



NORTH SHELBY WATER COMPANY
BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORTS

At December 31, 2011 and 2010



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Years Ended December 31, 2011 and 2010

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Certified Public Accountants

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To the Board of Directors of the
North Shelby Water Company
Bagdad, Kentucky 40003

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of North Shelby Water Company as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of North Shelby Water Company's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Shelby Water Company, as of December 31, 2011 and 2010, and the changes in financial position and cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 29, 2012, on our consideration of North Shelby Water Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 should be considered in assessing the results of our audit.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a 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. Our opinion on the basic financial statements is not affected by this missing information.

Raisor, Zapp & Woods, PSC

RAISOR, ZAPP & WOODS, PSC
Certified Public Accountants

March 29, 2012

NORTH SHELBY WATER COMPANY
STATEMENT OF NET ASSETS
December 31, 2011 and 2010

ASSETS	<u>2011</u>	<u>2010</u>
Current Assets:		
Cash	\$ 466,377	\$ 254,929
Accounts Receivable (Net)	147,551	167,086
Other Receivables	20,419	21,881
Note Receivable - Current Portion	1,640	-
Inventory	69,069	48,932
Prepaid Expenses	30,105	27,551
Total Current Assets	<u><u>\$ 735,161</u></u>	<u><u>\$ 520,379</u></u>
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 770,974	\$ 899,128
Note Receivable	58,828	-
Capital Assets (Net)	11,193,264	11,601,060
Total Noncurrent Assets	<u><u>\$ 12,023,066</u></u>	<u><u>\$ 12,500,188</u></u>
Total Assets	<u><u>\$ 12,758,227</u></u>	<u><u>\$ 13,020,567</u></u>
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 131,421	\$ 132,329
Accrued Compensated Absences	8,295	7,249
Accrued Employee Benefits	6,770	8,371
Accrued Payroll Taxes/Employee Withholding	6,248	6,898
Utility Tax Payable	4,945	5,122
Sales Tax Payable	185	263
Accrued Interest Payable - Customer Deposits	1,669	1,652
Interim Financing - Accrued Interest	-	4,372
Interim Financing	-	379,743
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Notes Payable	28,809	32,115
Notes Payable	40,472	79,676
Total Current Liabilities	<u><u>\$ 228,814</u></u>	<u><u>\$ 657,790</u></u>
Noncurrent Liabilities:		
Notes Payable	\$ 1,049,360	\$ 1,089,832
Customer Deposits Payable	246,536	250,356
Total Noncurrent Liabilities	<u><u>\$ 1,295,896</u></u>	<u><u>\$ 1,340,188</u></u>
Total Liabilities	<u><u>\$ 1,524,710</u></u>	<u><u>\$ 1,997,978</u></u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	\$ 10,103,432	\$ 10,051,809
Restricted for Capital Projects	4,661	235,161
Restricted for Debt Service	737,504	631,852
Unrestricted	387,920	103,767
Total Net Assets	<u><u>\$ 11,233,517</u></u>	<u><u>\$ 11,022,589</u></u>

NORTH SHELBY WATER COMPANY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For the Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 2,138,224	\$ 2,090,914
Total Charges for Services	<u>\$ 2,138,224</u>	<u>\$ 2,090,914</u>
Other Charges and Miscellaneous:		
Forfeited Discounts & Service Charges	\$ 57,752	\$ 59,007
Building Rental Income	24,000	24,000
Equipment Rental Income	58,022	64,706
Contractual Services	86,923	76,462
Miscellaneous	5,545	2,535
Total Other Charges and Miscellaneous	<u>\$ 232,242</u>	<u>\$ 226,710</u>
Total Operating Revenues	<u>\$ 2,370,466</u>	<u>\$ 2,317,624</u>
Operating Expenses:		
Accounting and Collecting Labor	\$ 228,680	\$ 263,575
Commissioner Fees	32,000	31,450
Contractual Service	86,613	69,115
Employee Retirement & Benefits	136,767	145,511
Insurance	31,985	28,295
Maintenance of Mains	104,075	112,628
Miscellaneous	11,759	14,914
Office Supplies and Expense	60,027	49,149
Operating Labor	65,302	77,013
Other Interest Expense	1,726	1,719
Payroll Taxes	28,904	32,666
Professional Services	46,658	40,348
Purchased Water	836,923	853,861
Purchased Power	97,252	90,380
Regulatory Fees	3,564	3,066
Rental of Equipment	287	407
Transportation Expense	46,009	47,599
Utilities	23,699	27,090
Depreciation Expense	421,823	408,222
Total Operating Expenses	<u>\$ 2,264,053</u>	<u>\$ 2,297,008</u>
Net Operating Income (Loss)	<u>\$ 106,413</u>	<u>\$ 20,616</u>
Nonoperating Revenue (Expense):		
Investment Income	\$ 7,826	\$ 8,307
Interest Expense	(55,317)	(61,589)
Gain on Sale of Fixed Assets	41,143	-
Total Nonoperating Revenues (Expense)	<u>\$ (6,348)</u>	<u>\$ (53,282)</u>
Net Loss Before Contributions	\$ 100,065	\$ (32,666)
Capital Contributions	<u>110,863</u>	<u>703,283</u>
Net Income	\$ 210,928	\$ 670,617
Net Assets--Beginning of Year	<u>11,022,589</u>	<u>10,351,972</u>
Net Assets--End of Year	<u>\$ 11,233,517</u>	<u>\$ 11,022,589</u>

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 2,373,082	\$ 2,289,688
Payments to Suppliers	(1,523,480)	(1,500,742)
Payments to Employees	(334,776)	(372,159)
Other Receipts (Payments)	5,545	2,096
Net Cash Provided (Used) by Operating Activities	<u>\$ 520,371</u>	<u>\$ 418,883</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Contributions	\$ 110,863	\$ 703,283
Purchases of Capital Assets	(39,397)	(1,266,176)
Principal Paid on Interim Financing	(379,743)	-
Proceeds from Interim Financing	-	150,000
Proceeds Sale of Capital Assets	6,045	-
Principal Paid on Capital Debt	(79,676)	(107,564)
Interest Paid on Capital Debt (Including Capitalized Interest)	(62,995)	(74,647)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>\$ (444,903)</u>	<u>\$ (595,104)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Cash Received (Invested) in Certificates of Deposits	\$ (3,730)	\$ 145,222
Interest Received	7,826	8,307
Net Cash Provided (Used) by Investing Activities	<u>\$ 4,096</u>	<u>\$ 153,529</u>
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 79,564	\$ (22,692)
Balances-Beginning of the Year	843,320	866,012
Balances-End of the Year	<u>\$ 922,884</u>	<u>\$ 843,320</u>

	Balances Per December 31, 2011 Statement of Net Assets	Balances Per December 31, 2011 Statement of Cash Flows
Unrestricted Cash	\$ 466,377	\$ 466,377
Restricted Cash	456,507	456,507
Restricted Certificates of Deposit	314,467	-
Total Cash and Cash Equivalents, End of Year	<u>\$ 1,237,351</u>	<u>\$ 922,884</u>

	Balances Per December 31, 2010 Statement of Net Assets	Balances Per December 31, 2010 Statement of Cash Flows
Unrestricted Cash	\$ 254,929	\$ 254,929
Restricted Cash	588,391	588,391
Restricted Certificates of Deposit	310,737	-
Total Cash and Cash Equivalents, End of Year	<u>\$ 1,154,057</u>	<u>\$ 843,320</u>

(Continued)

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ 106,413	\$ 20,616
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	421,823	408,222
Change in Assets and Liabilities:		
Receivables, Net	19,535	(27,969)
Other Receivables	1,462	33
Inventories	(20,137)	1,673
Prepaid Expenses	(2,554)	(1,548)
Accounts and Other Payables	(908)	14,413
Accrued Expenses	(1,443)	1,895
Customer Meter Deposits Payable	(3,820)	1,548
Net Cash Provided by Operating Activities	<u>\$ 520,371</u>	<u>\$ 418,883</u>

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

There were no outstanding capital expenditures at December 31, 2011 or 2010.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2011 and 2010**

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES

The North Shelby Water Company is a rural water company serving customers in Franklin, Henry, Oldham and Shelby Counties, Kentucky, and is regulated by the Public Service Commission of the Commonwealth of Kentucky. The Water Company was formed as a 501(c)12 nonprofit organization in August 1972. Eight directors are elected from the members to manage the affairs of the corporation.

In evaluating how to define North Shelby Water Company for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The basic -- but not the only -- criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the Water Company is able to exercise oversight responsibilities. Based upon the application of these criteria, the Water Company has no component units.

A summary of the Water Company's significant accounting policies follows:

Basis of presentation and accounting: As stated in Kentucky Revised Statutes (KRS) 278.012, "any water association formed for the purpose of furnishing water services to the general public pursuant to KRS Chapter 273 is deemed to be and shall be a public utility and shall be subject to the jurisdiction of the Public Service Commission." In KRS 278.220, it is outlined that the Public Service Commission may establish a system of accounts to be kept by the utilities subject to its jurisdiction, and may prescribe the manner in which such accounts shall be kept. The financial statements of the Water Company are prepared in accordance with generally accepted accounting principles (GAAP). The Water Company applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

All activities of the Water Company 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 business 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.

Proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used.

The accounting and financial reporting treatment applied to the Water Company is determined by its measurement focus. The transactions of the Water Company are accounted for on a flow of economic resources measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted; and unrestricted components.

Revenues and expenses: Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the Water Company. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities. The Water Company adheres to the use restrictions established by note agreements when expenses are incurred for which both restricted and unrestricted net assets are available. The Water Company has no policy defining which resources (restricted or unrestricted) to use first.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 1 – DESCRIPTION OF ENTITY AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and equipment: Property and equipment purchased or constructed is stated at cost. Interest related to costs, and major improvements, renewals and replacements is capitalized as a cost of the project. Costs associated with hook-up fees are capitalized as meters, installations, and services. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. The range of estimated useful lives by type of asset is as follows:

- Buildings & Improvements	10-30 years
- Distribution System	5-50 years
- Machinery & Equipment	3-30 years

Inventory: Inventories are stated at cost based on first in – first out.

Income Taxes: The corporation is a nonprofit organization and is exempt from income taxes under Section 501(c)12 of the Internal Revenue Code.

Contributed Capital: Under the Governmental Accounting Standards Board's (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the Water Company recognizes capital contributions as revenues in the statement of revenues, expenses and changes in fund net assets. Grants totaling \$94,863 and \$682,783 were received by the Water Company for the years ended December 31, 2011 and 2010, respectively. Tap-on fees of \$16,000 were received by the Water Company for the year ended December 31, 2011. Tap-on fees of \$17,000 and contributions in aid of construction of \$3,500 were received by the Water Company for the year ended December 31, 2010.

Net Assets: Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net assets are classified in the following three components: invested in capital assets, net of related debt; restricted; and unrestricted net assets. Invested in capital assets, net of related debt, consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted net assets consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net assets consist of all other net assets not included in the above categories.

Estimates: The preparation of financial statements 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.

Statement of Cash Flows: For the purpose of the Statement of Cash Flows, North Shelby Water Company considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS

The Debt Service Account was established with the original RECD note payable, and is to be continued to be maintained as long as any of the 1971, 1972, 1979, 1993, 1998 or 2000 notes are outstanding. Under the loan agreement which established this account, it was provided that a minimum balance be maintained in this account as security to the creditor. In order to attain the minimum balance, a monthly transfer must be made in the sum equal to at least 1/12 of the annual installment next becoming due.

Transfers sufficient to meet the total obligation outstanding on all notes were made timely during the years ended December 31, 2011 and 2010.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS (Continued)

Under the loan agreements of the original 1971 (2 notes) and 1972 (1 note) notes, a Depreciation Account was to be established to provide funds for extraordinary repairs and extensions to the system, and to make up any deficiency in the Debt Service Account. The monthly transfer required to be made to the Depreciation Account would be a minimum of \$741 each month until a balance of \$88,920 is accumulated. The 1979 note required an additional \$113 each month until a balance of \$13,560 is accumulated. The 1993 note required an additional \$185 each month until a balance of \$22,200 is accumulated. The 1998 note required an additional \$135 each month until a balance of \$16,200 is accumulated. The 2000 note required an additional \$260 each month until a balance of \$31,200 is accumulated. The Depreciation Account is to be maintained as long as any of the above notes are outstanding. Sufficient funds were transferred during the years ended December 31, 2011 and 2010.

NOTE 3 – CASH AND INVESTMENTS

The table presented below is designed to disclose the level of custody credit risk assumed by the Water Company based upon how its deposits were insured or secured with collateral at December 31, 2011 and 2010. The categories of credit risk are defined as follows:

Category 1 – Insured by FDIC Insurance or collateralized with a depository surety bond or securities held by the Water Company (public trust) or by its agent in its name.

Category 2 – Uninsured but collateralized with securities held by the pledging financial institution's trust department or agent in the Water Company's name.

Category 3 – Uninsured and uncollateralized; or collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Water Company's name; or collateralized with no written or approved collateral agreement.

December 31, 2011

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Checking & Savings Deposits	\$ 936,024	\$ 504,661	\$ 229,517	\$ 201,846	\$ 922,634
Certificates of Deposit	314,467	-	164,038	150,429	314,467
Total Deposits	<u>\$ 1,250,491</u>	<u>\$ 504,661</u>	<u>\$ 393,555</u>	<u>\$ 352,275</u>	<u>\$ 1,237,101</u>

December 31, 2010

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Checking & Savings Deposits	\$ 965,119	\$ 500,000	\$ 362,593	\$ 102,526	\$ 843,070
Certificates of Deposit	310,737	250,000	-	60,737	310,737
Total Deposits	<u>\$ 1,275,856</u>	<u>\$ 750,000</u>	<u>\$ 362,593</u>	<u>\$ 163,263</u>	<u>\$ 1,153,807</u>

Reconciliation to Statement of Net Assets:

	December 31, 2011	December 31, 2010
Unrestricted Cash,	\$ 466,377	\$ 254,929
Restricted Cash, Including Time Deposits	770,974	899,128
Less Cash on Hand	(250)	(250)
	<u>\$ 1,237,101</u>	<u>\$ 1,153,807</u>

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 4 – RESTRICTED ASSETS

Restricted cash and time deposits consist of the following:

	December 31, 2011	December 31, 2010
Debt Service Accounts	\$ 484,009	\$ 413,383
Depreciation Accounts	282,304	250,584
Construction Accounts	4,661	235,161
 Total	 \$ 770,974	 \$ 899,128

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$9,529 and \$7,050 at December 31, 2011 and 2010, respectively. The amount provided for bad debts represents the portion of the total amounts for which collection is unlikely, based on historical collection data.

Estimated unbilled water service revenue of \$129,299 and \$139,248 is included in accounts receivable at December 31, 2011 and 2010, respectively.

NOTE 6 – NOTE RECEIVABLE

On August 29, 2011, the Company sold the office building located on Elmburg Road to RX Plumbing, LLC. The sales price was \$65,000. The District received \$4,000 as a downpayment and financed the remaining balance through a note receivable. Interest is charged at six percent (6%) per annum. Fifty nine monthly payments of \$437.02 (principal and interest) are to be made until July 29, 2016, when all remaining principal and interest becomes due.

NOTE 7 – CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2011 and 2010, was as follows:

	Balance at January 1, 2011	Additions	Disposals	Balance at December 31, 2011
Land & Land Rights	\$ 92,526	\$ -	\$ (3,000)	\$ 89,526
Structures & Improvements	496,317	-	(110,592)	385,725
Distribution System	15,258,256	16,000	-	15,274,256
Machinery & Equipment	1,515,632	23,397	(6,900)	1,532,129
Totals at Historical Cost	\$ 17,362,731	\$ 39,397	\$ (120,492)	\$ 17,281,636
 Less: Accumulated Depreciation				
Structures & Improvements	\$ (132,691)	\$ (14,759)	\$ 88,222	\$ (59,228)
Distribution System	(4,802,488)	(312,978)	-	(5,115,466)
Machinery & Equipment	(826,492)	(94,086)	6,900	(913,678)
Total Accumulated Depreciation	\$ (5,761,671)	\$ (421,823)	\$ 95,122	\$ (6,088,372)
 Capital Assets, Net	 \$ 11,601,060	 \$ (382,426)	 \$ (25,370)	 \$ 11,193,264

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 7 – CAPITAL ASSETS (Continued)

	Balance at January 1, 2010	Additions	Disposals	Balance at December 31, 2010
Land & Land Rights	\$ 92,526	\$ -	\$ -	\$ 92,526
Structures & Improvements	496,317	-	-	496,317
Distribution System	13,031,754	2,226,502	-	15,258,256
Machinery & Equipment	1,478,384	37,248	-	1,515,632
Construction in Process	1,114,834	1,090,166	(2,205,000)	-
Totals at Historical Cost	<u>\$ 16,213,815</u>	<u>\$ 3,353,916</u>	<u>\$ (2,205,000)</u>	<u>\$ 17,362,731</u>
Less: Accumulated Depreciation				
Structures & Improvements	\$ (116,141)	\$ (16,550)	\$ -	\$ (132,691)
Distribution System	(4,511,016)	(291,472)	-	(4,802,488)
Machinery & Equipment	(726,292)	(100,200)	-	(826,492)
Total Accumulated Depreciation	<u>\$ (5,353,449)</u>	<u>\$ (408,222)</u>	<u>\$ -</u>	<u>\$ (5,761,671)</u>
Capital Assets, Net	<u>\$ 10,860,366</u>	<u>\$ 2,945,694</u>	<u>\$ (2,205,000)</u>	<u>\$ 11,601,060</u>

Included under the Water Company's capital assets at December 31, 2011 and 2010, were \$1,106,261 and \$1,056,998 of fully depreciated assets, respectively. Land and land rights, and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$421,823 and \$408,222 in 2011 and 2010, respectively.

NOTE 8 – CUSTOMER DEPOSITS

Customer deposits are collected upon installation of water service. This amount is to be refunded to the customer upon discontinuation of service (after the customer's bill has been paid in full). Records are maintained which detail the accrued interest on each customer's deposit based on the current annual rate. Interest accrued is refunded to the customer or credited to the customer's bill on an annual basis. At December 31, 2011 and 2010, accrued interest on customer deposits was \$1,669 and \$1,652, respectively.

North Shelby Water Company has not maintained a separate bank account specifically for cash collected and disbursed relating to customer deposits.

NOTE 9 – LONG-TERM DEBT

As of December 31, 2011 and 2010, the long-term debt payable consisted of the following:

Notes Payable:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
1971 RECD note, original loan amount of \$500,000, secured by water revenues. Interest is charged 5.00% per annum. Final payment was January, 2011.	\$ -	\$ 12,353
1971 RECD note, original loan amount of \$500,000, secured by water revenues. Interest is charged 5.00% per annum. Final payment was January, 2011.	-	12,462
1972 RECD note, original loan amount of \$500,000, secured by water revenues. Interest is charged 5.00% per annum. Final maturity is January, 2012.	11,953	39,612

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 9 – LONG-TERM DEBT (Continued)

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
1979 RECD note, original loan amount of \$230,000, secured by water revenues. Interest is charged 5.00% per annum. Final maturity is July, 2019.	92,500	101,010
1993 RECD note, original loan amount of \$300,600, secured by water revenues. Interest is charged 5.625% per annum. Final maturity is April, 2033.	236,429	241,868
1998 RECD note, original loan amount of \$288,500, secured by water revenues. Interest is charged 4.5% per annum. Final maturity is October, 2038.	246,443	251,128
2000 RECD note, original loan amount of \$568,000, secured by water revenues. Interest is charged 4.375% per annum. Final maturity is May, 2040.	502,507	511,075
Total Notes Payable	\$ 1,089,832	\$ 1,169,508
Current Portion	\$ 40,472	\$ 79,676
Noncurrent Portion	1,049,360	1,089,832
Total Notes Payable	\$ 1,089,832	\$ 1,169,508
Accrued Compensated Absences:		
All Classified as Current	\$ 8,295	\$ 7,249

Changes in Long-term Debt

The following is a summary of changes in long-term debt for the years ended December 31, 2011 and 2010.

December 31, 2011

	<u>Balance at January 1, 2011</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2011</u>	<u>Current Portion</u>
Notes Payable	\$ 1,169,508	\$ -	\$ (79,676)	\$ 1,089,832	\$ 40,472
Accrued Compensated Absences	7,249	1,046	-	8,295	8,295
Total Long-Term Debt	\$ 1,176,757	\$ 1,046	\$ (79,676)	\$ 1,098,127	\$ 48,767

December 31, 2010

	<u>Balance at January 1, 2010</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2010</u>	<u>Current Portion</u>
Notes Payable	\$ 1,277,072	\$ -	\$ (107,564)	\$ 1,169,508	\$ 79,676
Accrued Compensated Absences	7,370	-	(121)	7,249	7,249
Total Long-Term Debt	\$ 1,284,442	\$ -	\$ (107,685)	\$ 1,176,757	\$ 86,925

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 9 – LONG-TERM DEBT (Continued)

The annual requirements for all notes payable outstanding at December 31, 2011 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 40,472	\$ 51,596	\$ 92,068
2013	29,901	49,617	79,518
2014	31,350	48,168	79,518
2015	32,869	46,649	79,518
2016	34,465	45,053	79,518
2017-2021	179,222	198,428	377,650
2022-2026	172,046	157,745	329,791
2027-2031	217,649	112,141	329,790
2032-2036	212,942	57,847	270,789
2037-2040	138,916	14,198	153,114
	<u>\$ 1,089,832</u>	<u>\$ 781,442</u>	<u>\$ 1,871,274</u>

The annual requirements for all notes payable outstanding at December 31, 2010 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 79,676	\$ 55,538	\$ 135,214
2012	40,472	51,596	92,068
2013	29,901	49,617	79,518
2014	31,350	48,168	79,518
2015	32,869	46,649	79,518
2016-2020	183,862	207,348	391,210
2021-2025	164,157	165,634	329,791
2026-2030	207,638	122,152	329,790
2031-2035	221,593	68,240	289,833
2036-2040	177,990	22,038	200,028
	<u>\$ 1,169,508</u>	<u>\$ 836,980</u>	<u>\$ 2,006,488</u>

NOTE 10 – SHORT-TERM DEBT – INTERIM FINANCING

North Shelby Water Company obtained a 5% fixed rate revolving line of credit loan through Commonwealth Bank & Trust Company. The \$1.6 million available line of credit (on December 30, 2010 the maturity date was extended from January 9, 2011 to April 9, 2011) was used to fund construction projects. The line of credit was repaid during 2011.

December 31, 2011

	<u>Balance at January 1, 2011</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2011</u>
Line of Credit	\$ 379,743	\$ -	\$ (379,743)	\$ -

December 31, 2010

	<u>Balance at January 1, 2010</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2010</u>
Line of Credit	\$ 229,743	\$ 150,000	\$ -	\$ 379,743

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010

NOTE 11 – INTEREST EXPENSE

Interest expense incurred for the years ended December 31, 2011 and 2010 was \$57,043 and \$63,308, respectively. \$11,688 of construction related interest expense was capitalized in 2010. No interest was capitalized in 2011.

NOTE 12 – FUND EQUITY – RESTRICTED NET ASSETS

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Restricted for Capital Projects:		
Monies Restricted for Construction	\$ 4,661	\$ 235,161
Total Restricted for Capital Projects	<u>\$ 4,661</u>	<u>\$ 235,161</u>
Restricted for Debt Service:		
RECD Notes Payable		
Cash	\$ 766,313	\$ 663,967
Less: Accrued Interest Payable	(28,809)	(32,115)
Total Restricted for Debt Service	<u>\$ 737,504</u>	<u>\$ 631,852</u>

NOTE 13 – BAD DEBT EXPENSE

Water revenue charges have been netted with an estimated bad debt expense of \$8,761 and \$13,567 at December 31, 2011 and 2010, respectively.

NOTE 14 – INSURANCE AND RELATED ACTIVITIES

The Water Company is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. and is also subject to the risks associated with employee injury. Each of these risks is covered through the purchase of commercial insurance.

NOTE 15 – THE COUNTY EMPLOYEES' RETIREMENT SYSTEM

North Shelby Water Company participates in the Commonwealth of Kentucky's County Employees' Retirement System (CERS). Electing employees and all new employees of the Water Company may participate in the System. The most recent financial report on CERS is included in the Kentucky Retirement System's annual report, June 30, 2011 and 2010. Copies of this report will be distributed to each participating employer in the Kentucky Employees Retirement System, County Employees Retirement System, and State Police Retirement System. Copies will also be available to Legislative personnel and state libraries.

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each participating county, city and school board, and any additional eligible local agencies electing to participate in CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the plan documents. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) adjustments are provided at the discretion of the State legislature.

Contributions - For the years ended June 30, 2011 and 2010, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565 (3), normal contribution and past service contribution rates shall be determined by the Board of Trustees of the Kentucky Retirement Systems (Board) on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2011 and 2010, participating employers contributed 16.93% and 16.16% respectively, of each employee's creditable

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010**

NOTE 15 – THE COUNTY EMPLOYEES' RETIREMENT SYSTEM (Continued)

compensation (17.93% and 17.16% for new members after September 1, 2008). The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010 were 16.93% and 20.91%, respectively. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

The Water Company's total payroll for the year ended December 31, 2011 was \$366,221. Contributions were based on \$335,016 (eligible gross wages). The total pension expense for the year ended December 31, 2011 was \$60,376 and \$16,751 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2011.

The Water Company's total payroll for the year ended December 31, 2010 was \$428,981. Contributions were based on \$418,248 (eligible gross wages). The total pension expense for the year ended December 31, 2010 was \$69,317 and \$30,284 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2010.

The Water Company's contribution for the years ended June 30, 2011 and 2010 were .018% and .022% of the System's total contribution requirements for all employers.

For non-hazardous duty, the required contributions to the plan were as follows:

	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Retiree Drug Subsidy Contributions</u>	<u>Percentage Contributions</u>
June 30, 2011	432,414,052	435,404,150	-	100.7%
June 30, 2010	453,055,709	373,682,939	9,156,991	84.5%
June 30, 2009	425,830,683	303,046,162	7,623,628	73.0%

The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from CERS. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance for current beneficiaries.

NOTE 16 – COMPENSATED ABSENCES

Vacation Days

Vacation is earned at rates varying one to twenty-four days per year depending on the length of service. A maximum of five vacation days may be carried over to the next year. At December 31, 2011, and 2010, the Water Company had accrued compensated absence liabilities of \$8,295 and \$7,249, respectively.

Sick Days

Sick leave accrues at the rate of twelve days per year and shall accumulate without limit. At December 31, 2011, the Water Company had an unrecorded sick pay liability of \$49,773. At December 31, 2010, the Water Company had an unrecorded sick pay liability of \$38,063.

NOTE 17 – ECONOMIC DEPENDENCY

The Water Company purchases 100% of the water it sells from the following entities: Shelbyville Municipal Water, Frankfort Electric & Water Plant Board, Louisville Water Company, and West Shelby Water.

NOTE 18 – OPERATION AND MAINTENANCE CONTRACT

The Water Company furnishes managerial, meter reading, maintenance, meter installation, accounts receivable processing, and general office services for U.S. 60 Water District. The Company received \$240,333 and \$245,541 for these services for the years ended December 31, 2011 and 2010, respectively. There is a receivable due from U.S. 60 Water District in the amount of \$20,419 and \$21,881, at December 31, 2011 and 2010, respectively.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2011 and 2010**

NOTE 19 – COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS

North Shelby Water Company and six other municipalities, are participating in a joint engineering study through the Shelby-Franklin Water Management Group to determine the short and long-term water supply needs of the Shelby-Franklin Region, the appropriate size of the regional water transmission main, and the estimated cost of the transmission main and associated facilities. The seven entities have created a regional water Commission pursuant to the provisions of KRS 74.420 to 74.520 to jointly acquire and operate sources of supply of potable water in order to furnish potable water to the water systems serving the Shelby-Franklin Region. The Shelby-Franklin Water Commission is both a public corporation and a public body corporate and politic with the powers and duties specified in KRS 74.420 to 74.520. North Shelby Water Company nor any of the other organizing entities, shall be responsible for payment of any of the expenses, fees, debt obligations or other obligations possibly incurred by the Commission.

In 2007, a \$1.5 million grant was transferred from the City of Shelbyville, Kentucky to North Shelby Water Company as financing toward the construction of approximately 52,000 linear feet of transmission lines for the Louisville Transmission Main project. Additional financing was provided through Company acquired funds. Construction on the project began in 2009. The construction contract was awarded to Hubert Excavating and Contracting, LLC in the amount of \$1,795,000. At a capitalized cost of \$2,205,000, the Louisville Transmission Main was placed in service in November, 2010.

NOTE 20 – RELATED PARTY TRANSACTIONS

During 2011, the Company contracted with Board Chairman, Jerry Ruble, to serve as an interim manager for the Company. \$12,250 was paid to Mr. Ruble for his services.

To the Board of Directors of the
North Shelby Water Company
Bagdad, KY 40003

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

We have audited the financial statements of North Shelby Water Company, as of and for the year ended December 31, 2011, and have issued our report thereon dated March 29, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit we considered North Shelby Water Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of North Shelby Water Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of North Shelby Water Company's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses (Items 11-1 through 11-3).

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether North Shelby Water Company'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.

Board of Directors of the
North Shelby Water Company
Page Two

We noted certain matters that we reported to management of North Shelby Water Company in a separate letter dated March 29, 2012.

North Shelby Water Company's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit North Shelby Water Company's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, lending agencies, and the Public Service Commission and is not intended to be and should not be used by anyone other than these specified parties.

Raisor, Zapp & Woods, PSC

RAISOR, ZAPP, & WOODS P.S.C
Certified Public Accountants

March 29, 2012

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND RESPONSES
For the Year Ended December 31, 2011**

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of North Shelby Water Company.
2. Three deficiencies in internal control related to the audit of the financial statements are reported in the Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. Items 11-1 through 11-3 were reported as material weaknesses.
3. No instances of noncompliance material to the financial statements of North Shelby Water Company, which would be required to be reported in accordance with Government Auditing Standards, were disclosed during the audit.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

GOVERNMENT AUDITING STANDARDS

DEFICIENCIES IN INTERNAL CONTROL

11-1 SIZE OF ENTITY, CROSS-TRAINING, CHECKING PROCEDURES AND DOCUMENTATION

CONDITION:

Due to the size of the entity, cross-training and checking procedures are not in place for certain administrative functions. Instances were observed where formal service contracts were not obtained. Some invoices could not be located. Some invoices were paid for an incorrect amount. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2010 as 10-1.

CRITERIA:

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and allow timely preparation of financial data consistent with management assertions.

CAUSE:

Responsibilities associated with individual positions limit the availability of individuals to rotate duties and implement checking procedures. Formal contracts were not obtained for certain services. Invoices were not checked for erroneous charges.

EFFECT:

These limitations may affect the ability to timely record, process, summarize and report financial data. Some transactions have not been fully documented.

RECOMMENDATION:

Management should strive to provide cross-training for administrative staff, implement checking processes and increase review procedures over invoices to be paid.

NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2011

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

11-1 SIZE OF ENTITY, CROSS-TRAINING, CHECKING PROCEDURES AND DOCUMENTATION (Continued)

RESPONSE:

We concur with the recommendation. Efforts have been made to cross train employees and improve transaction documentation. The Company will continue its efforts to improve training and maintenance and review procedures associated with supporting documentation. Management believes adequate resources have been expended and control procedures implemented, that are commensurate with the staff size limitations.

11-2 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED NOTE DISCLOSURES

CONDITION:

Company financial statements, including the required disclosures, are prepared as part of the annual audit. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2010 as 10-2.

CRITERIA:

Internal controls should be in place to provide management with reasonable, but not absolute, assurance that financial statements and required notes are prepared in accordance with generally accepted accounting principles.

CAUSE:

The draft accrual basis financial statements and disclosures are prepared during the audit process. The entries are entered into the Company's general ledger/financial reports.

EFFECT:

Management engaged auditor to prepare the draft of the financial statements, including the related notes to the financial statements. Management reviewed, approved, and accepted responsibility for the financial statements prior to their issuance.

RECOMMENDATION:

Company management should continue to enhance its knowledge of reporting requirements in providing oversight of this service.

RESPONSE:

The outsourcing of this service is a result of management's cost benefit decision to use others' accounting expertise rather than incur internal resource costs. We concur with the recommendation and will continue to improve our overall accounting knowledge in performing our oversight responsibilities.

NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
For the Year Ended December 31, 2011

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

11-3 RECONCILIATION OF CUSTOMER DEPOSITS

CONDITION:

The general ledger customer deposits payable account was not reconciled to the customer deposit subsidiary ledger at year-end. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2010 as 10-3.

CRITERIA:

Significant accounts in the general ledger should be reconciled to subsidiary ledgers in a timely manner.

CAUSE:

A proper reconciliation was not performed.

EFFECT:

The general ledger customer deposits payable balance was adjusted to the subsidiary balance upon completion of the annual audit.

RECOMMENDATION:

On a monthly basis, the general ledger customer deposits payable balance should be reconciled to the subsidiary ledger.

RESPONSE:

We concur with the recommendation.

COMPLIANCE AND OTHER MATTERS

NONE