities have been included.

The annual financial report is presented in four sections: introductory, financial, *Government Auditing Standards* section and comments and recommendations. The introductory section includes this transmittal letter, the Authority's organizational chart and a list of principal officials. The financial section includes the financial statements as well as the auditors' report thereon. Information related to *Government Auditing Standards* section, including the auditors' report on internal control and compliance with applicable laws and regulations and findings are included in the *Government Auditing Standards* section of this report.

## REPORTING ENTITY AND ITS SERVICES:

The Southeast Morris County Municipal Utilities Authority is a public body corporate and politic of the State of New Jersey and was created by parallel ordinances adopted by the governing bodies, effective in December 1976, of the Township of Hanover, the Township of Morris, the Borough of Morris Plains and the Town of Morristown (“the creating municipalities”).

The Authority was created for the purpose of acquiring, constructing, maintaining, operating and improving the water supply and distribution system previously owned and operated by the Town of Morristown.

The ordinances creating the Authority provide that the Authority shall consist of eight members, two of whom shall be appointed by each of the governing bodies of the creating municipalities.

All bond proceeds, revenue or other cash receipts must be applied for specific purposes in accordance with the provisions of the Bond resolution dated September 5, 1991 and amended and restated in its entirety by the Authority on June 21, 2001 and September 2, 2010, as more fully described in Note Ik.

As a public body under existing statute, the Authority is exempt from both federal and state taxes.

REPORTING ENTITY AND ITS SERVICES: (Cont'd)

Governmental Accounting Standards Board Codification Section 2100, "Defining the Financial Reporting Entity" establishes standards to determine whether a governmental component unit should be included in the financial reporting entity. The basic criterion for inclusion or exclusion from the financial reporting entity is the exercise of oversight responsibility over agencies, boards and commissions by the primary government. The exercise of oversight responsibility includes financial interdependency and a resulting financial benefit or burden relationship, selection of governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters.

CASH MANAGEMENT: The investment policy of the Authority is guided in large part by state statute as detailed in "Notes to Financial Statements", Note 5. The Authority has adopted a cash management plan which requires it to deposit public funds in public depositories protected from loss under the provisions of the Governmental Unit Deposit Protection Act ("GUDPA"). GUDPA was enacted in 1970 to protect Governmental Units from a loss of funds on deposit with a failed banking institution in New Jersey. The law requires governmental units to deposit public funds only in public depositories located in New Jersey, where the funds are secured in accordance with the Act.

RISK MANAGEMENT: The Authority carries various forms of insurance, including but not limited to general liability, excess liability, automobile liability and comprehensive/collision, hazard and theft insurance on property, contents, and fidelity bonds which are described in the "Notes to Financial Statements", Note 6.

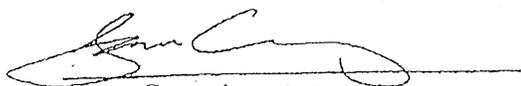
OTHER INFORMATION:

Independent Audit - State statutes require an annual audit by independent certified public accountants or registered municipal accountants. The accounting firm of Nisivoccia, LLP, CPAs, was selected by the Authority. The auditors' report on the financial statements is included in the financial section of this report.

ACKNOWLEDGEMENTS:

We would like to express our appreciation to the members of The Southeast Morris County Municipal Utilities Authority for their concern in providing fiscal accountability to the citizens of the participating municipalities and thereby contributing their full support to the development and maintenance of our financial operation. The preparation of this report could not have been accomplished without the efficient and dedicated services of our financial and accounting staff.

Respectfully submitted,

  
\_\_\_\_\_  
Laura Cummings, P.E.  
Executive Director/Chief Engineer

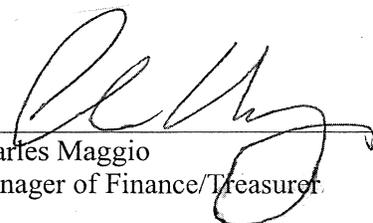
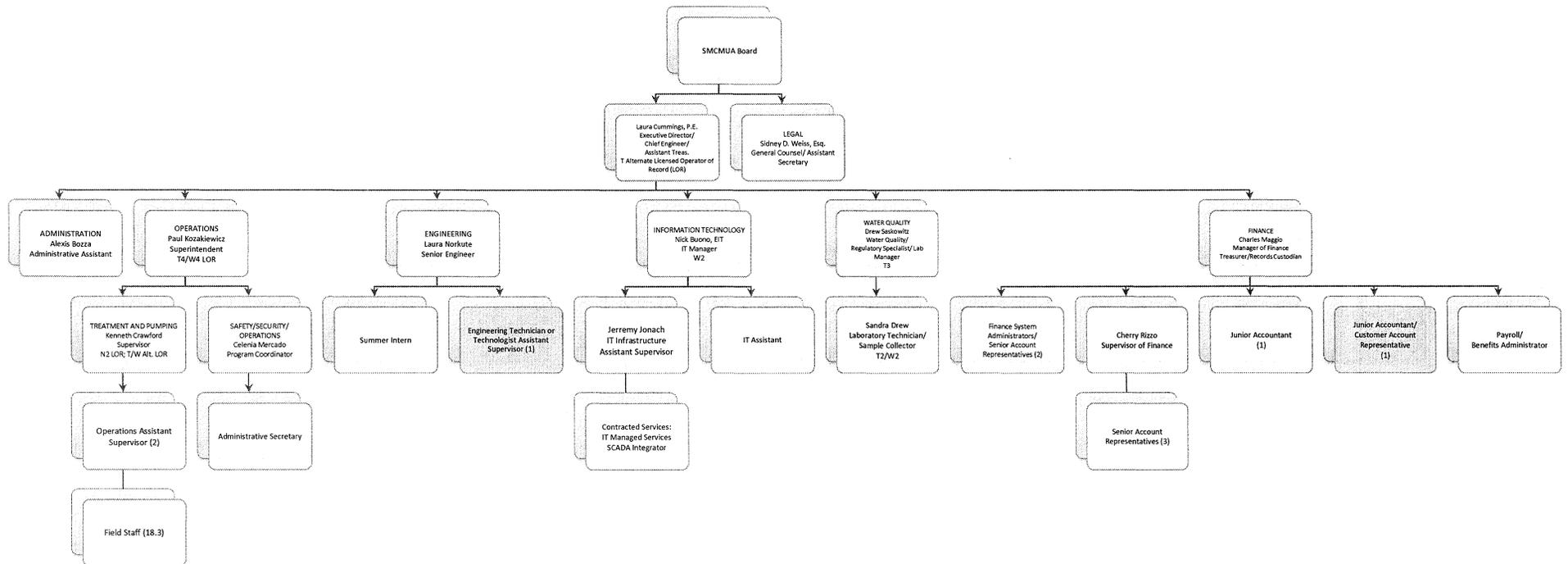
  
\_\_\_\_\_  
Charles Maggio  
Manager of Finance/Treasurer

Figure 1  
SMCMUA Organizational Chart



THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
ROSTER OF OFFICIALS  
DECEMBER 31, 2016

<u>Commissioners</u>	<u>Position</u>
Saverio C. Iannaccone	Chairperson
Donald Kissil	Vice Chairperson
William Conradi	Secretary
Dennis Baldassari	Board Member
Mary E. Dougherty	Board Member
Alan Johnson	Board Member
Ralph R. Rotando	Board Member
Adolf Schimpf, PhD.	Board Member
 <u>Other Officials</u>	
Laura Cummings, P.E.	Executive Director/Chief Engineer/ Assistant Treasurer
Janice A. Congleton	Chief Financial Officer/Treasurer/ (to 4/6/16)
Charles Maggio	Manager of Finance/Treasurer (from 4/6/16)
Paul Kozakiewicz	Superintendent
Sidney D. Weiss, Esquire	General Counsel/Assistant Secretary

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
CONSULTANTS AND ADVISORS

AUDIT FIRM

Nisivoccia, LLP  
200 Valley Road, Suite 300  
Mt. Arlington, New Jersey 07856

ATTORNEY

Sidney D. Weiss, Esquire  
19 Saddle Road  
Cedar Knolls, New Jersey 07927

CONSULTING ENGINEER

Mott McDonald  
Metropark, 111 Wood Avenue South  
Iselin, New Jersey 08830

INSURANCE AGENT

Willis of New Jersey  
10000 Midlantic Drive, East 200  
Mount Laurel, New Jersey 08054

PART II - FINANCIAL SECTION



Mount Arlington Corporate Center  
 200 Valley Road, Suite  
 Mt. Arlington, NJ 07856  
 973-328-1825 | 973-328-0507 Fax

Lawrence Business Center  
 11 Lawrence Road  
 Newton, NJ 07860  
 973-383-6699 | 973-383-6555 Fax

## Independent Auditors' Report

The Honorable Chairman and Members  
 of The Southeast Morris County  
 Municipal Utilities Authority  
 Cedar Knolls, NJ

### **Report on the Financial Statements**

We have audited the accompanying financial statements of The Southeast Morris County Municipal Utilities Authority, (the "Authority") for the year ended December 31, 2016, and the related notes to the financial statements, as listed in the foregoing 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, audit requirements prescribed by the Division of Local Government Services, Department of Community Affairs, State of New Jersey (the "Division"), 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 Authority'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 Authority'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 financial position of the Authority as of December 31, 2016, and the respective 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.

***Other Matters***

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the required supplementary information pension schedules be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the 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.

***Supplementary and Other Information***

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's financial statements. The supplementary information schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements.

The supplementary information schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information schedules and the schedules of expenditures of federal and state awards are fairly stated, in all material respects, in relation to the financial statements as a whole.

The introductory section has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

The Honorable Chairman and Members  
of The Southeast Morris County  
Municipal Utilities Authority  
Page 3

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 11, 2017 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

*Nisivoccia, LLP*

Mt. Arlington, New Jersey  
April 11, 2017

NISIVOCCIA, LLP

*Kathryn L. Mantell*

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Kathryn L. Mantell  
Registered Municipal Accountant #447  
Certified Public Accountant

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

This section presents management's analysis of the Authority's financial condition and activities for the year ended December 31, 2016. This information should be read in conjunction with the financial statements.

**FINANCIAL HIGHLIGHTS**

Management believes the Authority's financial position to be strong. The Authority is functioning within its stringent financial policies and guidelines set forth by the Authority members. Following is a list of key highlights for 2016:

- When compared to the 2016 budget, operating revenues were up by \$3,716,984 and expenses were below budget by \$1,086,480 before depreciation. Revenue increased primarily due to metered sales and connection fees. Operating expenses were lower than that budgeted for some accounts including chemicals, HVAC maintenance, water quality monitoring as well as for salary and wages and associated benefit costs. Salary and wage expenses were reduced below budget due to unanticipated vacancies.
- Overall operating revenue for 2016 increased 13.83% when compared to 2015.
- Actual water consumption decreased by 1.33% when compared to 2015 and metered sales decreased by .75%. Actual sales in 2016 exceeded the conservative projections that were based on normal precipitation due to higher than expected usage rates related to the lower than normal precipitation.
- Revenues from connection fees were \$1,985,507; this represents an increase of \$1,666,137 from 2015.
- Cash and cash equivalents and investments have increased by \$5,122,690 from 2015.
- Total expenses for capital projects and other capital assets were \$2.185 million.

**OVERVIEW OF THE ANNUAL FINANCIAL REPORT**

The Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with the audited financial statements and supplementary information. The Management's Discussion and Analysis represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, budget, and other management tools were used for this analysis.

The financial statements report information about the Authority using full accrual accounting as utilized by similar government activities. The financial statements include a statement of net position; a statement of revenues, expenses, and changes in net position; a statement of cash flows; and notes to the financial statements. In addition, there are several supplementary information schedules.

The *Statement of Net Position* presents the financial position of the Authority on a full accrual historical cost basis. The Statement of Net Position presents information on all of the Authority's assets and liabilities as well as any deferred inflows or outflows of resources, with the difference reported as net position. Over time, increases and decreases in net position is one indicator of whether the financial position of the Authority is improving or deteriorating.

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**OVERVIEW OF THE ANNUAL FINANCIAL REPORT (CONT'D)**

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the *Statement of Revenues, Expenses, and Changes in Net Position* presents the results of the business activities over the course of the year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs. Rate setting policies use different methods of cost recovery not fully provided for by generally accepted accounting principles. The primary objectives of the rate model are to improve equity among customer classes and ensure that capital costs are allocated on the basis of long-term requirements.

The *Statement of Cash Flows* presents changes in cash and cash equivalents, resulting from operational, capital financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The *Notes to Financial Statements* provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information concerning the Authority's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

The *supplementary information schedules* provide detailed comparison of budget to actual expenses, as well as important debt information.

**FINANCIAL CONDITION**

The Authority's total net position increased 7.77%. This was mainly the result of normal business operations and the continued reduction of debt associated with capital assets. The Authority is in excellent shape to meet future financial demands. The analysis below focuses on the Authority's net position (Table 1).

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**TABLE 1  
Condensed Statement of Net Position**

	Dec. 31, 2016	Dec. 31, 2015	Increase/ (Decrease) from 2015	Percentage Increase/ (Decrease)
Current Assets	\$ 21,745,827	\$ 16,297,749	\$ 5,448,078	33.43%
Capital Assets, Net	64,074,803	63,745,174	329,629	0.52%
Total Assets	<u>85,820,630</u>	<u>80,042,923</u>	<u>5,777,707</u>	7.22%
Deferred Outflows of Resources	4,239,860	396,376	3,843,484	969.66%
Current Liabilities	1,613,276	1,814,291	(201,015)	-11.08%
Long-Term Liabilities	13,728,039	9,196,380	4,531,659	49.28%
Total Liabilities	<u>15,341,315</u>	<u>11,010,671</u>	<u>4,330,644</u>	39.33%
Deferred Inflows of Resources	434,817	503,066	(68,249)	-13.57%
Net Position:				
Net Investment in Capital Assets	63,506,924	62,150,765	1,356,159	2.18%
Restricted	3,725,950	3,664,780	61,170	1.67%
Unrestricted	7,051,484	3,110,017	3,941,467	126.73%
Total Net Position	<u>\$ 74,284,358</u>	<u>\$ 68,925,562</u>	<u>\$ 5,358,796</u>	7.77%

**FINANCIAL RESULTS**

Changes in the Authority's net position can be determined by reviewing the following condensed Statement of Revenue, Expenses and Changes in Net Position for the year. The Authority's total net position increased from the prior year by \$5,358,796. The analysis below focuses on the Authority's changes in net position (Table 2) during the year.

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**TABLE 2  
Condensed Statement of Revenue, Expenses  
and Changes in Net Position**

	2016	2015	Increase/ (Decrease) from 2015	Percentage Increase/ (Decrease)
Operating Revenue	\$ 17,905,835	\$ 15,729,929	\$ 2,175,906	13.83%
Nonoperating Revenue	18,236	68,802	(50,566)	-73.49%
Total Revenue	<u>17,924,071</u>	<u>15,798,731</u>	<u>2,125,340</u>	13.45%
Operating Expenses	10,709,429	9,882,284	827,145	8.37%
Depreciation	1,827,376	1,678,635	148,741	8.86%
Nonoperating Expenses	28,470	122,945	(94,475)	-76.84%
Total Expenses	<u>12,565,275</u>	<u>11,683,864</u>	<u>881,411</u>	7.54%
Change in Net Position	5,358,796	4,114,867	1,243,929	30.23%
Beginning Net Position	<u>68,925,562</u>	<u>64,810,695</u>	<u>4,114,867</u>	6.35%
Ending Net Position	<u>\$ 74,284,358</u>	<u>\$ 68,925,562</u>	<u>\$ 5,358,796</u>	7.77%

**Operating Revenues:** The \$2,175,906 increase in operating revenues compared to 2015 is primarily due to the increase in water charges (rate increase) and connection fees from the previous year.

**Expenses:** Operating expenses increased 8.37% from 2015 but were \$1,057,230 below budget. The Authority closely monitors its budget and spending throughout the year in order to control its operations.

When comparing the expenses from 2015 to 2016, the items to be noted include:

- Approximate increases in costs of:
  - o \$200,000 for purchased water
  - o \$75,000 for retiree benefits
  - o \$33,000 for active employee benefits
  - o \$45,000 for waste removal
  - o \$40,000 in labor costs associated with operating the membrane treatment facility
  - o \$40,000 for environmental engineering services

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**FINANCIAL ANALYSIS OF THE AUTHORITY AS A WHOLE**

One of the most important questions asked about the Authority's finances is "is the Authority, as a whole, better or worse off as a result of the year's activities?" The Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position report information about the Authority's activities in a way that will help answer this question. These two statements report the net position of the Authority, and changes in them. The Authority's net position – the difference between assets and liabilities and deferred inflows and outflows – is a measurement of its financial health or financial position.

Over time, increases or decreases in the Authority's net position are an indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, customer growth and legislative mandates also need to be considered.

The greatest impacts on the Authority's performance were:

- Revenue from metered sales for 2016 was \$1,494,077 above the 2016 projected amount.
- Connection fees were \$1,985,507 above 2016 budget.
- Miscellaneous revenue was \$238,035, up over \$35,000 from 2015 and \$53,035 above the 2016 budget.
- Interest income for the Authority was \$16,846, lower than the \$19,812 realized in 2015 but \$4,846 above the 2016 budget. Until interest rates improve on certificates of deposits and similar instruments, investment income is limited to interest from money market accounts.
- Salary and wages and associated benefit costs were less than budgeted due to unanticipated vacancies and a delay in hiring replacement staff.
- Purchased water expenses were about \$200,000 above that projected necessary to supplement the sources of supply relative to the drought like conditions and resultant impacts on the Clyde Potts Reservoir supply.
- Both Passaic Valley Water Commission and the Morris County Municipal Utilities Authority increased their water rates by 4% and 3%, respectively, for 2016.
- The Authority paid its actuarially calculated pension payment of \$357,765 in 2016.

**BUDGETARY HIGHLIGHTS**

The State of New Jersey requires local authorities to prepare and adopt annual budgets in accordance with the Local Authorities Fiscal Control Law and regulations adopted by the Local Finance Board pursuant to statute and codified as N.J.A.C. 5:31-1 et seq. The statutory budget was designed to demonstrate to the Bureau of Authority Regulation of the Division of Local Government Services that the cash flows of the Authority for the coming year will be sufficient to cover operating expenses, interest accruing on bonded indebtedness and cash payments of maturing bond and loan principal.

In the event that current projected revenues lag behind budget amounts, adjustments to discretionary spending and/or rate impact analyses need to be performed. However, in order to present a true budgetary comparison, the statutory budget is amended only in instances wherein planned spending will exceed legal appropriation amounts.

In order to continue its aggressive capital improvement program as outlined in the 2006 Master Plan on a "pay-as-you-go" basis, the Authority raises rates when necessary to fund current and future capital projects.

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**BUDGETARY HIGHLIGHTS**

A Cost of Services study was generated in early 2016 and an analysis of revenues and expenses was performed mid-year in 2016 as part of the budget production process. As a result, it was determined that a required water rate increase of 1% for commercial rates, 2.25% for residential rates and a 2% rate increase for all other charges need to be implemented in order to continue to achieve the business goals of the Authority. Statutory adjustments to the Connection Fee will continue annually as required.

**CAPITAL ASSETS**

At December 31, 2016, the Authority had \$64,074,803 invested in a broad range of utility capital assets, including water treatment plants, water storage facilities, water mains, pump stations, and related land, facilities and equipment.

The following table summarizes the Authority's capital assets, net of accumulated depreciation and changes therein, for the year ended December 31, 2016. These changes are presented in detail in Note 2 to the financial statements.

**TABLE 3  
Capital Assets, Net of Accumulated Depreciation**

	Dec. 31, 2016	Dec. 31, 2015	Increase/ (Decrease) from 2015	Percentage Increase/ (Decrease)
Land	\$ 4,045,860	\$ 4,045,860		
Plant, Equipment and Vehicles	87,762,903	87,698,083	\$ 64,820	0.07%
Construction in Progress	4,340,175	2,247,990	2,092,185	93.07%
Total	<u>96,148,938</u>	<u>93,991,933</u>	<u>2,157,005</u>	<u>2.29%</u>
Less: Accumulated Depreciation	<u>32,074,135</u>	<u>30,246,759</u>	<u>1,827,376</u>	<u>6.04%</u>
Capital Assets, Net of Accumulated Depreciation	<u>\$ 64,074,803</u>	<u>\$ 63,745,174</u>	<u>\$ 329,629</u>	<u>0.52%</u>

Additions during the year ended December 31, 2016 included:

Vehicle	\$26,143
Construction in Progress	\$2,159,170

During the year the Authority transferred \$38,677 of Construction in Progress to Plant for fully completed projects, deleted \$28,308 and depreciated \$1,827,376 of its capital assets.

Based on the 2006 Master Plan and revised in 2012, the Authority's 2017 capital budget requires an investment of \$4,363,000, including the following:

Engineering	\$ 245,000
Information Technology	215,000
Facilities Improvements	400,000
Meters and Services	137,500
Transmission and Distribution Improvements	1,775,500
Treatment and Pumping Improvements	1,480,000
Equipment	<u>110,000</u>
Total Capital Budget for 2017	<u>\$4,363,000</u>

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**LONG TERM LIABILITIES**

The Authority plans to continue funding its capital projects through its general operating budget which also comprises annual depreciation and connection fee transfers from revenues.

At year-end, the Authority had \$13,729,645 in long term liabilities – an increase of \$3,506,735 from last year – as shown in Table 4. (More detailed information about the Authority’s long-term liabilities is presented in Note 4 to the financial statements.)

**TABLE 4  
Outstanding Long-Term Liabilities**

	<u>Dec. 31, 2016</u>	<u>Dec. 31, 2015</u>	<u>Increase/ (Decrease) from 2015</u>	<u>Percentage Increase/ (Decrease)</u>
Water Revenue Refunding				
Bonds Payable		\$ 1,025,000	\$ (1,025,000)	-100.00%
Loan - Town of Morristown	\$ 567,879	569,409	(1,530)	-0.27%
Net Pension Liability	12,958,770	8,441,480	4,517,290	53.51%
Other Long-Term Liabilities	<u>202,996</u>	<u>187,021</u>	<u>15,975</u>	8.54%
	<u>\$ 13,729,645</u>	<u>\$ 10,222,910</u>	<u>\$ 3,506,735</u>	34.30%

At December 31, 2016, the Authority paid down the revenue refunding bonds in the amount of \$1,025,000. The Net Pension Liability increased \$4,517,290 to \$12,958,770 as a result primarily from changes in assumptions and other factors.

**ECONOMIC FACTORS AND NEXT YEAR’S BUDGET AND RATES**

The Authority’s 2017 budget revenues were projected conservatively at \$14,422,986, assuming normal sales based on average precipitation and no connection fees. The 2017 total budgetary expenses are equal to \$14,300,100 requiring no contribution from net position to balance the budget. The 2017 operating budget was based on management’s thorough review of expenses for each Division as compared to 2016 and to incorporate necessary expenditures for 2017. Revenue projections incorporated the proposed rate increases of 1% for commercial rates, 2.25% for residential rates and a 2% rate increase for all other charges and assumed no income from connection fees. Budgeted 2017 salary and wages decreased by approximately \$80,900 due to the retirement of a fleet mechanic where these services will now be outsourced due to the complexities of the work.

The final payment for the 2010 Series Bond was made on January 1, 2016 resulting in a net decrease in operating expenses of 4.3% from 2016 to 2017.

**THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
MANAGEMENT DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES**

- The 2017 Budget was developed utilizing a six (6) year planning period. Criteria utilized to develop the budget includes the following:
  - Projected demand (consumption) based on the 2015 Demand Study.
  - Class rate adjustments based on the 2016 Cost of Services Study.
  - Assumption of “zero” collection of connection fees.
  - Cash funding of all capital projects.
  - Assume an annual rate increase of 4% for PVWC and 4% for MCMUA.
  - Maintenance of a minimum of a 12.5%, or \$2 million, cash working capital (cash flow reserve).
  - Maintain a year-end General Fund balance of \$5 million at the end of the six (6) year budgeting cycle.
  - Include depreciation and amortization in the budget.
- An overall operating budget decrease of 4.3% was observed from 2016 to 2017 due to the payoff of the 2010 Series Bonds.
- The addition of a contract with Wharton Borough for water with a reserve amount of \$30,031.
- Metered sales are estimated to be \$148,966 above that estimated for 2016 due to the rate increase.
- Expenses for PVWC and MCMUA increased by 5% and 3%, respectively, above the 2016 rates.
- Public Employee Retirement System contributions increased by \$14,738.
- NJ State Health Benefit Program contributions for active employees increased by \$52,000.
- NJ State Health Benefits Program for retired employees increased by \$18,900.
- Depreciation and amortization for 2017 is equal to \$2,464,000.

It should be noted that based on the Board's commitment to supply the highest water quality and superior customer service and the practice of internal financing for projects and capital improvements, an annual review of revenues and rates is required.

**CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide the Authority's customers and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact Laura Cummings, P.E., Executive Director/Chief Engineer at The Southeast Morris County Municipal Utilities Authority, 19 Saddle Road, Cedar Knolls, NJ 07927 or e-mail [lcummings@smcmua.org](mailto:lcummings@smcmua.org).

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
STATEMENT OF NET POSITION  
DECEMBER 31, 2016

ASSETS

## Current Assets:

Cash and Cash Equivalents	\$ 19,525,707
Change Fund	700
	19,526,407

Total Cash and Cash Equivalents	19,526,407
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Water Charges Receivable	1,663,387
Other Accounts Receivable	445,206
Inventory	110,827
	1,663,387

Total Current Assets	21,745,827
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## Noncurrent Assets:

Depreciable Capital Assets	55,688,768
Land	4,045,860
Construction in Progress	4,340,175
	64,074,803

Total Capital Assets	64,074,803
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Total Noncurrent Assets	64,074,803
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TOTAL ASSETS	85,820,630
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DEFERRED OUTFLOWS OF RESOURCES

Changes in Assumptions - Pensions	2,684,365
Changes in Proportion - Pensions	431,664
Difference between Expected and Actual Experience - Pensions	240,994
Investment Gains - Pensions	494,130
Authority Contribution Subsequent to the Measurement Date - Pensions	388,707
	3,839,860

Total Deferred Outflows of Resources	4,239,860
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THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
STATEMENT OF NET POSITION  
DECEMBER 31, 2016  
(Continued)

LIABILITIES

## Current Liabilities:

Accounts Payable	\$ 1,022,715
Contracts Payable	431,577
Payroll Deductions Payable	26,997
Accrued Wages Payable	130,381
Loan Payable - Due to Town of Morristown	1,606
	1,606

Total Current Liabilities	1,613,276
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## Noncurrent Liabilities:

Net Pension Liability	12,958,770
Compensated Absences Payable	202,996
Loan Payable - Due to Town of Morristown	566,273
	566,273

Total Noncurrent Liabilities	13,728,039
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Total Liabilities	15,341,315
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DEFERRED INFLOWS OF RESOURCES:

Charges in Proportion - Pensions	434,817
	434,817

Total Deferred Inflows of Resources	434,817
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NET POSITION

Net Investment in Capital Assets	63,506,924
Restricted	3,725,950
Unrestricted	7,051,484
	7,051,484

Total Net Position	\$ 74,284,358
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THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS  
ARE AN INTEGRAL PART OF THIS STATEMENT

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
STATEMENT OF REVENUE, EXPENSES  
AND CHANGES IN NET POSITION  
FOR THE YEAR ENDED DECEMBER 31, 2016

Operating Revenue:		
Water Charges		\$ 15,611,049
Water Connection Fees		1,985,507
Other		71,244
Miscellaneous:		
Wet Cut Application Fees	\$ 9,152	
Tap Application Fees	23,068	
Main Extension Inspection Fees	23,814	
Fines/Penalties	72,281	
Leases/Rents	109,720	
Total Miscellaneous		<u>238,035</u>
 Total Operating Revenue		 <u>17,905,835</u>
Operating Expenses:		
Operating Appropriations		10,709,429
Depreciation		<u>1,827,376</u>
 Total Operating Expenses		 <u>12,536,805</u>
 Operating Income		 <u>5,369,030</u>
Nonoperating Revenue (Expenses):		
Interest Income		16,846
Statewide Insurance Grant		1,390
Interest Expense - Loans		<u>(28,470)</u>
 Total Nonoperating Revenue (Expenses)		 <u>(10,234)</u>
 Change in Net Position		 5,358,796
Net Position, Beginning of Year		<u>68,925,562</u>
Net Position, End of Year		<u>\$ 74,284,358</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS  
ARE AN INTEGRAL PART OF THIS STATEMENT

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2016

Cash Flows from Operating Activities:	
Cash Received from Customers	\$ 17,561,597
Cash Paid to Suppliers and Employees	(9,552,372)
Net Cash Provided by Operating Activities	<u>8,009,225</u>
Cash Flows from Capital and Related Financing Activities:	
Purchase of Capital Assets	(26,143)
Construction in Progress	(1,804,378)
Principal Paid on Bonds and Loans	(1,026,530)
Interest Expense	(47,720)
Net Cash Used for Capital and Related Financing Activities	<u>(2,904,771)</u>
Cash Flows from Noncapital Financing Activities:	
Grants Received	1,390
Net Cash Provided by Noncapital Financing Activities	<u>1,390</u>
Cash Flows from Investing Activities:	
Interest on Investments	16,846
Net Cash Provided by Investing Activities	<u>16,846</u>
Net Increase in Cash and Cash Equivalents	5,122,690
Cash and Cash Equivalents - Beginning of Year	<u>14,403,717</u>
Cash and Cash Equivalents - End of Year	<u>\$ 19,526,407</u>
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:	
Operating Income	\$ 5,369,030
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	1,827,376
Changes in Net Position:	
(Increase) in Water Rents Receivable	(353,877)
Decrease in Other Accounts Receivable	9,639
Decrease in Inventory	18,850
Increase in Accounts Payable	540,803
Increase in Payroll Deductions Payable	2,315
Increase in Accrued Compensated Absences Payable	15,975
(Decrease) in Accrued Wages Payable	(26,443)
(Increase) in Deferred Inflows/Outflows	(3,911,733)
Increase in Net Pension Liability	4,517,290
Net Cash Provided By Operating Activities	<u>\$ 8,009,225</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS  
ARE AN INTEGRAL PART OF THIS STATEMENT

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016

Note 1 - Organization and Summary of Significant Accounting Policies

The Southeast Morris County Municipal Utilities Authority is a public body corporate and politic of the State of New Jersey and was created by parallel ordinances adopted by the governing bodies, effective in December 1976, of the Township of Hanover, the Township of Morris, the Borough of Morris Plains and the Town of Morristown (“the creating municipalities”), all municipal corporations of the State of New Jersey located in the County of Morris.

The Authority was created for the purpose of acquiring, constructing, maintaining, operating and improving the water supply and distribution system previously owned and operated by the Town of Morristown.

The ordinances creating the Authority provide that the Authority shall consist of eight members, two of whom shall be appointed by each of the governing bodies of the creating municipalities.

A. Basis of Presentation and Accounting

The Authority utilizes the accrual basis of accounting whereby revenue is recorded as earned and expenses are reflected as the liability is incurred. Operating revenue, such as charges for services result from exchange transactions associated with the principal activity of the Authority. Exchange transactions are those in which each party receives and gives up essentially equal value. Nonoperating revenue, such as subsidies and investment earnings, results from nonexchange transactions or ancillary activities. Nonexchange transactions, in which the Authority gives or receives value without directly receiving or giving equal value in exchange, generally do not occur, with the exception of investment earnings.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenue earned and/or expenses incurred is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The financial statements are reported using the economic measurement focus and the accrual basis of accounting. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Position. Net Position (i.e., totals assets and deferred outflows net of total liabilities and deferred inflows) are segregated into “net investment in capital assets”, “restricted” and “unrestricted” components.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 1 - Organization and Summary of Significant Accounting Policies (Cont'd)

A. Basis of Presentation and Accounting (Cont'd)

Reporting Entity

Governmental Accounting Standards Board publication Codification of Governmental Accounting and Financial Reporting Standards section 2100, "Defining the Financial Reporting Entity", establishes standards to determine whether a governmental component unit should be included in the financial reporting entity. The basic criterion for inclusion or exclusion from the financial reporting entity is the exercise of oversight responsibility over agencies, boards and commissions by the primary government. The exercise of oversight responsibility includes financial interdependency and a resulting financial benefit or burden relationship, selection of governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters. The Authority is a legally separate organization. Financial transactions are processed and accounted for by the Authority's financial administration. There were no additional entities required to be included in the reporting entity under the criteria as described above, in the current fiscal year. Furthermore, the Authority is not includable in any other reporting entity on the basis of such criteria.

B. Grants

Recognition of revenue from grants is based on the accrual basis of accounting. Grant funds received before costs are incurred are recorded as unearned revenue.

Grant related expenses incurred in advance of receipt of grant funds result in the recording of receivables and revenue. Grants not externally restricted and utilized to finance operations are identified as nonoperating revenue.

C. Inventories

The cost of inventories of supplies are recorded on a first-in, first-out basis and are stated at cost.

D. Cash and Cash Equivalents

Amounts include petty cash, amounts on deposit, and short-term investments with original maturities of three months or less.

E. Investments

Investments are generally stated at fair value with a few exceptions. The Authority classifies certificates of deposit which have original maturity dates of more than three months but less than twelve months from the date of purchase, as investments.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 1 - Organization and Summary of Significant Accounting Policies (Cont'd)

F. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from the estimates.

G. Compensated Absences

The Authority accounts for compensated absences (e.g., unused vacation, sick leave) as directed by Governmental Accounting Standards Board Statement No. 16 (GASB 16), *Accounting for Compensated Absences*. A liability for compensated absences attributable to services already rendered and not contingent on a specific event that is outside the control of the employer and employee is accrued as employees earn the rights to the benefits.

Authority employees are granted varying amounts of vacation and sick leave in accordance with the Authority's employee contracts/agreements and personnel manual. Employees are permitted to accrue up to one year of unused vacation time and all unused sick time. Upon retirement, employees shall be paid for their unused (prorated) vacation time. Employees hired prior to December 31, 2011 shall be paid for their unused sick leave in accordance with the Authority's applicable employee contracts/agreements and personnel manual. Employees hired after December 31, 2011, are not entitled to payment for their unused sick time.

In the *Statement of Net Position*, the liabilities, whose average maturities are greater than one year, should be reported in two components – the amount due within one year and the amount due in more than one year. Compensated absences are accrued and reported as a liability in the period earned. The balance as of December 31, 2016 was \$202,996, which is included on the Statement of Net Position as a non-current liability.

H. Net Position

Net Position is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources.

A deferred outflow of resources is a consumption of net position by the Authority that is applicable to a future reporting period. The Authority had deferred outflows of resources at December 31, 2016 for the changes in assumptions in pension, changes in proportion in pension, the net difference between projected and actual investment earnings on pension plan investments, the difference between expected and actual pension experience and the Authority contribution subsequent to the measurement date related to pensions at December 31, 2016.

A deferred inflow of resources is an acquisition of net position by the Authority that is applicable to a future reporting period. The Authority had a deferred inflow of resources at December 31, 2016 for changes in proportion in pensions.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 1 - Organization and Summary of Significant Accounting Policies (Cont'd)

H. Net Position (Cont'd)

Net position is displayed in three components - net investment in capital assets; restricted and unrestricted.

The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of 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 also would be included in this component of net position.

The restricted component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets.

The unrestricted component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

I. Allowance for Uncollectible Accounts

All receivables are reported at their gross values and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. The allowance is established at the discretion of management of the Authority as deemed necessary based on prior collection history.

J. Revenue Recognition

Large commercial customers are billed monthly and residential and small commercial customers are billed quarterly. Revenue is recorded net of any discounts, assessments or abatements, if applicable.

K. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the State of New Jersey Public Employees' Retirement System (PERS) and additions to/deductions from the PERS's net position have been determined on the same basis as they are reported by the PERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Pension Plan investments are reported at fair value.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 2 - Capital Assets

Capital assets are recorded at cost and consisted of the following:

	<u>Dec. 31, 2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	<u>Dec. 31, 2016</u>
Capital Assets Being Depreciated:					
Plant	\$ 63,252,343			\$ 38,677	\$ 63,291,020
Vehicles	1,026,160	\$ 26,143			1,052,303
Machinery and Equipment	23,419,580				23,419,580
Total Capital Assets Being Depreciated	<u>87,698,083</u>	<u>26,143</u>		<u>38,677</u>	<u>87,762,903</u>
Capital Assets not Being Depreciated:					
Land	4,045,860				4,045,860
Construction in Progress	2,247,990	2,159,170	\$ (28,308)	(38,677)	4,340,175
Total Capital Assets not Being Depreciated	<u>6,293,850</u>	<u>2,159,170</u>	<u>(28,308)</u>	<u>(38,677)</u>	<u>8,386,035</u>
Total Capital Assets	93,991,933	2,185,313	(28,308)		96,148,938
Accumulated Depreciation	<u>(30,246,759)</u>	<u>(1,827,376)</u>			<u>(32,074,135)</u>
Capital Assets (Net)	<u>\$ 63,745,174</u>	<u>\$ 357,937</u>	<u>\$ (28,308)</u>	<u>\$ - 0 -</u>	<u>\$ 64,074,803</u>

Property and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets. Maintenance and repairs are charged to expense as incurred; major renewals and betterments are capitalized. Capital assets have been reviewed for impairments.

Major classes of property, plant and equipment and their estimated useful lives are summarized below:

Structures and Improvements	50-100 Years
Transmission and Distribution Mains, Reservoirs and Standpipes	100 Years
Vehicles and Equipment	5-50 Years

Construction-in-Progress

As of December 31, 2016, the Authority continues to move forward with plans to upgrade its water treatment facilities with cumulative costs totaling \$4,340,175.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 3 - Operating Leases

The Authority has commitments to lease copying equipment and a postage machine under operating leases which expire in June 2019. Total operating lease payments made during the year ended December 31, 2016 were \$8,627.

Future lease payments are as follows:

<u>Year</u>	<u>Amount</u>
2017	\$ 8,627
2018	6,532
2019	<u>2,742</u>
	<u>\$ 17,902</u>

Note 4 - Long-Term Liabilities

During the year ended December 31, 2016, the following changes occurred in the long-term liabilities reported in the financial statements:

	<u>Balance</u> <u>Dec. 31, 2015</u>	<u>Accrued</u>	<u>Retired</u>	<u>Balance</u> <u>Dec. 31, 2016</u>
Water Revenue Refunding				
Bonds Payable	\$ 1,025,000		\$ 1,025,000	
Loan - Town of Morristown	569,409		1,530	\$ 567,879
Net Pension Liability	8,441,480	\$ 4,517,290		12,958,770
Other Long-Term Liabilities	<u>187,021</u>	<u>15,975</u>		<u>202,996</u>
	<u>\$ 10,222,910</u>	<u>\$ 4,533,265</u>	<u>\$ 1,026,530</u>	<u>\$ 13,729,645</u>

Loans Payable

On January 20, 1977, under a regionalization plan approved by ordinances of the creating municipalities (see Note 1), the Authority acquired the water utility owned and operated by the Town of Morristown. Under the plan, a portion of the acquisition cost is required to be paid to the Town of Morristown in annual installments of \$30,000 until year 2076. The unpaid balances at December 31, 2016 and 2015 were \$567,879 and \$569,409, respectively, at an assumed interest rate of 5%. Interest expense on the annual payment due to the Town of Morristown was \$28,470 and \$28,543 for 2016 and 2015, respectively.

Bonds Authorized But Not Issued

As of December 31, 2016, the Authority has no bonds authorized but not issued.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 4 - Long-Term Liabilities (Cont'd)

Net Pension Liability

The Public Employee's Retirement System (PERS) net pension liability is recorded in the current and long-term liabilities. The current portion of the net pension liability at December 31, 2016 is \$- and the long term portion is \$12,958,770. See Note 13 for further information on the PERS.

Note 5 - Cash and Cash Equivalents and Investments

Cash and cash equivalents include petty cash, amounts in deposits, money market accounts, and short-term investments with original maturities of three months or less.

Investments are generally stated at fair value with a few exceptions. The Authority classifies certificates of deposit which have original maturity dates of more than three months but less than twelve months from the date of purchase, as investments.

GASB Statement No. 40, *Governmental Accounting Standards Board Deposit and Investment Risk Disclosures*, requires disclosure of the level of custodial credit risk assumed by the Authority in its cash, cash equivalents and investments, if those items are uninsured or unregistered. Custodial risk is the risk that in the event of bank failure, the government's deposits may not be returned.

Interest Rate Risk – In accordance with its cash management plan, the Authority ensures that any deposit or investment matures within the time period that approximates the prospective need for the funds, deposited or invested, so that there is not a risk to the market value of such deposits or investments.

Custodial Credit Risk – The Authority's policy with respect to custodial credit risk requires that the Authority ensures that Authority funds are only deposited in financial institutions in which NJ Authorities are permitted to invest their funds.

Credit Risk – The Authority limits its investments to those authorized in its cash management plan which are permitted under state statutes as detailed in the investments section of this note.

Deposits:

New Jersey statutes require that authorities deposit public funds in public depositories located in New Jersey which are insured by the Federal Deposit Insurance Corporation, or by any other agency of the United States that insures deposits made in public depositories. Authorities are also permitted to deposit public funds in the State of New Jersey Cash Management Fund.

New Jersey statutes require public depositories to maintain collateral for deposits of public funds that exceed insurance limits as follows:

The market value of the collateral must equal 5% of the average daily balance of collected public funds on deposit.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 5 - Cash and Cash Equivalents and Investments (Cont'd)

In addition to the above collateral requirement, if the public funds deposited exceed 75% of the capital funds of the depository must provide collateral having market value at least equal to 100% of the amount exceeding 75%.

All collateral must be deposited with the Federal Reserve Bank, the Federal Home Loan Bank Board or a banking institution that is a member of the Federal Reserve System and has capital funds of not less than \$25,000,000.

Investments:

New Jersey statutes permit the Authority to purchase the following types of securities:

- (1) Bonds or other obligations of the United States of America or obligations guaranteed by the United States of America;
- (2) Government money market mutual funds;
- (3) Any obligation that a federal agency or a federal instrumentality has issued in accordance with an act of Congress, which security has a maturity date not greater than 397 days from the date of purchase, provided that such obligation bears a fixed rate of interest not dependent on any index or other external factor;
- (4) Bonds or other obligations of the local unit or bonds or other obligations of school districts of which the local unit is a part or within which the school district is located;
- (5) Bonds or other obligations, having a maturity date not more than 397 days from the date of purchase, approved by the Division of Local Government Services in the Department of Community Affairs for investment by local units;
- (6) Local government investment pools;
- (7) Deposits with the State of New Jersey Cash Management Fund established pursuant to section 1 of P.L. 1977, c.281 (C.52:18A-90.4); or
- (8) Agreements for the repurchase of fully collateralized securities if:
  - (a) the underlying securities are permitted investments pursuant to paragraphs (1) and (3) above;
  - (b) the custody of collateral is transferred to a third party;
  - (c) the maturity of the agreement is not more than 30 days;
  - (d) the underlying securities are purchased through a public depository as defined in section 1 of P.L. 1970, c.236 (C.17:9-41); and
  - (e) a master repurchase agreement providing for the custody and security of collateral is executed.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 5 - Cash and Cash Equivalents and Investments (Cont'd)

As of December 31, 2016, cash and cash equivalents of the Southeast Morris County Municipal Utilities Authority consisted of the following:

	<u>Cash on Hand</u>	<u>Checking/ Savings Accounts</u>	<u>Money Market Funds</u>	<u>Total</u>
Cash and Cash Equivalents	<u>\$ 700</u>	<u>\$ 17,400,216</u>	<u>\$ 2,125,491</u>	<u>\$ 19,526,407</u>

The carrying amount of the Authority's cash and cash equivalents at December 31, 2016, was \$19,526,407, and the bank balance was \$19,497,249. The Authority did not hold any investments during the year ended December 31, 2016.

Note 6 - Risk Management

The Authority 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. Health benefits are provided to employees through the State of New Jersey health benefits plan. The Authority carries commercial insurance coverage for all other risks of loss except for Workers' Compensation Insurance coverage.

The Authority is a member of the Statewide Insurance Fund (the "Fund"). The Fund provides its members with Workers' Compensation coverage. The Fund is a risk-sharing public entity risk pool that is both an insured and self-administered group of governmental entities established for the purpose of providing low-cost insurance coverage for its members in order to keep local property taxes at a minimum. Each member appoints an official to represent their respective entity for the purpose of creating a governing body from which officers for the Fund are elected.

As a member of the Fund, the Authority could be subject to supplemental assessments in the event of deficiencies. If the assets of the Fund were to be exhausted, members would become responsible for their respective shares of the Fund's liabilities.

The Fund can declare and distribute dividends to members upon approval of the State of New Jersey Department of Banking and Insurance. These distributions are divided amongst the members in the same ratio as their individual assessment relates to the total assessment of the membership body. The members may either receive payment or offset their subsequent year assessments with their respective share of the distribution.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 6 - Risk Management (Cont'd)

The December 31, 2016 audit report has not been filed as of the date of this audit. Selected, summarized financial information for the Fund as of December 31, 2015 is as follows:

Total Assets	\$ 42,511,989
Net Position	\$ 5,327,694
Total Revenue	\$ 27,313,612
Total Expenses	\$ 27,163,170
Change in Net Position	\$ 150,442
Members Dividends	\$ -0-

Financial statements for the Fund are available at the offices of the Fund's Executive Director:

Statewide Insurance Fund  
C/O HRH of Northern New Jersey, Inc.  
30A Vreeland Road  
Florham Park, NJ 07932-0678

New Jersey Unemployment Compensation Insurance

The Authority has elected to fund its New Jersey Unemployment Compensation Insurance under the "Benefit Reimbursement Method". Under this plan, the Authority is required to reimburse the New Jersey Unemployment Trust Fund for benefits paid to its former employees and charged to its account with the State. The Authority is billed quarterly for amounts due to the State.

The following is a summary of Authority and employee contributions, interest earned and reimbursements to the State for benefits paid and the ending balance of the Authority's account for the current and previous two years which is included in the Authority's restricted net position:

Year	Authority/ Employee Contributions	Interest Earned	Amount Reimbursed	Ending Balance
2014	\$ 6,345	- 0 -	\$ 2,054	\$ 109,311
2015	5,333	- 0 -	76	114,568
2016	5,707	- 0 -	71	120,204

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 7 - Post-Retirement Benefits

The Authority contributes to the State Health Benefits Program (SHBP), a cost-sharing, multiple-employer defined benefit post-employment healthcare plan administered by the State of New Jersey Division of Pension and Benefits. SHBP was established in 1961 under N.J.S.A. 52:14-17.25 et seq. to provide health benefits to State employees, retirees, and their dependents.

The SHBP was extended to employees, retirees, and dependents of participating local public employers in 1964. Local employers must adopt a resolution to participate in the SHBP.

Rules governing the operations and administration of the program are found in Title 17, Chapter 9 of the New Jersey Administrative Code. SHBP provides medical, prescription drugs, mental health/ substance abuse, and Medicare Part B reimbursement to retirees and their covered dependents.

The State Health Benefits Commission is the executive body by statute to be responsible for the operations of the SHBP. The New Jersey Division of Pensions and Benefits issues a publicly available financial report that includes financial statements and required supplementary information for the SHBP. This report may be obtained by writing to the New Jersey Division of Pensions and Benefits, P.O. Box 295, Trenton, New Jersey 08625-0295.

Participating employers are contractually required to contribute based on the amount of premiums attributable to their retirees. Post-retirement medical benefits under the plan have been funded on the pay-as-you-go basis since 1994. Prior to 1994, medical benefits were funded on an actuarial basis.

Contributions to pay for the health benefits of participating retirees in the SHBP are billed to the Authority on a monthly basis. The Authority's portion of post-retirement benefits is funded on a pay-as-you-go basis from the operating budget.

The Authority provides its retirees with health benefits which are funded by the Authority (and in some cases, may be offset by employee contributions). These benefits are negotiated through each bargaining unit's contract. In order to receive fully paid health benefits, retirees must have been enrolled in the Public Employees Retirement System for 25 years and have served 20 consecutive years with the Authority. Retirees receive the same type of health insurance coverage that they were receiving prior to retirement. There are nineteen (19) retirees and fourteen (14) spouses, including (5) families, enrolled in retiree health benefits programs which are funded by the Authority. The annual costs are determined by the provider, per approved schedules in accordance with the insured individual's age and plan status. This represents billings to the Authority on an experience basis. The Authority's annual costs for the years ended December 31, 2016 and 2015 were \$395,448 and \$317,586, respectively.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 8 - Intraentity and Interfund Transfers

In the normal course of business, the Authority will from time to time authorize transfers between accounts. There were no transfers outstanding as of December 31, 2016.

Note 9 - Accounts Payable, Contracts Payable and Accrued Expenses

Accounts payable and accrued expenses were as follows:

	<u>2016</u>	<u>2015</u>
Vendors	\$ 1,065,585	\$ 587,005
Pensions - Authority Contribution Subsequent to the Measurement Date	388,707	
Payroll Deductions Payable	26,997	24,682
Accrued Wages Payable	130,381	156,824
Accrued Interest Payable		19,250
Total	<u>\$ 1,611,670</u>	<u>\$ 787,761</u>

Note 10 - Environmental Matters

The Authority's past and present daily operations include activities which are subject to extensive federal and state environmental regulations. Compliance with these regulations has not had, nor does the Authority expect such compliance to have, any material effect upon expected capital expenses, financial condition or competitive position of the Authority. The Authority believes that its current practices and procedures comply with applicable regulations. The Authority's policy is to accrue environmental and related costs of a non-capital nature when it is both probable that a liability has been incurred and that the amount can be reasonably estimated. No such amounts have been accrued in these statements.

Note 11 - Contingencies

The Authority is periodically involved in various lawsuits, claims, and grievances arising in the normal course of business, including claims for personal injury and personnel practices, property damage, and disputes over eminent domain proceedings. In the opinion of the General Counsel to the Authority, payment of claims by the Authority, for amounts not covered by insurance, in the aggregate, are not expected to have a material adverse effect on the Authority's financial position.

Note 12 - Service Contract

On January 20, 1977, the Authority entered into service contracts with the Township of Hanover, the Township of Morris, the Borough of Morris Plains and the Town of Morristown. The contracts authorize the Authority to supply water within the territorial boundaries of the participating municipalities and to establish service charges at rates sufficient (1) to pay or provide for the expenses of operations and maintenance of the system and the principal of and interest on any and all bonds as the same become due, (2) to maintain such reserves and sinking funds as may be required by the terms of any contract of the Authority or any Bond Resolutions, or as may be deemed necessary or desirable by the Authority to the Town of Morristown pursuant to its agreement with said Town, (3) to provide for any deficits of the Authority resulting from failure to

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 12 - Service Contract (Cont'd)

receive any sum payable by any municipality, any county or any person, or from any other cause, and (4) to comply in all respects with the terms and provisions of any Bond Resolutions and of the Act.

The service contract does not obligate any municipality to make payments in lieu of service charges; however, the creating municipalities are required to enforce a lien on real property equal to the unpaid balance of service charges with respect to real property located within such municipalities.

The service contract also provides that the Authority shall not supply or distribute water to any property located outside its district (the territorial area of the creating municipalities) without the consent of all the creating municipalities unless such property was previously supplied with water by the Town of Morristown water system.

Note 13 - Pension Plans

Authority employees participate in a contributory, defined benefit public employee retirement system: the State of New Jersey Public Employee's Retirement System (PERS) or the Defined Contribution Retirement Program (DCRP), a tax-qualified defined contribution money purchase pension plan under Internal Revenue Code (IRC) 401(a).

Public Employees' Retirement System (PERS)

Plan Description

The State of New Jersey, Public Employees' Retirement System (PERS) is a cost-sharing multiple-employer defined benefit pension plan administered by the State of New Jersey, Division of Pensions and Benefits (the Division). For additional information about the PERS, please refer to the Division's Comprehensive Annual Financial Report (CAFR) which can be found at [www.state.nj.us/treasury/pensions/annrpts.shtml](http://www.state.nj.us/treasury/pensions/annrpts.shtml).

Benefits Provided

The vesting and benefit provisions are set by N.J.S.A. 43:15A. PERS provides retirement, death and disability benefits. All benefits vest after ten years of service, except for medical benefits, which vest after 25 years of service or under the disability provisions of PERS.

The following represents the membership tiers for PERS:

Tier	Definition
1	Members who were enrolled prior to July 1, 2007
2	Members who were eligible to enroll on or after July 1, 2007 and prior to November 2, 2008
3	Members who were eligible to enroll on or after November 2, 2008 and prior to May 22, 2010
4	Members who were eligible to enroll on or after May 22, 2010 and prior to June 28, 2011
5	Members who were eligible to enroll on or after June 28, 2011

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 13 - Pension Plans (Cont'd)

Benefits Provided (Cont'd)

Service retirement benefits of 1/55<sup>th</sup> of final average salary for each year of service credit is available to Tiers 1 and 2 members upon reaching age 60 and to Tier 3 members upon reaching age 62. Service retirement benefits of 1/60<sup>th</sup> of final average salary for each year of service credit is available to Tier 4 members upon reaching age 62 and to Tier 5 members upon reaching age 65. Early retirement benefits are available to Tiers 1 and 2 members before reaching age 60, to Tiers 3 and 4 with 25 or more years of service credit before age 62 and Tier 5 with 30 or more years of service credit before age 65. Benefits are reduced by a fraction of a percent for each month that a member retires prior to the age at which a member can receive full early retirement benefits in accordance with their respective tier. Tier 1 members can receive an unreduced benefit from age 55 to age 60 if they have at least 25 years of service. Deferred retirement is available to members who have at least 10 years of service credit and have not reached the service retirement age for the respective tier.

Contributions

The contribution policy for PERS is set by N.J.S.A. 43:15A and requires contributions by active members and contributing members. The local employers' contribution amounts are based on an actuarially determined rate which includes the normal cost and unfunded accrued liability. Chapter 19, P.L. 2009 provided an option for local employers of PERS to contribute 50% of the normal and accrued liability contribution amounts certified for payments due in State fiscal year 2009. Such employers will be credited with the full payment and any such amounts will not be included in their unfunded liability. The actuaries will determine the unfunded liability of those retirement systems, by employer, for the reduced normal and accrued liability contributions provided under this law. This unfunded liability will be paid by the employer in level annual payments over a period of 15 years beginning with the payments due in the fiscal year ended June 30, 2012 and will be adjusted by the rate of return on the actuarial value of assets. Authority contributions to PERS amounted to \$357,765 for 2016.

The employee contribution rate was 7.06% effective July 1, 2015 and increased to 7.20% effective July 1, 2016. Subsequent increases after October 1, 2011 are being phased in over 7 years effective on each July 1<sup>st</sup> to bring the total pension contribution rate to 7.5% of base salary as of July 1, 2018.

Pension Liabilities and Pension Expense

At December 31, 2016, the Authority's liability was \$12,958,770 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of July 1, 2015 which was rolled forward to June 30, 2016. The Authority's proportion of the net pension liability was based on a projection of the Authority's long-term share of contributions to the pension plan relative to the projected contributions of all participating members, actuarially determined. At June 30, 2016, the Authority's proportion was 0.044%, which was an increase of 0.0021% from its proportion measured as of June 30, 2015.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 13 - Pension Plans (Cont'd)

Pension Liabilities and Pension Expense (Cont'd)

For the year ended December 31, 2016, the Authority recognized actual pension expense in the amount of \$1,220,722.

At December 31, 2016, the Authority reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Amortization Period in Years</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Changes in Assumptions - 2014	6.44	\$ 162,894	
Changes in Assumptions - 2015	5.72	665,622	
Changes in Assumptions - 2016	5.57	1,855,849	
Changes in Proportion - 2014	6.44	82,795	
Changes in Proportion - 2015	5.72		\$ 434,817
Changes in Proportion - 2016	5.57	348,869	
Authority Contribution Subsequent to the Measurement Date - 2016	1	388,707	
Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments - 2014	5	(244,099)	
Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments - 2015	5	156,173	
Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments - 2016	5	582,056	
Difference Between Expected/Actual Experience - 2015	5.72	184,674	
Difference Between Expected/Actual Experience - 2016	5.57	56,320	
		<u>\$ 4,239,860</u>	<u>\$ 434,817</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources (excluding employer specific amounts including changes in proportion and the Authority contribution subsequent to the measurement date) related to pensions will be recognized in pension expense as follows:

<u>December 31,</u>	<u>Total</u>
2017	\$ 769,867
2018	769,867
2019	891,917
2020	749,340
2021	238,498
	<u>\$ 3,419,489</u>

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 13 - Pension Plans (Cont'd)

Actuarial Assumptions

The total pension liability for the June 30, 2016 measurement date was determined by an actuarial valuation as of July 1, 2015 which was rolled forward to June 30, 2016. This actuarial valuation used the following actuarial assumptions:

Inflation Rate	3.08%
Salary Increases:	
Through 2026	1.65 – 4.15% based on age
Thereafter	2.65 – 5.15% based on age
Investment Rate of Return	7.65%

Pre-retirement mortality rates were based on the RP-2000 Employee Pre-retirement Mortality Table for male and female active participants. For local employees, mortality tables are set back 2 years for males and 7 years for females. In addition, the tables provide for future improvements in mortality from the base year of 2013 using a generational approach based on the plan actuary's modified MP-2014 projection scale. Post-retirement mortality rates were based on the RP-2000 Combined Healthy Male and Female Mortality Tables (set back 1 year for males and females) for service retirements and beneficiaries of former members and a one year static projection based on mortality improvement Scale AA. In addition, the tables for service retirements and beneficiaries of former members provide for future improvements in mortality from the base year of 2013 using a generational approach based on the plan actuary's modified MP-2014 projection scale. Disability retirement rates used to value disabled retirees were based on the RP-2000 Disabled Mortality Table (set back 3 years for males and set forward one year for females).

The actuarial assumptions used in the July 1, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2011 to June 30, 2014. It is likely that future experience will not exactly conform to these assumptions. To the extent that actual experience deviates from these assumptions, the emerging liabilities may be higher or lower than anticipated. The more the experience deviates, the larger the impact on future financial statements.

Long Term Expected Rate of Return

In accordance with State statute, the long-term expected rate of return on pension plan investments (7.65% at June 30, 2016) is determined by the State Treasurer, after consultation with the Directors of the Division of Investments and Division of Pensions and Benefits, the Board of Trustees and the actuaries. The long-term expected rate of return was determined using a building block 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 weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 13 - Pension Plans (Cont'd)

Long Term Expected Rate of Return

Best estimates of arithmetic real rates of return for each major asset class included in PERS' target asset allocation as of June 30, 2016 are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Cash	5.00%	0.87%
U.S. Treasuries	1.50%	1.74%
Investment Grade Credit	8.00%	1.79%
Mortgages	2.00%	1.67%
High Yield Bonds	2.00%	4.56%
Inflation-Indexed Bonds	1.50%	3.44%
Broad U.S. Equities	26.00%	8.53%
Developed Foreign Equities	13.25%	6.83%
Emerging Market Equities	6.50%	9.95%
Private Equity	9.00%	12.40%
Hedge Funds/Absolute Return	12.50%	4.68%
Real Estate (Property)	2.00%	6.91%
Commodities	0.50%	5.45%
Global Debt ex. U.S.	5.00%	-0.25%
REIT	5.25%	5.63%

Discount Rate

The discount rate used to measure the total pension liability was 3.98% as of June 30, 2016. This single blended discount rate was based on the long-term expected rate of return on pension plan investments of 7.65% and a municipal bond rate of 2.85% as of June 30, 2016 based on the Bond Buyer Go 20 Bond Municipal Bond Index which includes tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current member contribution rates and that contributions from employers will be made based upon the contribution rate in the most recent fiscal year. The local employers contributed 100% of their actuarially determined contributions. Based on those assumptions, the plan's fiduciary net position was projected to be available to make projected future benefit payments of current plan members through 2034. Therefore, the long-term expected rate of return on plan investments was applied to projected benefit payments through 2034, and the municipal bond rate was applied to projected benefit payments after that date in determining the total pension liability.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
YEAR ENDED DECEMBER 31, 2016  
(Continued)

Note 13 - Pension Plans (Cont'd)

Sensitivity of the Authority's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the Authority's proportionate share of the collective net pension liability as of December 31, 2016 calculated using the discount rate as disclosed below, as well as what the Authority's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate:

	December 31, 2016		
	At 1% Decrease <u>(2.98%)</u>	At Current Discount Rate <u>(3.98%)</u>	At 1% Increase <u>(4.98%)</u>
Authority's proportionate share of the Net Pension Liability	\$ 15,879,461	\$ 12,958,770	\$ 10,547,487
<u>Pension Plan Fiduciary Net Position</u>			

Detailed information about the pension plan's fiduciary net position is available in the separately issued PERS financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
REQUIRED SUPPLEMENTARY INFORMATION SCHEDULES  
SCHEDULE OF AUTHORITY'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY  
PUBLIC EMPLOYEES RETIREMENT SYSTEM  
LAST TWO YEARS  
UNAUDITED

	December 31,	
	2015	2016
Authority's Proportion of the Net Pension Liability	0.0416135588%	0.0437543056%
Authority's Proportionate Share of the Net Pension Liability	\$ 9,341,410	\$ 12,958,770
Authority's Covered Employee Payroll	\$ 2,875,527	\$ 2,999,003
Authority's Proportionate Share of the Net Pension Liability as a Percentage of its Covered Employee Payroll	324.86%	432.10%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	47.93%	40.14%

Note: This schedule does not contain ten years of information as GASB No. 68 was implemented during the year ended December 31, 2014

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
REQUIRED SUPPLEMENTARY INFORMATION SCHEDULES  
SCHEDULE OF AUTHORITY CONTRIBUTIONS  
PUBLIC EMPLOYEES RETIREMENT SYSTEM  
LAST TWO YEARS  
UNAUDITED

	December 31,	
	2015	2016
Contractually Required Contribution	\$ 371,689	\$ 357,765
Contributions in relation to the Contractually Required Contribution	<u>(371,689)</u>	<u>(357,765)</u>
Contribution Deficiency (Excess)	<u>\$ -0-</u>	<u>\$ -0-</u>
Authority's Covered Employee Payroll	\$ 2,999,003	\$ 3,010,790
Contributions as a Percentage of Covered Employee Payroll	12.39%	11.88%

Note: This schedule does not contain ten years of information as GASB No. 68 was implemented during the year ended December 31, 2014

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION  
FOR THE YEAR ENDED DECEMBER 31, 2016  
(UNAUDITED)

A. PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Benefit Changes

There were none.

Changes of Assumptions

The discount rate changed from 4.90% as of June 30, 2015 to 3.98% as of June 30, 2016. The municipal bond rate changed from 3.80% to 2.85%. The long-term expected rate of return on pension plan investments changed from 7.90% to 7.65%.

The inflation rate changed from 3.04% as of June 30, 2015 to 3.08% as of June 30, 2016. The salary increases changed from 2.15% - 4.40% for 2012 – 2021 to 1.65%-4.15% through 2026 and from 3.15%-5.40% thereafter to 2.65%-5.15% thereafter.

The mortality rates in the July 1, 2014 actuarial valuation were based on the following:

Mortality rates were based on the RP-2000 Combined Healthy Male and Female Mortality Tables (setback 1 year for females) for service retirement and beneficiaries of former members with adjustments for mortality improvements from the base year of 2012 based on Projection Scale AA. The RP-2000 Disabled Mortality Tables (setback 3 years for males and setback one year for females) are used to value disabled retirees.

The mortality rates in the July 1, 2015 actuarial valuation were based on the following:

Pre-retirement mortality rates were based on the RP-2000 Employee Pre-retirement Mortality Table for male and female active participants. For local employees, mortality tables are set back 2 years for males and 7 years for females. In addition, the tables provide for future improvements in mortality from the base year of 2013 using a generational approach based on the plan actuary's modified MP-2014 projection scale. Post-retirement mortality rates were based on the RP-2000 Combined Healthy Male and Female Mortality Tables (set back 1 year for males and females) for service retirements and beneficiaries of former members and a one year static projection based on mortality improvement Scale AA. In addition, the tables for service retirements and beneficiaries of former members provide for future improvements in mortality from the base year of 2013 using a generational approach based on the plan actuary's modified MP-2014 projection scale. Disability retirement rates used to value disabled retirees were based on the RP-2000 Disabled Mortality Table (set back 3 years for males and set forward one year for females).

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
STATEMENT OF REVENUE, EXPENSES  
AND CHANGES IN NET POSITION  
FOR THE YEAR ENDED DECEMBER 31, 2016

Operating Revenue:		
Water Charges		\$ 15,611,049
Water Connection Fees		1,985,507
Other		71,244
Miscellaneous:		
Wet Cut Application Fees	\$ 9,152	
Tap Application Fees	23,068	
Main Extension Inspection Fees	23,814	
Fines/Penalties	72,281	
Leases/Rents	109,720	
Total Miscellaneous		<u>238,035</u>
 Total Operating Revenue		 <u>17,905,835</u>
Operating Expenses:		
Operating Appropriations		10,709,429
Depreciation		<u>1,827,376</u>
 Total Operating Expenses		 <u>12,536,805</u>
 Operating Income		 <u>5,369,030</u>
Nonoperating Revenue (Expenses):		
Interest Income		16,846
Statewide Insurance Grant		1,390
Interest Expense - Loans		<u>(28,470)</u>
 Total Nonoperating Revenue (Expenses)		 <u>(10,234)</u>
 Change in Net Position		 5,358,796
 Net Position, Beginning of Year		 <u>68,925,562</u>
 Net Position, End of Year		 <u>\$ 74,284,358</u>

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
SCHEDULE OF REVENUE AND EXPENSES COMPARED TO BUDGET  
YEAR ENDED DECEMBER 31, 2016  
WITH COMPARATIVE ACTUAL AMOUNTS FOR THE YEAR ENDED DECEMBER 31, 2015

	2016 Budget	Budget After Modification	2016 Actual	Excess or (Deficit)	2015 Actual
Contribution from Unrestricted Net Position	\$ 741,225	\$ 791,168	*	\$ (791,168)	
Operating Revenue:					
Water Charges:					
Unmetered Sales	6,630	6,630	\$ 13,976	7,346	\$ 10,058
Metered Sales	12,658,604	12,658,604	14,152,681	1,494,077	13,831,865
Bulk Service Invoices	61,200	61,200	86,886	25,686	76,408
Fire Protection	693,600	693,600	761,375	67,775	705,058
Contract Operations	533,817	533,817	596,131	62,314	486,685
Water Connection Fees			1,985,507	1,985,507	319,370
Other	50,000	50,000	71,244	21,244	93,176
Wet Cut Application Fees	3,000	3,000	9,152	6,152	8,578
Tap Application Fees	8,000	8,000	23,068	15,068	16,455
Main Extension Inspection Fees			23,814	23,814	15,012
Fines/Penalty Charges	70,000	70,000	72,281	2,281	59,558
Leases/Rents	104,000	104,000	109,720	5,720	103,140
Total Operating Revenue	14,188,851	14,188,851	17,905,835	3,716,984	15,725,363
Nonoperating Revenue:					
Federal Emergency Management Grant		321,500		(321,500)	
Statewide Insurance Grant		1,390	1,390		
Interest on Investments and Deposits	12,000	12,000	16,846	4,846	19,812
Total Nonoperating Revenue	12,000	334,890	18,236	(316,654)	19,812
Total Revenue	14,942,076	15,314,909	17,924,071	2,609,162	15,745,175
Expenses:					
Operating Expenses:					
Administration Expenses:					
Salaries and Wages:					
General Administration	(515,782)	(495,782)	(340,451)	155,331	(519,972)
IT Administration	(259,000)	(259,000)	(213,276)	45,724	
Financial Operations	(652,833)	(605,493)	(568,227)	37,266	(643,163)
Administration Division	(387,913)	(444,413)	(418,291)	26,122	(465,355)
Employee Benefits:					
Dental Benefits	(32,000)	(32,000)	(25,150)	6,850	(23,808)
Vision Benefits	(2,900)	(2,900)	(2,826)	74	(1,958)
Medical Benefits	(1,136,080)	(1,136,080)	(1,007,268)	128,812	(921,562)
Social Security Tax	(290,000)	(290,000)	(232,107)	57,893	(252,508)
Public Employees' Retirement System	(375,000)	(375,000)	(1,352,029)	(977,029)	(457,877)
Accumulated Sick Time	(46,500)	(46,500)	(3,279)	43,221	(31,303)
Other Expenses:					
General Administration	(329,660)	(413,660)	(349,168)	64,492	(593,289)
IT Administration	(362,668)	(362,668)	(262,204)	100,464	
Financial Operations	(107,600)	(103,265)	(79,063)	24,202	(73,516)
Customer Service and Collection	(152,600)	(162,275)	(141,712)	20,563	(131,673)

\* The contribution from unrestricted net position was not realized due to a significant excess generated from operations.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
SCHEDULE OF REVENUE AND EXPENSES COMPARED TO BUDGET  
YEAR ENDED DECEMBER 31, 2016  
WITH COMPARATIVE ACTUAL AMOUNTS FOR THE YEAR ENDED DECEMBER 31, 2015  
(Continued)

	2016 Budget	Budget After Modification	2016 Actual	Excess or (Deficit)	2015 Actual
Expenses: (Cont'd):					
Operating Expenses: (Cont'd)					
Cost of Providing Services:					
Salaries and Wages:					
Administration Division					\$ (158,085)
Transmission and Distribution	\$ (1,161,179)	\$(1,161,179)	\$ (1,051,805)	\$ 109,374	(918,458)
Treatment and Pumping Division	(557,944)	(557,944)	(503,165)	54,779	(496,201)
Water Quality	(151,403)	(153,903)	(158,635)	(4,732)	(145,701)
Health, Safety and Security	(67,000)				
Other Expenses:					
Administration Division	(2,541,340)	(2,926,673)	(2,267,807)	658,866	(2,423,927)
Transmission and Distribution	(536,490)	(531,990)	(442,774)	89,216	(297,244)
Treatment and Pumping Division	(606,518)	(587,018)	(351,992)	235,026	(461,530)
Water Quality	(220,040)	(217,540)	(134,956)	82,584	(150,571)
Services and Meter Division	(16,000)	(16,000)	(12,305)	3,695	(13,264)
Field Support/Construction Division	(4,525)	(4,525)	(2,299)	2,226	(776)
Health, Safety and Security	(128,051)	(128,051)	(96,070)	31,981	
Insurance and Taxes	(752,800)	(752,800)	(692,570)	60,230	(700,543)
Total Operating Expenses	(11,393,826)	(11,766,659)	(10,709,429)	1,057,230	(9,882,284)
Debt Service:					
Bond Principal	(1,025,000)	(1,025,000)	(1,025,000)		(985,000)
Loan Principal	(1,530)	(1,530)	(1,530)		(1,457)
Bond Interest	(19,250)	(19,250)		19,250	(38,500)
Loan Interest	(28,470)	(28,470)	(28,470)		(28,543)
Amortization Expense	(10,000)	(10,000)		10,000	(39,023)
Total Debt Service Expenses	(1,084,250)	(1,084,250)	(1,055,000)	29,250	(1,092,523)
Depreciation Expense	(2,464,000)	(2,464,000)	(1,827,376)	636,624	(1,678,635)
Total Costs Funded by Operating Revenue	(14,942,076)	(15,314,909)	(13,591,805)	1,723,104	(12,653,442)
Operating Excess	\$ -0-	\$ -0-	\$ 4,332,266	\$ 4,332,266	\$ 3,091,733

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
SCHEDULE OF REVENUE SERIAL BONDS PAYABLE  
YEAR ENDED DECEMBER 31, 2016

	<u>Original</u>		<u>Balance</u>	<u>Matured</u>
	<u>Date</u>	<u>Amount</u>	<u>Jan. 1, 2016</u>	
Water Revenue Refunding Bond Series 2010	10/05/10	\$ 4,785,000	<u>\$ 1,025,000</u>	<u>\$ 1,025,000</u>

PART III  
GOVERNMENT AUDITING STANDARDS SECTION



Mount Arlington Corporate Center  
 200 Valley Road, Suite 300  
 Mt. Arlington, NJ 07856  
 973-328-1825 | 973-328-0507 Fax

Lawrence Business Park  
 11 Lawrence Road  
 Newton, NJ 07860  
 973-383-6699 | 973-383-6555 Fax

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*

Independent Auditors' Report

The Honorable Chairman and Members  
 of The Southeast Morris County  
 Municipal Utilities Authority  
 Cedar Knolls, NJ

We have audited, in accordance with auditing standards generally accepted in the United States of America, audit requirements prescribed by the Division of Local Government Services, Department of Community Affairs, State of New Jersey ("the Division"), 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 Southeast Morris County Municipal Utilities Authority (the "Authority") as of and for the year ended December 31, 2016, and the related notes to the financial statements, which comprise the Authority's financial statements, and have issued our report thereon dated April 11, 2017.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Authority'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 Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority'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 Authority's financial statements 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 the 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The Honorable Chairman and Members  
of The Southeast Morris County  
Municipal Utilities Authority  
Page 2

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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 result of that testing, and not to provide an opinion on the effectiveness of the Authority'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 Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Nisivoccia, LLP*

Mount Arlington, New Jersey  
April 11, 2017

NISIVOCCIA, LLP

*Kathryn L. Mantell*

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Kathryn L. Mantell  
Registered Municipal Accountant #447  
Certified Public Accountant

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED DECEMBER 31, 2016

Summary of Auditors' Results:

- The Independent Auditors' Report expresses an unmodified opinion on the financial statements of the Authority.
- There were no material weaknesses or significant deficiencies disclosed during the audit of the financial statements as reported in the *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*.
- No instances of noncompliance material to the financial statements of the Authority which would be required to be reported in accordance with *Government Auditing Standards*, were disclosed during the audit.

Findings Relating to the Financial Statements which are required to be Reported in Accordance with Generally Accepted Government Auditing Standards:

- The audit did not disclose any findings required to be reported under Generally Accepted Government Auditing Standards.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2016

Status of Prior Year Audit Findings:

There were no prior year audit findings.

PART IV  
COMMENTS AND RECOMMENDATIONS SECTION

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
COMMENTS AND RECOMMENDATIONS

Contracts and Agreements Required to be Advertised Per N.J.S. 40A:11-4 et seq.

N.J.S. 40A:11-3 states:

a. " When the cost or price of any contract awarded by the contracting agent in the aggregate does not exceed in a contract year the total sum of \$17,500, the contract may be awarded by a purchasing agent when so authorized by ordinance or resolution, as appropriate to the contracting unit, of the governing body of the contracting unit without public advertising for bids, except that the governing body of any contracting unit may adopt an ordinance or resolution to set a lower threshold for the receipt of public bids or the solicitation of competitive quotations. If the purchasing agent is qualified pursuant to subsection b. of section 9 of P.L. 1071, c.198 (C.40A:11-9), the governing body of the contracting unit may establish that the bid threshold may be up to \$25,000. Such authorization may be granted for each contract or by a general delegation of the power to negotiate and award such contracts pursuant to this section.

b. Any contract made pursuant to this section may be awarded for a period of 24 consecutive months, except that contracts for professional services pursuant to subparagraph (i) of paragraph (a) of subsection (1) of section 5 of P.L. 1971, c.198 (C.40A: 11-5) may be awarded for a period not exceeding 12 consecutive months. The Division of Local Government Services shall adopt and promulgate rules and regulations concerning the methods of accounting for all contracts that do not coincide with the contracting unit's fiscal year.

c. The Governor, in consultation with the Department of the Treasury, shall, no later than March 1 of every fifth year beginning in the fifth year after the year in which P.L.1999, c.440 takes effect, adjust the threshold amount and the higher threshold amount which the governing body is permitted to establish, as set forth in subsection a. of this section, or the threshold amount resulting from any adjustment under this subsection, in direct proportion to the rise or fall of the index rate as that term is defined in section 2 of P.L.1971, c.198 (C.40A11-2), and shall round the adjustment to the nearest \$1,000. The Governor shall, no later than June 1 of every fifth year, notify each governing body of the adjustment. The adjustment shall become effective on July 1 of the year in which it is made."

N.J.S. 40A: 11-4 states: "Every contract awarded by the contracting agent for the provision or performance of any goods or services, the cost of which in the aggregate exceeds the bid threshold, shall be awarded only by resolution of the governing body of the contracting unit to the lowest responsible bidder after public advertising for bids and bidding therefore, except as is provided otherwise in this act or specifically by any other law. The governing body of a contracting unit may, by resolution approved by a majority of the governing body and subject to subsections b. and c. of this section, disqualify a bidder who would otherwise be determined to be the lowest responsible bidder, if the governing body finds that it has had prior negative experience with the bidder."

Effective July 1, 2015 the bid threshold in accordance with N.J.S.A. 40A:11-3 and 40A:11-4 (as amended) is \$17,500, and with a qualified purchasing agent the threshold may be up to \$40,000.

The minutes indicated that resolutions were adopted authorizing the awarding of contracts or agreements for "Professional Services", per N.J.S. 40A:11-5.

Inasmuch as the system of records did provide for an accumulation of payments for categories for the performance of any work or the furnishing or hiring of any materials or supplies, the results of such an accumulation could not reasonably be ascertained. Disbursements were reviewed, however, to determine whether any clear-cut violations existed. None were noted.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
COMMENTS AND RECOMMENDATIONS  
(Continued)

Examination of Claims/Purchase Orders

We noted a few instances during our examination, where invoices were received prior to the placement of a purchase order; however, those instances occurred prior to last year's audit. We found no further instances after corrective action was taken on the prior year audit; therefore, no formal recommendation is being made.

Open purchase orders at year end were not completely reviewed, adjusted or closed for the year. The open purchase orders as of December 31, 2016 continued to be adjusted for several months.

Recommendation

It is recommended that open purchase orders are completely reviewed, adjusted and closed at year end.

Management's Response

The Manager of Finance/Treasurer will ensure that purchase orders are completely reviewed, adjusted and closed at year end.

Water Billing/Accounts Receivable

Water billing reports and aging receivable reports were not generated at the end of each month, and the ability to generate them after month-end is difficult. As a result, water billings, collections and receivable balances were not reviewed and reconciled with the general ledger on a monthly basis. Collections were compared on a monthly basis to bank deposits.

Recommendation

It is recommended that water billing and aging receivable reports are generated at the end of each month and water billings, collections and receivables balances are reviewed and reconciled with the general ledger on a monthly basis.

Management's Response

The Manager of Finance/Treasurer will ensure that billing reports are generated on a monthly basis and water billings, collections and receivable balances are reviewed and reconciled with the general ledger on a monthly basis.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
COMMENTS AND RECOMMENDATIONS

(Continued)

Status of Prior Year Recommendations

The prior year recommendations regarding employee health benefit withholdings not being accurately calculated and purchase orders being prepared prior to all purchases were resolved during the current year.

Suggestions to Management

Capital Assets

The capital asset inventory has been updated annually with additions and deletions, and inventory control numbers have been assigned to all assets in the inventory report. However, inventory control tags have not been created or affixed to all moveable assets. We suggest that the Authority review the existing capital asset inventory and ensure that all moveable capital assets bear an inventory control (number) tag. The Authority is attempting to purchase a software program that will also be able to electronically maintain the inventory which is expected to be implemented in the near future.

Budget Transfers

The Authority made appropriate transfers during the year; however, certain year-end accruals for GASB 68 (recording pensions) caused the pension line-item to be overexpended. For that reason, a formal audit recommendation is deemed to be unwarranted.

Cyber Security

Cybercrime has become much more prevalent in the last few years. Websites and internal networks, including personally identifiable information (“PII”), have been hacked and resulted in significant losses to organizations, both financial and reputational.

The Authority has instituted a number of safeguards to best prevent such attacks. In place are the following appliance and software deterrents:

- Router/Firewall with Gateway Anti-virus/Malware
- End-point Firewall
- End-point Anti-virus/Malware
- Local and Cloud Backups
- Auditing of File Activity
- Email SPAM Filters and Anti-virus

In addition, the Authority is currently reviewing vendor agreements regarding the vendor’s “PII” compliance, and the Authority will be working with consultants to develop internal compliance as defined by best practice and industry standards.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
COMMENTS AND RECOMMENDATIONS  
(Continued)

Suggestions to Management (Cont'd)

Governmental Accounting Standards Board Statements

The next Governmental Accounting Standards Board (“GASB”) statement which will have a significant impact on the Authority will be GASB#75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, will be effective for the fiscal year ending June 30, 2018. This standard replaces GASB#45, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. It is similar to GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, in that successful implementation of this standard will require the provision of certain key financial and non-financial information from the State of New Jersey.

THE SOUTHEAST MORRIS COUNTY MUNICIPAL UTILITIES AUTHORITY  
SUMMARY OF RECOMMENDATIONS

It is recommended that:

1. Open purchase orders are completely reviewed, adjusted and closed at year end.
2. Water billing reports and aging receivable reports are generated at the end of each month and water billings, collections and receivables balances are reviewed and reconciled with the general ledger on a monthly basis.

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