

**BUTLER COUNTY
WATER SYSTEM, INC.**

FINANCIAL STATEMENTS

DECEMBER 31, 2018 and 2017

BUTLER COUNTY WATER SYSTEM, INC.

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DECEMBER 31, 2018 and 2017**

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KIRBY & MOORE, LLP

CERTIFIED PUBLIC ACCOUNTANTS

1020 College Street
Bowling Green, KY 42101
Tel: 270.843.0244
Tel: 270.781.3488

INDEPENDENT AUDITOR'S 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, 2018 and 2017, and the related statements of operations, changes in members' equity and cash flows for the years 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, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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 19 and 20 and the Schedule of Expenditures of Federal Awards on page 25, as required by Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, 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 5, 2019, 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.

1 Carby & Moore, LLP

Bowling Green, Kentucky
April 5, 2019

BUTLER COUNTY WATER SYSTEM, INC.

FINANCIAL AND STATISTICAL HIGHLIGHTS

The following are financial and statistical highlights of Butler County Water System, Inc. for years ending December 31, 2018 and 2017.

- The System's assets totaled \$22,837,705 and increased by \$1,528,877, or 7.2% from the prior year. The increase in assets reflects the increase in construction in progress related to Project 18 – Line Extensions & AMR System implementation.
- Operating revenue for the year totaled \$2,093,917 and increased by \$145,782 from the prior year, a 7.5% increase. Operating expenses totaled \$1,944,185 for the year and increased by \$177,990 from last year, a 10.1% increase. Operating revenues increased due to a retail rate increase of 9.95% effective on June 1, 2018. Operating expenses increased due to increases in the System's other post-employment benefits expense and contributions to the Rochester Dam Rural Water Commission (RDRWC).
- Metered sales totaled \$2,025,389 and increased by \$134,749 from the prior year, a 7.1% increase. Residential sales increased by \$137,724, or 8.3%; commercial, agricultural, fire protection and other sales decreased by \$2,975, or -1.2%.
- Total revenues were less than budgeted revenue by \$4,087 and total expenses were greater than budgeted expenses by \$96,376. Net income of \$8,637 was less than budget by \$100,463. Lower than budgeted metered revenue occurred due a retail rate increase budgeted for April that was not implemented until June. Expenses that exceeded budget included contributions to RDRWC reported in contractual services – other, and other post-employment benefits.
- The System uses Green River as a water source and produces water at its water treatment facility located in Morgantown, Kentucky. Total gallons produced for the year was 329.4 million gallons compared to 309.4 million gallons produced in the prior year, an increase of 20 million gallons, or 6.4%. The peak production month was February which produced 31 million gallons and the peak production day was in July which produced 1.3 million gallons.
- Total gallons sold to the System's customers during the year amounted to 256.5 million gallons compared to 253.5 million gallons in the prior year, an increase of 3 million gallons, or 1.2%. The peak demand month was June with 25.5 million gallons sold.
- The average monthly usage per residential customer was 4,072 gallons compared to 3,990 gallons in the prior year, a 2.1% increase. The average monthly usage per commercial customer was 8,822 gallons compared to 9,438 gallons in the prior year, a 6.5% decrease.
- The number of customers totaled 4,908 consisting of 4,594 residential customers and 314 commercial and other class customers with 50 new meter applications received throughout the year. The System has a total of 518 miles of distribution main serving an average of 9.5 customers per mile.
- Projects in Progress: Project 18 consists of the construction of five water main extensions and the installation of an automated meter reading (AMR) system. In July 2018, the water main extensions were placed into service consisting of 22,860 feet of distribution main and the AMR portion of the project is currently being implemented with the installation of 2,300 AMR units. Full implementation of the AMR system will be February 2019. The project of \$1,735,255 is funded by loan and grant funds from USDA- Rural Development of \$1,422,000 and \$250,000, respectively, and System funds of \$63,255.

FINANCIAL STATEMENTS

BUTLER COUNTY WATER SYSTEM, INC.

BALANCE SHEETS
December 31, 2018 and 2017

	2018	2017
ASSETS		
Current assets		
Cash and cash equivalents	\$ 943,392	\$ 1,056,799
Short-term investments	500,000	500,000
Receivables		
Customer accounts receivable, net of allowance for uncollectibles of \$91,218 and \$87,131	69,286	72,804
Accounts receivable - WCWD	6,920	57,441
Interest	5,892	43
Prepaid expenses	<u>17,846</u>	<u>17,801</u>
Total current assets	<u>1,543,336</u>	<u>1,704,888</u>
PROPERTY, PLANT AND EQUIPMENT		
Land and land rights	101,521	101,521
Utility plant in service	29,571,288	28,783,326
Construction in progress	1,721,571	379,427
Less: accumulated depreciation	<u>(10,878,879)</u>	<u>(10,261,545)</u>
Property, plant and equipment, net	<u>20,515,501</u>	<u>19,002,729</u>
OTHER ASSETS		
Restricted cash and cash equivalents	523,549	316,834
Restricted investments	149,114	146,444
Deferred charges	<u>106,205</u>	<u>137,933</u>
Total other assets	<u>778,868</u>	<u>601,211</u>
Total assets	<u>\$ 22,837,705</u>	<u>\$ 21,308,828</u>

See Notes to Financial Statements

	2018	2017
LIABILITIES AND MEMBERS' EQUITY		
Liabilities		
Current liabilities		
Accounts payable	\$ 83,844	\$ 52,870
Accounts payable - WCWD	88,372	91,204
Accrued interest payable	70,255	58,725
Other current liabilities	5,808	6,573
Current portion of long-term debt	<u>226,756</u>	<u>193,658</u>
Total current liabilities	<u>475,035</u>	<u>403,030</u>
Long-term liabilities		
Rebates payable	9,450	9,450
Customer deposits	153,415	147,634
Loan payable	5,041,577	3,846,628
Other non-current liabilities	<u>162,490</u>	<u>14,264</u>
Total long-term liabilities	<u>5,366,932</u>	<u>4,017,976</u>
Total liabilities	<u>5,841,967</u>	<u>4,421,006</u>
MEMBERS' EQUITY		
Capital investments	14,508,316	14,409,037
Retained earnings	<u>2,487,422</u>	<u>2,478,785</u>
Total members' equity	<u>16,995,738</u>	<u>16,887,822</u>
Total liabilities and members' equity	<u>\$ 22,837,705</u>	<u>\$ 21,308,828</u>

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF OPERATIONS
Years Ended December 31, 2018 and 2017

	2018	2017
Operating revenues		
Metered sales		
Residential	\$ 1,790,411	\$ 1,652,687
Commercial	<u>234,978</u>	<u>237,953</u>
Total metered sales	2,025,389	1,890,640
Forfeited discounts	32,961	30,311
Miscellaneous service revenue	<u>35,567</u>	<u>27,184</u>
Total operating revenues	<u>2,093,917</u>	<u>1,948,135</u>
Operating expenses		
Pumping expense		
Purchased power	44,969	42,045
Insurance	2,752	2,869
Miscellaneous	1,904	2,812
Professional services	<u>750</u>	<u>708</u>
Total pumping expense	<u>50,375</u>	<u>48,434</u>
Water treatment expense		
Professional services	1,500	1,416
Purchased power	92,433	87,716
Purchased water	1,375	4
Chemicals	68,823	56,437
Materials and supplies	14,155	16,279
Insurance	5,503	5,737
Salaries and benefits	90,151	97,170
Contractual services	1,720	675
Miscellaneous	<u>4,740</u>	<u>4,842</u>
Total water treatment expense	<u>280,400</u>	<u>270,276</u>
General distribution expense		
Professional services	751	709
Purchased power	4,347	4,265
Salaries and benefits	98,325	101,805
Materials and supplies	28,176	26,017
Insurance	11,924	12,430
Miscellaneous	18,117	17,888
Contractual services	<u>21,261</u>	<u>24,304</u>
Total general distribution expense	<u>182,901</u>	<u>187,418</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF OPERATIONS (Continued)
Years Ended December 31, 2018 and 2017

	2018	2017
Customer accounts expense		
Salaries and benefits	\$ 231,387	\$ 211,929
Contractual services	52,022	53,353
Uncollectible accounts	3,947	2,885
Materials and supplies	1,152	904
Insurance	1,376	1,434
Miscellaneous	35,494	27,749
Professional services	<u>2,250</u>	<u>2,125</u>
Total customer accounts expense	<u>327,628</u>	<u>300,379</u>
Maintenance expense		
Pumping equipment and storage expense	26,459	18,508
Materials and supplies	3,640	539
Salaries and benefits	110,688	126,335
Contractual services	91,723	35,021
Professional services	<u>1,500</u>	<u>1,417</u>
Total maintenance expense	<u>234,010</u>	<u>181,820</u>
Administrative and general expense		
Salaries and benefits	91,149	90,480
Other post-employment benefits	91,896	8,542
Materials and supplies	4,794	6,506
Insurance	2,560	2,499
Miscellaneous	3,768	3,197
Contractual services	34,740	35,971
Professional services	<u>2,344</u>	<u>2,125</u>
Total administrative and general expense	<u>231,251</u>	<u>149,320</u>
Depreciation and amortization expense	<u>637,620</u>	<u>628,548</u>
Total operating expenses	<u>1,944,185</u>	<u>1,766,195</u>
Operating income	<u>149,732</u>	<u>181,940</u>
Non-operating revenues (expenses)		
Non-utility income	20	164
Interest income	14,575	9,227
Interest expense on long-term debt	(149,661)	(156,434)
Interest expense on customer deposits	(2,133)	(937)
PSC taxes	<u>(3,896)</u>	<u>(3,915)</u>
Total non-operating revenues (expenses)	<u>(141,095)</u>	<u>(151,895)</u>
Net income	<u>\$ 8,637</u>	<u>\$ 30,045</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF CHANGES IN MEMBERS' EQUITY
Years Ended December 31, 2018 and 2017

	<u>Retained Earnings</u>	<u>Contributions in Aid of Construction</u>	<u>Total</u>
Balance, December 31, 2016	\$ 2,448,740	\$14,384,463	\$16,833,203
Net income	30,045	—	30,045
Contributions in aid of construction	<u>—</u>	<u>24,574</u>	<u>24,574</u>
Balance, December 31, 2017	2,478,785	14,409,037	16,887,822
Net income	8,637	—	8,637
Contributions in aid of construction	<u>—</u>	<u>99,279</u>	<u>99,279</u>
Balance, December 31, 2018	<u>\$ 2,487,422</u>	<u>\$14,508,316</u>	<u>\$16,995,738</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers and agencies	\$ 2,147,999	\$ 1,946,293
Payments to suppliers for goods and services	(497,684)	(502,357)
Payments for contractual services	(605,335)	(611,377)
Net cash provided by operating activities	<u>1,044,980</u>	<u>832,559</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Interest paid on customer deposits	(2,133)	(937)
Net cash used in noncapital financial activities	(2,133)	(937)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Loan proceeds	1,422,000	—
Principal repayment on long-term debt	(193,953)	(215,503)
Contributions in aid of construction	99,279	24,574
Purchases of capital assets	(2,130,818)	(306,067)
Interest paid on long-term debt	(152,060)	(159,117)
Net cash used in capital and related financing activities	(955,552)	(656,113)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of short-term investments	(2,670)	(5,629)
Interest income	<u>8,683</u>	<u>9,227</u>
Net cash provided by investing activities	<u>6,013</u>	<u>3,598</u>
Net increase in cash and cash equivalents	93,308	179,107
Cash and cash equivalents, beginning of year	<u>1,373,633</u>	<u>1,194,526</u>
Cash and cash equivalents, end of year	<u>\$ 1,466,941</u>	<u>\$ 1,373,633</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

STATEMENTS OF CASH FLOWS (Continued)
Years Ended December 31, 2018 and 2017

	2018	2017
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 149,732	\$ 181,940
Adjustment to reconcile net operating income to net cash provided by operating activities		
Depreciation	631,976	622,565
Amortization	5,644	5,983
Non-utility income	20	164
Payment of PSC taxes	(3,896)	(3,915)
Changes in assets and liabilities		
Net (increase) decrease in accounts receivable, net	54,082	(1,842)
Net (increase) decrease in prepaid expenses	(45)	1,036
Net (increase) decrease in deferred charges	26,083	(29,014)
Net increase in accounts payable	28,142	46,684
Net increase (decrease) in other current liabilities	(765)	1,209
Net increase in customer deposits	5,781	7,749
Net increase in other liabilities	<u>148,226</u>	<u>—</u>
Net cash provided by operating activities	<u>\$ 1,044,980</u>	<u>\$ 832,559</u>

See Notes to Financial Statements

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

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, 2018 and 2017**

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.

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.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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

BUTLER COUNTY WATER SYSTEM, INC.

**NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2018, 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 5, 2019, which was the date the financial statements were made available.

Reclassification

Certain reclassifications have been made to the 2017 financial statements to conform to the 2018 presentation.

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, 2018 and 2017, the carrying amounts of the Utility's deposits were \$2,116,055 and \$2,020,077 and the bank balances were \$2,182,092 and \$2,029,682, respectively.

	2018	2017
Cash and cash equivalents	\$ 943,392	\$ 1,056,799
Restricted cash and cash equivalents	523,549	316,834
Short-term investments	500,000	500,000
Restricted investments	<u>149,114</u>	<u>146,444</u>
	<u>\$ 2,116,055</u>	<u>\$ 2,020,077</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, 2018 and 2017, the Utility's bank balance was not exposed to custodial credit risk.

BUTLER COUNTY WATER SYSTEM, INC.

**NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017**

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. The construction fund is restricted by USDA Rural Development for Project 18 receipts and disbursements.

Restricted cash and cash equivalents and investments consist of the following as of December 31, 2018 and 2017:

	2018	2017
Sinking funds	\$ 188,786	\$ 189,199
Depreciation fund	273,240	123,135
Customer deposits	154,114	146,444
Construction fund	<u>56,523</u>	<u>4,500</u>
	<u>\$ 672,663</u>	<u>\$ 463,278</u>

NOTE 3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following as of December 31, 2018 and 2017:

	2018	2017
Non-depreciable		
Land and land rights	\$ 101,521	\$ 101,521
Construction in progress	1,721,571	379,427
Depreciable		
Utility plant in service	29,571,288	28,783,326
Less: accumulated depreciation	<u>(10,878,879)</u>	<u>(10,261,545)</u>
Property, plant and equipment, net	<u>\$ 20,515,501</u>	<u>\$ 19,002,729</u>

Depreciation expense was \$631,976 and \$622,565 for the years ended December 31, 2018 and 2017, respectively.

BUTLER COUNTY WATER SYSTEM, INC.

**NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017**

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 2018 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, 2018 and 2017 consist of the following:

<u>Original Amount</u>	<u>Series of</u>	<u>Interest Rate</u>	<u>2018</u>	<u>2017</u>
\$ 191,400	1977	5.00%	\$ —	\$ —
152,000	1979	5.00%	—	5,200
950,000	1996	4.50%	633,396	655,993
197,214	1997	4.50%	123,912	129,143
545,000	1998	4.75%	335,537	349,615
3,045,000	2012	2.80%-4.00%	2,330,000	2,770,000
437,000	2014	2.75%	423,488	430,335
1,442,000	2018	2.75%	1,422,000	—
			<u>\$ 5,268,333</u>	<u>\$ 4,040,286</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, 2018 and 2017.

BUTLER COUNTY WATER SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

NOTE 5. LONG-TERM DEBT (Continued)

Principal and interest of various amounts are due at least annually in each of the years through 2058. 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>
2019	\$ 226,756	\$ 169,179
2020	214,092	177,923
2021	221,971	171,054
2022	229,969	163,926
2023	238,090	155,605
Thereafter	<u>4,137,455</u>	<u>1,508,571</u>
	<u>\$ 5,268,333</u>	<u>\$ 2,346,258</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, 2018 and 2017:

	2018	2017
Warren County Water District	\$ 6,920	\$ 57,441

The following related party amounts were included in accounts payable at December 31, 2018 and 2017:

	2018	2017
Warren County Water District	\$ 88,372	\$ 91,204

BUTLER COUNTY WATER SYSTEM, INC.

**NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017**

NOTE 6. RELATED PARTIES (Continued)

During 2018 and 2017, expenses from the WCWD amounted to \$1,101,885 and \$990,626, respectively, for the following:

	2018	2017
Wages and benefits:		
Operation	\$ 476,768	\$ 473,817
Administrative:		
Supervision and administration	116,315	118,804
Accounting	40,238	40,638
Customer service	85,115	91,954
Engineering	12,014	6,826
Operations - other	144,470	125,867
Additions to plant	92,853	117,548
Special projects	<u>134,112</u>	<u>15,172</u>
Totals	<u>\$1,101,885</u>	<u>\$ 990,626</u>

In addition to the above expenses from WCWD totaling \$1,101,885 and \$990,626 for the years ending December 31, 2018 and 2017, respectively, the Utility also recognized other post-employment benefits (OPEB) expense of \$91,896 and \$8,542 in 2018 and 2017, respectively. WCWD accrues the projected value of retiree healthcare benefits earned during its employees' working lifetime. The OPEB expense reflected in administrative and general expense in the statement of operations is the Utility's proportionate share of annual OPEB costs (expense) recorded by WCWD. The Utility's portion of the OPEB liability, included in the balance sheet caption "other non-current liabilities," totaled \$162,490 and \$14,264 at December 31, 2018 and 2017, respectively.

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.

BUTLER COUNTY WATER SYSTEM, INC.

**NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017**

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.

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. In October, 2017, the RDRWC was awarded a \$3,000,000 grant from the U.S. Economic Development Administration towards the estimated \$4,000,000 dam repair cost. Bids will be received for the repairs in year 2019 with construction expected through year 2020. The RDRWC has issued bonds for the remaining cost and each facility withdrawing water from the pool will pay \$0.10 per 1,000 gallons withdrawn beginning January 1, 2018. As of December 31, 2018 and 2017, Butler County Water System, Inc. has incurred cumulative costs totaling \$64,864 and \$33,030, respectively, for its participation in the RDRWC.

BUTLER COUNTY WATER SYSTEM, INC.

SCHEDULE OF BUDGETARY COMPARISON

Year Ended December 31, 2018

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variances</u>
	<u>Original</u>	<u>Final</u>		<u>Favorable (Unfavorable) Final to Actual</u>
Revenues				
Metered revenue	\$ 2,045,000	\$ 2,045,000	\$ 2,025,389	(\$ 19,611)
Forfeited discounts	32,300	32,300	32,961	661
Miscellaneous service revenue	27,000	27,000	35,510	8,510
Interest income	8,300	8,300	14,575	6,275
Other income	—	—	78	78
Total revenues	<u>2,112,600</u>	<u>2,112,600</u>	<u>2,108,513</u>	<u>(4,087)</u>
Expenses				
Salaries and wages	385,000	385,000	379,284	5,716
Commissioner fees	18,000	18,000	17,100	900
Fringe benefits	255,700	255,700	226,051	29,649
Purchased water	—	—	1,375	(1,375)
Purchased power	138,200	138,200	141,750	(3,550)
Chemicals	55,200	55,200	68,823	(13,623)
Materials and supplies	49,000	49,000	51,917	(2,917)
Contractual services - Accounting	8,500	8,500	9,000	(500)
Contractual services - Other	173,400	173,400	201,560	(28,160)
Rental of building and utilities	16,600	16,600	16,193	407
Equipment expense	60,400	60,400	68,618	(8,218)
Insurance - general liability	23,400	23,400	22,930	470
Insurance - other	1,100	1,100	1,184	(84)
Regulatory expense	4,000	4,000	3,896	104
Bad debt expense	2,400	2,400	3,947	(1,547)
Miscellaneous expense	5,500	5,500	4,937	563
Depreciation	628,200	628,200	631,976	(3,776)
Amortization	5,600	5,600	5,644	(44)
Interest expense	162,900	162,900	151,795	11,105
Other post-employment benefits	<u>10,400</u>	<u>10,400</u>	<u>91,896</u>	<u>(81,496)</u>
Total expenses	<u>2,003,500</u>	<u>2,003,500</u>	<u>2,099,876</u>	<u>(96,376)</u>
Net income	<u>\$ 109,100</u>	<u>\$ 109,100</u>	<u>\$ 8,637</u>	<u>(\$ 100,463)</u>

BUTLER COUNTY WATER SYSTEM, INC.

**SCHEDULE OF BUDGETARY COMPARISON
Year Ended December 31, 2017**

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variances</u>
	<u>Original</u>	<u>Final</u>		<u>Favorable</u> <u>(Unfavorable)</u> <u>Final to Actual</u>
				Revenues
Metered revenue	\$ 1,835,000	\$ 1,835,000	\$ 1,890,640	\$ 55,640
Forfeited discounts	31,340	31,340	30,311	(1,029)
Miscellaneous service revenue	25,370	25,370	27,091	1,721
Interest income	7,590	7,590	9,227	1,637
Other income	—	—	258	258
	<u>1,899,300</u>	<u>1,899,300</u>	<u>1,957,527</u>	<u>58,227</u>
Expenses				
Salaries and wages	365,000	365,000	363,634	1,366
Commissioner fees	18,000	18,000	18,000	—
Fringe benefits	240,780	240,780	247,743	(6,963)
Purchased water	—	—	4	(4)
Purchased power	137,000	137,000	134,027	2,973
Chemicals	57,610	57,610	56,437	1,173
Materials and supplies	40,000	40,000	50,245	(10,245)
Contractual services - Accounting	8,500	8,500	8,500	—
Contractual services - Other	136,400	136,400	149,324	(12,924)
Rental of building and utilities	16,410	16,410	16,155	255
Equipment expense	59,460	59,460	52,781	6,679
Insurance - general liability	25,200	25,200	23,905	1,295
Insurance - other	1,060	1,060	1,065	(5)
Regulatory expense	3,400	3,400	3,915	(515)
Bad debt expense	2,250	2,250	2,885	(635)
Miscellaneous expense	3,120	3,120	4,403	(1,283)
Depreciation	615,450	615,450	622,565	(7,115)
Amortization	6,000	6,000	5,983	17
Interest expense	160,260	160,260	157,371	2,889
OPEB expense	—	—	8,542	(8,542)
	<u>1,895,900</u>	<u>1,895,900</u>	<u>1,927,484</u>	<u>(31,584)</u>
Net income	<u>\$ 3,400</u>	<u>\$ 3,400</u>	<u>\$ 30,043</u>	<u>\$ 26,643</u>

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

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, 2018, 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 5, 2019.

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.

Bowling Green, Kentucky
April 5, 2019



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

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

Report on Compliance for Each Major Federal Program

We have audited the Butler County Water System, Inc.'s (the "Utility") compliance with the types of compliance requirements described in the OMB *Compliance Supplement* that could have a direct and material effect on each of the Utility's major federal programs for the year ended December 31, 2018. The Utility's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Utility's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Utility's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Utility's compliance.

Opinion on Each Major Federal Program

In our opinion, the Butler County Water System, Inc. complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2018.

Report on Internal Control over Compliance

Management of the Utility is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Utility's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Utility's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Bowling Green, Kentucky
April 5, 2019

BUTLER COUNTY WATER SYSTEM, INC.

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended December 31, 2018**

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Total Federal Expenditures</u>
U.S. Department of Agriculture		
Direct programs		
Water and Waste Disposal Systems for Rural Communities		
Rural Utilities Service		
Rural Development loan	10.760	\$ 1,422,000
Rural Development grant	10.760	<u>109,193</u>
Total U.S. Department of Agriculture		<u>\$ 1,531,193</u>
Total Expenditures of Federal Awards		<u>\$ 1,531,193</u>

See Notes to Schedule of Expenditures of Federal Awards

BUTLER COUNTY WATER SYSTEM, INC.

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended December 31, 2018**

NOTE A. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal award activity of the Butler County Water System, Inc. (the "Utility"), under programs of the federal government for the year ended December 31, 2018, in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Because the schedule presents only a selected portion of the operations of the Utility, it is not intended to and does not present the financial position, changes in members' equity, or cash flows of the Utility.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, wherein certain types of expenditures are not allowed or are limited as to reimbursement.

NOTE C. INDIRECT COST RATE

The Utility has not elected to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

BUTLER COUNTY WATER SYSTEM, INC.

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended December 31, 2018**

Section I – Summary of Auditor’s Results

1. The auditor’s report expresses an unmodified opinion on the financial statements of the Butler County Water System, Inc.
2. No significant deficiencies or material weaknesses were disclosed during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of the Butler County Water System, Inc. which would be required to be reported in accordance with *Government Auditing Standards*, were disclosed during the audit.
4. No significant deficiencies or material weaknesses in internal control over major federal award programs were disclosed during the audit.
5. The auditor’s report on compliance for the major federal award programs for the Butler County Water System, Inc. expresses an unmodified opinion on all major federal programs.
6. There were no audit findings that are required to be reported in accordance with Uniform Guidance 516(a).
7. The programs tested as major programs included:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
10.760	Water and Waste Disposal Systems for Rural Communities:
10.760	Rural Development loan
	Rural Development grant

8. The threshold used for distinguishing between Type A and B programs was \$750,000.
9. The Butler County Water System, Inc. did not qualify as a low-risk auditee.

Section II – Financial Statement Findings

No matters were reported.

Section III – Major Federal Award Findings and Questioned Costs

No matters were reported.

BUTLER COUNTY WATER SYSTEM, INC.
SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
Year Ended December 31, 2018

No matters were reported.