

GRAHAM COUNTY UTILITIES, INC.

PIMA, ARIZONA

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

LUBBOCK, TEXAS

GRAHAM COUNTY UTILITIES, INC.

PIMA, ARIZONA

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

**GRAHAM COUNTY UTILITIES, INC.
PIMA, ARIZONA**

**FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015**

TABLE OF CONTENTS

	<u>Statement Identification</u>	<u>Page No.</u>
Independent Auditor's Report		1
Financial Statements		
Balance Sheets	Exhibit A	3
Statements of Income and Accumulated Deficits	Exhibit B	4
Statements of Cash Flows	Exhibit C	5
Notes to Financial Statements		6
Accompanying Information		
Individual Department – Financial Statements		
Gas Department		
Balance Sheets	Schedule 1	15
Statements of Income and Accumulated Deficits	Schedule 2	16
Statements of Cash Flows	Schedule 3	17
Water Department		
Balance Sheets	Schedule 4	18
Statements of Income and Accumulated Margins	Schedule 5	19
Statements of Cash Flows	Schedule 6	20
Compliance and Internal Control Section		
Letter to Board of Directors Regarding Policies Concerning Audits of CFC Borrowers		21
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 <i>Government Auditing Standards</i>		22
Schedule of Findings and Responses		24

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

PHONE: (806) 747-3806

FAX: (806) 747-3815

8215 NASHVILLE AVENUE

LUBBOCK, TEXAS 79423-1954

Independent Auditor's Report

Board of Directors
Graham County Utilities, Inc.
Pima, Arizona

Report on the Financial Statements

We have audited the accompanying balance sheets of Graham County Utilities, Inc. (the Cooperative), as of September 30, 2016 and 2015, and the related statements of income and accumulated margins (deficits) 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 Graham County Utilities, Inc. as of September 30, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Accompanying Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The department financial statements are presented for purpose of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated December 21, 2016, on our consideration of the Cooperative's internal control over financial reporting and on our test of its compliance with certain provision 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* and in considering the Cooperative's internal control over financial reporting and compliance.

Bolinger, Segars, Gilbert & Moss L.L.P.

Certified Public Accountants

Lubbock, Texas

December 21, 2016

GRAHAM COUNTY UTILITIES, INC.

Exhibit A

BALANCE SHEETS
SEPTEMBER 30, 2016 AND 2015

ASSETS

	September 30,	
	2016	2015
UTILITY PLANT		
Plant in Service	\$ 9,272,787	\$ 9,023,160
Construction Work in Progress	(14,302)	(19,168)
Plant Acquisition Adjustment	1,025,652	1,025,652
	\$ 10,284,137	\$ 10,029,644
Less: Accumulated Provision for Depreciation and Amortization	6,058,540	5,793,098
	\$ 4,225,597	\$ 4,236,546
OTHER PROPERTY AND INVESTMENTS		
Investments in Associated Organizations	\$ 288,431	\$ 279,741
CURRENT ASSETS		
Cash - Restricted	\$ 86,581	\$ 80,889
Accounts Receivable (Less allowance for uncollectibles of \$46,942 in 2016 and \$49,603 in 2015)	140,460	89,700
Underbilled Consumers Fuel Cost		
Materials and Supplies	139,877	151,899
Other Current and Accrued Assets	22,173	21,751
Total Current Assets	\$ 389,091	\$ 344,239
DEFERRED CHARGES	\$ 9,139	\$ 13,709
TOTAL ASSETS	\$ 4,912,258	\$ 4,874,235

EQUITIES AND LIABILITIES

MEMBERS' EQUITY		
Memberships	\$ 32,015	\$ 31,950
Accumulated Deficits	(332,634)	(154,086)
	\$ (300,619)	\$ (122,136)
LONG -TERM DEBT		
CFC Mortgage Notes Less Current Maturities	\$ 1,377,363	\$ 1,435,440
USDA Rural Development Note Payable Less Current Maturities	1,345,796	1,376,945
Note Payable - Graham County Electric Coop	669,218	759,986
	\$ 3,392,377	\$ 3,572,371
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 175,270	\$ 163,180
Accounts Payable - Other	116,807	122,377
Accounts Payable - Graham County Electric Coop	1,152,746	812,706
Overbilled Consumers Fuel Cost	128,226	41,245
Customers' Deposits and Prepayments	145,087	145,731
Accrued Taxes	80,541	82,893
Accrued Interest	19,130	15,531
Accrued Payroll	2,693	40,337
Total Current Liabilities	\$ 1,820,500	\$ 1,424,000
TOTAL EQUITIES AND LIABILITIES	\$ 4,912,258	\$ 4,874,235

See accompanying notes to financial statements.

GRAHAM COUNTY UTILITIES, INC.

Exhibit B

STATEMENTS OF INCOME AND ACCUMULATED DEFICITS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015

	September 30,	
	2016	2015
OPERATING REVENUES	\$ 3,897,702	\$ 3,817,132
OPERATING EXPENSES		
Purchased Gas	\$ 1,072,163	\$ 1,121,480
Power for Pumping	26,110	35,775
Operations	614,539	547,593
Maintenance	702,514	493,450
Consumer Accounts	463,444	427,763
Administrative and General	717,934	706,205
Depreciation and Amortization	265,442	255,892
Other Interest	33,758	32,795
Total Operating Expenses	\$ 3,895,904	\$ 3,620,953
OPERATING MARGINS - BEFORE FIXED CHARGES	\$ 1,798	\$ 196,179
Interest on Long-Term Debt	191,348	200,650
OPERATING MARGINS (LOSS) - AFTER FIXED CHARGES	\$ (189,550)	\$ (4,471)
Capital Credits	10,705	8,246
NET OPERATING MARGINS	\$ (178,845)	\$ 3,775
NONOPERATING MARGINS		
Interest	297	313
NET MARGINS (DEFICIT)	\$ (178,548)	\$ 4,088
ACCUMULATED DEFICIT - BEGINNING OF YEAR	(154,086)	(158,174)
ACCUMULATED DEFICIT - END OF YEAR	\$ (332,634)	\$ (154,086)

See accompanying notes to financial statements.

GRAHAM COUNTY UTILITIES, INC.

Exhibit C

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015

	September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margin (Deficit)	\$ (178,548)	\$ 4,088
Adjustments to Reconcile Net Margins to Net Cash From Operating Activities		
Depreciation and Amortization	265,442	255,892
Capital Credits - Noncash	(10,705)	(8,246)
Underbilled Fuel Cost	86,981	60,550
Deferred Charges	4,570	12,150
Deferred Credits		
Accounts Receivable	(50,760)	(18,303)
Inventories and Other Current Assets	11,600	(15,040)
Payables and Accrued Expenses	(42,611)	51,837
Net Payments (To) From - Graham County Electric Cooperative	340,040	(42,507)
Net Cash From Operating Activities	\$ 426,009	\$ 300,421
 CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to Plant	\$ (254,493)	\$ (157,911)
Cash - Restricted	(5,692)	(5,610)
Investments in Associated Organizations	2,015	20,919
Net Cash From Investing Activities	\$ (258,170)	\$ (142,602)
 CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt To CFC	\$ (52,077)	\$ (48,822)
Payments on Long-Term Debt To USDA	(29,849)	(27,937)
Payments on Notes Payable - GCE	(85,978)	(81,435)
Memberships	65	375
Net Cash From Financing Activities	\$ (167,839)	\$ (157,819)
 CHANGE IN CASH	\$ 0	\$ 0
CASH - BEGINNING OF YEAR	0	0
CASH - END OF YEAR	\$ 0	\$ 0
 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Paid During the Year for:		
Interest on Long-Term Debt	\$ 191,348	\$ 200,485
Federal Income Tax	\$ 0	\$ 0

See accompanying notes to financial statements.

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Graham County Utilities, Inc. (the Cooperative) is organized as a cooperative to provide gas and water utility services to customers in Graham County, Arizona. The Cooperative was incorporated February 14, 1989, and began operations in November, 1989, with the purchase of assets and liabilities from two private utility companies. The Cooperative has been granted exemption from federal income taxes under Internal Revenue Code Section 501(c)(12).

Basis of Accounting

The Cooperative accounts for assets, liabilities, income, and expenses separately for each utility service furnished. Separate accounting is maintained for the gas department and the water department.

Recognition is given to all services rendered and facilities provided by each department, as well as those services provided by Graham County Electric Cooperative, Inc. under the operating and management agreement executed by both Cooperatives. These services are billed at predetermined rates. The accrual basis of accounting is followed in all departments.

Operating Revenues

Gas and water revenues are under the jurisdiction of the Arizona Corporation Commission.

The Cooperative records revenues as billed to the customers on a monthly basis. Revenue is not accrued for utility services delivered but not billed at the end of each month. The unbilled and unrecorded revenue at September 30, 2016 and 2015, was estimated to be \$75,827 and \$73,613, respectively, in the gas department and \$50,688 and \$55,702, respectively, in the water department. A recent FASB pronouncement related to revenue recognition will require the Cooperative to recognize unbilled revenue in future financial statements. The requirement is effective for annual reporting periods beginning after December 15, 2018.

The Cooperative's tariffs include an adjustment for flow-through of purchased natural gas costs. In order to match fuel costs and related revenues, costs billed in advance are recorded as overbilled consumers fuel cost and costs to be billed in the subsequent period are recorded as underbilled consumers fuel cost. For the year ended September 30, 2016 the Cooperative was overbilled \$128,226, and for September 30, 2015, the Cooperative was overbilled \$41,245.

Group Concentration of Credit Risk

The Cooperative's headquarters is located in Pima, Arizona. The service area includes members located in Graham County, Arizona, and also includes retail service to the towns of Pima and Ft. Thomas, and wholesale services to Eden Water Company. The Cooperative records a receivable for gas and water service as billed on a monthly basis. The Cooperative requires a deposit from customers upon connection which is applied to any unpaid bills upon default. The deposit accrues interest annually at the rate of six percent. Deposits on hand totaled \$145,087 and \$145,731 at September 30, 2016 and 2015, respectively.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificate.

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

Inventories

Inventories which consist of construction materials and supplies are valued at average unit cost.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents are represented by Cash – General.

Restricted Cash

As part of its agreement for loan funding from USDA Rural Development, the Cooperative is required to accumulate a cash reserve fund. The fund balance at September 30, 2016 and 2015 was \$86,581 and \$80,889, respectively. The cash reserve fund was in compliance with funding requirements as of September 30, 2016.

Federal Income Tax Status

The Cooperative qualifies for tax exempt status under Internal Revenue Code section 501(c)(12) with more than 85% of income consisting of amounts received from members.

The Cooperative has adopted the “uncertain tax positions” provisions of accounting principles generally accepted in the United States of America. The primary tax position of the Cooperative is its filing status as a tax exempt entity. The Cooperative determined that it is more likely than not that its tax position will be sustained upon examination by the Internal Revenue Service (IRS), or other state taxing authority and that all tax benefits are likely to be realized upon settlement with taxing authorities.

The Cooperative files income tax returns in the U.S. federal jurisdiction. The Cooperative is no longer subject to U.S. federal and state income tax examinations by federal taxing authorities for years before 2012.

The Cooperative recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. There were no penalties or interest recognized during the years ended September 30, 2016 and 2015.

Allowance for Uncollectible Accounts

The Cooperative uses the aging method to allow for uncollectible accounts receivable. During the year, management makes an evaluation of past due accounts to determine collection ability. The accounts deemed uncollectible are written off upon approval by the Board of Directors.

Use of Estimates in the Preparation of Financial Statements

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.

2. Assets Pledged

All assets are pledged as security for the long-term debt due the National Rural Utilities Cooperative Finance Corporation (CFC) and USDA.

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

3. Utility Plant and Depreciation

Utility plant is stated at the original cost of construction including the construction costs incurred by the utility from which the Cooperative acquired plant in November 1989. Original cost includes the cost of contracted services, direct labor, materials, and overhead reduced by contributions in aid to construction received in connection with new construction.

Maintenance and repairs including the renewal of minor items of plant not comprising a retirement unit are charged to the appropriate maintenance accounts.

Major classes of utility plant are summarized as follows:

	September 30,			
	2016			2015
	Gas Department	Water Department	Total	Total
Utility Plant in Service				
Intangible	\$ 42,522	\$ 37,708	\$ 80,230	\$ 80,230
Production		1,795,519	1,795,519	1,791,848
Transmission		1,119,615	1,119,615	1,113,915
Distribution	5,007,959	979,161	5,987,120	5,772,087
General	244,524	21,856	266,380	241,157
Land and Land Rights	1,416	22,507	23,923	23,923
Total Plant in Service	\$ 5,296,421	\$ 3,976,366	\$ 9,272,787	\$ 9,023,160
Construction Work in Progress	(41)	(14,261)	(14,302)	(19,168)
Utility Plant Acquisition Adjustment	415,484	610,168	1,025,652	1,025,652
Total Utility Plant	\$ <u>5,711,864</u>	\$ <u>4,572,273</u>	\$ <u>10,284,137</u>	\$ <u>10,029,644</u>

Provision has been made for depreciation on straight-line composite rates as follows:

	Gas Department	Water Department
Production		2.34% - 5.05%
Transmission		2.20% - 4.00%
Distribution		4.00% - 20.00%
Gas Mains	2.80%	
Services	4.10%	
Meters - Regulators	2.60%	
Structures	2.30%	
General	6.70% - 13.30%	10.00% - 20.00%

Depreciation accruals charged to expense for the periods ended September 30, 2016 and 2015, totaled \$265,442 and \$255,892, respectively.

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

A plant acquisition adjustment was created when the Cooperative purchased the assets and liabilities of City Utilities, Inc. and General Utilities, Inc. The acquisition adjustment, representing the amount of the purchase price over the book value of the net assets acquired, amounted to \$415,484 in the gas department and \$610,168 in the water department. Plant acquisition adjustments are amortizable over the estimated useful life of the plant acquired. The Cooperative has elected to amortize these costs over a 25-year period. The annual charge to depreciation and amortization expense is \$16,620 in the gas department and \$24,407 in the water department. For the years ended September 30, 2016 and 2015, the amortization of the acquisition adjustment was \$0 and \$0, respectively.

The plant acquisition costs and related provision for amortization at September 30, 2016, are summarized as follows:

	<u>Gas Department</u>	<u>Water Department</u>
Acquisition Adjustment	\$ 415,484	\$ 610,168
Less: Amortization Prior Periods	<u>415,484</u>	<u>610,168</u>
Unamortized Adjustment	<u><u>\$ 0</u></u>	<u><u>\$ 0</u></u>

4. Investments in Associated Organizations

Investments in associated organizations consisted of the following:

	<u>September 30,</u>	
	<u>2016</u>	<u>2015</u>
CFC		
Capital Term Certificates	\$ 131,378	\$ 133,000
Patronage Capital	129,531	121,550
Memberships	<u>1,000</u>	<u>1,000</u>
	\$ 261,909	\$ 255,550
Graham County Electric Cooperative, Inc.		
Patronage Capital	<u>26,522</u>	<u>24,191</u>
Total	<u><u>\$ 288,431</u></u>	<u><u>\$ 279,741</u></u>

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

5. Deferred Charges

Deferred charges consisted of the following:

	September 30,	
	<u>2016</u>	<u>2015</u>
Gas Department		
Unamortized Rate Case Expense	\$ <u>9,139</u>	\$ <u>13,709</u>
Water Department		
Unamortized Debt Expense	\$ <u>0</u>	\$ <u>0</u>
Total	\$ <u><u>9,139</u></u>	\$ <u><u>13,709</u></u>

During 1998, the Cooperative converted a CFC note to a lower interest rate of 7.1% for 15 years with a conversion fee of \$109,457. Amortization expense for the years ended September 30, 2016 and 2015, is \$0 and \$4,159, respectively.

6. Memberships

Memberships are comprised of the following:

	September 30,	
	<u>2016</u>	<u>2015</u>
Class A Memberships		
Graham County Electric Cooperative, Inc., Entitled to One Vote	\$ 5,000	\$ 5,000
Class B Memberships		
All Qualified Members of Graham County Electric Cooperative, Inc., \$5 Membership Fee Entitled to One Vote per Membership	22,345	22,280
Class C Memberships		
All Others Who Receive Service, \$5 Membership Fee, Entitled to One Vote Per Membership	<u>4,670</u>	<u>4,670</u>
	\$ <u><u>32,015</u></u>	\$ <u><u>31,950</u></u>

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

7. Accumulated Margins (Deficits)

This balance consists of net margins or (losses) as follows:

Calendar Year	<u>Gas Department</u>	<u>Water Department</u>	<u>Total</u>
1989	\$ 6,702	\$ (694)	\$ 6,008
1990	(14,127)	2,845	(11,282)
1991	(91,410)	(23,047)	(114,457)
1992	(41,115)	(13,851)	(54,966)
1993	(64,937)	5,077	(59,860)
1994	(46,268)	26,495	(19,773)
1995	(172,043)	(28,603)	(200,646)
1996	(68,293)	(3,409)	(71,702)
1997	(65,806)	(23,095)	(88,901)
1998	225,309	31,474	256,783
1999	97,405	62,256	159,661
2000	1,467	46,927	48,394
2001	39,062	40,741	79,803
2002	61,124	1,126	62,250
2003	(5,764)	69,524	63,760
2004	62,759	7,767	70,526
2005	92,446	47,242	139,688
2006	141,801	42,157	183,958
2007	69,003	36,636	105,639
2008	(179,686)	(26,292)	(205,978)
2009	(400,801)	(85,705)	(486,506)
2010	(239,276)	(5,043)	(244,319)
2011	119,105	45,681	164,786
2012	(46,026)	30,447	(15,579)
2013	34,295	48,926	83,221
2014	40,980	11,588	52,568
2015	(81,747)	26,006	(55,741)
2016 Nine Months	<u>(117,439)</u>	<u>19,505</u>	<u>(97,934)</u>
	\$ (643,280)	\$ 392,681	\$ (250,599)
Patronage Capital Retired	<u>(82,035)</u>	<u>(82,035)</u>	<u>(82,035)</u>
	<u>\$ (643,280)</u>	<u>\$ 310,646</u>	<u>\$ (332,634)</u>

The Board of Directors has adopted the policy of separating each department's net gains or losses for allocation purposes. Patronage capital is allocated after all deficits have been recovered. During the years ended September 30, 2016 and 2015, no retirements of patronage capital were made.

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

8. Mortgage Notes – CFC

Following is a summary of long-term debt due CFC maturing between September 30, 2016 and July 7, 2040:

	September 30,	
	2016	2015
Fixed - 7.45%	\$ 189,443	\$ 210,815
Fixed - 4.85%	286,229	298,927
Fixed - 7.00%	739,960	751,779
Fixed - 3.05%	<u>215,731</u>	<u>221,919</u>
	\$ 1,431,363	\$ 1,483,440
Less: Current Maturities	<u>54,000</u>	<u>48,000</u>
	<u>\$ 1,377,363</u>	<u>\$ 1,435,440</u>

Principal and interest installments on the above notes are due quarterly in amounts of approximately \$35,065. As of September 30, 2016, annual maturities of long-term debt due CFC for the next five years is as follows:

2017	\$ 54,000
2018	58,000
2019	63,000
2020	67,000
2021	71,000

The loan agreement with CFC contains provisions requiring a Debt Service Coverage (DSC) requirement of 1.15. This debt covenant was not met as of September 30, 2016.

9. USDA Rural Development Note Payable

Following is a summary of long-term debt due USDA Rural Development:

	September 30,	
	2016	2015
5.000% Note Maturing March, 2032	\$ 112,222	\$ 116,985
4.500% Note Maturing August, 2035	205,626	212,471
4.500% Note Maturing July, 2040	75,541	77,308
4.125% Note Maturing March, 2047	<u>982,907</u>	<u>999,381</u>
	\$ 1,376,296	\$ 1,406,145
Less: Current Maturities	<u>30,500</u>	<u>29,200</u>
	<u>\$ 1,345,796</u>	<u>\$ 1,376,945</u>

GRAHAM COUNTY UTILITIES, INC.

NOTES TO FINANCIAL STATEMENTS

Principal and interest installments on the above notes are due monthly in amounts of \$7,393. As of September 30, 2016, annual maturities of long-term debt due USDA Rural Development for the next five years are as follows:

2017	\$	30,500
2018		31,800
2019		33,300
2020		34,800
2021		36,300

10. Note Payable - Graham County Electric

During the year ended September 30, 2014, the Cooperative received loan funds from Graham County Electric Cooperative, Inc. in the amount of \$1,000,000 with a term of ten years at an interest rate of 5.44%. As of September 30, 2016, the outstanding balance on the note is \$759,988. The annual maturities of the long-term debt due Graham County Electric for the next five years are as follows:

2017	\$	90,770
2018		95,840
2019		101,180
2020		106,820
2021		112,780

11. CIAC Refund Due

As a part of the final ruling by the Arizona Corporation Commission on recent rate cases for both the gas and water utilities the Cooperative agreed to refund contributions in aid of construction previously charged to the members. The original balance to be refunded is \$226,765 for the gas division and \$15,536 in the water division. As of September 30, 2016, the balance remaining to be refunded is \$60,418 for the gas division and \$0 for the water division. This liability is reflected in Accounts Payable – Other on these financial statements.

12. Related Parties

The Cooperative is related by having substantially identical Boards of Directors and management with Graham County Electric Cooperative, Inc. (GCEC). GCEC provides administrative and general, management, operations, consumer accounting, and construction services to the Cooperative under an operating and management agreement signed by both parties on September 20, 1989.

GCEC is also the guarantor of the mortgage loan executed by the Cooperative to CFC.

GRAHAM COUNTY UTILITIES, INC.
NOTES TO FINANCIAL STATEMENTS

Balances between the two Cooperatives are summarized as follows:

	September 30,	
	<u>2016</u>	<u>2015</u>
Graham County Utilities, Inc.		
Accounts Payable	\$ (1,152,746)	\$ (812,706)
Loan Payable (Current and Long-Term)	<u>(759,989)</u>	<u>(845,966)</u>
Total	<u>\$ (1,912,735)</u>	<u>\$ (1,658,672)</u>
 Graham County Electric Cooperative, Inc.		
Accounts Receivable	\$ 1,152,746	\$ 812,706
Note Receivable (Current and Long-Term)	<u>759,989</u>	<u>845,966</u>
Total	<u>\$ 1,912,735</u>	<u>\$ 1,658,672</u>

13. Litigation and Contingencies

The Cooperative is not involved in any litigation that would materially affect the financial statements.

14. Subsequent Events

The Cooperative has evaluated subsequent events through December 21, 2016, the date the financial statements were available to be issued.

ACCOMPANYING INFORMATION

**GRAHAM COUNTY UTILITIES, INC.
GAS DEPARTMENT**

Schedule 1

**BALANCE SHEETS
SEPTEMBER 30, 2016 AND 2015**

ASSETS

	September 30,	
	<u>2016</u>	<u>2015</u>
UTILITY PLANT		
Plant in Service	\$ 5,296,421	\$ 5,091,424
Construction Work in Progress	(41)	(5,167)
Plant Acquisition Adjustment	415,484	415,484
	<u>\$ 5,711,864</u>	<u>\$ 5,501,741</u>
Less: Accumulated Provision for Depreciation and Amortization	3,311,816	3,153,099
	<u>\$ 2,400,048</u>	<u>\$ 2,348,642</u>
OTHER PROPERTY AND INVESTMENTS AT COST OR STATED VALUE		
Investments in Associated Organizations	\$ 173,165	\$ 170,558
CURRENT ASSETS		
Accounts Receivable (Less allowance for uncollectibles of \$43,306 in 2016 and \$44,950 in 2015)	\$ 100,040	\$ 65,964
Underbilled Consumers Fuel Cost		
Materials and Supplies	80,294	90,768
Other Current and Accrued Assets	16,630	16,312
Total Current Assets	<u>\$ 196,964</u>	<u>\$ 173,044</u>
DEFERRED CHARGES	<u>\$ 9,139</u>	<u>\$ 13,709</u>
TOTAL ASSETS	<u><u>\$ 2,779,316</u></u>	<u><u>\$ 2,705,953</u></u>

EQUITIES AND LIABILITIES

MEMBERS' EQUITY		
Memberships	\$ 29,515	\$ 29,450
Accumulated Deficits	(643,280)	(460,343)
	<u>\$ (613,765)</u>	<u>\$ (430,893)</u>
LONG - TERM DEBT		
CFC Mortgage Notes Less Current Maturities	\$ 1,167,632	\$ 1,217,521
Note Payable - Graham County Electric Coop	669,218	759,986
	<u>\$ 1,836,850</u>	<u>\$ 1,977,507</u>
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 138,770	\$ 129,980
Accounts Payable - Other	112,155	112,907
Accounts Payable - Graham County Electric Cooperative	977,564	647,673
Overbilled Consumers Fuel Cost	128,226	41,245
Accrued Taxes	50,658	51,300
Customers' Deposits and Prepayments	129,618	130,323
Accrued Interest	17,333	13,822
Accrued Payroll	1,907	32,089
Total Current Liabilities	<u>\$ 1,556,231</u>	<u>\$ 1,159,339</u>
TOTAL EQUITIES AND LIABILITIES	<u><u>\$ 2,779,316</u></u>	<u><u>\$ 2,705,953</u></u>

**GRAHAM COUNTY UTILITIES, INC.
GAS DEPARTMENT**

Schedule 2

**STATEMENTS OF INCOME AND ACCUMULATED DEFICITS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015**

	September 30,		Increase (Decrease)
	<u>2016</u>	<u>2015</u>	
OPERATING REVENUES			
Residential	\$ 2,317,597	\$ 2,238,549	\$ 79,048
Irrigation	5,463	13,047	(7,584)
Commercial and Industrial	863,067	833,347	29,720
Fuel Cost Under (Over) Billed	(86,513)	(60,597)	(25,916)
Other Operating Revenues	35,389	42,769	(7,380)
Total Operating Revenues	<u>\$ 3,135,003</u>	<u>\$ 3,067,115</u>	<u>\$ 67,888</u>
OPERATING EXPENSES			
Purchased Gas	\$ 1,072,163	\$ 1,121,480	\$ (49,317)
Operations	530,575	467,342	63,233
Maintenance	474,459	310,249	164,210
Customer Accounts	370,429	340,580	29,849
Administrative and General	564,077	547,651	16,426
Depreciation and Amortization	158,717	152,396	6,321
Other Interest	26,147	21,441	4,706
Total Operating Expenses	<u>\$ 3,196,567</u>	<u>\$ 2,961,139</u>	<u>\$ 235,428</u>
OPERATING MARGIN - Before Fixed Charges	<u>\$ (61,564)</u>	<u>\$ 105,976</u>	<u>\$ (167,540)</u>
FIXED CHARGES			
Interest on Long-Term Debt	<u>125,604</u>	<u>133,052</u>	<u>(7,448)</u>
OPERATING MARGIN (DEFICIT) - After Fixed Charges	<u>\$ (187,168)</u>	<u>\$ (27,076)</u>	<u>\$ (160,092)</u>
Capital Credits	<u>4,231</u>	<u>4,370</u>	<u>(139)</u>
NET MARGIN (DEFICIT)	<u>\$ (182,937)</u>	<u>\$ (22,706)</u>	<u>\$ (160,231)</u>
ACCUMULATED DEFICIT - BEGINNING OF YEAR	<u>(460,343)</u>	<u>(437,637)</u>	
ACCUMULATED DEFICIT - END OF YEAR	<u>\$ (643,280)</u>	<u>\$ (460,343)</u>	

**GRAHAM COUNTY UTILITIES, INC.
GAS DEPARTMENT**

Schedule 3

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015**

	September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margin (Deficit)	\$ (182,937)	\$ (22,706)
Adjustments to Reconcile Net Margin to Net Cash		
From Operating Activities		
Depreciation and Amortization	158,717	152,396
Capital Credits - Noncash	(4,231)	(4,370)
Deferred Charges	4,570	6,280
Deferred Credits	0	0
Over (Under) Billed Fuel Cost - Net	86,981	60,550
Accounts Receivable	(34,076)	(17,619)
Inventories and Other Current Assets	10,156	(22,185)
Payables and Accrued Expenses	(28,770)	45,655
Net Payments From - Graham County Electric Cooperative	329,891	48,615
Net Cash From Operating Activities	\$ 340,301	\$ 246,616
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to Gas Utility Plant	\$ (210,123)	\$ (134,068)
Investments in Associated Organizations	1,624	11,491
Net Cash From Investing Activities	\$ (208,499)	\$ (122,577)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt - CFC	\$ (45,889)	\$ (42,979)
Payments on Notes Payable - GCE	(85,978)	(81,435)
Memberships	65	375
Net Cash From Financing Activities	\$ (131,802)	\$ (124,039)
CHANGE IN CASH	\$ 0	\$ 0
CASH - BEGINNING OF YEAR	0	0
CASH - END OF YEAR	\$ 0	\$ 0
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Paid During the Year for:		
Interest on Long-Term Debt	\$ 125,604	\$ 133,052
Federal Income Tax	\$ 0	\$ 0

**GRAHAM COUNTY UTILITIES, INC.
WATER DEPARTMENT**

Schedule 4

**BALANCE SHEETS
SEPTEMBER 30, 2016 AND 2015**

ASSETS

	September 30,	
	<u>2016</u>	<u>2015</u>
UTILITY PLANT AT COST		
Water Plant in Service	\$ 3,976,366	\$ 3,931,736
Construction Work in Progress	(14,261)	(14,001)
Plant Acquisition Adjustment	610,168	610,168
	<u>\$ 4,572,273</u>	<u>\$ 4,527,903</u>
Less: Accumulated Provision for Depreciation and Amortization	2,746,724	2,639,999
	<u>\$ 1,825,549</u>	<u>\$ 1,887,904</u>
OTHER PROPERTY AND INVESTMENTS AT COST OR STATED VALUE		
Investments in Associated Organizations	\$ 115,266	\$ 109,183
CURRENT ASSETS		
Cash - Restricted	\$ 86,581	\$ 80,889
Accounts Receivable - Customers (Less allowance for uncollectibles of \$3,636 in 2016 and \$4,653 in 2015)	40,420	23,736
Materials and Supplies	59,583	61,131
Other Current and Accrued Assets	5,543	5,439
Total Current Assets	<u>\$ 192,127</u>	<u>\$ 171,195</u>
DEFERRED CHARGES	\$ 0	\$ 0
TOTAL ASSETS	<u>\$ 2,132,942</u>	<u>\$ 2,168,282</u>

EQUITIES AND LIABILITIES

MEMBERS' EQUITY		
Memberships	\$ 2,500	\$ 2,500
Accumulated Margins	310,646	306,257
	<u>\$ 313,146</u>	<u>\$ 308,757</u>
LONG-TERM DEBT		
CFC Mortgage Notes Less Current Maturities	\$ 209,731	\$ 217,919
USDA Rural Development Notes Less Current Maturities	1,345,796	1,376,945
	<u>\$ 1,555,527</u>	<u>\$ 1,594,864</u>
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 36,500	\$ 33,200
Accounts Payable - Other	4,652	9,470
Accounts Payable - Graham County Electric Cooperative	175,182	165,033
Accrued Taxes	29,883	31,593
Customers' Deposits and Prepayments	15,469	15,408
Accrued Interest	1,797	1,709
Accrued Payroll	786	8,248
Total Current Liabilities	<u>\$ 264,269</u>	<u>\$ 264,661</u>
TOTAL EQUITIES AND LIABILITIES	<u>\$ 2,132,942</u>	<u>\$ 2,168,282</u>

**GRAHAM COUNTY UTILITIES, INC.
WATER DEPARTMENT**

Schedule 5

**STATEMENTS OF INCOME AND ACCUMULATED MARGINS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015**

	September 30,		Increase (Decrease)
	2016	2015	
OPERATING REVENUES			
Residential	\$ 632,244	\$ 622,909	\$ 9,335
Commercial and Industrial	70,034	68,829	1,205
Sales for Resale	48,968	40,229	8,739
Other Operating Revenues	11,453	18,050	(6,597)
Total Operating Revenues	\$ 762,699	\$ 750,017	\$ 12,682
OPERATING EXPENSES			
Purchased Power - Pumping	\$ 26,110	\$ 35,775	\$ (9,665)
Operations	83,964	80,251	3,713
Maintenance	228,055	183,201	44,854
Customer Accounts	93,015	87,183	5,832
Administrative and General	153,857	158,554	(4,697)
Depreciation and Amortization	106,725	103,496	3,229
Other Interest	7,611	11,354	(3,743)
Total Operating Expenses	\$ 699,337	\$ 659,814	\$ 39,523
OPERATING MARGINS - Before Fixed Charges	\$ 63,362	\$ 90,203	\$ (26,841)
FIXED CHARGES			
Interest on Long-Term Debt	65,744	67,598	(1,854)
OPERATING MARGIN - After Fixed Charges	\$ (2,382)	\$ 22,605	\$ (24,987)
Capital Credits	6,474	3,876	2,598
NET OPERATING MARGIN	\$ 4,092	\$ 26,481	\$ (22,389)
NONOPERATING MARGINS			
Interest	297	313	(16)
NET MARGIN	\$ 4,389	\$ 26,794	\$ (22,405)
ACCUMULATED MARGINS - BEGINNING OF YEAR	306,257	279,463	
ACCUMULATED MARGINS - END OF YEAR	\$ 310,646	\$ 306,257	

**GRAHAM COUNTY UTILITIES, INC.
WATER DEPARTMENT**

Schedule 6

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015**

	September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margin	\$ 4,389	\$ 26,794
Adjustments to Reconcile Net Margins to Net Cash		
From Operating Activities		
Depreciation and Amortization	106,725	103,496
Capital Credits - Noncash	(6,474)	(3,876)
Deferred Charges		5,870
Accounts Receivable	(16,684)	(684)
Inventories and Other Current Assets	1,444	7,145
Payables and Accrued Expenses	(13,841)	6,182
Net Payments From (To) - Graham County Electric Cooperative	10,149	(91,122)
Net Cash From Operating Activities	<u>\$ 85,708</u>	<u>\$ 53,805</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Additions to Plant	\$ (44,370)	\$ (23,843)
Cash - Restricted	(5,692)	(5,610)
Investments in Associated Organizations	391	9,428
Net Cash From Investing Activities	<u>\$ (49,671)</u>	<u>\$ (20,025)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt To CFC	\$ (6,188)	\$ (5,843)
Payments on Long-Term Debt To USDA	(29,849)	(27,937)
Net Cash From Financing Activities	<u>\$ (36,037)</u>	<u>\$ (33,780)</u>
CHANGE IN CASH	\$ 0	\$ 0
CASH - BEGINNING OF YEAR	<u>0</u>	<u>0</u>
CASH - END OF YEAR	<u><u>\$ 0</u></u>	<u><u>\$ 0</u></u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Paid During the Year for:		
Interest on Long-Term Debt	\$ 65,744	72,217
Federal Income Tax	<u>\$ 0</u>	<u>\$ 0</u>