Water/Sewer Division of Bowling Green Municipal Utilities

A Component Unit of the City of Bowling Green, Kentucky

Independent Auditor's Reports and Financial Statements

June 30, 2016 and 2015

BKD LLP
CPAs & Advisors

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
June 30, 2016 and 2015

Contents

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Independent Auditor's Report

Board of Directors
Bowling Green Municipal Utilities
Bowling Green, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Water/Sewer Division (Division), a Division of Bowling Green Municipal Utilities (BGMU), a component unit of the City of Bowling Green, Kentucky, which are comprised of balance sheets as of June 30, 2016 and 2015, and statements of revenues, expenses and changes in net position and cash flows and the related notes to the basic financial statements for the years ended June 30, 2016 and 2015, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

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 the Division as of June 30, 2016 and 2015, and the changes in financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Division are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities that is attributable to the transactions of the Division. They do not purport to, and do not, present fairly the financial position of BGMU as of June 30, 2016 and 2015, the changes in its financial position or its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves and other 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 basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2016, on our consideration of the Division's internal control over financial reporting and 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 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 Division's internal control over financial reporting and compliance.

BKD, LLP

Bowling Green, Kentucky
September 30, 2016

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Management's Discussion and Analysis
Years Ended June 30, 2016 and 2015

Our discussion and analysis of the Water/Sewer Division (Division) of Bowling Green Municipal Utilities' (BGMU) financial performance provides an overview of the Division's financial activities for the fiscal years ended June 30, 2016. Please read it in conjunction with the Independent Auditor's Report and the Division's financial statements, which are included. The adoption of Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of the Governmental Accounting Standards Board Statement No. 27* has not been reflected in the 2014 information included in this management's discussion and analysis.

Financial Highlights

- The Division's net utility plant decreased by $984,101, or 0.71%.
- The Division's total assets and deferred outflows of resources increased by $562,775, or 0.36%.
- The Division's current liabilities decreased by $608,894, or 9.72%.
- The Division's noncurrent liabilities decreased by $547,436, or 0.73%.
- The Division's total earnings re-invested in system assets for 2016 were $2,565,181.

Overview of Annual Financial Report

The financial statements report information about the Division using accounting methods similar to those used by private sector companies. These statements offer short- and long-term financial information about its activities.

The balance sheet presents information on all of the Division's assets and liabilities with the difference reported as net assets (capital structure). Over time, increases and decreases in net assets are one indicator of whether the financial position of the Division is improving or deteriorating.

While the balance sheet provides information about the nature and amount of resources and obligations at year-end, the statement of revenues, expenses and changes in net position presents the results of the business activities over the course of the fiscal year and information as to how the assets changed during the year. This statement measures the success of the Division's operations over the past year and can be used to determine whether the Division has successfully recovered all its costs through its user fees (rates) and other charges. This statement also measures the Division's profitability and credit worthiness.

The statement of cash flows provides information about changes in the Division's cash and cash equivalents during the reporting period. This statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing and financing activities and provides answers to such questions as "where did cash come from, what was cash used for and what was the change in cash balance during the reporting period?"

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Division's accounting practices, significant balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

Summary of Organization and Business

BGMU is a municipal corporation governed by a five member board of directors (Board). The Board members for the fiscal year ended June 30, 2016, are Steve Snodgrass (chairperson), Donna Harmon (secretary), Todd Davis, Sarah Glenn Grise and Rick Williams. The members of the Board are appointed by the mayor subject to the approval of the City Commission. City Commissioner Rick Williams is the City's representative to the Board.

BGMU's management staff for the fiscal year are Mark Iverson (general manager), Gary Bridges (chief financial officer), Jeff White (Electric Division manager), Michael Gardner (Water/Sewer Division manager), Teresa Newman (General Services Division manager), Christy Twyman (customer relations and communications manager) and Jill Hartley (director of human resources). BGMU's controller is Holly Vaughn.

BGMU operates three divisions: Electric, Water/Sewer and General Services (herein after, collectively referred to as the Utilities) providing electricity, water, wastewater service and fiber optic services to the residents and businesses of Bowling Green (City). While no operating division is responsible for the debt of others, the Utilities do share certain costs, such as customer billing, which are allocated by cost allocation analysis and other calculations as appropriate. Related-party transactions are disclosed in the notes to the financial statements.

At June 30, 2016, the Division had 18,922 water customers and 20,781 wastewater customers.

The Division has one wholesale customer, Warren County Water District (WCWD). Sales to WCWD are approximately 22% of total revenues in 2016 and about 23% in 2015. WCWD rates are analyzed and adjusted on a periodic basis, about every two years. They are based on gallons sold, expenses and debt costs.

The Division has no taxing power. Operational and maintenance costs are funded from customer fees and charges. The acquisition and construction of capital assets are funded by capital (cash and systems) contributions from customers, including developers, grants and loans and customer revenues. A small portion of revenues is based on billing-service revenues for city sanitation and recycling pickup.

The Division is the focal point for this management discussion and analysis.

Financial Analysis of the Division as a Whole

The following comparative condensed financial statements and other selected information serve as the key financial data and indicators for management, monitoring and planning. Comments regarding year-to-year variances are included after the financial statement presentation.

Condensed Balance Sheets
(Dollars in Thousands)

	June 30			Increase (Decrease) 2015 to 2016	
	2016	2015	2014	$	%
Current assets	$ 8,776	$ 7,450	$ 5,161	$ 1,326	18%
Utility plant, net	136,855	137,838	139,350	(983)	1%
Restricted assets and investments	5,043	4,999	4,842	44	1%
Other assets	3,756	4,474	5,799	(718)	16%
Total assets	154,430	154,761	155,152	(331)	0%
Deferred outflows of resources	2,127	1,234	300	893	72%
Total assets and deferred outflows of resources	$ 156,557	$ 155,995	$ 155,452	$ 562	0%
Long-term debt	$ 64,498	$ 67,556	$ 71,719	$ (3,058)	5%
Long-term liabilities	10,251	7,740	143	2,511	32%
Other liabilities	5,656	6,265	5,640	(609)	10%
Total liabilities	80,405	81,561	77,502	(1,156)	1%
Deferred inflows of resources	-	846	-	(846)	100%
Net position					
Net investment in capital assets	68,095	66,105	63,628	1,990	3%
Restricted	5,043	4,999	4,842	44	1%
Unrestricted	3,014	2,484	9,480	530	21%
Total net position	76,152	73,588	77,950	2,564	3%
Total liabilities, deferred inflows of resources and net position	$ 156,557	$ 155,995	$ 155,452	$ 562	0%

Condensed Statements of Revenues, Expenses and Changes in Net Position
(Dollars in Thousands)

	June 30			Increase (Decrease) 2015 to 2016	
	2016	**2015**	**2014**	**$**	**%**
Operating revenues					
Metered and unmetered sales	$ 22,377	$ 21,601	$ 20,136	$ 776	4%
Other operating revenues	1,460	1,514	1,288	(54)	4%
Total operating revenues	23,837	23,115	21,424	722	3%
Other revenues (loss)	58	84	(371)	(26)	31%
Total revenues	23,895	23,199	21,053	696	3%
Operating and maintenance – Water	4,627	4,452	4,393	175	4%
Operating and maintenance – Sewer	4,255	3,973	3,956	282	7%
Administrative and billing	6,466	5,789	5,648	677	12%
Depreciation	5,425	5,384	5,251	41	1%
Interest and debt expense	1,199	1,246	1,416	(47)	4%
Total expenses	21,972	20,844	20,664	1,128	5%
Increase in net position	1,923	2,355	389	(432)	18%
Beginning net position, as previously reported	73,588	77,950	76,307	(4,362)	6%
Cumulative effect of change in accounting principle	-	(7,820)	-	7,820	100%
Beginning net position, as restated	73,588	70,130	76,307	3,458	5%
Capital contributions	641	1,103	1,254	(462)	42%
Ending net position	$ 76,152	$ 73,588	$ 77,950	$ 2,564	3%

Comments Regarding Variances

Balance Sheets

Current assets are $1,326,737, or 17.81% more in 2016 than in 2015. The current year increase relates primarily to an increase in cash.

Current liabilities are $608,894, or 9.72% less in 2016 than in 2015. The current year decrease pertains in large part to a decrease in accounts payable.

Statements of Revenues, Expenses and Changes in Net Position

The majority of the Division's revenues result from metered and unmetered sales (93.88% of total operating revenues in 2016 and 93.45% of total operating revenues in 2015). The other four categories are industrial sewer surcharge, miscellaneous service revenues, penalties and nonutility revenues, including tower rental and billing-services revenue. Metered and unmetered sales are $776,257, or 3.59% more in 2016 than in 2015. The increase can be partially attributed to the increase in rates as of February 1, 2016.

Growth in number of customers has been slow in prior years and remained so in both 2016 and 2015, increasing by 494 customers, or 1.26% in 2016 (from 18,713 water customers and 20,496 wastewater customers in 2015 to 18,922 water customers and 20,781 wastewater customers in 2016) and increasing by 514 customers, or 1.31% in 2015 (from 18,512 water customers and 20,183 wastewater customers in 2014 to 18,713 water customers and 20,496 wastewater customers in 2015). Sales may fluctuate significantly as the utility industry is "weather-driven".

Operating expenses were 87.14% of operating revenues in 2016 and 84.79% of operating revenues in 2015. The utility industry is "system-driven", meaning classification of labor and material expenses is driven by the types of system conditions each year, *e.g.*, main-line breaks due to freezing temperatures as opposed to new line construction; pump repairs as opposed to ordinary maintenance. Major variances between years can and do occur. This year major differences are:

- The Division loaned $4,000,000 during 2002 – 2003 and 2003 – 2004 to the General Services Division for construction, start-up costs and operations. An additional $1,000,000 loan was approved by the Board in June 2005. The total note was restructured in June 2005 to be interest-only at a 4.50% interest rate due annually over the following five years. The loan was re-evaluated in fiscal year 2011 and it was determined that interest would be suspended and become principal-only debt. Payments of $275,000 were received on previously accrued interest during the current year paying that in full. Payments received toward principal during the fiscal year totaled $600,000.
- Labor and other employment costs make up the largest single expense category for the Division. Labor costs before benefits are more than $11,000,000 for the Utilities. Other labor costs include payroll tax for social security taxes (reduced by state retirement fund), state retirement (CERS), health, dental, disability and life insurance and various company functions. Salary and hourly costs increased by approximately 3.00% in 2016 for merit and other necessary increases.

Statements of Cash Flows

- Cash flows from operating activities for the current year totaled $9,381,121. This is a decrease of $250,114, or 2.60%.

Capital Assets and Debt Administration

Capital Assets

At the end of the fiscal year, the Division's investment in capital amounted to $136,854,279, which is stated net of $78,206,887 of accumulated depreciation. This investment in capital includes:

- Water plant and system
- Sewer plant and system

- Equipment
- Trucks and autos
- Office equipment and additions
- Land

During 2016, the net decrease in the Division's investment in capital assets was $984,101. In 2015, the net decrease in the Division's investment in capital assets was approximately $1,512,000. Major capital assets events during 2016 include the following:

- Increase to water plant and system of approximately $2,215,000.
- Increase to sewer plant and system of approximately $1,357,000.
- Net decrease to construction in progress of approximately $539,000.

Utility Plant, Net of Accumulated Deprecation
(Dollars in Thousands)

	June 30		
	2016	**2015**	**2014**
Water treatment plant and system	$ 91,238	$ 89,023	$ 87,559
Wastewater treatment plant and system	112,917	111,560	110,283
Land	2,280	1,306	1,279
Equipment	3,595	3,479	3,387
Trucks and autos	2,201	2,084	2,112
Office equipment	1,352	1,219	1,281
Office additions	66	66	66
Total plant in service	213,649	208,737	205,967
Accumulated depreciation	78,207	72,850	67,574
	135,442	135,887	138,393
Construction in progress	1,412	1,951	957
Net utility plant	$ 136,854	$ 137,838	$ 139,350

Long-Term Debt and Debt Administration

At the end of the fiscal year, the Division had $68,759,136 in long-term debt outstanding, which was down $2,974,610 over the prior year's $71,733,746.

The Division has seven outstanding KIA loans (final payments due in December 2022, December 2027, June 2028, December 2030, December 2032, June 2033 and November 2036), as well as owing a small long-term loan to the Electric Division for the Division's portion of pension-related debt (final payment due March 2017). Revenue bonds were issued in the 2012 fiscal year for the construction of a new general office building. Funds were issued in December 2011 and January 2012 totaling $11,035,000. That final payment is due in December 2031. The Division did a bond refunding of a portion of the 2004 bonds during the 2014 fiscal year. The refunding involved a new 2013 issuance of $5,460,000 and left a remaining balance of $930,000 on the 2004 bonds. The 2004 final payment was made December 2015. The 2013 bond final payment is due December 2024.

The City Commission must approve all debt issued. Management, however, continues to review and monitor current bond market conditions for evaluating the feasibility of restructuring any and all outstanding debt obligations if, and when, the opportunity presents itself and only after it is conclusively determined that it makes significant financial sense to pursue.

A summary of the long-term debt transactions for the years ended June 30, 2016 and 2015, and more details regarding the outstanding debt can be found in Note 5.

Economic Factors and Rates

Many economic factors are considered each year by BGMU in its efforts to operate the Division. Some of these factors and information regarding rates include:

- A rate study that analyzed projected future annual operating and maintenance expenses, necessary capital expenditures and debt requirements was performed during fiscal year 2015. The results of the study were used to recommend a rate action sufficient to recover those needs. This rate increase was approved by the Board and became effective February 1, 2015. This rate action provided systematic increases over a seven year period. Rates for BGMU customers (excluding those to WCWD) are approved by the City Commission. WCWD water rates were recalculated in fiscal year 2012 to incorporate the new water treatment plant expansion costs, with WCWD assuming a majority of the expansion-debt cost through the rate structure. Those rates went into effect as of September 2011. WCWD sewer rates were recalculated in fiscal year 2013 to incorporate the new waste-water treatment plant expansion costs and related debt service requirements. Those rates went into effect as of December 2012. Overall WCWD rates are analyzed and updated periodically. An analysis was done in fiscal year 2016. Those rates will be implemented in fiscal year 2017. The rates provided by the Division to WCWD are regulated by the Commonwealth of Kentucky's Public Service Commission.

- Employment costs: Health costs continue to rise for BGMU as they do for other employers. BGMU continues to investigate different health insurance programs to find a balance of cost efficiency and employee benefit. Rates for the current plans increased an average of 3.50% in fiscal year ended June 30, 2016. County Employees Retirement System of Kentucky (CERS), the Kentucky retirement system covering all BGMU employees, announced an increase in BGMU's contribution, which is a percentage of annual covered payroll, for the 2016 – 2017 fiscal year from 17.06% to 18.68%. The employee contribution remains 5.00%.
- Significant capital projects anticipated in the next fiscal year include:

WTP expansion design and initial construction	$	2,266,588
Water meter replacements	$	300,000
Various pump station repairs	$	607,000
Wastewater collection system projects	$	693,163
Property purchase and construction	$	1,800,000
Vehicles	$	286,500

Contacting the Division's Financial Management

This financial report is designed to provide our ratepayers, creditors, City officials and other persons with an interest in BGMU with a general overview of the Division's finances and to show the Division's accountability for the money it receives from ratepayers. If you have questions about this report or need financial information, contact the Division's chief financial officer at Bowling Green Municipal Utilities, 801 Center Street, P.O. Box 10300, Bowling Green, KY 42102-7300.

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Balance Sheets
June 30, 2016 and 2015

Assets and Deferred Outflows of Resources

	2016	2015
Current Assets		
Cash and cash equivalents	$ 5,932,531	$ 4,496,862
Accounts receivable – customers, net of allowance; 2016 and 2015 – $7,500	1,316,797	1,363,068
Accounts receivable – others	103,759	176,655
Accounts receivable – Electric Division	396,279	435,891
Current portion of long-term receivable – General Services Division	600,000	600,000
Inventories	193,475	192,674
Prepaid expenses	233,268	184,222
Total current assets	8,776,109	7,449,372
Noncurrent Cash and Investments		
Restricted cash	3,254,660	3,271,066
Restricted investments	1,788,634	1,727,873
	5,043,294	4,998,939
Utility Plant		
Utility plant in service, at cost	213,649,150	208,736,830
Construction in progress	1,412,016	1,950,901
	215,061,166	210,687,731
Accumulated depreciation	(78,206,887)	(72,849,351)
Total utility plant, net	136,854,279	137,838,380
Other Assets		
Long-term receivable – General Services Division	3,450,000	4,050,000
Long-term receivable – other	218,750	262,500
Other	87,667	161,207
	3,756,417	4,473,707
Total assets	154,430,099	154,760,398
Deferred Outflows of Resources	2,127,206	1,234,132
Total assets and deferred outflows of resources	$ 156,557,305	$ 155,994,530

Liabilities, Deferred Inflows of Resources and Net Position

	2016	2015
Current Liabilities		
Current portion of long-term debt	$ 4,261,576	$ 4,177,397
Accounts payable	767,787	1,498,207
Accrued interest payable	93,850	96,544
Accrued compensated absences	227,002	226,529
Customer deposits	100	12,040
Other current liabilities	305,408	253,900
Total current liabilities	5,655,723	6,264,617
Noncurrent Liabilities		
Net pension liability	10,081,994	7,581,385
Long-term debt, net	64,497,560	67,556,349
Accrued compensated absences	169,619	158,875
Total noncurrent liabilities	74,749,173	75,296,609
Total liabilities	80,404,896	81,561,226
Deferred Inflows of Resources	-	846,076
Net Position		
Net investment in capital assets	68,095,143	66,104,634
Restricted for debt service	5,043,294	4,998,939
Unrestricted	3,013,972	2,483,655
Total net position	76,152,409	73,587,228
Total liabilities, deferred inflows of resources and net position	$ 156,557,305	$ 155,994,530

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2016 and 2015

	2016	2015
Operating Revenues		
Metered and unmetered sales	$ 22,377,215	$ 21,600,958
Industrial sewer surcharges	487,551	422,117
Miscellaneous service revenues	181,950	180,390
Penalties – delinquent accounts	125,244	117,441
Nonutility revenues	665,270	794,201
Total operating revenues	23,837,230	23,115,107
Operating Expenses		
Purification	2,734,775	2,606,520
Distribution	1,281,258	1,341,865
Engineering	1,049,643	907,446
Customer's accounting and collections	1,043,172	1,029,965
Sewer plant and disposal	3,815,905	3,569,293
Administrative and general	5,398,332	4,709,587
Uncollectible accounts	24,071	49,304
Depreciation, excluding vehicles	5,424,627	5,384,230
Total operating expenses	20,771,783	19,598,210
Operating Income	3,065,447	3,516,897
Nonoperating Revenues (Expenses)		
Interest income	64,061	64,619
Gain (loss) on dispositions of utility plant	(6,239)	19,456
Interest expense	(1,199,145)	(1,245,698)
Net nonoperating expenses	(1,141,323)	(1,161,623)
Increase in Position, Before Capital Contributions	1,924,124	2,355,274
Capital Contributions	641,057	1,102,394
Increase in Net Position	2,565,181	3,457,668
Net Position, Beginning of Year	73,587,228	70,129,560
Net Position, End of Year	$ 76,152,409	$ 73,587,228

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Statements of Cash Flows
Years Ended June 30, 2016 and 2015

	2016	2015
Operating Activities		
Cash received from customers	$ 23,937,895	$ 23,105,812
Cash paid to suppliers and employees	(14,556,774)	(13,474,577)
Net cash provided by operating activities	9,381,121	9,631,235
Capital and Related Financing Activities		
Proceeds from capital contributions	641,057	1,102,394
Principal payments on long-term debt	(4,179,998)	(4,114,752)
Proceeds from borrowings on long-term debt	1,190,489	-
Interest paid on long-term debt	(1,186,940)	(1,236,568)
Acquisition and construction of utility plant assets	(5,079,557)	(3,925,840)
Proceeds from sale of utility plant assets	6,041	19,657
Net cash used in capital and related financing activities	(8,608,908)	(8,155,109)
Investing Activities		
Sales and redemptions of investments	10,568,644	3,247,454
Purchases of investments	(10,612,999)	(3,404,752)
Collection of note receivable	43,750	43,750
Collections of General Services Division note receivable	600,000	350,000
Interest income from General Services Division	-	275,000
Investment income	64,061	64,619
Net cash provided by investing activities	663,456	576,071
Increase in Cash and Cash Equivalents	1,435,669	2,052,197
Cash and Cash Equivalents, Beginning of Year	4,496,862	2,444,665
Cash and Cash Equivalents, End of Year	$ 5,932,531	$ 4,496,862

See Notes to Financial Statements

	2016	2015
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 3,065,447	$ 3,516,897
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	5,607,311	5,573,955
Changes in operating assets and liabilities		
Accounts receivable	158,779	364,848
Inventories	(801)	1,323
Prepaid expenses	(49,046)	(2,934)
Other assets	73,540	56,908
Deferred outflows of resources	(893,074)	280,041
Accounts payable and accrued liabilities	(235,568)	447,083
Net pension liability	2,500,609	(606,886)
Deferred inflows of resources	(846,076)	-
Net cash provided by operating activities	$ 9,381,121	$ 9,631,235
Noncash Investing, Capital and Financing Activities		
Utility plant and construction in progress in accounts payable	$ 108,767	$ 552,834

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Notes to Financial Statements
June 30, 2016 and 2015

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The Water/Sewer Division (Division) of Bowling Green Municipal Utilities (BGMU) owns and operates the water treatment and distribution system (Water System) and the wastewater collection and treatment system (Sewer System) in the City of Bowling Green, Kentucky (City). The Water System provides potable water to the citizens of the City and also is the primary source of potable water for Warren County, Kentucky via the Warren County Water District (WCWD). The Sewer System collects and treats wastewater for the citizens of the City and also collects and treats wastewater for the WCWD.

The rates and services provided by the Division to its largest customer, WCWD, are regulated by the Commonwealth of Kentucky's Public Service Commission.

Financial Reporting Division

BGMU is a municipal corporation governed by a five member board (Board). The members of the Board are appointed by the mayor subject to the approval of the City Commission. BGMU operates three distinct divisions: the Division, the Electric Division (ED) and General Services Division (GSD) (hereinafter, collectively referred to as the Utilities). These Utilities provide electric, water/sewer and fiber optic services to the residents and businesses of the City. The Board has exclusive jurisdiction and control over the construction, equipment, management and operation of BGMU. None of the operating Divisions are responsible for the debts of the other Divisions.

These financial statements represent only the Division and are not intended to present the financial position, results of operations and cash flows of the Utilities in conformity with accounting principles generally accepted in the United States of America.

These Division-only financial statements are prepared for the purpose of meeting bond financing and regulatory requirements.

BGMU is a component unit of the City. Accordingly, BGMU's financial statements are included in the City's general purpose financial statements because of BGMU's financial relationship with the City. Those relationships include:

- The Division may not issue debt without the approval of the City Commission.
- Water and sewer rates must be approved by the City Commission.
- Four of the five Board members are appointed by the mayor and approved by the City Commission. The fifth member is one of the members of the City Commission, designated by the mayor, with the approval of the board of commissioners.

Basis of Accounting and Presentation

The financial statements of the Division have been prepared on the accrual basis of accounting. All activities of the Division are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are: (a) financed and operated in a manner similar to private enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The accounting and financial reporting treatment applied to the Division is determined by its measurement focus. The transactions of the Division are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets, deferred outflows of resources, liabilities and deferred inflows of resources associated with the operations are included on the balance sheet.

Use of 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, expenses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Division considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2016 and 2015, cash equivalents consisted of a money market account with a broker.

Investments and Investment Income

Investments are reported at fair value. Fair value is determined using quoted market prices.

Investment income consists of interest and dividend income and the net change for the year in fair value of investments.

Accounts Receivable

Accounts receivable has been reported net of an allowance for uncollectible amounts, which has been provided based on management's analysis of historical trends. The Division's operating revenues are recognized on the basis of cycle billings rendered daily. If payment has not been received on or before the eighth day following the due date of the bill, all services are subject to disconnection. After all internal attempts have been made to collect, accounts are turned over to a collection agency within three months unless a payment agreement is signed. New service is denied until all outstanding balances have been settled.

Amortization of Bond Discount

Bond discount costs arising from bond issues are amortized using the effective interest method over the life of the issue.

Inventories

Inventories consist primarily of plant materials and are stated at the lower of cost or market, on an average cost method.

Compensated Absences

The Division policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments, such as social security and Medicare taxes computed using rates in effect at that date. The estimated compensated absences liability expected to be paid more than one year after the balance sheet date is included in other noncurrent liabilities.

Utility Plant

Utility plant is stated at original cost when first constructed or purchased, net of developer or governmental contributions. The cost of the current repairs and maintenance is charged to expense as incurred, while the cost of replacements and betterments is capitalized.

The Division capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowing. There was no interest capitalized during the years ended June 30, 2016 and 2015.

Depreciation

Provision for depreciation of the utility plant is computed on the straight-line method, using rates based on estimated lives as follows:

Treatment plant	40 years
Distribution and collector system	40 years
Equipment	7 years
Vehicles	5 years
Office equipment	5 years

Cost-Sharing Defined Benefit Pension Plan

The Division participates in the county employees retirement system (CERS), a component unit of the Commonwealth of Kentucky, a cost-sharing multiple-employer defined benefit pension plan (Plan). For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the Plan and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. Investments are reported at fair value.

Net Position

Net position is classified in three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is made up of noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Division, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Capital Contributions

Contributions are recognized in the statements of revenues, expenses and changes in net position when earned. Contributions include capacity 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.

Operating Revenues

The Division recognizes metered sales revenue based on cycle billings, whereby customers are billed at various dates throughout the month for water and sewer service through metering dates. Metering for the Division's largest customer, WCWD, is performed and billed at the end of each month. The Division does not accrue for unbilled revenues for water and sewer services furnished to its remaining customers from the metering dates to the end of each accounting period, a practice permitted by generally accepted accounting principles.

Income Taxes

The Division is exempt from federal and state income taxes. Accordingly, the financial statements include no provision for such taxes.

Reclassifications

Certain reclassifications have been made to the 2015 financial statements to conform to the 2016 presentation. The reclassifications had no effect on the changes in financial position.

Change in Accounting Principle

During the year ended June 30, 2016, the Division adopted Governmental Accounting Standards Board No. 27, *Fair Value Measurement and Application.* The provisions of this statement were retroactively applied and did not impact the Division's net position.

Note 2: Deposits, Investments and Investment Return

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposit may not be returned to it. The Division's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance, bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of Kentucky, bonds of any city, county, school district or special road district of the state of Kentucky or a surety bond having an aggregate value at least equal to the amount of the deposits. State law also allows uncollateralized deposits issued by any bank rated in one of the three highest categories by a nationally recognized rating agency.

At June 30, 2016 and 2015, the Division's deposits covered by federal deposit insurance or by collateral held by the bank's agent in the Division's name had a carrying amount of $4,576,607 and $3,748,442, respectively, and a bank balance of $4,879,210 and $3,796,273, respectively. At June 30, 2016 and 2015, the Division also had uncollateralized deposits with both carrying amounts and bank balances of $2,535,876 and $2,418,178, respectively, at a bank rated by Standard & Poor's (S&P) and by Moody's Investors Services (Moody's) as A, as permitted by state law.

Investments

The Division may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities, Kentucky bonds and certificates of indebtedness, highly-rated securities issued by a state or local government in the United States and certain other investments more fully described in Kentucky Revised Statutes (KRS).

At June 30, 2016 and 2015, the Division had the following investments and maturities:

	2016				
		Maturities in Years			
Type	**Fair Value**	**Less than 1**	**1 – 5**	**6 – 10**	**More than 10**
U.S. agencies obligations	$ 594,295	$ 594,295	$ -	$ -	$ -
Money market account	3,268,985	3,268,985	-	-	-
	$ 3,863,280	$ 3,863,280	$ -	$ -	$ -

	2015				
		Maturities in Years			
Type	**Fair Value**	**Less than 1**	**1 – 5**	**6 – 10**	**More than 10**
U.S. agencies obligations	$ 276,529	$ 276,529	$ -	$ -	$ -
Money market account	3,052,590	3,052,590	-	-	-
	$ 3,329,119	$ 3,329,119	$ -	$ -	$ -

Interest Rate Risk – Interest rate risk is the risk of fair value losses arising from rising interest rates. The U.S. Treasury mutual fund is presented as an investment with a maturity of less than one year because it is redeemable in full immediately. The Division does not have a formal policy to limit its interest rate risk.

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2016 and 2015, the Division's investments in U.S. agencies obligations not directly guaranteed by the U.S. Government were rated by S&P and by Moody's as AAA.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. At June 30, 2016 and 2015, the Division was not exposed to custodial credit risk.

Concentration of Credit Risk – The Division places no limit on the amount that may be invested in any one issuer. At June 30, 2016 and 2015, the Division's investments in Federal Home Loan Bank obligations constituted 15% and 8%, respectively, of its total investments.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets as follows:

	2016	2015
Carrying value		
Deposits	$ 7,112,545	$ 6,166,682
Investments	3,863,280	3,329,119
	$ 10,975,825	$ 9,495,801
Included in the following balance sheet captions		
Cash and cash equivalents	$ 5,932,531	$ 4,496,862
Noncurrent cash and investments	5,043,294	4,998,939
	$ 10,975,825	$ 9,495,801

Investment Income

Investment income for the year ended June 30, 2016 and 2015, consisted of:

	2016	2015
Interest income – investments	$ 64,061	$ 64,619

Note 3: Utility Plant

Utility plant activity for the year ended June 30, 2016 and 2015, was:

	2016				
	Beginning Balance	**Additions**	**Disposals**	**Transfers**	**Ending Balance**
Water plant	$ 89,022,905	$ 454,809	$ -	$ 1,760,064	$ 91,237,778
Sewer plant	111,587,148	68,158	(253,205)	1,515,343	112,917,444
Equipment	3,478,879	116,622	-	-	3,595,501
Trucks and autos	2,083,967	125,982	(8,850)	-	2,201,099
Office equipment	1,219,636	132,084	-	-	1,351,720
Office additions	65,716	-	-	-	65,716
Land	1,278,579	1,001,313	-	-	2,279,892
Utility plant in service	208,736,830	1,898,968	(262,055)	3,275,407	213,649,150
Construction in progress	1,950,901	2,736,522	-	(3,275,407)	1,412,016
Total utility plant	210,687,731	4,635,490	(262,055)	-	215,061,166
Accumulated depreciation	(72,849,351)	(5,607,311)	249,775	-	(78,206,887)
Utility plant, net	$ 137,838,380	$ (971,821)	$ (12,280)	$ -	$ 136,854,279

	2015				
	Beginning Balance	**Additions**	**Disposals**	**Transfers**	**Ending Balance**
Water plant	$ 87,558,975	$ 400,664	$ -	$ 1,063,266	$ 89,022,905
Sewer plant	110,283,547	348,430	-	955,171	111,587,148
Equipment	3,386,765	92,114	-	-	3,478,879
Trucks and autos	2,112,359	158,317	(186,709)	-	2,083,967
Office equipment	1,281,075	50,499	(111,938)	-	1,219,636
Office additions	65,716	-	-	-	65,716
Land	1,278,579	-	-	-	1,278,579
Utility plant in service	205,967,016	1,050,024	(298,647)	2,018,437	208,736,830
Construction in progress	956,952	3,012,386	-	(2,018,437)	1,950,901
Total utility plant	206,923,968	4,062,410	(298,647)	-	210,687,731
Accumulated depreciation	(67,573,842)	(5,573,955)	298,446	-	(72,849,351)
Utility plant, net	$ 139,350,126	$ (1,511,545)	$ (201)	$ -	$ 137,838,380

The Division allocates depreciation for vehicles to transportation expense. The amount of depreciation charged to transportation expense was $182,684 and $189,725, respectively, for years ended June 30, 2016 and 2015.

Note 4: Deferred Outflows of Resources

As of June 30, 2016, the deferred outflows of resources consisted of $1,890,047 related to pensions (see Note 7) and $237,159 related to debt refunding. The amount related to debt refunding will be recognized in interest expense using the straight-line method over the next seven years. As of June 30, 2015, the deferred outflows of resources consisted of $965,352 related to pensions (see Note 7) and $268,780 related to debt refunding.

Note 5: Long-Term Liabilities

The following is a summary of long-term debt transactions for the Division for the year ended June 30, 2016 and 2015:

	2016				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds					
Series 2004	$ 475,000	$ -	$ 475,000	$ -	$ -
Series 2011/2012	9,635,000	-	475,000	9,160,000	480,000
Series 2013	5,395,000	-	65,000	5,330,000	550,000
KIA Assistance Agreement, 2000	1,417,893	-	166,738	1,251,155	173,134
KIA Assistance Agreement, 2003	2,756,535	-	184,760	2,571,775	190,343
KIA Assistance Agreement, 2007	3,449,736	-	249,774	3,199,962	252,278
KIA Assistance Agreement, 2008	47,753,552	-	2,510,025	45,243,527	2,535,189
KIA Assistance Agreement, 2009	52,271	-	2,908	49,363	2,966
KIA Assistance Agreement, 2012	977,690	-	45,620	932,070	46,536
KIA Assistance Agreement, 2016	-	1,190,489	-	1,190,489	25,575
Pension-related debt to ED	16,466	-	5,173	11,293	5,555
	71,929,143	1,190,489	4,179,998	68,939,634	4,261,576
Less unamortized bond discount	195,397	-	14,899	180,498	-
Total long-term debt obligations	$ 71,733,746	$ 1,190,489	$ 4,165,099	$ 68,759,136	$ 4,261,576

	2015				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds					
Series 2004	$ 930,000	$ -	$ 455,000	$ 475,000	$ 475,000
Series 2011/2012	10,105,000	-	470,000	9,635,000	475,000
Series 2013	5,460,000	-	65,000	5,395,000	65,000
KIA Assistance Agreement, 2000	1,578,471	-	160,578	1,417,893	166,738
KIA Assistance Agreement, 2003	2,935,873	-	179,338	2,756,535	182,029
KIA Assistance Agreement, 2007	3,697,031	-	247,295	3,449,736	249,774
KIA Assistance Agreement, 2008	50,238,664	-	2,485,112	47,753,552	2,510,026
KIA Assistance Agreement, 2009	55,122	-	2,851	52,271	2,908
KIA Assistance Agreement, 2012	1,022,410	-	44,720	977,690	45,620
Pension-related debt to ED	21,324	-	4,858	16,466	5,302
	76,043,895	-	4,114,752	71,929,143	4,177,397
Less unamortized bond discount	210,295	-	14,898	195,397	-
Total long-term debt obligations	$ 75,833,600	$ -	$ 4,099,854	$ 71,733,746	$ 4,177,397

Revenue Bonds Payable – Series 2004

The Series 2004 revenue bonds payable, which were held by the public, consist of Water and Sewer Revenue Bonds in the original amount of $9,690,000 dated August 1, 2004, which bore interest at 2.50% to 4.625%. On December 19, 2013, the Division issued $5,460,000 in refunding revenue bonds with an average interest rate (coupon) of 2.08% to advance refund $5,310,000 of the outstanding 2004 Water and Sewer Revenue Bonds. The refunded bonds were paid on December 1, 2014, with funds held in escrow. As a result, refunded series of the 2004 Water and Sewer Revenue Bonds, in the amount disclosed, are considered to be defeased as of the issuance date and liability for those bonds removed from the financial statements in the period of defeasance. The Division advance refunded these bonds to benefit from the recent declines in interest rates and achieved an economic gain of approximately $308,000. The remaining Series 2004 bonds were payable in annual installments through December 1, 2015. The Division was required to make monthly deposits in a sinking fund for the redemption of the bonds and payment of bond interest, to maintain an appropriate balance for a debt service fund, depreciation fund and reserve fund. The bonds were secured by the net revenues of the Division and the assets restricted under the bond indenture agreement.

Revenue Bonds Payable – Series 2011/2012

The Series 2011/2012 revenue bonds payable, which are held by the public, consist of Water and Sewer Revenue Bonds in the original amount of $11,035,000 dated December 6, 2011, which bear interest at 0.60% to 3.25%. The Bonds are payable in annual installments through December 1, 2031. The Division is required to make monthly deposits in a sinking fund for the redemption of the bonds and payment of bond interest, to maintain an appropriate balance for a debt service fund, depreciation fund and reserve fund. The bonds maturing on or after December 1, 2031, are subject to redemption prior to maturity, at the option of the Division, on any date on or after April 1, 2016, in whole or in part, in inverse order of maturities and by lot within a single maturity, at a redemption price of 100% of the principal amount of the series 2011/2012 bonds called for redemption, plus accrued interest to the date of redemption. The bonds are secured by the net revenues of the Division and the assets restricted under the bond indenture agreement.

The 2011 bonds maturing on December 1, 2021, are subject to mandatory redemption on December 1 in the years and amounts as follows, at a price of 100% of the principal amount of the bonds being redeemed, plus accrued interest to the date of redemption.

Year	Principal Amount
2019	$ 355,000
2020	$ 360,000
2021	$ 370,000

The 2012 bonds maturing on December 1, 2027, are subject to mandatory redemption on December 1 in the years and amounts as follows, at a price of 100% of the principal amount of the bonds being redeemed, plus accrued interest to the date of redemption.

Year	Principal Amount
2026	$ 180,000
2027	$ 185,000
2028	$ 195,000
2029	$ 200,000
2030	$ 205,000
2031	$ 215,000

Revenue Bonds Payable – Series 2013

The Series 2013 refunding revenue bonds payable, which are held by the public, consist of Water and Sewer Revenue Bonds in the original amount of $5,460,000 dated December 19, 2013, which bear interest at 0.40% to 3.00%. The Bonds are payable in annual installments through December 1, 2024. The Division is required to make monthly deposits in a sinking fund for the redemption of the bonds and payment of bond interest, to maintain an appropriate balance for a debt service fund, depreciation fund and reserve fund. The bonds are secured by the net revenues of the Division and the assets restricted under the bond indenture agreement.

KIA Assistance Agreement, 2000

KIA Assistance Agreement (Fund F), dated August 1, 2000, in the amount of $3,049,314; funding for water treatment plant renovation, upgrade and water transmission system improvements. The loan is to be repaid in 20 years with final payment due December 1, 2022, payable semi-annually on June 1 and December 1 including interest at 3.80%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

KIA Assistance Agreement, 2003

KIA Assistance Agreement (Fund F), dated May 1, 2003, in the amount of $3,980,000; funding for water treatment plant renovation, upgrade and water transmission system improvements. The loan is to be repaid in 20 years with final payment due December 1, 2027, payable semi-annually on June 1 and December 1, including interest at 3.00%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

KIA Assistance Agreement, 2007

KIA Assistance Agreement (Fund A), dated March 1, 2007, in the amount of $5,130,000; funding for sewer line extensions and water transmission system improvements. The loan is to be repaid in 20 years with final payment due June 1, 2028, payable semi-annually on June 1 and December 1, including interest at 1.00%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

KIA Assistance Agreement, 2008

KIA Assistance Agreement (Fund A), dated December 1, 2008, KIA loan not to exceed $53,881,569; funding for the new waste water treatment facility. The loan is to be repaid in 20 years with final payment due December 1, 2032, payable semi-annually on June 1 and December 1, including interest at 1.00%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

KIA Assistance Agreement, 2009

KIA Assistance Agreement (Fund A), dated December 1, 2009, in the amount of $64,665; funding for mobile generators. The loan is to be repaid in 20 years with final payment due December 1, 2030, payable semi-annually on June 1 and December 1, including interest at 2.00%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

KIA Assistance Agreement, 2012

KIA Assistance Agreement (Fund F), dated September 1, 2012, in the amount of $1,298,680; funding for the replacement of water lines. The loan is to be repaid in 20 years with final payment due June 1, 2033, payable semi-annually on June 1 and December 1, including interest at 2.00%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

KIA Assistance Agreement, 2016

KIA Assistance Agreement (Fund C), dated January 1, 2015, in the amount of $1,599,511; funding for a piping renovation project. The loan is to be repaid in 20 years with final payment due November 1, 2036, payable monthly, including interest at 3.00%; secured by gross revenues of the Division and the assets restricted under the bond indenture agreement. The Division is required to make annual deposits in a maintenance and replacement reserve fund for extraordinary maintenance expenses or unbudgeted costs.

Pension-Related Debt

On October 1, 1997, the ED of BGMU issued revenue refunding bonds to currently refund outstanding ED bonds and to refinance $1,151,800 of outstanding pension-related debt to the CERS. The portion of the CERS pension-related debt attributable to the Division has been recorded in these financial statements using the same repayment terms as the revenue refunding bonds with a corresponding amount included in the ED's financial statements as a long-term receivable.

The debt service requirements as of June 30, 2016, are as follows:

Year Ended June 30	Interest	Principal	Total
2017	$ 998,401	$ 4,261,576	$ 5,259,977
2018	943,066	4,337,293	5,280,359
2019	882,563	4,390,106	5,272,669
2020	817,699	4,459,322	5,277,021
2021	749,911	4,519,348	5,269,259
2022 – 2026	2,673,535	22,260,130	24,933,665
2027 – 2031	1,121,607	19,056,779	20,178,386
2032 – 2036	92,256	5,622,193	5,714,449
2037	245	32,887	33,132
	$ 8,279,283	$ 68,939,634	$ 77,218,917

During the years ended June 30, 2016 and 2015, additions to long-term compensated absences for the Division totaled $59,720 and $48,840, respectively, while deductions totaled $48,976 and $32,793, respectively.

Note 6: Related-Party Transactions

BGMU is composed of three Utilities. Shared office facilities are owned by the Division and charged monthly to the ED and GSD. In addition, joint purchases and other routine services are performed by or for the Division. Outstanding receivables or payables between Utilities of BGMU are generally satisfied on a monthly basis or specific terms.

	2016	2015
Balances		
Current note receivable from GSD	$ 600,000	$ 600,000
Long-term note receivable from GSD	$ 3,450,000	$ 4,050,000
Current receivable from GSD	$ 4,477	$ 11,039
Current receivable from ED	$ 396,279	$ 435,891
Current payable to ED	$ (5,555)	$ (5,302)
Long-term payable to ED	$ (5,738)	$ (11,164)
Transactions		
Rent income from ED	$ 372,000	$ 372,000
Rent income from GSD	$ 20,160	$ 20,040
Utility sales to ED	$ 9,995	$ 12,950
Utility purchases from ED and GSD	$ 1,590,596	$ 1,662,514
Rent income from ED (for computer and radio usage)	$ 44,592	$ 54,238
Interest received from GSD	$ -	$ 275,000

Note 7: Pension Plan

Plan Description

The Division contributes to the nonhazardous CERS, a component unit of the Commonwealth of Kentucky, a cost-sharing multiple-employer defined benefit pension plan covering substantially all employees. The Plan is administered by a Board of Trustees appointed by the KRS. Benefit provisions are contained in the Plan Document and were established and can be amended by action of the KRS's governing body. The Plan issues a publicly available financial report that can be obtained at www.kyret.ky.gov.

Benefits Provided

Nonhazardous	Tier 1 Participation Prior to September 1, 2004	Tier 2 Participation September 1, 2008 Through December 31, 2013	Tier 3 Participation on or After January 1, 2014
Benefit Formula	Final Compensation X Benefit Factor X Years of Service		Cash balance plan
Final Compensation	Average of the highest five fiscal years (must contain at least 48 months). Includes lump-sum compensation payments (before and at retirement).	Five complete fiscal years immediately preceding retirement; each year must contain 12 months. Lump-sum compensation payments (before and at retirement) are not to be included in creditable compensation.	No final compensation
Benefit Factor	2.2% if the participation date was before August 1, 2004, or 2.0% if participation date was after August 1, 2004.	10 years or less = 1.10%. Greater than 10 years, but no more than 20 years = 1.30%. Greater than 20 years, but not more than 26 years = 1.50%. Greater than 26 years, but no more than 30 years = 1.75%. Additional years above 30 = 2.00% (2.00% benefit factor only applies to service earned in excess of 30 years).	No benefit factor. A life annuity can be calculated in accordance with actuarial assumptions and methods adopted by the board based on member's accumulated account balance.
Cost of Living Adjustment (COLA)	No COLA unless authorized by the Legislature. If authorized, COLA is limited to 1.5%. This impacts all retirees regardless of Tier.		
Unreduced Retirement Benefit	Any age with 27 years of service. Age 65 with 48 months of service. Money purchase for age 65 with less than 48 months based on contributions and interest.	Rule of 87: Member must be at least age 57 and age plus earned service must equal 87 years at retirement to retire under this provision. Age 65 with 5 years of earned service. No money purchase calculations.	
Reduced Retirement Benefit	Any age with 25 years of service. Age 55 with 5 years of service.	Age 60 with 10 years of service. Excludes purchased service (exception: refunds, omitted, free military).	No reduced retirement benefit

Contributions

The KRS Board of Trustees determines CERS employer contribution rates necessary for the actuarial soundness of KRS as required by KRS 61.565 and 61.702. Those rates can be altered by legislation enacted by the Kentucky General Assembly. Employees are required to contribute 5% of their annual pay. Employees with a participation date after September 1, 2008, are required to contribute an additional 1% of their annual pay for retiree health care benefits. The Division's contractually required contribution rate applied to pension (12.42% and 12.75%) and insurance (4.64% and 4.92%) for the years ended June 30, 2016 and 2015, was 17.06% and 17.67%, respectively, of annual payroll, actuarially determined as an amount that, when combined with employee contributions, is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. For the years ended June 30, 2016 and 2015, contributions to the pension plan from the Division were $676,886 and $696,561, respectively.

Pension Liabilities, Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2016 and 2015, the Division reported a liability of $10,081,994 and $7,581,385, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015 and 2014, respectively, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of those dates. BGMU's proportion of the net pension liability was based on a projection of the Division's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2016 and 2015, BGMU's proportion was 0.499271% and 0.498258%, respectively. The Division's proportion of BGMU's net pension liability was based on the Division's share of contributions relative to the contributions of all three divisions of BGMU.

For the years ended June 30, 2016 and 2015, the Division recognized pension expense of $1,406,724 and $606,886, respectively. At June 30, 2016 and 2015, the Division reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on pension plan investments	$ 95,638	$ -
Difference between expected and actual experience	84,148	-
Change of assumptions	1,021,060	-
Changes in proportion and differences between employer contributions and proportionate share of contributions	12,315	-
Division's contributions subsequent to the measurement date	676,886	-
Total	$ 1,890,047	$ -

	2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on pension plan investments	$ -	$ 846,076
Division's contributions subsequent to the measurement date	965,352	-
Total	$ 965,352	$ 846,076

At June 30, 2016 and 2015, the Division reported $676,886 and $965,352, respectively, as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date that will be recognized as a reduction of the net pension liability in the following year. Other amounts reported as deferred outflows of resources and deferred inflows of resources at June 30, 2016, related to pensions will be recognized in pension expense as follows:

2017	$ 414,615
2018	414,615
2019	196,453
2020	187,478
	$ 1,213,161

Actuarial Assumptions

The total pension liability in the June 30, 2015, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	4.00% average, including inflation
Investment rate of return	7.50% net of pension plan investment expense, including inflation

Mortality rates were based on the RP-200 Combined Mortality Table projected with Scale BB to 2013 for active members, RP-2000 Combined Mortality Table projected with Scale BB to 2013 for healthy retired members and beneficiaries and RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 for the period after disability retirement.

The actuarial assumptions used in the June 30, 2015, valuation were based on the results of an actuarial experience study for the period July 1, 2008, through June 30, 2013. The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for KRS. The most recent analysis performed for the period covering fiscal years 2008 through 2013 is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans, which covers a longer time frame. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption or a fundamental change in the market that alters expected returns in future years. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Combined equity	44%	5.4
Combined fixed income	19%	1.5
Real return (diversified inflation strategies)	10%	3.5
Real estate	5%	4.5
Absolute return (diversified hedge funds)	10%	4.25
Private equity	10%	8.5
Cash equivalent	2%	(0.25)
Total	100%	

Discount Rate

The discount rate used to measure the total pension liability was 7.50% for the year ended June 30, 2016. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that participating employer contributions will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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

The Division's proportionate share of the net pension liability has been calculated using a discount rate of 7.50%. The following presents the Division's proportionate share of the net pension liability calculated using a discount rate 1% higher and 1% lower than the current rate.

1% Decrease	Current Discount Rate	1% Increase
$ 12,870,918	$ 10,081,994	$ 7,693,529

Pension Plan Fiduciary Net Position

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

Payable to the Pension Plan

At June 30, 2016 and 2015, the Division reported a payable of $57,215 and $75,666, respectively, for the outstanding amount of contributions to the pension plan required for the years ended June 30, 2016 and 2015, that were remitted in July 2016 and 2015.

Note 8: Postemployment Health Care Plan

Plan Description

The Division contributes to the nonhazardous, CERS, a cost-sharing multiple-employer defined benefit postretirement health care plan (insurance fund) administered by an agency of the Commonwealth of Kentucky. The plan provides medical insurance benefits to eligible retirees and their spouses. State law assigns the authority to establish and amend benefit provisions to the plan's Board of Trustees, which is appointed by the Governor with the approval of the State Legislature. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601 or by calling 502.564.4646.

Funding Policy

Benefit and contribution rates are established by state stature. Per KRS 61.565, contribution requirements of the active employees and the participating organizations are established and may be amended by the KRS board. Employees are required to contribute 5% of their annual pay. Employees with a participation date after September 1, 2008, are required to contribute an additional 1% of their annual pay for retiree health care benefits. The Division's contractually required contribution rate applied to pension (12.42% and 12.75%) and insurance (4.64% and 4.92%) for the years ended June 30, 2016 and 2015, was 17.06% and 17.67%, respectively, of annual payroll. Employer contributions are actuarially determined as an amount that, when combined with employee contributions, are expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. For the years ended June 30, 2016 and 2015, contributions to the insurance fund from the Division were $255,141 and $268,791, respectively.

Note 9: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Recurring Measurements

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying financial statements measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2016 and 2015:

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2016				
U.S. agencies obligations	$ 594,295	$ -	$ 594,295	$ -
Money market account	3,268,985	3,268,985	-	-
	$ 3,863,280	$ 3,268,985	$ 594,295	$ -
June 30, 2015				
U.S. agencies obligations	$ 276,529	$ -	$ 276,529	$ -
Money market account	3,052,590	3,052,590	-	-
	$ 3,329,119	$ 3,052,590	$ 276,529	$ -

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

Note 10: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

General Litigation

The Division is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Division.

Note 11: Risk Management

The Division is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, business interruption, errors and omissions, employee injuries and illnesses, natural disasters and employee health and accident benefits.

The Division carries commercial insurance coverage for all risks of loss, including workers' compensation and natural disasters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Note 12: Segment Information

Available segment information for the Division for the years ended June 30, 2016 and 2015, follows:

	2016		
	Water	Sewer	Total
Operating revenues	$ 11,243,237	$ 12,593,993	$ 23,837,230
Operating expenses	$ 10,492,759	$ 10,279,024	$ 20,771,783
Operating income	$ 750,478	$ 2,314,969	$ 3,065,447
Increase in net position before capital contributions	$ 197,717	$ 1,726,407	$ 1,924,124

	2015		
	Water	Sewer	Total
Operating revenues	$ 11,173,827	$ 11,941,280	$ 23,115,107
Operating expenses	$ 9,813,833	$ 9,784,377	$ 19,598,210
Operating income	$ 1,359,994	$ 2,156,903	$ 3,516,897
Increase in net position before capital contributions	$ 799,302	$ 1,555,972	$ 2,355,274

The Division does not separately account for the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the two segments.

Note 13: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued.

Required Supplementary Information

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of the Division's Proportionate Share of the Net Pension Liability
County Employees Retirement System of the State of Kentucky
Last 10 Fiscal Years

	2016	2015
Division's proportion of the net pension liability	0.2355%	0.2337%
Division's proportionate share of the net pension liability	$ 10,081,994	$ 7,581,385
Division's covered – employee payroll	$ 5,449,971	$ 5,463,226
Division's proportionate share of the net pension liability as a percentage of its covered – employee payroll	184.99%	138.77%
Plan fiduciary net position as a percentage of the total pension liability	59.97%	66.80%

Note to Schedule: This schedule is intended to show a 10-year trend. Additional years will be reported as they become avaliable.

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Division's Contributions
County Employees Retirement System of the State of Kentucky
Last 10 Fiscal Years

	2016	2015
Contractually required contribution	$ 676,886	$ 696,561
Contribution in relation to the contractually required contribution	676,886	696,561
Contribution deficiency (excess)	$ -	$ -
Division's covered – employee payroll	$ 5,449,971	$ 5,463,226
Contributions as a percentage of covered – employee payroll	12.42%	12.75%

Note to Schedule: This schedule is intended to show a 10-year trend. Additional years will be reported as they become avaliable.

Supplementary Information

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Investments and Restricted Funds
June 30, 2016 and 2015

	2016	2015
Water/Sewer Debt Service Fund		
Investments/cash	$ 1,405,352	$ 1,402,779
Invested Sinking Fund		
Investments/cash	1,023,588	922,318
Water/Sewer Depreciation Fund		
Investments/cash	1,500,624	1,504,405
Maintenance and Replacement Reserve		
Investments/cash	1,113,730	1,169,437
	$ 5,043,294	$ 4,998,939

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Revenues and Expenses – Water Segment
Years Ended June 30, 2016 and 2015

Water Segment

	2016	2015
Operating Revenues		
Metered and unmetered sales	$ 10,592,540	$ 10,433,762
Miscellaneous service revenues	185,830	189,370
Penalties – delinquent accounts	54,128	51,263
Nonutility revenues	410,739	499,432
Total operating revenues	11,243,237	11,173,827
Operating Expenses		
Purification	2,734,775	2,606,520
Distribution	1,281,258	1,341,865
Engineering	610,852	503,265
Customers accounting and collection	528,946	517,255
Administrative and general	2,948,404	2,483,517
Uncollectible accounts	8,178	26,076
Depreciation, excluding vehicles	2,380,346	2,335,335
Total operating expenses	10,492,759	9,813,833
Operating income	750,478	1,359,994
Other Income (Expenses)		
Interest income	44,952	37,767
Gain (loss) on disposition of utility plant	(3,120)	9,728
Interest expense	(594,593)	(608,187)
Net other expenses	(552,761)	(560,692)
Increase in Net Position, Before Capital Contributions	$ 197,717	$ 799,302

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Revenue and Expenses – Sewer Segment
Years Ended June 30, 2016 and 2015

Sewer Segment

	2016	2015
Operating Revenues		
Metered and unmetered sales	$ 11,784,675	$ 11,167,196
Industrial sewer surcharges	487,551	422,117
Penalties – delinquent accounts	71,116	66,178
Nonutility revenues	250,651	285,789
Total operating revenues	12,593,993	11,941,280
Operating Expenses		
Customers accounting and collection	514,226	512,710
Engineering	438,791	404,181
Sewer plant and disposal	3,815,905	3,569,293
Administrative and general	2,449,927	2,226,070
Uncollectible accounts	15,894	23,228
Depreciation	3,044,281	3,048,895
Total operating expenses	10,279,024	9,784,377
Operating income	2,314,969	2,156,903
Other Income (Expenses)		
Interest income	19,109	26,852
Gain (loss) on disposition of utility plant	(3,119)	9,728
Interest expense	(604,552)	(637,511)
Net other expenses	(588,562)	(600,931)
Increase in Net Position, Before Capital Contributions	$ 1,726,407	$ 1,555,972

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Selected Expense Categories
Years Ended June 30, 2016 and 2015

	2016	2015
Purification Expenses		
Supervision and labor	$ 1,089,535	$ 1,105,418
Supplies and expense	73,146	53,079
Chemicals	710,577	653,864
Repairs to structure	95,025	71,102
Repairs to equipment	136,732	43,986
Electric power purchased	607,811	638,479
Miscellaneous expense	21,949	40,592
	$ 2,734,775	$ 2,606,520
Distribution Expenses		
Supervision and labor	$ 1,088,336	$ 1,097,317
Repairs to distribution lines	5,419	8,746
Repairs to and changing mains	34,343	53,507
Repairs to service lines	48,170	66,729
Repairs to customer meters	12,644	13,164
Electric power purchased	61,372	59,847
Miscellaneous expense	30,974	42,555
	$ 1,281,258	$ 1,341,865
Engineering Expenses		
Supervision and labor	$ 810,036	$ 762,670
Supplies and expense	11,242	15,006
Transportation	66,331	74,058
Software systems	101,418	36,409
Outside services	60,616	19,303
	$ 1,049,643	$ 907,446
Customers Accounting and Collections		
Supervision and labor	$ 647,370	$ 641,899
Supplies and expense	203,307	197,409
Equipment rent and maintenance	192,495	190,657
	$ 1,043,172	$ 1,029,965

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Selected Expense Categories (Continued)
Years Ended June 30, 2016 and 2015

	2016	2015
Sewer Plant and Disposal Expenses		
Supervision and labor	$ 1,617,876	$ 1,584,765
Supplies and expense	26,052	38,364
Sludge hauling	434,767	141,141
Chemicals	486,172	398,241
Power purchased	850,713	1,031,942
Repairs to structure	7,555	5,102
Repairs to equipment	191,937	162,866
Repairs to service lines	59,253	81,689
Repairs to mains	33,987	31,714
Repairs to interceptor lines	90,971	74,525
Miscellaneous expenses	16,622	18,944
	$ 3,815,905	$ 3,569,293
Administrative and General Expenses		
Management and administrative salaries – Water	$ 381,460	$ 382,017
Management and administrative salaries – Sewer	383,583	383,125
Insurance – Water	192,257	202,976
Insurance – Sewer	185,813	289,568
Transportation – Water	2,702	4,854
Transportation – Sewer	3,552	4,991
Other general expense – Water	153,622	176,737
Other general expense – Sewer	155,325	178,425
Payroll taxes – Water	215,623	215,828
Payroll taxes – Sewer	175,641	176,644
Professional services	57,714	127,099
Office rent – ED	28	-
Equipment rent and maintenance	397,158	476,402
Employee benefits – Water	1,611,523	1,021,273
Employee benefits – Sewer	1,265,390	857,925
Paying agent fees – Water	391	750
Paying agent fees – Sewer	391	750
Gross receipts tax	216,159	210,223
	$ 5,398,332	$ 4,709,587

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Interest Income
Years Ended June 30, 2016 and 2015

	2016	2015
2011/2012 Debt Service Fund	$ 2,691	$ 5,443
Invested Sinking Fund – Bonds	10,507	9,148
KIA Waste Water Project Reserve Fund/		
2004 Bond Construction Fund	48,548	48,164
Water/Sewer Operating Fund	1,565	1,110
Water/Sewer Depreciation Fund	750	754
	$ 64,061	$ 64,619

Water/Sewer Division
of Bowling Green Municipal Utilities
A Component Unit of the City of Bowling Green, Kentucky
Schedule of Interest Expense
Years Ended June 30, 2016 and 2015

	2016	2015
Interest on long-term debt	$ 1,199,145	$ 1,245,698

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Directors
Bowling Green Municipal Utilities
Bowling Green, Kentucky

We have audited, 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, the financial statements of the Water/Sewer Division (Division), a division of Bowling Green Municipal Utilities, which is a component unit of the City of Bowling Green, Kentucky, which comprise the balance sheets as of June 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements, and have issued our report thereon dated September 30, 2016, which contained an *Emphasis of Matter* paragraph regarding divisional reporting.

Internal Control Over Financial Reporting

Management of the Division is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the Division's 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 Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Division'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 as defined above. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

We noted certain matters that we reported to the Division's management in a separate letter dated September 30, 2016.

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 Division'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 Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Bowling Green, Kentucky
September 30, 2016