

Rowan Water, Inc.
Regular Audit
For the Years Ended December 31, 2017 and 2016



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Rowan Water, Inc.
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Independent Auditor's Report

Board of Directors
Rowan Water, Inc.
1765 Christy Creek
Morehead, Kentucky 40351

Report on the Financial Statements

We have audited the accompanying financial statements of Rowan Water, Inc., (the Company), which comprise the statements of financial position as of December 31, 2017 and 2016, and the related statements of activities 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 Rowan Water, Inc., as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2018 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.



Natalie Millhuff-Stang, CPA, CITP
President/Owner
Millhuff-Stang, CPA, Inc.
Portsmouth, Ohio

March 23, 2018

Rowan Water, Inc.
Statements of Financial Position
December 31, 2017 and 2016

	2017	(Restated) 2016
Assets:		
Current Assets		
Cash	\$562,988	\$590,246
Accounts receivable customers (net of allowance for uncollectibles of \$16,192 in 2017 and \$16,098 in 2016)	279,151	275,604
Inventory	119,475	130,288
Total current assets	961,614	996,138
Other Assets		
Restricted cash	366,552	335,125
Utility deposits	305	305
Total other assets	366,857	335,430
Property, Plant and Equipment		
Land and land rights	220,715	220,715
Building	899,538	899,538
Pumping plant	1,338,729	1,338,729
Transmission and distribution lines	16,342,496	16,295,064
Office furniture, fixtures and equipment	64,369	64,369
Machinery and equipment	667,749	658,238
Construction work in progress	526,999	0
	20,060,595	19,476,653
Less: accumulated depreciation	(9,645,121)	(9,172,930)
Property, plant and equipment (net)	10,415,474	10,303,723
Total assets	\$11,743,945	\$11,635,291

See accompanying notes to the financial statements.

Rowan Water, Inc.
Statements of Financial Position (Continued)
December 31, 2017 and 2016

	<u>2017</u>	<u>(Restated) 2016</u>
Liabilities and Net Assets:		
Current Liabilities		
Accounts payable	\$119,136	\$144,134
Accrued interest payable	98,576	99,036
Other accrued expenses	123,491	111,645
Customer deposits	94,015	93,955
Current portion of long-term debt	<u>152,206</u>	<u>117,075</u>
Total current liabilities	<u>587,424</u>	<u>565,845</u>
Long-Term Debt		
Notes payable, less current portion	<u>4,719,649</u>	<u>4,298,646</u>
Total liabilities	5,307,073	4,864,491
Net Assets		
Unrestricted	<u>6,436,872</u>	<u>6,770,800</u>
Total net assets	<u>6,436,872</u>	<u>6,770,800</u>
Total liabilities and net assets	<u><u>\$11,743,945</u></u>	<u><u>\$11,635,291</u></u>

See accompanying notes to the financial statements.

Rowan Water, Inc.
Statements of Activities
For the Years Ended December 31, 2017 and 2016

	2017	(Restated) 2016
Operating Revenue		
Water sales	\$2,784,611	\$2,713,970
Miscellaneous	151,029	163,126
Total operating revenues	2,935,640	2,877,096
Operating Expenses		
Cost of water purchased	1,151,435	995,818
Salaries	519,661	505,930
Payroll tax expense	36,817	32,657
Employee insurance and benefits	276,400	254,863
Retirement	32,156	31,172
Repairs and maintenance	171,004	161,513
Professional services	19,336	16,384
Outside services	47,755	82,274
Truck and fuel expenses	49,306	38,103
Telephone and electricity	139,727	148,455
Office supplies and expense	36,063	41,029
Insurance	39,816	37,099
Miscellaneous expenses	46,450	55,991
Board member fees	24,027	21,600
Bad debt expense	10,990	19,960
Depreciation expense	505,181	518,171
Total operating expenses	3,106,124	2,961,019
Loss from Operations	(170,484)	(83,923)
Nonoperating Income (Expenses)		
Interest expense	(184,002)	(186,848)
Interest income	5,092	11,608
Gain on sale of assets	13,816	0
Other nonoperating income	1,650	6,651
Total nonoperating income (expenses)	(163,444)	(168,589)
Net Loss	(333,928)	(252,512)
Unrestricted Net Assets, Beginning of Year	6,770,800	7,023,312
Unrestricted Net Assets, End of Year	\$6,436,872	\$6,770,800

See accompanying notes to the financial statements.

Rowan Water, Inc.
Statements of Cash Flows
For the Years Ended December 31, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Net loss from operations	(\$170,484)	(\$83,923)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation expense	505,181	518,171
Decrease (increase) in other receivable	0	32,530
Decrease (increase) in accounts receivable	(3,547)	(7,995)
Decrease (increase) in inventory	10,813	(15,885)
Decrease (increase) in other assets	(31,427)	29,616
Increase (decrease) in accounts payable	(24,998)	55,746
Increase (decrease) in accrued liabilities	11,846	4,843
Increase (decrease) in customer deposits	60	(38,813)
	297,444	494,290
Net cash provided by operating activities	297,444	494,290
Cash Flows from Investing Activities		
Purchases of plant and equipment	(603,116)	(115,750)
Interest income received	5,092	11,608
	(598,024)	(104,142)
Net cash used in investing activities	(598,024)	(104,142)
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	573,109	0
Principal payments on long-term debt	(116,975)	(112,120)
Interest paid on long-term debt	(184,462)	(189,407)
Other nonoperating income	1,650	6,651
	273,322	(294,876)
Net cash provided by (used in) financing activities	273,322	(294,876)
Net increase (decrease) in cash and cash equivalents	(27,258)	95,272
Cash and Cash Equivalents, Beginning of Year	590,246	494,974
Cash and Cash Equivalents, End of Year	\$562,988	\$590,246
Noncash Transactions		
Trade-In Allowance on Truck Purchase	\$13,816	\$0

See accompanying notes to the financial statements.

Rowan Water, Inc.
Notes to the Financial Statements
For the Years Ended December 31, 2017 and 2016

Note 1. Summary of Significant Accounting Policies

Accounting Method

Rowan Water, Inc. (the Company) maintains its records on the cash basis of accounting. Accrual adjustments are made at year end in order to conform with generally accepted accounting principles.

Utility Plant

Utility plant is stated at original cost, net of contributions, which is the cost when first dedicated to public service. Such costs include applicable supervisory and overhead costs.

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated capital assets are recorded at their fair market values as of the date received. The Company maintains a capitalization threshold of five thousand dollars for all items added to the utility plant with an estimated useful life of three or more years.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to the utility plant. The company capitalizes labor on certain capitalized assets constructed by the Company. The amounts capitalized for 2017 and 2016 are \$7,372 and \$8,658, respectively.

Depreciation

Provisions for depreciation have been made on the basis of estimated lives of assets, using the straight-line method. Depreciable lives for the various assets are as follows:

Building	45 Years
Pumping plant	10-25 Years
Transmission and distribution	10-50 Years
Furniture and fixtures	5-10 Years
Equipment	3-7 Years

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers unrestricted cash and all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents.

Inventory

Inventory is stated at the lower of cost or market using the first-in, first-out (FIFO) method.

Operating Facilities

Interest incurred during construction periods on funds used to finance construction of capital assets is capitalized as part of the cost of those assets. Interest capitalized in 2017 and 2016 was \$0 and \$0, respectively.

Revenues and Cost of Purchased Water

Revenues are recorded during the month in which water is consumed by members. The cost of water purchased is recorded during the period the water is consumed from the supplier.

Rowan Water, Inc.
Notes to the Financial Statements
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Group Concentration of Credit Risk

The Company is located in Morehead, Kentucky. Its service area includes portions of several counties surrounding the City. The Company requires a deposit from its members when services are provided to rental property. Such deposits are applied to unpaid bills in the event of default.

Net Assets

The Company follows generally accepted accounting principles (GAAP) which establish standards for external financial reporting by not-for-profit organizations and requires that resources be classified for accounting and reporting purposes into three net asset categories according to externally (donor) imposed restrictions. GAAP requires that unconditional promises to give (pledges) be recorded as receivables and revenues and requires the organization to distinguish between contributions received and for each net asset category in accordance with donor imposed restrictions. A description of the three net asset categories follows:

Permanently Restricted Net Assets – Gifts of cash and other assets are reported as permanently restricted support if they are received with donor stipulations that limit the use of the donated assets in perpetuity.

Temporarily Restricted Net Assets – Gifts of cash, grants and other assets are reported as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. These net assets may be met with actions of the Company and/or the passage of time.

Unrestricted Net Assets – Gifts of cash, land, buildings and equipment are reported as unrestricted unless explicit donor stipulations specify how the donated assets must be used.

The Company has no net assets that are restricted by donors. Therefore, the Company considers all net assets to be unrestricted.

Income Tax Status

The Company is exempt from Federal income taxes under Section 501(c)(12) of the Internal Revenue Code of 1954; accordingly, the accompanying financial statements include no provision for such taxes.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Note 2. Pension Plan

Pension benefits are provided for substantially all employees through an insurance company, under a defined contribution pension plan. The Company contributes 7% of each employee's gross salary to a Simple IRA. The Company's pension contributions for 2017 and 2016 were \$32,156 and \$31,172, respectively.

Rowan Water, Inc.
Notes to the Financial Statements
For the Years Ended December 31, 2017 and 2016

Note 3. Long-Term Debt

Long-term debt at December 31, 2017 and 2016 consisted of:

	<u>2017</u>	<u>2016</u>
4.5% secured promissory note dated May 9, 2001, due to USDA, Rural Development 40 years from the date of this note with annual installments of \$10,322 including interest, until maturity.	\$281,951	\$288,846
5% secured promissory note dated September 15, 1992, due to USDA, Rural Development 40 years from the date of this note with annual installments of \$22,886, including interest, until maturity.	237,417	247,907
4.125% secured promissory note dated October 24, 2007, due to USDA, Rural Development 40 years from the date of this note with annual installments of \$31,076, including interest, until maturity.	537,106	546,121
5% secured promissory note dated July 19, 1991, due to USDA, Rural Development 40 years from the date of this note with annual installments of \$76,959, including interest, until maturity.	760,679	797,751
4.5% secured promissory note to USDA, Rural Development dated May 13, 1998, due 40 years from the date of this note with payments of \$68,155, including interest, maturing May 2038.	912,567	938,490
4.5% secured promissory note to USDA, Rural Development dated January 27, 2004, due 40 years from the date of this note with annual installments of \$17,953, including interest, maturing January 2044.	406,519	414,200

Rowan Water, Inc.
Notes to the Financial Statements
For the Years Ended December 31, 2017 and 2016

	2017	2016
4.5% secured promissory note to USDA, Rural Development dated January 27, 2004, due 40 years from the date of this note with annual installments of \$6,400, including interest, maturing January 2044.	\$179,886	\$183,286
2.75% secured promissory note to USDA, Rural Development dated July 11, 2012, due 40 years from the date of this note with annual installments of \$18,596, including interest, maturing July 2052.	887,222	902,213
2.75% secured promissory note to USDA, Rural Development dated July 11, 2012, due 40 years from the date of this note with annual installments of \$2,641, including interest, maturing July 2052.	95,399	96,907
2.625% secured promissory note to USDA, Rural Development dated September 15, 2017, due 40 years from the date of this note with annual installments of \$44,993, including interest, maturing September 2057.	573,109	0
Total	4,871,855	4,415,721
Less: principal payments due within one year classified as current liability	(152,206)	(117,075)
	\$4,719,649	\$4,298,646

Maturities of long-term debt are as follows:

2018	\$122,257
2019	127,675
2020	133,339
2021	139,261
2022	145,453
Thereafter	3,630,660
Total	\$4,298,645

This schedule does not agree to the previous schedule of loan balances because the September 2017 loan has not been finalized and therefore an amortization schedule has not yet been prepared.

Operating facilities, together with all revenue and service charges which may arise from operations of the Company, are pledged as security for the notes payable to USDA, Rural Development.

Rowan Water, Inc.
Notes to the Financial Statements
For the Years Ended December 31, 2017 and 2016

The notes payable agreements with the United States Department of Agriculture, Rural Development (USDA, RD) require that depreciation reserve accounts be established as follows:

- (A) For the notes dated July 19, 1991, and September 15, 1992, the Company is required to deposit \$835 a month, starting January 1, 1993, in a depreciation reserve account until the balance reaches \$100,200.
- (B) For the note dated May 13, 1998, the Company is required to deposit \$570 a month into a depreciation reserve account. The Company is required to make these deposits starting January 2000 until the balance reaches \$68,400.
- (C) For the notes dated January 27, 2004, the Company is required to deposit \$320 a month into a depreciation reserve account. The Company is required to make these deposits until the balance reaches \$38,400.
- (D) For the note dated October 24, 2007, the Company is required to deposit \$265 a month into a depreciation reserve account. The Company is required to make these deposits until the balance reaches \$31,800.
- (E) For the note dated May 9, 2001, the Company is required to deposit \$170 a month into a depreciation reserve account. The Company is required to make these deposits until the balance reaches \$20,400.
- (F) For the note dated July 11, 2012, the Company is required to deposit \$410 a month into a depreciation reserve account. The Company is required to make these deposits until the balance reaches \$49,200.
- (G) For the note dated September 15, 2017, the Company is required to deposit \$385 a month into a depreciation reserve account. The Company is required to make these deposits until the balance reaches \$46,200.

The required balances of the depreciation reserves at December 31, 2017 and 2016 were \$291,000 and \$286,080, respectively. The amounts in the depreciation reserves at December 31, 2017 and 2016 were \$335,408 and \$335,125, respectively.

Note 4. Commitments

Under its wholesale water agreement, the Company is committed to purchase its water from another local utility. The rates paid for such purchases are subject to review and revision. The Company has also entered into a long-term water resale contract with a local water district whereby the Company is committed to provide water, as provided in the contract, to the district over the next 25 years.

Note 5. Membership Fees

The Company uses the membership fees account to record membership fees collected from new customers (members). Membership fees collected in 2017 and 2016, respectively, amounted to \$460 and \$440.

Note 6. Tap-On Fees

The Company uses the tap-on fees account to record tap fees collected from new customers (members). Tap fees collected in 2017 and 2016, respectively, amounted to \$67,607 and \$80,076.

Note 7. Federal Grants in Aid of Construction

Federal grants in aid of construction consist of federal grants for the construction of water mains to serve customers. The Company capitalizes the costs of such mains.

Rowan Water, Inc.
Notes to the Financial Statements
For the Years Ended December 31, 2017 and 2016

Note 8. Bank Deposits

The Company maintains bank accounts at US Bank and Morehead Community Federal Credit Union. Accounts at these institutions are insured up to \$250,000 per bank. As of December 31, 2017, the Company's bank balance was \$962,706, of which \$459,520 was insured by the banks. The remaining balances were not insured.

Note 9. Accrued Sick Leave

Accrued sick leave balances at December 31, 2017 and 2016 were \$103,491 and \$92,251, respectively.

Note 10. Subsequent Events

Management has performed an analysis for the activities and transactions subsequent to December 31, 2017 to determine the need for any adjustments or disclosures within the financial statements for the year ended. Management has performed their analysis through March 23, 2018, which is the date the financial statements were available to be issued.

Note 11. Restatement of Beginning Balances

The Company formally approved a capitalization policy with a five thousand dollar threshold. Restatements were required to eliminate from the financial statements assets that were previously recognized that fell below this threshold. Those restatements had the following effect on beginning net assets.

Net Assets, As Reported, December 31, 2016	\$6,826,875
Restatements	<u>(56,075)</u>
Net Assets, As Restated, December 31, 2016	<u>\$6,770,800</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 *Government Auditing Standards*

Independent Auditor's Report

Board of Directors
Rowan Water, Inc.
1765 Christy Creek
Morehead, Kentucky 40351

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 Rowan Water, Inc., (the Company), which comprise the statement of financial position as of December 31, 2017, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 23, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company'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 Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Company'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.

Rowan Water, Inc.

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*

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company'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 Company'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 Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Natalie Millhuff-Stang, CPA, CITP
President/Owner
Millhuff-Stang, CPA, Inc.
Portsmouth, Ohio

March 23, 2018