

**NORTH SHELBY WATER COMPANY**  
**BASIC FINANCIAL STATEMENTS**  
**AND INDEPENDENT AUDITOR'S REPORTS**

**At December 31, 2013 and 2012**

**NORTH SHELBY WATER COMPANY  
BASIC FINANCIAL STATEMENTS  
AND INDEPENDENT AUDITOR'S REPORTS**

Years Ended December 31, 2013 and 2012

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**INDEPENDENT AUDITOR'S REPORT**

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

**Report on the Financial Statements**

We have audited the accompanying financial statements of North Shelby Water Company as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the North Shelby Water Company's basic financial statements 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 North Shelby Water Company, as of December 31, 2013 and 2012, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Other Matters*

*Required Supplementary Information*

Management has omitted the 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2014, on our consideration of the 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* in considering North Shelby Water Company's internal control over financial reporting and compliance.

*Raisor, Zapp & Woods, PSC*

RAISOR, ZAPP & WOODS, PSC  
Certified Public Accountants  
Carrollton, Kentucky

March 27, 2014

**NORTH SHELBY WATER COMPANY**  
**STATEMENT OF NET POSITION**  
December 31, 2013 and 2012

ASSETS	2013	2012
<b>Current Assets:</b>		
Cash	\$ 1,084,401	\$ 714,388
Accounts Receivable (Net)	184,407	176,654
Other Receivables	-	11,771
Note Receivable - Current Portion	1,832	1,742
Inventory	84,670	80,613
Prepaid Expenses	35,680	23,121
Total Current Assets	\$ 1,390,990	\$ 1,008,289
<b>Noncurrent Assets:</b>		
<b>Restricted Assets:</b>		
Cash, Including Time Deposits	\$ 986,056	\$ 905,037
Note Receivable	55,554	57,085
Capital Assets (Net)	11,485,248	10,916,129
Total Noncurrent Assets	\$ 12,526,858	\$ 11,878,251
<b>Total Assets</b>	<b>\$ 13,917,848</b>	<b>\$ 12,886,540</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts Payable	\$ 140,803	\$ 115,714
Accounts Payable - Construction	9,874	5,542
Accrued Compensated Absences	8,561	8,732
Accrued Employee Benefits	5,807	5,887
Accrued Payroll Taxes/Employee Withholding	5,460	5,860
Utility Tax Payable	5,294	5,279
Sales Tax Payable	235	191
Accrued Interest Payable - Customer Deposits	169	1,677
<b>Current Liabilities Payable from Restricted Assets:</b>		
Accrued Interest Payable - Notes Payable	30,442	27,759
Notes Payable	31,350	29,901
Total Current Liabilities	\$ 237,995	\$ 206,542
<b>Noncurrent Liabilities:</b>		
Notes Payable	\$ 1,955,546	\$ 1,096,288
Customer Deposits Payable	262,728	253,056
Total Noncurrent Liabilities	\$ 2,218,274	\$ 1,349,344
<b>Total Liabilities</b>	<b>\$ 2,456,269</b>	<b>\$ 1,555,886</b>
<b>NET POSITION</b>		
Net Investment in Capital Assets	\$ 9,498,352	\$ 9,789,940
Restricted for Capital Projects	37,756	12,839
Restricted for Debt Service	917,858	864,439
Unrestricted	1,007,613	663,436
Total Net Position	\$ 11,461,579	\$ 11,330,654

**NORTH SHELBY WATER COMPANY**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**  
For the Years Ended December 31, 2013 and 2012

	2013	2012
<b>Operating Revenues:</b>		
<b>Charges for Services:</b>		
Water Charges (Net of Estimated Bad Debts)	\$ 2,227,728	\$ 2,199,595
Total Charges for Services	\$ 2,227,728	\$ 2,199,595
<b>Other Charges and Miscellaneous:</b>		
Forfeited Discounts & Service Charges	\$ 63,882	\$ 56,100
Building Rental Income	24,000	24,000
Equipment Rental Income	59,562	52,309
Contractual Services	89,053	93,533
Miscellaneous	6,088	4,698
Total Other Charges and Miscellaneous	\$ 242,585	\$ 230,640
<b>Total Operating Revenues</b>	\$ 2,470,313	\$ 2,430,235
<b>Operating Expenses:</b>		
Accounting and Collecting Labor	\$ 258,436	\$ 242,578
Commissioner Fees	33,700	33,150
Contractual Service	81,391	77,877
Employee Retirement & Benefits	193,319	173,124
Insurance	38,423	36,892
Maintenance of Mains	80,998	94,325
Miscellaneous	11,893	7,312
Office Supplies and Expense	54,692	50,980
Operating Labor	75,297	73,183
Other Interest Expense	1,216	1,757
Payroll Taxes	32,135	30,326
Professional Services	47,106	50,726
Purchased Water	859,563	848,181
Purchased Power	94,276	91,670
Regulatory Fees	4,349	4,173
Rental of Equipment	-	856
Transportation Expense	47,340	48,084
Utilities	18,995	20,893
Depreciation Expense	408,143	414,473
<b>Total Operating Expenses</b>	\$ 2,341,272	\$ 2,300,560
<b>Operating Income (Loss)</b>	\$ 129,041	\$ 129,675
<b>Nonoperating Revenue (Expense):</b>		
Investment Income	\$ 6,594	\$ 8,599
Interest Expense	(52,300)	(50,277)
Gain (Loss) on Disposition of Fixed Assets	8,685	(16,797)
<b>Total Nonoperating Revenues (Expense)</b>	\$ (37,021)	\$ (58,475)
<b>Net Income Before Contributions</b>	\$ 92,020	\$ 71,200
<b>Capital Contributions</b>	38,905	25,937
<b>Net Income</b>	\$ 130,925	\$ 97,137
<b>Net Position--Beginning of Year</b>	11,330,654	11,233,517
<b>Net Position--End of Year</b>	\$ 11,461,579	\$ 11,330,654

**NORTH SHELBY WATER COMPANY**  
**STATEMENT OF CASH FLOWS**  
For the Years Ended December 31, 2013 and 2012

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from Customers	\$ 2,480,938	\$ 2,411,942
Payments to Suppliers	(1,546,557)	(1,545,565)
Payments to Employees	(380,258)	(361,615)
Other Receipts (Payments)	3,124	4,698
Net Cash Provided (Used) by Operating Activities	\$ 557,247	\$ 509,460
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital Contributions	\$ 38,905	\$ 25,937
Purchases of Capital Assets	(985,666)	(155,070)
Principal Received on Note Receivable - Building Sale	1,441	1,641
Proceeds from Rural Development Note	890,850	76,830
Proceeds Sale of Capital Assets	21,421	6,477
Principal Paid on Capital Debt	(30,143)	(40,473)
Interest Paid on Capital Debt (Including Capitalized Interest)	(49,617)	(51,327)
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ (112,809)	\$ (135,985)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net Cash Received (Invested) in Certificates of Deposits	\$ (1,709)	\$ (2,983)
Interest Received	6,594	8,599
Net Cash Provided (Used) by Investing Activities	\$ 4,885	\$ 5,616
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 449,323	\$ 379,091
Balances-Beginning of the Year	1,301,975	922,884
Balances-End of the Year	\$ 1,751,298	\$ 1,301,975

	Balances Per December 31, 2013 Statement of Net Position	Balances Per December 31, 2013 Statement of Cash Flows
Unrestricted Cash	\$ 1,084,401	\$ 1,084,401
Restricted Cash	666,897	666,897
Restricted Certificates of Deposit	319,159	-
Total Cash and Cash Equivalents, End of Year	\$ 2,070,457	\$ 1,751,298

	Balances Per December 31, 2012 Statement of Net Position	Balances Per December 31, 2012 Statement of Cash Flows
Unrestricted Cash	\$ 714,388	\$ 714,388
Restricted Cash	587,587	587,587
Restricted Certificates of Deposit	317,450	-
Total Cash and Cash Equivalents, End of Year	\$ 1,619,425	\$ 1,301,975

(Continued)

**NORTH SHELBY WATER COMPANY  
STATEMENT OF CASH FLOWS  
For the Years Ended December 31, 2013 and 2012**

	2013	2012
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>		
Operating Income (Loss)	\$ 129,041	\$ 129,675
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	408,143	414,473
Change in Assets and Liabilities:		
Receivables, Net	(7,753)	(29,103)
Other Receivables	11,771	8,648
Inventories	(4,057)	(11,544)
Prepaid Expenses	(12,559)	6,984
Accounts Payable	25,089	(15,707)
Accrued Expenses	(2,100)	(486)
Customer Meter Deposits Payable	9,672	6,520
Net Cash Provided by Operating Activities	\$ 557,247	\$ 509,460

**SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

At December 31, 2013, North Shelby Water Company had \$9,874 outstanding accounts payable related to capital projects in process.

At December 31, 2012, North Shelby Water Company had \$5,542 outstanding accounts payable related to capital projects in process.

**NORTH SHELBY WATER COMPANY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
December 31, 2013 and 2012

**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.

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 position (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 position. Net position (i.e., total assets plus deferred outflows net of total liabilities and deferred inflows) are segregated into net investment in capital assets, 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 position is 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, 2013 and 2012

**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.

**Compensated Absences:** See Note 16 for the Water Company's policy on vacation and sick pay.

**Deferred Outflows and Deferred Inflows**

North Shelby Water Company adopted GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* "GASB 65". GASB 65 established accounting and reporting standards that reclassified certain items that were previously reported as assets and liabilities to deferred outflows of resources or deferred inflows of resources and that recognized certain items previously reported as assets and liabilities as outflows and inflows of resources. In addition, it limits the use of the term "deferred" in the financial statement presentation.

**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 position. Grants totaling \$0- and \$5,137 were received by the Water Company for the years ended December 31, 2013 and 2012, respectively. Tap-on fees of \$30,000 and \$20,800 were received by the Water Company for the years ended December 31, 2013 and 2012. Customer contributions of \$8,905 were received by the Water Company for the year ended December 31, 2013 for hydrants.

**Net position:** In 2012, the Water Company adopted Statement of Governmental Standards (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which required the Water Company to report net position and changed the title of the Statement of Net Assets to the Statement of Net Position (effective for periods beginning after December 15, 2011). Net position comprises the various net earnings from operating and non-operating revenues, expenses, and contributions of capital. Net position is classified in the following three components: net investment in capital assets, restricted, and unrestricted net position. Net investment in capital assets 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 position consists of net position 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 position consists of all net position 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.

**NORTH SHELBY WATER COMPANY  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2013 and 2012**

**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, 2013 and 2012.

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, 2013 and 2012.

**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, 2013 and 2012. 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, 2013**

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Demand Deposits	\$ 1,764,078	\$ 907,097	\$ 856,981	\$ -	\$ 1,751,048
Certificates of Deposit	319,159	319,159	-	-	319,159
<b>Total Deposits</b>	<b>\$ 2,083,237</b>	<b>\$ 1,226,256</b>	<b>\$ 856,981</b>	<b>\$ -</b>	<b>\$ 2,070,207</b>

**December 31, 2012**

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Demand Deposits	\$ 1,303,569	\$ 829,631	\$ 473,938	\$ -	\$ 1,301,725
Certificates of Deposit	317,450	317,450	-	-	317,450
<b>Total Deposits</b>	<b>\$ 1,621,019</b>	<b>\$ 1,147,081</b>	<b>\$ 473,938</b>	<b>\$ -</b>	<b>\$ 1,619,175</b>

**NORTH SHELBY WATER COMPANY  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2013 and 2012**

**NOTE 3 – CASH AND INVESTMENTS (Continued)**

Reconciliation to Statement of Net Position:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Unrestricted Cash,	\$ 1,084,401	\$ 714,388
Restricted Cash, Including Time Deposits	986,056	905,037
Less Cash on Hand	(250)	(250)
	<u>\$ 2,070,207</u>	<u>\$ 1,619,175</u>

**NOTE 4 – RESTRICTED ASSETS**

Restricted cash and time deposits consist of the following:

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Debt Service Accounts	\$ 611,101	\$ 582,307
Depreciation Accounts	337,199	309,891
Construction Accounts	<u>37,756</u>	<u>12,839</u>
Total	<u>\$ 986,056</u>	<u>\$ 905,037</u>

**NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE**

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$10,674 and \$11,926 at December 31, 2013 and 2012, 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 \$173,981 and \$149,294 is included in accounts receivable at December 31, 2013 and 2012, respectively.

**NOTE 6 – OTHER RECEIVABLES**

Other receivables at December 31, 2012, included \$10,990 receivable for the December, 2012 billing of the joint operations contract between North Shelby Water Company and U.S. 60 Water District of Shelby and Franklin Counties. One month of the joint operations contract was overpaid to North Shelby Water Company in December 2013. This was repaid to U.S. 60 Water District in January, 2014. This overpayment of \$583 has been included in Accounts Payable at December 31, 2013.

**NOTE 7 – 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. The balance outstanding at December 31, 2013 and 2012 was \$57,386 and \$58,827, respectively.

**NORTH SHELBY WATER COMPANY**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2013 and 2012

**NOTE 8 – CAPITAL ASSETS**

Capital asset activity for the years ended December 31, 2013 and 2012, was as follows:

	Balance at January 1, 2013	Additions	Disposals	Balance at December 31, 2013
Land & Land Rights	\$ 89,526	\$ -	\$ -	\$ 89,526
Structures & Improvements	385,725	-	-	385,725
Distribution System	15,297,692	38,904	-	15,336,596
Machinery & Equipment	1,554,556	1,030,694	(46,056)	2,539,194
Construction in Process	79,600	898,572	(978,172)	-
<b>Totals at Historical Cost</b>	<b>\$ 17,407,099</b>	<b>\$ 1,968,170</b>	<b>\$ (1,024,228)</b>	<b>\$ 18,351,041</b>
<b>Less: Accumulated Depreciation</b>				
Structures & Improvements	\$ (72,196)	\$ (12,968)	\$ -	\$ (85,164)
Distribution System	(5,421,732)	(313,231)	-	(5,734,963)
Machinery & Equipment	(997,042)	(81,944)	33,320	(1,045,666)
<b>Total Accumulated Depreciation</b>	<b>\$ (6,490,970)</b>	<b>\$ (408,143)</b>	<b>\$ 33,320</b>	<b>\$ (6,865,793)</b>
<b>Capital Assets, Net</b>	<b>\$ 10,916,129</b>	<b>\$ 1,560,027</b>	<b>\$ (990,908)</b>	<b>\$ 11,485,248</b>

  

	Balance at January 1, 2012	Additions	Disposals	Balance at December 31, 2012
Land & Land Rights	\$ 89,526	\$ -	\$ -	\$ 89,526
Structures & Improvements	385,725	-	-	385,725
Distribution System	15,274,256	53,086	(29,650)	15,297,692
Machinery & Equipment	1,532,129	27,927	(5,500)	1,554,556
Construction in Process	-	79,600	-	79,600
<b>Totals at Historical Cost</b>	<b>\$ 17,281,636</b>	<b>\$ 160,613</b>	<b>\$ (35,150)</b>	<b>\$ 17,407,099</b>
<b>Less: Accumulated Depreciation</b>				
Structures & Improvements	\$ (59,228)	\$ (12,968)	\$ -	\$ (72,196)
Distribution System	(5,115,466)	(312,641)	6,375	(5,421,732)
Machinery & Equipment	(913,678)	(88,864)	5,500	(997,042)
<b>Total Accumulated Depreciation</b>	<b>\$ (6,088,372)</b>	<b>\$ (414,473)</b>	<b>\$ 11,875</b>	<b>\$ (6,490,970)</b>
<b>Capital Assets, Net</b>	<b>\$ 11,193,264</b>	<b>\$ (253,860)</b>	<b>\$ (23,275)</b>	<b>\$ 10,916,129</b>

Included under the Water Company's capital assets at December 31, 2013 and 2012, were \$1,346,825 and \$1,243,679 of fully depreciated assets, respectively. Land and land rights, and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$408,143 and \$414,473 in 2013 and 2012, respectively.

**NOTE 9 – 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, 2013 and 2012, accrued interest on customer deposits was \$169 and \$1,677, respectively.

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

**NORTH SHELBY WATER COMPANY**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2013 and 2012

**NOTE 10 – LONG TERM DEBT**

As of December 31, 2013 and 2012, the long-term debt payable consisted of the following:

**Notes Payable:**

	<u>December 31, 2013</u>	<u>December 31, 2012</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.	\$ 74,183	\$ 83,565
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.	224,616	230,684
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.	236,431	241,547
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.	484,228	493,563
2012 RECD note, approved for \$1,070,000, secured by water revenues. Interest is charged at 3.5% per annum. Final maturity is November 21, 2052. Final draw is expected in 2014.	<u>967,438</u>	<u>76,830</u>
<b>Total Notes Payable</b>	<b>\$ 1,986,896</b>	<b>\$ 1,126,189</b>
<b>Current Portion</b>	<b>\$ 31,350</b>	<b>\$ 29,901</b>
<b>Noncurrent Portion</b>	<b>1,955,546</b>	<b>1,096,288</b>
<b>Total Notes Payable</b>	<b>\$ 1,986,896</b>	<b>\$ 1,126,189</b>

**Accrued Compensated Absences:**

<b>All Classified as Current</b>	<b>\$ 8,561</b>	<b>\$ 8,732</b>
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**Changes in Long-term Debt**

The following is a summary of changes in long-term debt for the years ended December 31, 2013 and 2012.

**December 31, 2013**

	<u>Balance at January 1, 2013</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2013</u>	<u>Current Portion</u>
Notes Payable	\$ 1,126,189	\$ 890,850	\$ (30,143)	\$ 1,986,896	\$ 31,350
Accrued Compensated Absences	8,732	-	(171)	8,561	8,561
<b>Total Long-Term Debt</b>	<b>\$ 1,134,921</b>	<b>\$ 890,850</b>	<b>\$ (30,314)</b>	<b>\$ 1,995,457</b>	<b>\$ 39,911</b>

**December 31, 2012**

	<u>Balance at January 1, 2012</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2012</u>	<u>Current Portion</u>
Notes Payable	\$ 1,089,832	\$ 76,830	\$ (40,473)	\$ 1,126,189	\$ 29,901
Accrued Compensated Absences	8,295	437	-	8,732	8,732
<b>Total Long-Term Debt</b>	<b>\$ 1,098,127</b>	<b>\$ 77,267</b>	<b>\$ (40,473)</b>	<b>\$ 1,134,921</b>	<b>\$ 38,633</b>

**NORTH SHELBY WATER COMPANY**  
**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**  
December 31, 2013 and 2012

**NOTE 10 – LONG-TERM DEBT (Continued)**

The annual requirements for all notes payable outstanding at December 31, 2013 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 31,350	\$ 86,225	\$ 117,575
2015	46,162	84,706	130,868
2016	48,231	82,637	130,868
2017	50,393	80,475	130,868
2018	52,654	78,214	130,868
2019-2023	251,285	355,996	607,281
2024-2028	286,741	299,799	586,540
2029-2033	353,702	230,968	584,670
2034-2038	332,529	156,948	489,477
2039-2043	222,461	95,419	317,880
2044-2048	196,635	60,115	256,750
2049-2053	114,753	16,421	131,174
	<u>\$ 1,986,896</u>	<u>\$ 1,627,923</u>	<u>\$ 3,614,819</u>

The annual requirements for all notes payable outstanding at December 31, 2012 (excluding the 2012 note for which amortization has not begun) are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	36,137	43,381	79,518
2018-2022	174,342	189,749	364,091
2023-2027	180,319	149,471	329,790
2028-2032	228,150	101,640	329,790
2033-2037	203,712	48,033	251,745
2038-2040	98,114	8,085	106,199
	<u>\$ 1,049,359</u>	<u>\$ 729,846</u>	<u>\$ 1,779,205</u>

**NOTE 11 – INTEREST EXPENSE**

Interest expense incurred for the years ended December 31, 2013 and 2012 was \$53,516 and \$52,034, respectively. \$16,770 of construction related interest expense was capitalized in 2013. \$269 of construction related interest expense was capitalized in 2012.

**NOTE 12 – FUND EQUITY – RESTRICTED NET POSITION**

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
Restricted for Capital Projects:		
Monies Restricted for Construction	\$ 37,756	\$ 12,839
Total Restricted for Capital Projects	<u>\$ 37,756</u>	<u>\$ 12,839</u>
Restricted for Debt Service:		
RECD Notes Payable		
Cash	\$ 948,300	\$ 892,198
Less: Accrued Interest Payable	(30,442)	(27,759)
Total Restricted for Debt Service	<u>\$ 917,858</u>	<u>\$ 864,439</u>

NORTH SHELBY WATER COMPANY  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2013 and 2012

**NOTE 13 – BAD DEBT EXPENSE**

Water revenue charges have been netted with an estimated bad debt expense of \$3,727 and \$6,185 at December 31, 2013 and 2012, 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, 2013 and 2012. 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 may be extended to beneficiaries of plan members under certain circumstances. Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce cost-of-living adjustments if, in its judgment, the welfare of the Commonwealth so demands. On July 1, 2013, the COLA was not granted.

**Contributions** – For the fiscal years ended June 30, 2013, and 2012, plan members who began participating prior to September 1, 2008, 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 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 fiscal years ended June 30, 2013 and 2012, participating employers contributed 19.55% and 18.96%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012, were 19.55% and 18.96%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member's account while the 1% was deposited to an account created for the payment of health insurance benefits under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 5% of their annual creditable compensation.

**NORTH SHELBY WATER COMPANY  
 NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
 December 31, 2013 and 2012**

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

The Water Company's total payroll for the year ended December 31, 2013 was \$413,707. Contributions were based on \$404,907 (eligible gross wages). The total pension expense for the year ended December 31, 2013 was \$77,793 and \$20,733 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2013.

The Water Company's total payroll for the year ended December 31, 2012 was \$394,319. Contributions were based on \$361,169 (eligible gross wages). The total pension expense for the year ended December 31, 2012 was \$74,321 and \$19,755 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2012.

The Water Company's contribution for the years ended June 30, 2013 and 2012 were .021% and .020% 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>Percentage Contributions</u>
June 30, 2013	490,475,114	454,906,887	92.7%
June 30, 2012	476,185,027	447,661,027	94.0%
June 30, 2011	432,414,052	435,404,150	100.0%

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, 2013, and 2012, the Water Company had accrued compensated absence liabilities of \$8,561 and \$8,732, respectively.

**Sick Days**

Sick leave accrues at the rate of twelve days per year and shall accumulate without limit. At December 31, 2013, the Water Company had an unrecorded sick pay liability of \$70,494. At December 31, 2012, the Water Company had an unrecorded sick pay liability of \$61,211.

**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, and Louisville Water Company.

**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 \$271,978 and \$266,731 for these services for the years ended December 31, 2013 and 2012, respectively. There was a receivable due from U.S. 60 Water District in the amount of \$10,990, at December 31, 2012. There was a payable to U.S. 60 Water District at December 31, 2013, of \$583 that was the result of a one month overpayment.

NORTH SHELBY WATER COMPANY  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
December 31, 2013 and 2012

**NOTE 19 – COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS**

North Shelby Water Company plans to replace all of the meters on its system over the next four years with Radio Read Meters. This will begin in 2014.

North Shelby Water Company is beginning Phase III of the East-West Connector project. North Shelby Water Company will construct an East-West Connector line which will transport water purchased from Louisville Water Company. The first phase of this project consisted of the construction of the new Long Run Pump Station. A second, dual purpose pump station to pump water from Louisville Water Company eastward through the new East-West Connector and/or westward to North Central and Northwestern Shelby County is to be constructed during the second phase once the East-West Connector lines are complete.

**NOTE 20 – RECENTLY ISSUED ACCOUNTING PRONOUCEMENTS**

In June 2012, the GASB issued Statement 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement 27*. GASB 68 is effective for periods beginning after June 15, 2014. Under this statement governments will be required to report the net pension liability associated with its employee's pensions as a liability in their accrual-based financial statements (for example, the government-wide Statement of Net Position). A government has a present obligation to pay deferred benefits earned by its employees. "*Net Position Liability*" represents the government's obligation to pay deferred benefits when the total pension [plan's] liability exceeds the pension plan's net assets. This reporting requirement is an important change that will more clearly depict the government's financial position. While this information will, in some cases give the appearance that a government is financially weaker than it was previously, the financial reality of the government's situation will not have changed. Management is currently evaluating the impact of the adoption of this statement on the Company's financial statements.

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

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

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 North Shelby Water Company as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise North Shelby Water Company's basic financial statements, and have issued our report thereon dated March 27, 2014.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit of the financial statements, we considered North Shelby Water Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of North Shelby Water Company's internal control. Accordingly, we do not express an opinion on the effectiveness of North Shelby Water Company's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

*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 2013-001 and 2013-002).

*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. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency (Item 2013-003).

**COMPLIANCE AND OTHER MATTERS**

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

**NORTH SHELBY WATER COMPANY'S RESPONSE TO FINDINGS**

North Shelby Water Company's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. North Shelby Water Company's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**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 result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Raisor, Zapp & Woods, P.S.C.*

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

March 27, 2014

**NORTH SHELBY WATER COMPANY  
SCHEDULE OF FINDINGS AND RESPONSES  
For the Year Ended December 31, 2013**

**A. SUMMARY OF AUDIT RESULTS**

1. The auditor's 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 2013-001 and 2013-002 were reported as material weaknesses. Item 2013-003 was reported as a significant deficiency.
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**

**2013-001 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, 2012 as Item 12-1.

**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, 2013**

**B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)**

**GOVERNMENT AUDITING STANDARDS (Continued)**

**DEFICIENCIES IN INTERNAL CONTROL (Continued)**

**2013-001 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.

**2013-002 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, 2012 as Item 12-2.

**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, 2013**

**B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)**

**GOVERNMENT AUDITING STANDARDS (Continued)**

**DEFICIENCIES IN INTERNAL CONTROL (Continued)**

**2013-003 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 cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2012 as Item 12-3.

**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**