

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

At December 31, 2015 and 2014

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

Years Ended December 31, 2015 and 2014

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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, 2015 and 2014, 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, 2015 and 2014, 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.

Changes in Accounting Principle

As described in Note 19 to the financial statements for the year ended December 31, 2015, the North Shelby Water Company adopted new accounting guidance, GASB Statement No. 68, *Accounting and Finance Reporting for Pensions – an Amendment of GASB Statement No. 27* and GASB Statement No. 71 – *Pension Transition for Contributions Made Subsequent to the Measurement Date – an Amendment of GASB No. 68*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Schedule of the Water Company's Proportionate Share of the Net Pension Liability – County Employees Retirement System on Page 21, and the Schedule of Water Company's Contributions – County Employee Retirement System on Page 22 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the North Shelby Water Company's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2016, 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

June 24, 2016

NORTH SHELBY WATER COMPANY
STATEMENT OF NET POSITION
December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
ASSETS		
Current Assets:		
Cash	\$ 1,409,760	\$ 1,467,198
Accounts Receivable (Net)	179,227	156,909
Other Receivables	24,090	27,132
Inventory	141,788	97,494
Prepaid Expenses	30,422	22,239
Total Current Assets	<u>\$ 1,785,287</u>	<u>\$ 1,770,972</u>
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 1,191,051	\$ 1,351,007
Capital Assets (Net)	13,293,366	12,669,333
Total Noncurrent Assets	<u>\$ 14,484,417</u>	<u>\$ 14,020,340</u>
Total Assets	<u>\$ 16,269,704</u>	<u>\$ 15,791,312</u>
DEFERRED OUTFLOWS OF RESOURCES		
Attributable to Employee Pension Plan	<u>\$ 141,648</u>	<u>\$ 39,634</u>
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 138,466	\$ 144,693
Accounts Payable - Construction	-	480,116
Retainage Payable - Construction	1,000	28,682
Accrued Compensated Absences	8,935	8,628
Accrued Employee Benefits	7,178	7,043
Accrued Payroll Taxes/Employee Withholding	6,186	6,893
Utility Tax Payable	5,622	5,501
Sales Tax Payable	159	172
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Customer Deposits	131	173
Accrued Interest Payable - Notes Payable	49,797	38,302
Notes Payable	48,231	46,162
Total Current Liabilities	<u>\$ 265,705</u>	<u>\$ 766,365</u>
Noncurrent Liabilities:		
Notes Payable	\$ 4,064,543	\$ 3,210,971
Customer Deposits Payable	270,492	267,870
Net Pension Liability	783,379	579,000
Total Noncurrent Liabilities	<u>\$ 5,118,414</u>	<u>\$ 4,057,841</u>
Total Liabilities	<u>\$ 5,384,119</u>	<u>\$ 4,824,206</u>
DEFERRED INFLOWS OF RESOURCES		
Attributable to Employee Pension Plan	<u>\$ 52,000</u>	<u>\$ 65,000</u>
NET POSITION		
Net Investment in Capital Assets	\$ 9,179,592	\$ 9,241,054
Restricted for Capital Projects	132,914	373,563
Restricted for Debt Service	1,008,340	939,142
Unrestricted	654,387	387,981
Total Net Position	<u>\$ 10,975,233</u>	<u>\$ 10,941,740</u>

See accompanying notes to the basic financial statements.

NORTH SHELBY WATER COMPANY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For the Years Ended December 31, 2015 and 2014

	2015	Restated 2014
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 2,440,681	\$ 2,223,930
Total Charges for Services	<u>\$ 2,440,681</u>	<u>\$ 2,223,930</u>
Other Charges and Miscellaneous:		
Forfeited Discounts & Service Charges	\$ 61,163	\$ 66,725
Building Rental Income	24,000	24,000
Equipment Rental Income	57,796	58,001
Contractual Services	106,828	94,775
Miscellaneous	12,641	8,844
Total Other Charges and Miscellaneous	<u>\$ 262,428</u>	<u>\$ 252,345</u>
Total Operating Revenues	<u>\$ 2,703,109</u>	<u>\$ 2,476,275</u>
Operating Expenses:		
Accounting and Collecting Labor	\$ 288,504	\$ 275,735
Commissioner Fees	32,600	33,600
Contractual Service	105,469	79,349
Employee Retirement & Benefits	313,083	247,365
Insurance	44,156	44,310
Maintenance of Mains	59,237	77,730
Miscellaneous	17,580	10,234
Office Supplies and Expense	53,013	57,216
Operating Labor	70,528	72,715
Other Interest Expense	1,505	1,239
Payroll Taxes	33,899	34,071
Professional Services	47,998	44,327
Purchased Water	958,453	899,948
Purchased Power	86,706	92,525
Regulatory Fees	4,732	4,829
Transportation Expense	29,588	42,959
Utilities	26,751	20,719
Depreciation Expense	458,962	453,674
Total Operating Expenses	<u>\$ 2,632,764</u>	<u>\$ 2,492,545</u>
Operating Income (Loss)	<u>\$ 70,345</u>	<u>\$ (16,270)</u>
Nonoperating Revenue (Expense):		
Investment Income	\$ 4,843	\$ 4,562
Interest Expense	(102,745)	(82,315)
Gain (Loss) on Disposition of Fixed Assets	-	8,304
Total Nonoperating Revenues (Expense)	<u>\$ (97,902)</u>	<u>\$ (69,449)</u>
Net Income Before Contributions	\$ (27,557)	\$ (85,719)
Capital Contributions	<u>61,050</u>	<u>124,246</u>
Net Income	\$ 33,493	\$ 38,527
Net Position--Beginning of Year	<u>10,941,740</u>	<u>10,903,213</u>
Net Position--End of Year	<u><u>\$ 10,975,233</u></u>	<u><u>\$ 10,941,740</u></u>

See accompanying notes to the basic financial statements.

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2015 and 2014

	2015	Restated 2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 2,686,563	\$ 2,482,125
Payments to Suppliers	(1,731,586)	(1,584,997)
Payments to Employees	(409,609)	(400,627)
Other Receipts (Payments)	(2,254)	(198)
Net Cash Provided (Used) by Operating Activities	<u>\$ 543,114</u>	<u>\$ 496,303</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Contributions	\$ 61,050	\$ 124,246
Purchases of Capital Assets	(1,590,793)	(1,138,835)
Principal Received - Building Sale	-	57,386
Proceeds from Rural Development Note	900,734	1,301,587
Proceeds Sale of Capital Assets	-	8,304
Principal Paid on Capital Debt	(45,093)	(31,350)
Interest Paid on Capital Debt (Including Capitalized Interest)	(91,249)	(74,455)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>\$ (765,351)</u>	<u>\$ 246,883</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Cash Received (Invested) in Certificates of Deposits	\$ (1,314)	\$ (922)
Interest Received	4,843	4,562
Net Cash Provided (Used) by Investing Activities	<u>\$ 3,529</u>	<u>\$ 3,640</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	 \$ (218,708)	 \$ 746,826
 Balances-Beginning of the Year	 <u>2,498,124</u>	 <u>1,751,298</u>
 Balances-End of the Year	 <u><u>\$ 2,279,416</u></u>	 <u><u>\$ 2,498,124</u></u>

	Balances Per December 31, 2015 Statement of Net Position	Balances Per December 31, 2015 Statement of Cash Flows
Unrestricted Cash	\$ 1,409,760	\$ 1,409,760
Restricted Cash	869,656	869,656
Restricted Certificates of Deposit	321,395	-
Total Cash and Cash Equivalents, End of Year	<u>\$ 2,600,811</u>	<u>\$ 2,279,416</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>\$ 2,818,205</u>	<u>\$ 2,498,124</u>

(Continued)

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ 70,345	\$ (16,270)
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	458,962	453,674
Pension Expense	89,364	46,000
Change in Assets and Liabilities:		
Receivables, Net	(22,318)	27,498
Other Receivables	3,042	(27,132)
Inventories	(44,294)	(12,824)
Prepaid Expenses	(8,183)	13,441
Accounts Payable	(6,227)	3,890
Accrued Expenses	(199)	2,884
Customer Meter Deposits Payable	2,622	5,142
Net Cash Provided by Operating Activities	<u><u>\$ 543,114</u></u>	<u><u>\$ 496,303</u></u>

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

At December 31, 2015, North Shelby Water Company had \$1,000 outstanding retainage payable related to capital projects in process.

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

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2015 and 2014**

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 of resources net of total liabilities and deferred inflows of resources) 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, 2015 and 2014

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 15 for the Water Company's policy on vacation and sick pay.

Pension: For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Commonwealth of Kentucky's County Employees' Retirement System (CERS), and additions to/deductions from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS.

Deferred Outflows of Resources and Deferred Inflows of Resources: 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 \$57,550 and \$55,896 were received by the Water Company for the years ended December 31, 2015 and 2014. Customer contributions of \$3,500 and \$68,350 were received by the Water Company for the years ended December 31, 2015 and 2014, 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.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014**

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.

Transfers sufficient to meet the total obligation outstanding on all notes were made timely during the years ended December 31, 2015 and 2014.

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, 2015 and 2014.

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 31, 2015.

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 for deposits 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, 2015, and 2014, \$685,037 and \$1,205,021, respectively, of the Company's deposits were covered by federal depository insurance and \$1,920,489 and \$1,573,810 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.

At December 31, 2015 and 2014, the Water Company's deposits were as follows:

December 31, 2015

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Total Carrying Value</u>
Demand Deposits	\$ 185,037	\$ 183,227
Time and Savings	2,420,489	2,417,084
Total Deposits	<u>\$ 2,605,526</u>	<u>\$ 2,600,311</u>

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 3 – CASH AND INVESTMENTS (Continued)

December 31, 2014

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Total Carrying Value</u>
Demand Deposits	\$ 373,563	\$ 373,563
Time and Savings	2,448,669	2,444,142
Total Deposits	<u>\$ 2,822,232</u>	<u>\$ 2,817,705</u>

Reconciliation to Statement of Net Position:

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Unrestricted Cash,	\$ 1,409,760	\$ 1,467,198
Restricted Cash, Including Time Deposits	1,191,051	1,351,007
Less Cash on Hand	(500)	(500)
	<u>\$ 2,600,311</u>	<u>\$ 2,817,705</u>

NOTE 4 – RESTRICTED ASSETS

Restricted cash and time deposits consist of the following:

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Debt Service Accounts	\$ 665,544	\$ 612,795
Depreciation Accounts	392,593	364,649
Construction Accounts	<u>132,914</u>	<u>373,563</u>
Total	<u>\$ 1,191,051</u>	<u>\$ 1,351,007</u>

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$20,066 and \$21,316 at December 31, 2015 and 2014, 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 \$165,720 and \$149,846 is included in accounts receivable at December 31, 2015 and 2014, respectively.

NOTE 6 – OTHER RECEIVABLES

Other receivables at December 31, 2015 and December 31, 2014, included \$24,090 and \$27,132 receivable for the joint operations contract between North Shelby Water Company and U.S. 60 Water District of Shelby and Franklin Counties, respectively.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 7 – CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2015 and 2014, was as follows:

	Balance at January 1, 2015	Additions	Disposals	Balance at December 31, 2015
Land & Land Rights	\$ 89,526	\$ -	\$ -	\$ 89,526
Structures & Improvements	385,725	-	-	385,725
Distribution System	15,359,402	1,898,854	(9,935)	17,248,321
Machinery & Equipment	2,571,604	302,800	-	2,874,404
Construction in Process	1,481,103	978,340	(2,096,999)	362,444
Totals at Historical Cost	<u>\$ 19,887,360</u>	<u>\$ 3,179,994</u>	<u>\$ (2,106,934)</u>	<u>\$ 20,960,420</u>
Less: Accumulated Depreciation				
Structures & Improvements	\$ (98,131)	\$ (12,967)	\$ -	\$ (111,098)
Distribution System	(5,948,186)	(329,219)	9,935	(6,267,470)
Machinery & Equipment	(1,171,710)	(116,776)	-	(1,288,486)
Total Accumulated Depreciation	<u>\$ (7,218,027)</u>	<u>\$ (458,962)</u>	<u>\$ 9,935</u>	<u>\$ (7,667,054)</u>
Capital Assets, Net	<u>\$ 12,669,333</u>	<u>\$ 2,721,032</u>	<u>\$ (2,096,999)</u>	<u>\$ 13,293,366</u>

	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>

Included under the Water Company's capital assets at December 31, 2015 and 2014, were \$1,487,185 and \$1,339,504 of fully depreciated assets, respectively. Land and land rights, and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$458,962 and \$453,674 in 2015 and 2014, respectively.

NOTE 8 – CUSTOMER DEPOSITS

Customer deposits are collected upon installation of water service. This amount is to be refunded to the customer upon discontinuation of service (after the customer's bill has been paid in full). Records are maintained which detail the accrued interest on each customer's deposit based on the current annual rate. Interest accrued is refunded to the customer or credited to the customer's bill on an annual basis. At December 31, 2015 and 2014, accrued interest on customer deposits was \$131 and \$173, 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, 2015 and 2014

NOTE 9 – LONG TERM DEBT

As of December 31, 2015 and 2014, the long-term debt payable consisted of the following:

Notes Payable:

	<u>December 31, 2015</u>	<u>December 31, 2014</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.	\$ 53,989	\$ 64,332
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.	211,437	218,207
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.	225,497	231,084
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.	464,317	474,486
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 2016.	1,057,534	1,004,348
2014 RECD note, original loan amount of \$2,100,000, secured by water revenues. Interest is charged at 3.125% per annum. Final maturity is September, 2054. Final draw was in 2015.	<u>2,100,000</u>	<u>1,264,676</u>
Total Notes Payable	\$ 4,112,774	\$ 3,257,133
Current Portion	\$ 48,231	\$ 46,162
Noncurrent Portion	4,064,543	3,210,971
Total Notes Payable	\$ 4,112,774	\$ 3,257,133

Accrued Compensated Absences:

All Classified as Current	\$ 8,935	\$ 8,628
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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, 2015 and 2014.

December 31, 2015

	<u>Balance at January 1, 2015</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2015</u>	<u>Current Portion</u>
Notes Payable	\$ 3,257,133	\$ 900,734	\$ 45,093	\$ 4,112,774	\$ 48,231
Accrued Compensated Absences	8,628	307	-	8,935	8,935
Total Long-Term Debt	\$ 3,265,761	\$ 901,041	\$ 45,093	\$ 4,121,709	\$ 57,166

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 9 – LONG TERM DEBT (Continued)

Changes in Long-term Debt (Continued)

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>

The annual requirements for all notes payable outstanding at December 31, 2015 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 48,231	\$ 147,688	\$ 195,919
2017	79,013	147,048	226,061
2018	82,181	143,880	226,061
2019	92,660	140,581	233,241
2020	75,721	136,780	212,501
2021-2025	424,910	637,595	1,062,505
2026-2030	514,369	548,137	1,062,506
2031-2035	582,437	440,110	1,022,547
2036-2040	602,528	330,215	932,743
2041-2045	499,513	233,202	732,715
2046-2050	587,779	144,936	732,715
2051-2055	523,432	44,075	567,507
	<u>\$ 4,112,774</u>	<u>\$ 3,094,247</u>	<u>\$ 7,207,021</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>

NOTE 10 – INTEREST EXPENSE

Interest expense incurred for the years ended December 31, 2015 and 2014 was \$137,033 and \$89,029, respectively. \$32,783 and \$5,475 of construction related interest expense was capitalized in 2015 and 2014, respectively.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014**

NOTE 11 – FUND EQUITY – RESTRICTED NET POSITION

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Restricted for Capital Projects:		
Monies Restricted for Construction	\$ 132,914	\$ 373,563
Total Restricted for Capital Projects	<u>\$ 132,914</u>	<u>\$ 373,563</u>
Restricted for Debt Service:		
RECD Notes Payable		
Cash	\$ 1,058,137	\$ 977,444
Less: Accrued Interest Payable	(49,797)	(38,302)
Total Restricted for Debt Service	<u>\$ 1,008,340</u>	<u>\$ 939,142</u>

NOTE 12 – BAD DEBT EXPENSE

Water revenue charges have been netted with an estimated bad debt expense of \$7,216 and \$12,743 at December 31, 2015 and 2014, respectively.

NOTE 13 – 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 14 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN

Entry into the Commonwealth of Kentucky's County Employees' Retirement System (CERS) was authorized by the Board of Directors. Electing employees and all new employees of the Water Company may participate in the System.

Under the provision of Kentucky Revised Statute ("KRS") Section 61.645, the Board of Trustees of the Kentucky Retirement System administers CERS and has the authority to establish and amend benefit provisions. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for CERS. The most recent financial report, dated June 30, 2015, may be obtained from <https://kyret.ky.gov/Financial%20Statements/2015/Financial.pdf>. Additionally, the Kentucky Retirement System issues a publically available financial report that includes the Schedules of Employer Allocations and Pension amounts by Employer. The most recent report, dated June 30, 2015 may be obtained from <https://kyret.ky.gov/employers/GASB/pages/GASB-library.aspx>.

Plan Description – CERS is a cost-sharing multiple-employer defined benefit pension plan that covers 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, 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 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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 12 months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce the COLA if, in its judgment, the welfare of the Commonwealth so demands. No COLA has been granted since July 1, 2011.

Basis of Accounting – CERS's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the plan. Premium payments are recognized when due and payable in accordance with the terms of the plan. Administrative and investment expenses are recognized when incurred.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014**

**NOTE 14 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN
(Continued)**

Method Used to Value Investments – Investments of the plan are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Short-term investments are reported at cost, which approximates fair value.

Benefits provided – CERS provides retirement, health insurance, death and disability benefits to Plan employees and beneficiaries. Employees are vested in the plan after five years' service. For retirement purposes, employees are grouped into three tiers, based on hire date:

Tier 1	Participation date	Before September 1, 2008
	Unreduced retirement	27 years service or 65 years old
	Reduced retirement	At least 5 years service and 55 years old
Tier 2	Participation date	September 1, 2008 – December 31, 2013
	Unreduced retirement	At least 5 years service and 65 years old Or age 57+ and sum of service years plus age equal 87
	Reduced retirement	At least 10 years service and 60 years old
Tier 3	Participation date	After December 31, 2013
	Unreduced retirement	At least 5 years service and 65 years old Or age 57+ and sum of service years plus age equal 87
	Reduced retirement	Not available

Retirement is based on a factor of the number of years' service and hire date multiplied by the average of the highest five years' earnings. Reduced benefits are based on factors of both of these components. Participating employees become eligible to receive the health insurance benefit after at least 180 months of service. Death benefits are provided for both death after retirement and death prior to retirement. Death benefits after retirement are \$5,000 in lump sum. Five years' service is required for death benefits prior to retirement and the employee must have suffered a duty-related death. The decedent's beneficiary will receive the higher of the normal death benefit and \$10,000 plus 25% of the decedent's monthly final rate of pay and any dependent child will receive 10% of the decedent's monthly final rate of pay up to 40% for all dependent children. Five years' service is required for nonservice-related disability benefits.

Contributions - For the fiscal years ended June 30, 2015 and 2014, plan members who began participating prior to September 1, 2008, were required to contribute 5% of their annual creditable compensation. These members were classified in the Tier 1 structure of benefits. 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, 2015 and 2014, participating employers contributed 17.67% and 18.89%, respectively, of each employer's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2015 and 2014, were 17.67% and 18.89%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

Plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. These members were classified in the Tier 2 structure of benefits. 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

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 14 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN
(Continued)

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.

Plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. These members were classified in the Tier 3 structure of benefits. 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.

Actuarial Methods and Assumptions

The actuarially determined contribution rates are determined on a biennial basis beginning with the fiscal years ended 2016 and 2017, determined as of June 30, 2015. The amortization period of the unfunded liability has been reset as of July 1, 2013 to a closed 30 year period. The following actuarial methods and assumptions were used to determine contribution rates reported for all KRS Systems:

Actuarial Cost Method	Entry Age
Amortization Method	Level of Percentage of Payroll, closed
Remaining Amortization Period	28 years
Asset Valuation Method	5 year Smoothed Market
Inflation	3.25%
Salary Increase	4%, average, including Inflation
Investment Rate of Return	7.5%, Net of Pension Plan Investment Expense, including Inflation

There were no changes of benefit terms. However, the following changes in assumptions were adopted by the Board of Trustees and reflected in the valuation performed as of June 30, 2015:

- The assumed investment rate of return was decreased from 7.75% to 7.5%.
- The assumed rate of inflation was reduced from 3.5% to 3.25%.
- The assumed rate of wage inflation was reduced from 1% to .75%.
- Payroll growth assumption was reduced from 4.5% to 4%.
- The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females).
- For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.
- The assumed rates of retirement, withdrawal, and disability were updated to more accurately reflect experience.

The following table presents the net pension liability of CERS [as reported in its publicly available financial statements for the year ended June 30, 2015], calculated using the discount rate of 7.5%, as well as what CERS' net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.5%) or one percentage point higher (8.5%):

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 14 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN
(Continued)

	1% Decrease [6.5%]	Current Discount [7.5%]	1% Increase [8.5%]
Net Pension Liability	\$ 5,488,878,000	\$ 4,299,525,565	\$ 3,280,950,000
Water Company's Proportionate Share	1,000,081	783,379	597,793

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to the County Employee Retirement System Pension

At December 31, 2015, and 2014 the Water Company reported a liability of \$783,379 and \$579,000, respectively for its proportionate share of the net pension liability. The net pension liability for CERS was measured as of June 30, 2015, and 2014 and was based on the actual liability of the employees and former employees relative to the total liability of the system as determined by an actuarial valuation as of those dates. The Water Company's proportion of the net pension liability was based on a projection of the Water Company's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2015, and 2014 the Water Company's proportion was 0.018220 and 0.017846 percent, respectively. Data is not available for the change in its proportion from previous periods.

The Water Company's total payroll for the fiscal year ended December 31, 2015 was \$442,651. Contributions to CERS were based on \$433,851 (eligible gross wages). The total employer contributions for the year ended December 31, 2015 were \$75,240.

The Water Company's total payroll for the fiscal year ended December 31, 2014, was \$435,530. Contributions to CERS were based on \$426,930 (eligible gross wages). The total employer pension contributions for the year ended December 31, 2014, were \$78,386.

All contributions were made as required during these years.

The Water Company's contribution for the County Employees' Retirement System's year(s) ended December 31, 2015, and 2014 was 0.01822 and 0.01785 percent, respectively, of the System's total contribution requirements for all employers.

For the years ended December 31, 2015, and December 31, 2014, the Water Company recognized pension expense of \$164,605 and \$123,911, respectively. At December 31, 2015 and 2014 the Water Company reported deferred outflows of resources and deferred inflows of resources related to CERS pensions from the following sources:

	December 31, 2015		December 31, 2014	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Expected and Actual Experience	\$ 6,510	\$ -	\$ -	\$ -
Change in Assumptions	78,995	-	-	-
Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	9,363	-	-	-
Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	7,022	52,000	-	65,000
District Contributions Made Subsequent to the NPL Measurement Date	39,758	-	39,634	-
Total	<u>\$ 141,648</u>	<u>\$ 52,000</u>	<u>\$ 39,634</u>	<u>\$ 65,000</u>

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 14 – COUNTY EMPLOYEES' RETIREMENT SYSTEM – NON-HAZARDOUS EMPLOYEES PENSION PLAN
(Continued)

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to the County Employee Retirement System Pension (Continued)

\$39,758 and \$39,634 reported as deferred outflows of resources related to pensions arising from Water Company contributions made subsequent to the measurement date will be recognized as a reduction in the net pension liability in the years ended December 31, 2016 and 2015. Amounts reported as deferred inflows and outflows of resources due to the net difference between projected and actual investment earnings on pension plan investments will be amortized over five years and recognized in pension expense as follows:

Year Ended December 31, 2015:		Deferred Outflows of Resources	Deferred Inflows of Resources
	2016	\$ 1,404	\$ 13,000
	2017	1,404	13,000
	2018	1,404	13,000
	2019	1,404	13,000
	2020	1,406	-
		<u>\$ 7,022</u>	<u>\$ 52,000</u>
Year Ended December 31, 2014:		Deferred Outflows of Resources	Deferred Inflows of Resources
	2015	\$ -	\$ 13,000
	2016	-	13,000
	2017	-	13,000
	2018	-	13,000
	2019	-	13,000
		<u>\$ -</u>	<u>\$ 65,000</u>

Amounts reported as deferred outflows of resources due to the difference between expected and actual experience, change of assumptions, and changes in proportion and differences between employer contributions and proportionate share of contributions will be amortized over the expected remaining service lives of all employees that are provided with pensions through the pension plan (twelve years) and recognized in pension expense as follows:

Year Ended December 31, 2015:		Deferred Outflows of Resources	Deferred Inflows of Resources
	2016	\$ 7,906	\$ -
	2017	7,906	-
	2018	7,906	-
	2019	7,906	-
	2020	7,906	-
	2021-2025	39,530	-
	2026-2028	15,808	-
		<u>\$ 94,868</u>	<u>\$ -</u>
Year Ended December 31, 2014:		Deferred Outflows of Resources	Deferred Inflows of Resources
	None	\$ -	\$ -

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014**

NOTE 15 – 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, 2015, and 2014, the Water Company had accrued compensated absence liabilities of \$8,935 and \$8,628, respectively.

Sick Days

Sick leave accrues at the rate of twelve days per year and shall accumulate without limit. At December 31, 2015, the Water Company had an unrecorded sick pay liability of \$93,031. At December 31, 2014, the Water Company had an unrecorded sick pay liability of \$84,053.

NOTE 16 – 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 17 – 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 Company. The Company received \$281,382 and \$259,662 for these services for the years ended December 31, 2015 and 2014, respectively. There was a receivable due from U.S. 60 Water Company in the amount of \$24,090 and \$27,132, at December 31, 2015 and December 31, 2014, respectively.

NOTE 18 – 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 was constructed during the second phase of the East-West Connector project. The third phase of this project is in the preliminary stage. The third phase will build a new tank at the Todd's Point site.

NOTE 19 – FINANCIAL STATEMENTS RESTATEMENT

In June, 2012, the GASB issued Statement 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement 27*. In November, 2013, the GASB issued Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB No. 68*. Both of these statements were adopted by the Water Company for the fiscal year ended June 30, 2015. Under these statements, the Water Company is required to report the net pension liability associated with its' employees' pensions as a liability. It is also required to report a deferred outflow of resources for its pension contributions made subsequent to the measurement date of the beginning net pension liability. These balances reflect the Water Company's obligation to pay deferred benefits earned by its employees when the pension [plan's] liability exceeds the value of the pension plan's assets.

Retroactive application by restating financial statements for all periods presented is required. The effect of the reinstatement is as follows for the year ended December 31, 2014.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2015 and 2014

NOTE 19 – FINANCIAL STATEMENTS RESTATEMENT (Continued)

Statement of Net Position:

Total Net Position as Originally Presented December 31, 2014	\$ 11,546,106
Less Net Pension Liability	(579,000)
Plus Deferred Outflows Employer Pension Contributions	39,634
Less Deferred Inflows of Resources - Difference Between Projected and Actual Earnings	<u>(65,000)</u>
Total Net Position December 31, 2014	<u>\$ 10,941,740</u>

The components of Net Position at December 31, 2014
after restatement are as follows:

Net Investment in Capital Assets	\$ 9,241,054
Restricted for Capital Projects	373,563
Restricted for Debt Service	939,142
Unrestricted (deficit)	<u>387,981</u>
Total Net Position	<u>\$ 10,941,740</u>

NOTE 20 – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2015, the GASB issued Statement 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective for fiscal years beginning after June 15, 2017. This statement requires the liability of employers to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. The Water Company is evaluating the requirements of this statement.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify (in the context of the current governmental financial reporting environment) the hierarchy of GAAP. The GAAP hierarchy consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction of other event is not specified within a source of authoritative GAAP. This Statement becomes effective for the fiscal year beginning July 1, 2015. The Water Company is evaluating the requirements of this Statement.

NORTH SHELBY WATER COMPANY

SCHEDULE OF THE WATER COMPANY'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY County Employees Retirement System

December 31, 2015*

	<u>2015</u>	<u>2014</u>
Water Company's proportion of the net pension liability (asset)	0.018220%	0.017846%
Water Company's proportionate share of the net pension liability (asset)	\$ 783,379	\$579,000
Water Company's covered-employee payroll	\$ 433,851	\$426,930
Water Company's proportionate share of the net pension liability (asset) as a percentage of its of its covered- employee payroll	180.56%	135.62%
Plan fiduciary net position as a percentage of the total pension liability	60.3%	62.6%

*Calculations based on June 30, 2015 and 2014, County Employees Retirement Systems' Schedules of Employer Allocations and Pension Amounts by Employer. Water Company payroll is reported for its' covered calendar years ending December 31, 2015 and 2014.

GASB 68 requires the Water Company to present the above information for 10 years. The information will be expanded annually until a full 10-year trend is compiled.

There were no changes of benefit terms. However, the following changes in assumptions were adopted by the Board of Trustees and reflected in the valuation performed as of June 30, 2015:

- The assumed investment rate of return was decreased from 7.75% to 7.5%.
- The assumed rate of inflation was reduced from 3.5% to 3.25%.
- The assumed rate of wage inflation was reduced from 1% to .75%.
- Payroll growth assumption was reduced from 4.5% to 4%.
- The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females).
- For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.
- The assumed rates of retirement, withdrawal, and disability were updated to more accurately reflect experience.

NORTH SHELBY WATER COMPANY

SCHEDULE OF THE WATER COMPANY'S CONTRIBUTIONS

County Employees Retirement System

Last Ten (10) Fiscal Years Ended December 31

	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Contractually required contributions	\$ 75,240	\$ 78,386	\$ 77,793	\$ 74,321	\$ 60,376	\$ 69,317	\$ 60,580	\$ 57,225	\$ 51,716	\$ 37,093
Contributions in relation to the contractually required contributions	75,240	78,386	77,793	74,321	60,376	69,317	60,580	57,225	51,716	37,093
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Water Company's covered-employee payroll	\$ 433,851	\$ 426,930	\$ 404,907	\$ 361,169	\$ 335,016	\$ 418,248	\$ 407,478	\$ 385,906	\$ 351,718	\$ 306,007
Contributions as a percentage of covered-employee payroll	17.34%	18.36%	19.21%	20.58%	18.02%	16.57%	14.87%	14.83%	14.70%	12.12%

See accompanying notes to the basic 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, 2015, 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 June 24, 2016.

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.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be material weaknesses (Items 2015-001 and 2015-002).

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.

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

June 24, 2016

RAISOR, ZAPP & WOODS, PSC

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

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 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, 2015. 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 federal statutes, regulations and the terms and conditions of its federal awards 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; the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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, 2015.

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 the Uniform Guidance, 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 a deficiency in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as Item 2015-003 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 the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Raisor, Zapp & Woods, PSC
RAISOR, ZAPP & WOODS, PSC
Certified Public Accountants
Carrollton, Kentucky

June 24, 2016

**NORTH SHELBY WATER COMPANY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2015**

<u>Federal Grant/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
<u>United States Department of Agriculture</u>		
Rural Development		
Direct Program		
Water and Waste Disposal Systems for Rural Communities	10.760	\$ 817,707
Total United States Department of Agriculture		\$ 817,707
Total Expenditures of Federal Awards		\$ 817,707

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 award activity of North Shelby Water Company under programs of the federal government for the year ended December 31, 2015. The information in this Schedule is presented in accordance with the requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). 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: Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Note C: Non Cash Awards

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, 2015.

Note D: Notes Payable

At December 31, 2015, including the above total expenditures, North Shelby Water Company had loans outstanding and payable to the USDA Rural Development in the amount of \$4,112,774. These loans impose no continuing compliance requirements other than to repay the loans.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2015**

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unmodified opinion on whether the financial statements of North Shelby Water Company were prepared in accordance with GAAP.
2. Two deficiencies in internal control disclosed during 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 2015-001 and 2015-002 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 is reported in the Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance. Item 2015-003 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.
6. Audit findings that are required to be reported in accordance with 2 CFR Section 200.516(a) 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 \$750,000.
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

2015-001 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. This condition was also cited as a material weakness in the schedule of findings and questioned costs for the year ended December 31, 2014 as Item 2014-001.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2015**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

**2015-001 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.

EFFECT:

These limitations may affect the ability to timely record, process, summarize and report financial data.

RECOMMENDATION:

Management should strive to provide cross-training for administrative staff, implement checking processes and increase review procedures. Management should periodically review invoice and expenditures processes and documentation to help employees maintain good practices.

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 associated procedures.

**2015-002 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, 2014 as Item 2014-002.

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, 2015**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

**2015-002 FAILURE TO PREPARE COMPLETE SET OF FINANCIAL STATEMENTS INCLUDING REQUIRED
NOTE DISCLOSURES**

EFFECT:

Management engaged auditor assistance 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

2015-003 Checking and Review Procedures

U.S. Department of Agriculture: Direct Program, Water and Waste Disposal Systems for Rural Communities - CFDA #10.760; loan dated September 4, 2014

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. Proper payment procedures were not followed in all instances.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2015**

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

SIGNIFICANT DEFICIENCIES (Continued)

2015-003 Checking and Review Procedures (Continued)

U.S. Department of Agriculture: Direct Program, Water and Waste Disposal Systems for Rural Communities - CFDA #10.760; loan dated September 4, 2014 (Continued)

EFFECT:

An instance was observed where a payment to a contractor was not made timely after a draw was made on the construction loan; and, a second instance where a vendor was paid for materials prior to their receipt. 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 adhere to federally mandated rules and regulations.

RECOMMENDATION:

Management should strive to separate duties and implement checking procedures. Employees should be fully trained on compliance requirements associated with the federal programs and responsibility should be assigned. 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, 2015**

Finding 2014-001: Size of Entity, Cross-Training, Checking Procedures and Documentation

Condition: This finding was a material weakness stating that due to the size of the entity, cross-training and checking procedures were not in place for certain administrative functions. This lack of checking procedures and 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.

Recommendation: It was recommended that procedures be implemented to ensure all Board actions are fully conducted by Company management and staff.

Current Status: Management continues to implement checking and review procedures. All approved rate increases were implemented in the current year. As indicated in Finding 2015-001, there is a continued need to enhance documentation and implement formal checking and review procedures.

Finding 2014-002: Failure to Prepare a Complete Set of Financial Statements Including Required Note Disclosures

Condition: This finding was a material weakness indicating that the Company's financial statements, including the required note disclosures, are prepared as part of the annual audit.

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

Current Status: As indicated in Finding 2015-002, the Water Company continues to outsource this service as a result of management's cost benefit decision.

U.S. Department of Agriculture

Finding 2014-003: U.S. Department of Agriculture: Direct Program, Water and Waste Disposal Systems for Rural Communities – CFDA #10.760: Checking and Review Procedures

Condition: The finding was a significant deficiency stating that administrative review procedures were not executed fully in oversight.

Recommendation: It was recommended that employees be fully trained on compliance requirements associated with the federal programs.

Current Status: Finding 2015-003 has identified a continued need for checking procedures and federal program requirement training.