

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

At December 31, 2014 and 2013

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

Years Ended December 31, 2014 and 2013

TABLE OF CONTENTS

Independent Auditor's Report	1-2
Basic Financial Statements:	
Statement of Net Position	3
Statement of Revenues, Expenses, and Changes in Fund Net Position	4
Statement of Cash Flows	5-6
Notes to Basic Financial Statements	7-17
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 <u>Government Auditing Standards</u>	18-19
Independent Auditor's Report on Compliance for Each Major Program and on Internal Control Over Compliance Required by OMB Circular A-133	20-21
Schedule of Expenditures of Federal Award and Notes to the Schedule of Expenditures of Federal Awards	22
Schedule of Findings and Questioned Costs	23-26
Summary Schedule of Prior Audit Findings	27

RAISOR, ZAPP & WOODS, PSC

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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, 2014 and 2013, 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, 2014 and 2013, 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 25, 2015, 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
Certified Public Accountants
Carrollton, Kentucky

March 25, 2015

NORTH SHELBY WATER COMPANY
STATEMENT OF NET POSITION
December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Current Assets:		
Cash	\$ 1,467,198	\$ 1,084,401
Accounts Receivable (Net)	156,909	184,407
Other Receivables	27,132	-
Note Receivable - Current Portion	-	1,832
Inventory	97,494	84,670
Prepaid Expenses	22,239	35,680
Total Current Assets	<u>\$ 1,770,972</u>	<u>\$ 1,390,990</u>
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 1,351,007	\$ 986,056
Note Receivable	-	55,554
Capital Assets (Net)	<u>12,669,333</u>	<u>11,485,248</u>
Total Noncurrent Assets	<u>\$ 14,020,340</u>	<u>\$ 12,526,858</u>
Total Assets	<u>\$ 15,791,312</u>	<u>\$ 13,917,848</u>
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 144,693	\$ 140,803
Accounts Payable - Construction	480,116	9,874
Retainage Payable - Construction	28,682	-
Accrued Compensated Absences	8,628	8,561
Accrued Employee Benefits	7,043	5,807
Accrued Payroll Taxes/Employee Withholding	6,893	5,460
Utility Tax Payable	5,501	5,294
Sales Tax Payable	172	235
Accrued Interest Payable - Customer Deposits	173	169
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Notes Payable	38,302	30,442
Notes Payable	46,162	31,350
Total Current Liabilities	<u>\$ 766,365</u>	<u>\$ 237,995</u>
Noncurrent Liabilities:		
Notes Payable	\$ 3,210,971	\$ 1,955,546
Customer Deposits Payable	267,870	262,728
Total Noncurrent Liabilities	<u>\$ 3,478,841</u>	<u>\$ 2,218,274</u>
Total Liabilities	<u>\$ 4,245,206</u>	<u>\$ 2,456,269</u>
NET POSITION		
Net Investment in Capital Assets	\$ 9,241,054	\$ 9,498,352
Restricted for Capital Projects	373,563	37,756
Restricted for Debt Service	939,142	917,858
Unrestricted	<u>992,347</u>	<u>1,007,613</u>
Total Net Position	<u>\$ 11,546,106</u>	<u>\$ 11,461,579</u>

NORTH SHELBY WATER COMPANY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For the Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 2,223,930	\$ 2,227,728
Total Charges for Services	<u>\$ 2,223,930</u>	<u>\$ 2,227,728</u>
Other Charges and Miscellaneous:		
Forfeited Discounts & Service Charges	\$ 66,725	\$ 63,882
Building Rental Income	24,000	24,000
Equipment Rental Income	58,001	59,562
Contractual Services	94,775	89,053
Miscellaneous	8,844	6,088
Total Other Charges and Miscellaneous	<u>\$ 252,345</u>	<u>\$ 242,585</u>
Total Operating Revenues	<u>\$ 2,476,275</u>	<u>\$ 2,470,313</u>
Operating Expenses:		
Accounting and Collecting Labor	\$ 275,735	\$ 258,436
Commissioner Fees	33,600	33,700
Contractual Service	79,349	81,391
Employee Retirement & Benefits	201,365	193,319
Insurance	44,310	38,423
Maintenance of Mains	77,730	80,998
Miscellaneous	10,234	11,893
Office Supplies and Expense	57,216	54,692
Operating Labor	72,715	75,297
Other Interest Expense	1,239	1,216
Payroll Taxes	34,071	32,135
Professional Services	44,327	47,106
Purchased Water	899,948	859,563
Purchased Power	92,525	94,276
Regulatory Fees	4,829	4,349
Transportation Expense	42,959	47,340
Utilities	20,719	18,995
Depreciation Expense	453,674	408,143
Total Operating Expenses	<u>\$ 2,446,545</u>	<u>\$ 2,341,272</u>
Operating Income (Loss)	<u>\$ 29,730</u>	<u>\$ 129,041</u>
Nonoperating Revenue (Expense):		
Investment Income	\$ 4,562	\$ 6,594
Interest Expense	(82,315)	(52,300)
Gain (Loss) on Disposition of Fixed Assets	8,304	8,685
Total Nonoperating Revenues (Expense)	<u>\$ (69,449)</u>	<u>\$ (37,021)</u>
Net Income Before Contributions	\$ (39,719)	\$ 92,020
Capital Contributions	<u>124,246</u>	<u>38,905</u>
Net Income	\$ 84,527	\$ 130,925
Net Position--Beginning of Year	<u>11,461,579</u>	<u>11,330,654</u>
Net Position--End of Year	<u>\$ 11,546,106</u>	<u>\$ 11,461,579</u>

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2014 and 2013

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 2,482,125	\$ 2,480,938
Payments to Suppliers	(1,584,997)	(1,546,557)
Payments to Employees	(400,627)	(380,258)
Other Receipts (Payments)	(198)	3,124
Net Cash Provided (Used) by Operating Activities	<u>\$ 496,303</u>	<u>\$ 557,247</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Contributions	\$ 124,246	\$ 38,905
Purchases of Capital Assets	(1,138,835)	(985,666)
Principal Received - Building Sale	57,386	1,441
Proceeds from Rural Development Note	1,301,587	890,850
Proceeds Sale of Capital Assets	8,304	21,421
Principal Paid on Capital Debt	(31,350)	(30,143)
Interest Paid on Capital Debt (Including Capitalized Interest)	(74,455)	(49,617)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>\$ 246,883</u>	<u>\$ (112,809)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Cash Received (Invested) in Certificates of Deposits	\$ (922)	\$ (1,709)
Interest Received	4,562	6,594
Net Cash Provided (Used) by Investing Activities	<u>\$ 3,640</u>	<u>\$ 4,885</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	 \$ 746,826	 \$ 449,323
 Balances-Beginning of the Year	 <u>1,751,298</u>	 <u>1,301,975</u>
 Balances-End of the Year	 <u><u>\$ 2,498,124</u></u>	 <u><u>\$ 1,751,298</u></u>

	Balances Per December 31, 2014 Statement of Net Position	Balances Per December 31, 2014 Statement of Cash Flows
Unrestricted Cash	\$ 1,467,198	\$ 1,467,198
Restricted Cash	1,030,926	1,030,926
Restricted Certificates of Deposit	320,081	-
Total Cash and Cash Equivalents, End of Year	<u><u>\$ 2,818,205</u></u>	<u><u>\$ 2,498,124</u></u>

	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	<u><u>\$ 2,070,457</u></u>	<u><u>\$ 1,751,298</u></u>

(Continued)

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ 29,730	\$ 129,041
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	453,674	408,143
Change in Assets and Liabilities:		
Receivables, Net	27,498	(7,753)
Other Receivables	(27,132)	11,771
Inventories	(12,824)	(4,057)
Prepaid Expenses	13,441	(12,559)
Accounts Payable	3,890	25,089
Accrued Expenses	2,884	(2,100)
Customer Meter Deposits Payable	5,142	9,672
Net Cash Provided by Operating Activities	<u>\$ 496,303</u>	<u>\$ 557,247</u>

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

At December 31, 2014, North Shelby Water Company had \$508,798 outstanding accounts payable and retainage payable related to capital projects in process.

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

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2014 and 2013**

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, 2014 and 2013

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

Deferred outflows of resources and deferred inflows of resources are not assets or liabilities; revenues or expenses. Rather, they represent resources or the use of resources related to future periods.

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. Tap-on fees of \$55,896 and \$30,000 were received by the Water Company for the years ended December 31, 2014 and 2013. Customer contributions of \$68,350 and \$8,905 were received by the Water Company for the years ended December 31, 2014 and 2013, respectively, for hydrants.

Net position: 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.

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 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.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013**

NOTE 2 – DEBT RESTRICTIONS AND COVENANTS (Continued)

Transfers sufficient to meet the total obligation outstanding on all notes were made timely during the years ended December 31, 2014 and 2013.

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 2012 note required an additional \$515 each month until a balance of \$61,800 is accumulated. The 2013 note required an additional \$840 each month until a balance of \$100,800 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, 2014 and 2013.

A funded short lived asset account is required under the letter of conditions establishing funding for the 2012 and 2013 Rural Development notes. A short lived asset account must be funded at the beginning of the next calendar year following the completion and operational startup of the asset. Under the 2012 Note agreement, the Company must deposit \$1,667 monthly into the account. Under the 2013 Note agreement, the Company must deposit \$3,335 monthly into the account. This account may be used as needed to replace and add short lived assets in the Company's water system. A short lived asset account had not been created as of December 2014.

NOTE 3 – CASH AND INVESTMENTS

North Shelby Water Company invests in obligations of the United States and its agencies and instrumentalities through sources including national and state banks chartered in Kentucky, obligations and contracts for future delivery backed by the full faith of the United States or its Agency, certificates of deposit and interest bearing accounts in institutions insured by the Federal Depository Insurance Corporation and other investments described therein.

Custodial Credit Risk

Custodial credit risk for deposit is the risk that in the event of a bank failure, the Company's deposits may not be returned to it. As of December 31, 2014, and 2013, \$1,205,021 and \$981,479, respectively, of the Company's deposits were covered by federal depository insurance and \$1,573,810 and \$1,101,758 were collateralized by securities held by the pledging financial institution's agent or trust department in the Company's name. As of December 31, 2014, \$43,401 was not collateralized by securities and therefore exposed to custodial risk.

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, 2014 and 2013. 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.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

NOTE 3 – CASH AND INVESTMENTS (Continued)

December 31, 2014

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Demand Deposits	\$ 373,563	\$ 260,050	\$ 113,513	\$ -	\$ 373,563
Time and Savings	2,448,669	944,971	1,460,297	43,401	2,444,142
Total Deposits	<u>\$ 2,822,232</u>	<u>\$ 1,205,021</u>	<u>\$ 1,573,810</u>	<u>\$ 43,401</u>	<u>\$ 2,817,705</u>

December 31, 2013

Type of Deposits	Total Bank Balance	Custody Credit Risk Category			Total Carrying Value
		1	2	3	
Demand Deposits	\$ 37,756	\$ 37,756	\$ -	\$ -	\$ 37,756
Time and Savings	2,045,481	943,723	1,101,758	-	2,032,451
Total Deposits	<u>\$ 2,083,237</u>	<u>\$ 981,479</u>	<u>\$ 1,101,758</u>	<u>\$ -</u>	<u>\$ 2,070,207</u>

Reconciliation to Statement of Net Position:

	December 31, 2014	December 31, 2013
Unrestricted Cash,	\$ 1,467,198	\$ 1,084,401
Restricted Cash, Including Time Deposits	1,351,007	986,056
Less Cash on Hand	(500)	(250)
	<u>\$ 2,817,705</u>	<u>\$ 2,070,207</u>

NOTE 4 – RESTRICTED ASSETS

Restricted cash and time deposits consist of the following:

	December 31, 2014	December 31, 2013
Debt Service Accounts	\$ 612,795	\$ 611,101
Depreciation Accounts	364,649	337,199
Construction Accounts	<u>373,563</u>	<u>37,756</u>
Total	<u>\$ 1,351,007</u>	<u>\$ 986,056</u>

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$21,316 and \$10,674 at December 31, 2014 and 2013, 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 \$149,846 and \$173,981 is included in accounts receivable at December 31, 2014 and 2013, respectively.

NOTE 6 – OTHER RECEIVABLES

Other receivables at December 31, 2014, included \$27,132 receivable for the joint operations contract between North Shelby Water Company and U.S. 60 Water District of Shelby and Franklin Counties. 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 was included in Accounts Payable at December 31, 2013.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

NOTE 7 – NOTE RECEIVABLE

On August 29, 2011, the Company sold the office building located on Elmburg Road. The sales price was \$65,000. The Company received \$4,000 as a downpayment and financed the remaining balance through a note receivable. Interest was charged at six percent (6%) per annum. Fifty nine monthly payments of \$437.02 (principal and interest) were to be made until July 29, 2016. The balance outstanding at December 31, 2013 was \$57,386.

Two payments were made on the loan during 2014 prior to the loan entering a default status. The Company reacquired the building and relinquished the buyer of its debt to the Company. In 2014, the Company again sold the office building. The Company received the funds from the sale at closing and no longer possess an interest in the office building. The Company recognized a gain of \$3,264 upon the disposition of the building in 2014.

NOTE 8 – CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2014 and 2013, was as follows:

	Balance at January 1, 2014	Additions	Disposals	Balance at December 31, 2014
Land & Land Rights	\$ 89,526	\$ -	\$ -	\$ 89,526
Structures & Improvements	385,725	-	-	385,725
Distribution System	15,336,596	124,246	(101,440)	15,359,402
Machinery & Equipment	2,539,194	32,410	-	2,571,604
Construction in Process	-	1,586,362	(105,259)	1,481,103
Totals at Historical Cost	<u>\$ 18,351,041</u>	<u>\$ 1,743,018</u>	<u>\$ (206,699)</u>	<u>\$ 19,887,360</u>
Less: Accumulated Depreciation				
Structures & Improvements	\$ (85,164)	\$ (12,967)	\$ -	\$ (98,131)
Distribution System	(5,734,963)	(314,663)	101,440	(5,948,186)
Machinery & Equipment	(1,045,666)	(126,044)	-	(1,171,710)
Total Accumulated Depreciation	<u>\$ (6,865,793)</u>	<u>\$ (453,674)</u>	<u>\$ 101,440</u>	<u>\$ (7,218,027)</u>
Capital Assets, Net	<u>\$ 11,485,248</u>	<u>\$ 1,289,344</u>	<u>\$ (105,259)</u>	<u>\$ 12,669,333</u>
	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)	-
Totals at Historical Cost	<u>\$ 17,407,099</u>	<u>\$ 1,968,170</u>	<u>\$ (1,024,228)</u>	<u>\$ 18,351,041</u>
Less: Accumulated Depreciation				
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)
Total Accumulated Depreciation	<u>\$ (6,490,970)</u>	<u>\$ (408,143)</u>	<u>\$ 33,320</u>	<u>\$ (6,865,793)</u>
Capital Assets, Net	<u>\$ 10,916,129</u>	<u>\$ 1,560,027</u>	<u>\$ (990,908)</u>	<u>\$ 11,485,248</u>

Included under the Water Company's capital assets at December 31, 2014 and 2013, were \$1,339,504 and \$1,346,825 of fully depreciated assets, respectively. Land and land rights, and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$453,674 and \$408,143 in 2014 and 2013, respectively.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

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, 2014 and 2013, accrued interest on customer deposits was \$173 and \$169, respectively.

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

NOTE 10 – LONG TERM DEBT

As of December 31, 2014 and 2013, the long-term debt payable consisted of the following:

Notes Payable:

	<u>December 31, 2014</u>	<u>December 31, 2013</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.	\$ 64,332	\$ 74,183
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.	218,207	224,616
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.	231,084	236,431
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.	474,486	484,228
2012 RECD note, approved for \$1,070,000, secured by water revenues. Interest is charged at 3.5% per annum. Final maturity is November, 2052. Final draw is expected in 2015.	1,004,348	967,438
2014 RECD note, approved for \$2,100,000, secured by water revenues. Interest is charged at 3.125% per annum. Final maturity is September, 2054. Final draw is expected in 2015.	1,264,676	-
Total Notes Payable	\$ 3,257,133	\$ 1,986,896
Current Portion	\$ 46,162	\$ 31,350
Noncurrent Portion	3,210,971	1,955,546
Total Notes Payable	\$ 3,257,133	\$ 1,986,896
Accrued Compensated Absences:		
All Classified as Current	\$ 8,628	\$ 8,561

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

NOTE 10 – LONG TERM DEBT (Continued)

Changes in Long-term Debt

The following is a summary of changes in long-term debt for the years ended December 31, 2014 and 2013.

December 31, 2014

	Balance at January 1, 2014	Additions	Repayments	Balance at December 31, 2014	Current Portion
Notes Payable	\$ 1,986,896	\$ 1,301,587	\$ (31,350)	\$ 3,257,133	\$ 46,162
Accrued Compensated Absences	8,561	67	-	8,628	8,628
Total Long-Term Debt	<u>\$ 1,995,457</u>	<u>\$ 1,301,654</u>	<u>\$ (31,350)</u>	<u>\$ 3,265,761</u>	<u>\$ 54,790</u>

December 31, 2013

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

The annual requirements for all notes payable outstanding at December 31, 2014 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 46,162	\$ 124,798	\$ 170,960
2016	48,231	122,729	170,960
2017	68,025	120,567	188,592
2018	70,845	117,747	188,592
2019	80,965	114,807	195,772
2020-2024	344,777	530,386	875,163
2025-2029	419,886	455,275	875,161
2030-2034	491,181	363,068	854,249
2035-2039	494,774	267,338	762,112
2040-2044	392,467	183,105	575,572
2045-2049	428,699	116,671	545,370
2050-2054	371,121	40,381	411,502
	<u>\$ 3,257,133</u>	<u>\$ 2,556,872</u>	<u>\$ 5,814,005</u>

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>

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

NOTE 11 – INTEREST EXPENSE

Interest expense incurred for the years ended December 31, 2014 and 2013 was \$89,029 and \$70,286, respectively. \$5,475 and \$16,770 of construction related interest expense was capitalized in 2014 and 2013, respectively.

NOTE 12 – FUND EQUITY – RESTRICTED NET POSITION

	<u>December 31, 2014</u>	<u>December 31, 2013</u>
Restricted for Capital Projects:		
Monies Restricted for Construction	\$ 373,563	\$ 37,756
Total Restricted for Capital Projects	<u>\$ 373,563</u>	<u>\$ 37,756</u>
Restricted for Debt Service:		
RECD Notes Payable		
Cash	\$ 977,444	\$ 948,300
Less: Accrued Interest Payable	(38,302)	(30,442)
Total Restricted for Debt Service	<u>\$ 939,142</u>	<u>\$ 917,858</u>

NOTE 13 – BAD DEBT EXPENSE

Water revenue charges have been netted with an estimated bad debt expense of \$12,743 and \$3,727 at December 31, 2014 and 2013, 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 District may participate in the System. The most recent financial report on CERS is included in the Kentucky Retirement System's annual report, June 30, 2014. 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 (COLAs) 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.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

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

Contributions - For the fiscal years ended June 30, 2014 and 2013, 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 78.545(33), 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, 2014 and 2013, participating employers contributed 18.89% and 19.55%, respectively, of each employer's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2014 and 2013, were 18.89% and 19.55%, 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.

In accordance with Senate Bill 2, signed by the Governor on April 4, 2013, plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own account. Non-hazardous members contribute 5% of their annual creditable compensation and 1% to the health insurance fund which is not credited to the member's account and is not refundable. The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of the member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. For non-hazardous members, their account is credited with a 4% employer pay credit. The employer pay credit represents a portion of the employer contribution.

The Company's total payroll for the year ended December 31, 2014 was \$435,530. Contributions were based on \$426,930 (eligible gross wages). The total pension expense for the year ended December 31, 2014 was \$78,386 and \$21,875 for the employer and employees, respectively. All contributions were made as required during the year ended December 31, 2014.

The 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 this year.

The Company's contribution for the year ended June 30, 2014 and 2013, was .022% and .021%, respectively, of the System's total contribution requirements for all employers.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013**

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

For non-hazardous duty, the required contributions to the plan for all participating employees were as follows (\$ in thousands):

County Employees Retirement System (CERS) – Pension Funds

	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Actual Contributions as a Percentage of Covered Employee Payroll</u>
June 30, 2014	324,231	324,231	14.27%
June 30, 2013	294,914	294,914	13.19%
June 30, 2012	261,764	275,736	12.33%

County Employees Retirement System (CERS) – Insurance Funds

	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Actual Contributions as a Percentage of Covered Employee Payroll</u>
June 30, 2014	130,652	123,278	94.40%
June 30, 2013	195,561	159,993	81.80%
June 30, 2012	214,421	171,925	80.20%

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, 2014, and 2013, the Water Company had accrued compensated absence liabilities of \$8,628 and \$8,561, respectively.

Sick Days

Sick leave accrues at the rate of twelve days per year and shall accumulate without limit. At December 31, 2014, the Water Company had an unrecorded sick pay liability of \$84,053. At December 31, 2013, the Water Company had an unrecorded sick pay liability of \$70,494.

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 \$259,662 and \$271,978 for these services for the years ended December 31, 2014 and 2013, respectively. There was a receivable due from U.S. 60 Water District in the amount of \$27,132, at December 31, 2014. There was a payable to U.S. 60 Water District at December 31, 2013, of \$583 that was the result of an overpayment.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2014 and 2013

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 began in 2014 and will continue.

North Shelby Water Company is beginning Phase III of the East-West Connector project. North Shelby Water Company is constructing 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 being constructed during the second phase of the East-West Connector project. The third phase of this project is in the preliminary stage.

NOTE 20 – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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.

RAISOR, ZAPP & WOODS, PSC

Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF 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 the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of North Shelby Water Company as of and for the year ended December 31, 2014, 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 25, 2015.

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 questioned costs, we identified certain deficiencies in internal control 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 questioned costs to be material weaknesses (Items 2014-001 and 2014-002).

COMPLIANCE AND OTHER MATTERS

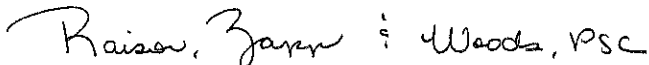
As part of obtaining reasonable assurance about whether North Shelby Water Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct 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 questioned costs. 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
Certified Public Accountants
Carrollton, Kentucky

March 25, 2015

RAISOR, ZAPP & WOODS, PSC

Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

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

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM

We have audited North Shelby Water Company's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of North Shelby Water Company's major federal programs for the year ended December 31, 2014. North Shelby Water Company's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of North Shelby Water Company's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about North Shelby Water Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of North Shelby Water Company's compliance.

Opinion on Each Major Federal Program

In our opinion, North Shelby Water Company complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2014.

To the Board of Directors of
North Shelby Water Company
Page Two

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Management of North Shelby Water Company is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered North Shelby Water Company's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of North Shelby Water Company's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as Item 2014-003 that we consider to be a significant deficiency.

North Shelby Water Company's response to the internal control over compliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. North Shelby Water Company's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Raisor, Zapp & Woods, PSC

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

March 25, 2015

**NORTH SHELBY WATER COMPANY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2014**

<u>Federal Grant/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures</u>
<u>United States Department of Agriculture</u>			
Direct Program			
Water and Waste Disposal Systems for Rural Communities	10.760	-	\$ 1,381,645
Total United States Department of Agriculture			\$ 1,381,645
Total Expenditures of Federal Awards			\$ 1,381,645

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note A: Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of North Shelby Water Company under programs of the federal government for the year ended December 31, 2014, and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the North Shelby Water Company, it is not intended to and does not present the financial position, changes in net position, or cash flows of North Shelby Water Company.

Note B: Insurance

The North Shelby Water Company did not receive any other federal awards in the form of non-cash assistance, insurance contracts, or loan guarantees for the year ended December 31, 2014.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2014**

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unmodified opinion on the financial statements of North Shelby Water Company.
2. Two 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 2014-001 and 2014-002 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.
4. One significant deficiency in internal control over the major federal award program was disclosed during the audit and reported in the Report on Compliance for Each Major Program and on Internal Control over Compliance Required by OMB Circular A-133. Item 2014-003 was reported as a significant deficiency.
5. The auditor's report on compliance for the major federal award program for the North Shelby Water Company expresses an unmodified opinion on the major federal program.
6. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this Schedule.
7. The program tested as a major program was:

	<u>CFDA No.</u>
United States Department of Agriculture: Water and Waste Disposal Systems for Rural Communities	 10.760

8. The threshold used for distinguishing between Type A and Type B programs was \$300,000.
9. The North Shelby Water Company did not qualify as a low risk auditee.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

GOVERNMENT AUDITING STANDARDS

DEFICIENCIES IN INTERNAL CONTROL

2014-001 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. A breakdown of communication among management positions allowed approved rate increases to not be implemented timely resulting in the Company charging less than the approved rates for approximately half of the calendar year. This condition was also cited as a material weakness in the schedule of findings and responses for the year ended December 31, 2013 as Item 2013-001.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2014**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

**2014-001 SIZE OF ENTITY, CROSS-TRAINING, CHECKING PROCEDURES AND DOCUMENTATION
(Continued)**

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. Communication between the Board of Directors, management and administrative staff was inadequate in regards to Board approved changes.

EFFECT:

These limitations may affect the ability to timely record, process, summarize and report financial data. Approved rate increases were not implemented resulting in smaller margins for the Company.

RECOMMENDATION:

Management should strive to provide cross-training for administrative staff, implement checking processes and increase review procedures. Procedures should be implemented to ensure all Board actions are fully conducted by Company management and staff.

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 review procedures associated.

**2014-002 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, 2013 as Item 2013-002.

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.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2014**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

**2014-002 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED
NOTE DISCLOSURES**

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.

COMPLIANCE

None

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

SIGNIFICANT DEFICIENCIES

2014-003 Checking and Review Procedures

U.S. Department of Agriculture: Direct Program, Water and Waste Disposal Systems for Rural Communities - CFDA #10.760

CONDITION:

Checking procedures and rotation of duties are limited due to the size of the administrative staff and responsibilities associated with individual positions. Training for managerial and staff responsibilities associated with the federal program are limited. Administrative review procedures have not been executed fully in oversight. Managerial staff depends on external parties for federal program oversight.

CRITERIA:

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

CAUSE:

Responsibilities of the Water Company staff for federal program requirements have not been clearly defined and communicated resulting in board approvals not being implemented timely.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2014**

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT (Continued)

SIGNIFICANT DEFICIENCIES (Continued)

2014-003 Checking and Review Procedures (Continued)

U.S. Department of Agriculture: Direct Program, Water and Waste Disposal Systems for Rural Communities - CFDA #10.760 (Continued)

EFFECT:

Board approved rate increases were not implemented timely. Specific requirements of the Rural Development financing as set forth in its letter of conditions were not communicated to all appropriate Water Company staff. Lack of communication could cause a failure to implement board directives.

RECOMMENDATION:

Management should strive to separate duties and implement checking procedures. Employees should be fully trained on compliance requirements associated with the federal programs. Additionally, the Water Company should clearly define job requirements and responsibilities. Management should continue to contract with knowledgeable parties of federal program compliance, but should be aware that the Company, itself, is the entity with ultimate responsibility.

RESPONSE:

The Water Company will clearly define the job requirements and responsibilities of Water Company staff. North Shelby Water Company will implement review and checking procedures to determine that all requirements and board approvals are communicated and implemented properly.

COMPLIANCE

None

**NORTH SHELBY WATER COMPANY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
For the Year Ended December 31, 2014**

There were no prior year audit findings to report.