

**BUTLER COUNTY
WATER SYSTEM, INC.**

FINANCIAL STATEMENTS

DECEMBER 31, 2016 AND 2015

BUTLER COUNTY WATER SYSTEM, INC.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Butler County Water System, Inc.
Morgantown, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Butler County Water System, Inc. (the "Utility") which comprise the balance sheet as of December 31, 2016, and the related statements of operations, changes in members' equity and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Butler County Water System, Inc. as of December 31, 2016, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the Utility as of December 31, 2015, were audited by other auditors whose report dated April 8, 2016, expressed an unmodified opinion on those statements.

Other Matters

Supplemental and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of budgetary comparison on pages 18 and 19 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 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 information is fairly stated, in all material respects, in relation to the financial statements as a whole.

The financial and statistical highlights have 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 them.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 7, 2017, on our consideration of the Utility'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 Utility's internal control over financial reporting and compliance.



Kirby & Moore, LLP
Bowling Green, Kentucky
April 7, 2017

BUTLER COUNTY WATER SYSTEM, INC.

FINANCIAL AND STATISTICAL HIGHLIGHTS

The following are financial and statistical highlights of Butler County Water System, Inc. for the years ending December 31, 2016 and 2015:

- The System's assets totaled \$21,416,753 and decreased by \$165,512 or 0.8% from the prior year.
- Operating revenue for the year totaled \$1,916,282 and decreased by \$12,235 from the prior year, a 0.6% decrease. Operating expenses totaled \$1,730,594 for the year and increased by \$34,463 from last year, a 2.0% increase.
- Metered sales totaled \$1,857,683 and decreased by \$9,705 from the prior year, a 0.5% decrease. Residential sales increased by \$14,317 or 0.90%; commercial, agricultural, fire protection and other sales decreased by \$24,022 or 9.8%.
- Total revenues were less than budgeted by \$34,995 and total expenses were less than budgeted expenses by \$51,791. Net income totaled \$29,536 exceeding budgeted income by \$16,796.
- The System uses Green River as a water source and produces water at its water treatment facility located on Middle Ferry Road in Morgantown, Kentucky. Total gallons produced for the year amounted to 307.7 million gallons compared to 315.5 million gallons in the prior year, a decrease of 7.8 million gallons, or 2.5%. The peak production month was July, 2016 which produced 29.2 million gallons and the peak production day was in June, 2016 which produced 1.3 million gallons.
- Total gallons sold to the System's customers during the year amounted to 247.3 million gallons compared to 252.7 million gallons in the prior year, a decrease of 5.4 million gallons, or 2.1%. The peak demand month was July, 2016, with 24.2 million gallons sold.
- The average monthly usage per residential customer was 3,961 gallons compared to 3,925 gallons in the prior year, a 0.9% increase. The average monthly usage per commercial customer was 8,711 gallons compared to 11,280 gallons in the prior year, a 13.4% decrease.
- The number of customers at the end of the year totaled 4,819 consisting of 4,505 residential customers and 4,314 commercial and other class customers.
- The System received 43 new meter applications throughout the year.
- The System has a total of 515 miles of distribution main serving an average of 9 customers per mile and 30 miles of service line.
- Major projects completed: The Jetson Tank and Highway 70 Tank were inspected and repainted at a cost of \$115,000 and \$60,000, respectively.

FINANCIAL STATEMENTS

BUTLER COUNTY WATER SYSTEM, INC.**BALANCE SHEETS**
December 31, 2016 and 2015

	2016	2015
ASSETS		
Current assets		
Cash and cash equivalents	\$ 859,293	\$ 985,060
Short-term investments	500,000	500,000
Accounts receivable		
Customer accounts receivable, net of allowance for uncollectibles of \$86,003 and \$83,706	67,320	61,048
Accounts receivable - WCWD	61,099	60,062
Accounts receivable - SCWD	27	32
Prepaid expenses	<u>18,837</u>	<u>18,999</u>
Total current assets	<u>1,506,576</u>	<u>1,625,201</u>
PROPERTY, PLANT AND EQUIPMENT		
Land and land rights	101,521	101,521
Utility plant in service	28,606,234	28,159,787
Construction in progress	256,683	181,573
Less: accumulated depreciation	<u>(9,645,211)</u>	<u>(9,091,646)</u>
Property, plant and equipment, net	<u>19,319,227</u>	<u>19,351,235</u>
OTHER ASSETS		
Restricted cash and cash equivalents	335,233	340,516
Restricted investments	140,815	132,082
Deferred charges	<u>114,902</u>	<u>133,231</u>
Total other assets	<u>590,950</u>	<u>605,829</u>
Total assets	<u>\$ 21,416,753</u>	<u>\$ 21,582,265</u>

See Notes to Financial Statements

	2016	2015
LIABILITIES AND MEMBERS' EQUITY		
Liabilities		
Current liabilities		
Accounts payable	\$ 31,112	\$ 23,632
Accounts payable - WCWD	80,542	95,723
Accrued interest payable	61,408	64,049
Other current liabilities	5,364	5,110
Current portion of long-term debt	<u>215,186</u>	<u>209,489</u>
Total current liabilities	<u>393,612</u>	<u>398,003</u>
Long-term liabilities		
Rebates payable	9,450	12,150
Customer deposits	139,885	132,642
Loan payable	<u>4,040,603</u>	<u>4,256,089</u>
Total long-term liabilities	<u>4,189,938</u>	<u>4,400,881</u>
Total liabilities	<u>4,583,550</u>	<u>4,798,884</u>
MEMBERS' EQUITY		
Capital investments	14,384,463	14,364,177
Retained earnings	<u>2,448,740</u>	<u>2,419,204</u>
Total members' equity	<u>16,833,203</u>	<u>16,783,381</u>
Total liabilities and members' equity	<u>\$ 21,416,753</u>	<u>\$ 21,582,265</u>

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF OPERATIONS

December 31, 2016 and 2015

	2016	2015
Operating revenues		
Metered sales		
Residential	\$ 1,637,736	\$ 1,623,419
Commercial	<u>219,947</u>	<u>243,969</u>
Total metered sales	1,857,683	1,867,388
Forfeited discounts	31,715	31,454
Miscellaneous service revenue	<u>26,884</u>	<u>29,675</u>
Total operating revenues	<u>1,916,282</u>	<u>1,928,517</u>
Operating expenses		
Pumping expense		
Purchased power	41,774	42,594
Materials and supplies	135	—
Insurance	2,914	2,792
Miscellaneous	2,145	1,147
Professional services	<u>794</u>	<u>781</u>
Total pumping expense	<u>47,762</u>	<u>47,314</u>
Water treatment expense		
Purchased power	85,908	87,026
Chemicals	58,168	53,146
Materials and supplies	16,637	14,505
Insurance	5,828	5,583
Salaries and benefits	87,466	86,446
Contractual services	3,103	2,550
Miscellaneous	4,717	4,786
Professional services	<u>1,587</u>	<u>1,562</u>
Total water treatment expense	<u>263,414</u>	<u>255,604</u>
General distribution expense		
Purchased power	4,252	4,056
Salaries and benefits	109,312	115,777
Materials and supplies	18,865	28,845
Insurance	12,627	12,097
Miscellaneous	20,945	23,766
Contractual services	17,351	15,749
Professional services	<u>795</u>	<u>782</u>
Total general distribution expense	<u>184,147</u>	<u>201,072</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF OPERATIONS (Continued) December 31, 2016 and 2015

	2016	2015
Customer accounts expense		
Salaries and benefits	229,652	220,573
Contractual services	53,595	51,386
Uncollectible accounts	2,337	3,431
Materials and supplies	2,461	1,851
Insurance	1,457	1,396
Miscellaneous	27,387	26,489
Professional services	<u>2,382</u>	<u>2,345</u>
Total customer accounts expense	<u>318,271</u>	<u>307,471</u>
Maintenance expense		
Pumping equipment and storage expense	18,019	20,044
Salaries and benefits	116,289	117,318
Contractual services	33,740	35,042
Professional services	<u>1,588</u>	<u>1,563</u>
Total maintenance expense	<u>169,636</u>	<u>173,967</u>
Administrative and general expense		
Salaries and benefits	86,292	85,315
Materials and supplies	4,934	5,703
Insurance	2,522	2,461
Miscellaneous	3,073	3,749
Contractual services	42,477	32,218
Professional services	<u>2,382</u>	<u>2,473</u>
Total administrative and general expense	<u>141,680</u>	<u>131,919</u>
Depreciation and amortization expense	<u>605,684</u>	<u>578,784</u>
Total operating expenses	<u>1,730,594</u>	<u>1,696,131</u>
Operating income	<u>185,688</u>	<u>232,386</u>
Non-operating revenues (expenses)		
Non-utility income	21	2
Interest income	7,757	7,979
Interest expense on long-term debt	(163,576)	(166,056)
Interest expense on customer deposits	(486)	(158)
Gain on disposition of assets	3,875	—
PSC taxes	<u>(3,743)</u>	<u>(3,463)</u>
Total non-operating revenues (expenses)	<u>(156,152)</u>	<u>(161,696)</u>
Net income	<u>\$ 29,536</u>	<u>\$ 70,690</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF CHANGES IN MEMBERS' EQUITY
Years Ended December 31, 2016 and 2015

	<u>Retained Earnings</u>	<u>Contributions in Aid of Construction</u>	<u>Total</u>
Balance, December 31, 2014	\$ 2,348,514	\$14,198,877	\$16,547,391
Net income	70,690	—	70,690
Contributions in aid of construction	<u>—</u>	<u>165,300</u>	<u>165,300</u>
Balance, December 31, 2015	2,419,204	14,364,177	16,783,381
Net income	29,536	—	29,536
Contributions in aid of construction	<u>—</u>	<u>20,286</u>	<u>20,286</u>
Balance, December 31, 2016	<u>\$ 2,448,740</u>	<u>\$14,384,463</u>	<u>\$16,833,203</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF CASH FLOWS
Years Ended December 31, 2016 and 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers and agencies	\$ 1,908,978	\$ 1,970,538
Payments to suppliers for goods and services	(508,358)	(490,736)
Payments for contractual services	(611,034)	(625,429)
Net cash provided by operating activities	<u>789,586</u>	<u>854,373</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Interest paid on customer deposits	(486)	(158)
Net cash used in noncapital financial activities	<u>(486)</u>	<u>(158)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital asset disposals	3,875	—
Proceeds from debt issuance	—	436,900
Principal repayment on long-term debt	(209,789)	(202,137)
Contributions in aid of construction	20,286	165,300
Purchases of capital assets	(567,329)	(988,396)
Interest paid on long-term debt	(166,217)	(167,445)
Net cash used in capital and related financing activities	<u>(919,174)</u>	<u>(755,778)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of short-term investments	(8,733)	(1,052)
Interest income	<u>7,757</u>	<u>7,979</u>
Net cash provided by (used in) investing activities	<u>(976)</u>	<u>6,927</u>
Net increase (decrease) in cash and cash equivalents	(131,050)	105,364
Cash and cash equivalents, beginning of year	<u>1,325,576</u>	<u>1,220,212</u>
Cash and cash equivalents, end of year	<u>\$ 1,194,526</u>	<u>\$ 1,325,576</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.**STATEMENTS OF CASH FLOWS**
Years Ended December 31, 2016 and 2015

	2016	2015
Reconciliation of operating income to net cash provided by operating activities		
Operating come	\$ 185,688	\$ 232,386
Adjustment to reconcile net operating income to net cash provided by operating activities		
Depreciation	599,337	572,074
Amortization	6,347	6,710
Non-utility income	21	2
Payment of PSC taxes	(3,743)	(3,463)
Changes in assets and liabilities		
Net (increase) decrease in accounts receivable, net	(7,304)	42,021
Net (increase) decrease in prepaid insurance	162	(371)
Net (increase) decrease in deferred charges	11,982	(17,088)
Net increase (decrease) in accounts payable	(7,701)	17,044
Net increase (decrease) in other current liabilities	254	(294)
Net increase in customer deposits	7,243	5,352
Net decrease in rebates payable	(2,700)	—
Net cash provided by operating activities	<u>\$ 789,586</u>	<u>\$ 854,373</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

The Butler County Water System, Inc. (the "Utility") is a water association organized as a non-profit corporation under KRS 273 and is under the authority of the Public Service Commission of Kentucky. The Utility provides a public water system to primarily citizens located in Butler County, Kentucky.

The accounting policies of the Utility conform to generally accepted accounting principles as applicable to a non-profit membership association. The following is a summary of the more significant policies:

Reporting Entity

The Utility is governed by a five-member board (the "Board"). The Board of Directors are elected by the members of the Utility. The Board has the power and authority to acquire, construct, maintain and operate the waterworks system.

Basis of Accounting

Basis of accounting refers to the point at which revenues or expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied. The accompanying financial statements have been prepared on the accrual basis of accounting.

The Utility follows the practice of recording metered sales when billed to the customers and recording related expenses when billed to the water utility. This results in a lag of recording revenue and related expenses. However, it does provide approximate matching of revenues and expenses and does not have a material effect between years. Operating revenues are revenues generated from general water operations (water sales, forfeited discounts and miscellaneous service revenue) and all other non-water revenues are considered non-operating revenues.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Utility has defined cash and cash equivalents to include all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Accounts Receivable

Customer accounts receivable amounts arise from monthly water usage. Based on Utility policy, water meters are read monthly, with billings occurring approximately ten days subsequent to the reading. Once billed, the customer has 16 days to pay the amount due. If payment is not made by the due date, a two to four day grace period is granted. If payment is not made at the expiration of the grace period, a late penalty is assessed to water charges and delinquent notices are sent. Customers are given 14 days from the date of the delinquent notice to render payment. Customer service places calls to facilitate collection; if no payment is received, collection trips are made to the service location. If collection does not occur, the meter is shut off. If collection is considered unlikely, the balances are charged off as a bad debt expense in the period in which they were deemed uncollectible.

Management's periodic evaluation of the adequacy of the allowance for doubtful accounts is based on past loss experience, known and other risks inherent to the specific amount, adverse situations that may affect the customer's ability to render payment and current economic conditions. Management considers many factors in determining whether a receivable is impaired, such as payment history and changes in employment.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Concentration of Credit Risk

The Utility extends credit to all citizens who live within the geographic location of the Utility and who utilize the utility system. Credit losses may be minimal and are generally within management's expectations.

Investments

Investments consist of certificates of deposit and are recorded at cost. The cost of investments approximates their fair value.

Property, Plant and Equipment

The Utility has an ongoing activity of assessing the feasibility of installing additional lines to new service areas. Once an extension is considered feasible, there are additional engineering studies, applications to various funding agencies and project administrative costs. The Utility defers the ongoing activity and capitalizes these costs as part of the utility plant upon completion of the project.

Management's capitalization policy is based upon the assets' estimated future benefit. Depreciation is computed using the straight-line method over the estimated useful lives of the utility plant. The estimated useful lives range from 5 to 50 years for utility plant assets. Upon retirement, the cost of the asset, less any proceeds, is charged to accumulated depreciation.

The Utility capitalizes construction period interest on loans that were obtained to finance construction.

Income Taxes

The Utility is a tax-exempt organization under Section 501(c)(12) of the Internal Revenue Code. Therefore, no provision for income taxes is made in the accompanying financial statements.

Contributions in Aid of Construction

Contributions in aid of construction consist of member fees, developer contributed utility systems, capital grants and other supplemental support by other utilities and industrial customers, and federal, state and local grants in support of system improvements.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Uncertain Tax Positions

The Utility follows accounting requirements associated with uncertainty in income taxes using the provisions of Financial Accounting Standards Board (FASB) ASC 740, *Income Taxes*. The guidance prescribed a minimum recognition threshold and measurement methodology that a tax position taken or expected to be taken in a tax return is required before being recognized in the financial statements. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As of December 31, 2016, the Utility has no uncertain tax positions that qualify for recognition.

Subsequent Events

The Utility has evaluated any recognized or unrecognized subsequent events for consideration in the accompanying financial statements through April 7, 2017, which was the date the financial statements were made available.

NOTE 2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

The Utility maintains its deposits with financial institutions insured by the Federal Deposit Insurance Corporation (FDIC). As of December 31, 2016 and 2015, the carrying amounts of the Utility's deposits were \$1,835,341 and \$1,957,658 and the bank balances were \$1,949,591 and \$1,954,938, respectively.

	2016	2015
Cash and cash equivalents	\$ 859,293	\$ 985,060
Restricted cash and cash equivalents	335,233	340,516
Short-term investments	500,000	500,000
Restricted investments	<u>140,815</u>	<u>132,082</u>
	<u>\$ 1,835,341</u>	<u>\$ 1,957,658</u>

Cash Concentration Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's formal deposit policy for custodial credit risk requires deposits in banks which are in excess of the FDIC insurance coverage to be secured by the bank pledging securities in direct obligations of the United States of America or by approved security bonds. As of December 31, 2016 and 2015, the Utility's bank balance was not exposed to custodial credit risk.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 2. CASH AND CASH EQUIVALENTS AND INVESTMENTS (Continued)

Restricted Cash and Cash Equivalents and Investments

The sinking funds are restricted to the payment of principal and interest on long-term debt. The depreciation fund is restricted to payment for improvements and approved repairs. The customer deposits fund is restricted to hold customer deposits until service is terminated.

Restricted cash and cash equivalents and investments consist of the following as of December 31, 2016 and 2015:

	2016	2015
Sinking funds	\$ 200,748	\$ 202,716
Depreciation fund	134,485	137,800
Customer deposits	<u>140,815</u>	<u>132,082</u>
	<u>\$ 476,048</u>	<u>\$ 472,598</u>

NOTE 3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following as of December 31, 2016 and 2015:

	2016	2015
Non-depreciable		
Land and land rights	\$ 101,521	\$ 101,521
Construction in progress	256,683	181,573
Depreciable		
Utility plant in service	28,606,234	28,159,787
Less: accumulated depreciation	(9,645,211)	(9,091,646)
Property, plant and equipment, net	<u>\$19,319,227</u>	<u>\$19,351,235</u>

Depreciation expense was \$599,337 and \$572,074 for the years ended December 31, 2016 and 2015, respectively.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 4. REBATES PAYABLE

These amounts are partially made up of private developers' unrecovered costs in installing water lines. Utility plant was increased for a like amount when the facilities were donated to the Utility. As meters are placed in the development, the developer receives half of the new customers' contribution for meters connected directly to the extension over the next ten years or up to the value of facilities constructed. The remaining balance in this account was obtained from subscriptions of prospective users of the Utility. When a meter is installed, the subscribed amount is transferred to contributions in aid of construction.

NOTE 5. LONG-TERM DEBT

The loans below from Series 1977 through Series 2014 were issued through USDA Rural Development (RD). The Series 2012 loan was issued through Kentucky Rural Water Finance Corporation (KRWFC). Loans outstanding as of December 31, 2016 and 2015 consist of the following:

<u>Original Amount</u>	<u>Series of</u>	<u>Interest Rate</u>	<u>2016</u>	<u>2015</u>
\$ 191,400	1977	5.00%	\$ 10,297	\$ 20,615
152,000	1979	5.00%	13,673	21,734
950,000	1996	4.50%	677,617	698,310
40,013	1997	5.00%	—	3,098
197,214	1997	4.50%	134,148	138,938
545,000	1998	4.75%	363,054	375,883
3,045,000	2012	2.80%-4.00%	2,620,000	2,770,000
437,000	2014	2.75%	<u>437,000</u>	<u>437,000</u>
			<u>\$ 4,255,789</u>	<u>\$ 4,465,578</u>

All loans are secured by an exclusive pledge of a fixed portion of the income and revenues derived from the operation of the Utility's water distribution system. The RD loans each have a requirement for depreciation reserves. The KRWFC loan has requirements for a debt service sinking fund and a debt service coverage ratio. The Utility was in compliance with the depreciation reserve, debt service sinking fund and debt service coverage ratio requirements as of December 31, 2016 and 2015.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 5. LONG-TERM DEBT (Continued)

Principal and interest of various amounts are due at least annually in each of the years through 2054. The principal and interest due for each of the next five years and thereafter is as follows:

<u>Year</u>	<u>Principal Amount</u>	<u>Interest Amount</u>
2017	\$ 215,186	\$ 159,431
2018	193,658	152,628
2019	190,532	146,521
2020	192,719	140,420
2021	200,003	134,150
Thereafter	<u>3,263,691</u>	<u>1,053,909</u>
	<u>\$ 4,255,789</u>	<u>\$ 1,787,059</u>

NOTE 6. RELATED PARTIES

The Warren County Water District (WCWD) provides management, engineering and repair and maintenance services to the Utility. Butler County Water System, Inc. shares common management with WCWD.

The following related party amounts were included in accounts receivable at December 31, 2016 and 2015:

	2016	2015
Warren County Water District	\$ 61,099	\$ 60,062
Simpson County Water District	27	32

The following related party amounts were included in accounts payable at December 31, 2016 and 2015:

	2016	2015
Warren County Water District	\$ 80,542	\$ 95,723

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 6. RELATED PARTIES (Continued)

During 2016 and 2015, expenses from the WCWD amounted to \$1,051,332 and \$1,052,705, respectively, for the following:

	2016	2015
Wages and benefits:		
Operation	\$ 500,479	\$ 492,526
Administrative:		
Supervision and administration	105,695	101,490
Accounting	45,036	42,790
Customer service	89,666	83,516
Engineering	22,730	9,874
Operations - other	135,243	145,519
Additions to plant	116,175	59,714
Special projects	<u>36,308</u>	<u>117,276</u>
Totals	<u>\$ 1,051,332</u>	<u>\$ 1,052,705</u>

In the ordinary course of business, the Utility has and expects to continue to have transactions with WCWD. In the opinion of management, such transactions were on substantially the same terms as those prevailing at the time of comparable transactions with other persons and did not involve more than a normal risk of collectability or present any other unfavorable features to the Utility.

NOTE 7. RISKS OF LOSS

The Utility's risks of loss are addressed by the purchase of commercial insurance. These areas include employee dishonesty bonds, property coverage, vehicle coverage and a public entity liability policy which includes errors and omission. Coverage is reviewed for adequacy by management and agents on an annual basis.

NOTE 8. ROCHESTER DAM REGIONAL WATER COMMISSION

The Rochester Dam Regional Water Commission ("RDRWC") is a water commission which was created by an Order issued by the Ohio County Judge/Executive on June 13, 2013 pursuant to the provision of KRS 74.440. Butler County Water System, Inc. participated in the creation of the RDRWC along with the City of Morgantown, Kentucky and the Ohio County Water District. The Board of Commissioners for the RDRWC is comprised of one representative from each of the three establishing entities plus two additional representatives appointed by the Ohio County Judge/Executive and approved by the Ohio County Fiscal Court.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE 8. ROCHESTER DAM REGIONAL WATER COMMISSION (Continued)

The primary purpose of the RDRWC is to provide an adequate and dependable supply of water for the region which derives its water supply from Pool 3 of the Green River including, but not limited to, Butler, Muhlenberg, and Ohio Counties and all customers and entities served by the RDRWC members. RDRWC will endeavor to accomplish this purpose by (1) acquiring an ownership interest, either by lease, easement, or deed, in the Rochester Dam on Pool 3 of the Green River, (2) repairing and stabilizing the Rochester Dam; and (3) maintaining the Rochester Dam.

In 2015, the RDRWC obtained a lease on the Rochester Dam from the Corp of Engineers in order to obtain funding through the EDA or other agency grants to perform the necessary repairs for the dam. Congress passed, and the President signed, legislation in December, 2016 to permanently transfer the dam and associated property to RDRWC. As of December 31, 2016 and 2015, Butler County Water System has incurred cumulative costs totaling \$13,320 and \$13,320, respectively, for its participation in the RDRWC. Future payments to cover legal expenses of the RDRWC will be prorated between all participating entities.

BUTLER COUNTY WATER SYSTEM, INC.

SCHEDULE OF BUDGETARY COMPARISON

Year Ended December 31, 2016

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variances Favorable (Unfavorable) Final to Actual</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Metered revenue	\$ 1,894,000	\$ 1,894,000	\$ 1,857,683	(\$ 36,317)
Forfeited discounts	31,500	31,500	31,715	215
Miscellaneous service revenue	29,700	29,700	26,850	(2,850)
Interest income	7,730	7,730	7,757	27
Other income	—	—	55	55
Disposition gains (losses)	—	—	3,875	3,875
Total revenues	<u>1,962,930</u>	<u>1,962,930</u>	<u>1,927,935</u>	<u>(34,995)</u>
Expenses				
Salaries and wages	381,970	381,970	366,533	15,437
Commissioner fees	18,000	18,000	18,000	—
Fringe benefits	272,360	272,360	244,501	27,859
Purchased power	135,460	135,460	131,935	3,525
Chemicals	56,000	56,000	58,168	(2,168)
Materials and supplies	49,520	49,520	43,032	6,488
Contractual services - Accounting	9,500	9,500	9,527	(27)
Contractual services - Other	138,170	138,170	150,267	(12,097)
Rental of building and utilities	15,780	15,780	15,689	91
Equipment expense	70,960	70,960	56,423	14,537
Insurance - general liability	25,000	25,000	24,282	718
Insurance - other	1,070	1,070	1,065	5
Regulatory expense	3,500	3,500	3,743	(243)
Bad debt expense	4,500	4,500	2,337	2,163
Miscellaneous expense	5,000	5,000	3,151	1,849
Depreciation	591,380	591,380	599,337	(7,957)
Amortization	6,350	6,350	6,347	3
Interest expense	<u>165,670</u>	<u>165,670</u>	<u>164,062</u>	<u>1,608</u>
Total expenses	<u>1,950,190</u>	<u>1,950,190</u>	<u>1,898,399</u>	<u>51,791</u>
Net income	<u>\$ 12,740</u>	<u>\$ 12,740</u>	<u>\$ 29,536</u>	<u>\$ 16,796</u>

BUTLER COUNTY WATER SYSTEM, INC.

**SCHEDULE OF BUDGETARY COMPARISON
Year Ended December 31, 2015**

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variances Favorable (Unfavorable) Final to Actual</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Metered revenue	\$ 1,871,000	\$ 1,871,000	\$ 1,867,388	(\$ 3,612)
Forfeited discounts	31,300	31,300	31,454	154
Miscellaneous service revenue	31,680	31,680	29,675	(2,005)
Interest income	9,060	9,060	7,979	(1,081)
Other income	<u>—</u>	<u>—</u>	<u>2</u>	<u>2</u>
Total revenues	<u>1,943,040</u>	<u>1,943,040</u>	<u>1,936,498</u>	<u>(6,542)</u>
Expenses				
Salaries and wages	377,450	377,450	386,700	(9,250)
Fringe benefits	243,400	243,400	238,799	4,601
Purchased power	148,470	148,470	133,676	14,794
Chemicals	53,240	53,240	53,146	94
Materials and supplies	40,740	40,740	50,904	(10,164)
Contractual services - Accounting	9,350	9,350	9,378	(28)
Contractual services - Legal	—	—	128	(128)
Contractual services - Other	128,710	128,710	136,945	(8,235)
Rental of building and utilities	15,340	15,340	15,073	267
Equipment expense	71,240	71,240	60,850	10,390
Insurance - general liability	23,400	23,400	23,264	136
Insurance - other	1,070	1,070	1,065	5
Regulatory expense	3,360	3,360	3,463	(103)
Bad debt expense	3,750	3,750	3,431	319
Miscellaneous expense	6,000	6,000	3,988	2,012
Depreciation	570,190	570,190	572,074	(1,884)
Amortization	6,710	6,710	6,710	—
Interest expense	<u>163,910</u>	<u>163,910</u>	<u>166,214</u>	<u>(2,304)</u>
Total expenses	<u>1,866,330</u>	<u>1,866,330</u>	<u>1,865,808</u>	<u>522</u>
Net income	<u>\$ 76,710</u>	<u>\$ 76,710</u>	<u>\$ 70,690</u>	<u>(\$ 6,020)</u>



**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***

Board of Directors
Butler County Water System, Inc.
Morgantown, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Butler County Water System, Inc. (the "Utility") (a nonprofit organization), which comprise the balance sheet as of December 31, 2016, and the related statements of operations and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 7, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Utility'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of the Utility'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 possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.


Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. 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.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Utility's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Kirby & Moore, LLP". The signature is written in a cursive, flowing style.

Kirby & Moore, LLP
Bowling Green, Kentucky
April 7, 2017