

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

At December 31, 2017 and 2016

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

Years Ended December 31, 2017 and 2016

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RAISOR, ZAPP & WOODS, PSC

Certified Public Accountants

P.O. Box 354 • 513 Highland Ave • Carrollton, KY 41008
502-732-6655 • taxes@rzwcpas.com

Dennis S. Raisor, CPA
Jerilyn P. Zapp, CPA
Jeffery C. Woods, CPA
Susan A. Dukes, CPA

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, 2017 and 2016, 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, 2017 and 2016, 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

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 22, and the Schedule of Water Company's Contributions – County Employees Retirement System on Page 23 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 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*, is presented for purposes of additional analysis 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 28, 2018, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the North Shelby Water Company's 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 28, 2018

NORTH SHELBY WATER COMPANY
STATEMENT OF NET POSITION
December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Current Assets:		
Cash	\$ 2,362,486	\$ 1,767,106
Accounts Receivable (Net)	255,566	262,151
Other Receivables	25,005	3,313
Inventory	135,801	121,133
Prepaid Expenses	42,849	43,128
Total Current Assets	<u>\$ 2,821,707</u>	<u>\$ 2,196,831</u>
Noncurrent Assets:		
Restricted Assets:		
Cash, Including Time Deposits	\$ 1,007,972	\$ 1,456,676
Capital Assets (Net)	15,441,550	14,641,622
Total Noncurrent Assets	<u>\$ 16,449,522</u>	<u>\$ 16,098,298</u>
Total Assets	<u>\$ 19,271,229</u>	<u>\$ 18,295,129</u>
DEFERRED OUTFLOWS OF RESOURCES		
Attributable to Employee Pension Plan	<u>\$ 273,433</u>	<u>\$ 205,840</u>
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 156,172	\$ 150,258
Accounts Payable - Construction	-	480,548
Retainage Payable - Construction	-	61,291
Accrued Compensated Absences	9,435	9,383
Accrued Employee Benefits	6,214	8,013
Accrued Payroll Taxes/Employee Withholding	6,574	6,361
Utility Tax Payable	6,376	6,594
Sales Tax Payable	226	177
Current Liabilities Payable from Restricted Assets:		
Accrued Interest Payable - Customer Deposits	2,671	169
Accrued Interest Payable - Notes Payable	59,449	52,385
Notes Payable	83,741	80,543
Total Current Liabilities	<u>\$ 330,858</u>	<u>\$ 855,722</u>
Noncurrent Liabilities:		
Notes Payable	\$ 6,450,165	\$ 5,152,465
Customer Deposits Payable	287,337	277,413
Net Pension Liability	1,093,398	927,293
Total Noncurrent Liabilities	<u>\$ 7,830,900</u>	<u>\$ 6,357,171</u>
Total Liabilities	<u>\$ 8,161,758</u>	<u>\$ 7,212,893</u>
DEFERRED INFLOWS OF RESOURCES		
Attributable to Employee Pension Plan	<u>\$ 31,526</u>	<u>\$ -</u>
NET POSITION		
Net Investment in Capital Assets	\$ 8,907,644	\$ 8,866,775
Restricted for Capital Projects	129,332	418,212
Restricted for Debt Service	819,191	986,079
Unrestricted	1,495,211	1,017,010
Total Net Position	<u>\$ 11,351,378</u>	<u>\$ 11,288,076</u>

NORTH SHELBY WATER COMPANY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Revenues:		
Charges for Services:		
Water Charges (Net of Estimated Bad Debts)	\$ 2,767,490	\$ 2,592,991
Total Charges for Services	<u>\$ 2,767,490</u>	<u>\$ 2,592,991</u>
Other Charges and Miscellaneous:		
Forfeited Discounts & Service Charges	\$ 71,368	\$ 63,876
Building Rental Income	28,000	24,000
Equipment Rental Income	38,192	37,212
Contractual Services	130,761	111,977
Miscellaneous	29,980	11,166
Total Other Charges and Miscellaneous	<u>\$ 298,301</u>	<u>\$ 248,231</u>
Total Operating Revenues	<u>\$ 3,065,791</u>	<u>\$ 2,841,222</u>
Operating Expenses:		
Accounting and Collecting Labor	\$ 303,507	\$ 296,060
Commissioner Fees	34,200	33,800
Contractual Service	95,518	93,402
Employee Retirement & Benefits	363,672	301,667
Insurance	52,442	44,109
Maintenance of Mains	79,679	89,422
Miscellaneous	12,750	16,382
Office Supplies and Expense	63,171	62,385
Operating Labor	65,709	76,564
Other Interest Expense	3,945	2,076
Payroll Taxes	36,759	34,859
Professional Services	46,282	45,938
Purchased Water	1,006,961	971,318
Purchased Power	72,798	76,723
Regulatory Fees	5,681	5,261
Transportation Expense	31,114	28,618
Utilities	26,893	32,641
Depreciation Expense	553,270	482,531
Total Operating Expenses	<u>\$ 2,854,351</u>	<u>\$ 2,693,756</u>
Operating Income (Loss)	<u>\$ 211,440</u>	<u>\$ 147,466</u>
Nonoperating Revenue (Expense):		
Investment Income	\$ 5,286	\$ 5,006
Interest Expense	(152,582)	(146,761)
Gain (Loss) on Disposition of Fixed Assets	(98,667)	14,500
Total Nonoperating Revenues (Expense)	<u>\$ (245,963)</u>	<u>\$ (127,255)</u>
Net Income Before Contributions	\$ (34,523)	\$ 20,211
Capital Contributions	<u>97,825</u>	<u>240,632</u>
Special Item		
Industrial & Department of Transportation Line Relocation Projects		
Income	\$ -	\$ 100,000
Expense	<u>-</u>	<u>100,000</u>
Net Income	\$ 63,302	\$ 260,843
Net Position--Beginning of Year	<u>11,288,076</u>	<u>11,027,233</u>
Net Position--End of Year	<u>\$ 11,351,378</u>	<u>\$ 11,288,076</u>

See accompanying notes to the basic financial statements.

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 3,060,439	\$ 2,786,986
Payments to Suppliers	(1,742,596)	(1,686,002)
Payments to Employees	(434,724)	(422,401)
Other Receipts (Payments)	(1,230)	(1,863)
Net Cash Provided (Used) by Operating Activities	<u>\$ 881,889</u>	<u>\$ 676,720</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Contributions	\$ 97,825	\$ 240,632
Purchases of Capital Assets	(1,964,308)	(1,289,948)
Proceeds from Rural Development Note	1,381,441	1,169,035
Proceeds Sale of Capital Assets	14,572	14,500
Principal Paid on Capital Debt	(80,543)	(48,801)
Interest Paid on Capital Debt (Including Capitalized Interest)	(189,486)	(144,173)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>\$ (740,499)</u>	<u>\$ (58,755)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Cash Received (Invested) in Certificates of Deposits	\$ (67,301)	\$ 64,269
Interest Received	5,286	5,006
Net Cash Provided (Used) by Investing Activities	<u>\$ (62,015)</u>	<u>\$ 69,275</u>
 Net Increase (Decrease) in Cash and Cash Equivalents	 \$ 79,375	 \$ 687,240
 Balances-Beginning of the Year	 <u>2,966,656</u>	 <u>2,279,416</u>
 Balances-End of the Year	 <u><u>\$ 3,046,031</u></u>	 <u><u>\$ 2,966,656</u></u>

	Balances Per December 31, 2017 Statement of Net Position	Balances Per December 31, 2017 Statement of Cash Flows
Unrestricted Cash	\$ 2,362,486	\$ 2,362,486
Restricted Cash	683,545	683,545
Restricted Certificates of Deposit	324,427	-
Total Cash and Cash Equivalents, End of Year	<u><u>\$ 3,370,458</u></u>	<u><u>\$ 3,046,031</u></u>

	Balances Per December 31, 2016 Statement of Net Position	Balances Per December 31, 2016 Statement of Cash Flows
Unrestricted Cash	\$ 1,767,106	\$ 1,767,106
Restricted Cash	1,199,550	1,199,550
Restricted Certificates of Deposit	257,126	-
Total Cash and Cash Equivalents, End of Year	<u><u>\$ 3,223,782</u></u>	<u><u>\$ 2,966,656</u></u>

(Continued)

NORTH SHELBY WATER COMPANY
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ 211,440	\$ 147,466
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Cash Flows Reported in Other Categories:		
Depreciation Expense	553,270	482,531
Pension Expense	130,038	79,722
Change in Assets and Liabilities:		
Receivables, Net	6,585	(82,924)
Other Receivables	(21,692)	20,777
Inventories	(14,668)	20,655
Prepaid Expenses	279	(12,706)
Accounts Payable	5,914	11,792
Accrued Expenses	799	2,486
Customer Meter Deposits Payable	9,924	6,921
Net Cash Provided by Operating Activities	<u>\$ 881,889</u>	<u>\$ 676,720</u>

SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

North Shelby Water Company had \$0 and \$541,839 outstanding accounts payable and retainage payable related to capital projects in process at December 31, 2017 and 2016, respectively.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS
December 31, 2017 and 2016

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, 2017 and 2016

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 \$97,825 and \$70,275 were received by the Water Company for the years ended December 31, 2017 and 2016. Customer contributions of \$0 and \$170,357 were received by the Water Company for the years ended December 31, 2017 and 2016, respectively, for hydrants and line extensions.

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, 2017 and 2016

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.

Sufficient transfers were not made during the year ended December 31, 2017, however the balance in the account was sufficient to make debt service payments. Transfers sufficient to meet the total obligation outstanding on all notes were made timely during the year ended December 31, 2016.

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 2014 note required an additional \$1,345 each month until the account reaches \$161,000. The monthly deposits are to commence with the first month of the first full year after the facility becomes operational. The Depreciation Account is to be maintained as long as any of the above notes are outstanding. Sufficient funds were maintained in the depreciation accounts for the years ended December 31, 2017 and 2016.

A funded short lived asset account is required under the letter of conditions establishing funding for the 2012, 2013 and 2014 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. Under the 2014 note agreement, the Company must deposit \$3,333 monthly to this account once the project is operational. 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, 2017.

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, 2017, and 2016, \$757,803 and \$757,126, respectively, of the Company's deposits were covered by federal depository insurance and \$2,616,766 and \$2,493,059 were collateralized by securities held by the pledging financial institution's agent or trust department in the Company's name. As of December 31, 2017 and 2016, all of the Company's deposits were collateralized by securities and therefore not exposed to custodial risk.

At December 31, 2017 and 2016, the Water Company's deposits were as follows:

December 31, 2017

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Total Carrying Value</u>
Demand Deposits	\$ 2,495,929	\$ 2,491,318
Time and Savings	878,640	878,640
Total Deposits	<u>\$ 3,374,569</u>	<u>\$ 3,369,958</u>

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

NOTE 3 – CASH AND INVESTMENTS (Continued)

December 31, 2016

<u>Type of Deposits</u>	<u>Total Bank Balance</u>	<u>Total Carrying Value</u>
Demand Deposits	\$ 2,211,721	\$ 2,184,818
Time and Savings	1,038,464	1,038,464
Total Deposits	<u>\$ 3,250,185</u>	<u>\$ 3,223,282</u>

Reconciliation to Statement of Net Position:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Unrestricted Cash,	\$ 2,362,486	\$ 1,767,106
Restricted Cash, Including Time Deposits	1,007,972	1,456,676
Less Cash on Hand	(500)	(500)
	<u>\$ 3,369,958</u>	<u>\$ 3,223,282</u>

NOTE 4 – RESTRICTED ASSETS

Restricted cash and time deposits consist of the following:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Debt Service Accounts	\$ 429,437	\$ 617,674
Depreciation Accounts	449,203	420,790
Construction Accounts	<u>129,332</u>	<u>418,212</u>
Total	<u>\$ 1,007,972</u>	<u>\$ 1,456,676</u>

NOTE 5 – CUSTOMER ACCOUNTS RECEIVABLE

Customer Accounts Receivable has been netted with an Allowance for Bad Debts of \$21,592 and \$25,101 at December 31, 2017 and 2016, 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 \$196,980 and \$199,766 is included in accounts receivable at December 31, 2017 and 2016, respectively.

NOTE 6 – OTHER RECEIVABLES

Other receivables at December 31, 2017 and 2016, respectively, included \$25,005 and \$3,313 receivable for the joint operations contract between North Shelby Water Company and U.S. 60 Water Company of Shelby and Franklin Counties, respectively.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

NOTE 7 – CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2017 and 2016, was as follows:

	Balance at January 1, 2017	Additions	Disposals	Balance at December 31, 2017
Land & Land Rights	\$ 89,526	\$ 52,700	\$ -	\$ 142,226
Structures & Improvements	385,725	349,424	-	735,149
Distribution System	17,809,682	2,328,531	(205,730)	19,932,483
Machinery & Equipment	2,952,064	190,329	(95,763)	3,046,630
Construction in Process	1,485,742	1,119,846	(2,597,393)	8,195
Totals at Historical Cost	<u>\$ 22,722,739</u>	<u>\$ 4,040,830</u>	<u>\$ (2,898,886)</u>	<u>\$ 23,864,683</u>
Less: Accumulated Depreciation				
Structures & Improvements	\$ (124,065)	\$ (13,194)	\$ -	\$ (137,259)
Distribution System	(6,571,367)	(375,242)	125,339	(6,821,270)
Machinery & Equipment	(1,385,685)	(164,834)	85,915	(1,464,604)
Total Accumulated Depreciation	<u>\$ (8,081,117)</u>	<u>\$ (553,270)</u>	<u>\$ 211,254</u>	<u>\$ (8,423,133)</u>
Capital Assets, Net	<u>\$ 14,641,622</u>	<u>\$ 3,487,560</u>	<u>\$ (2,687,632)</u>	<u>\$ 15,441,550</u>

	Balance at January 1, 2016	Additions	Disposals	Balance at December 31, 2016
Land & Land Rights	\$ 89,526	\$ -	\$ -	\$ 89,526
Structures & Improvements	385,725	-	-	385,725
Distribution System	17,248,321	577,320	(15,959)	17,809,682
Machinery & Equipment	2,874,404	130,169	(52,509)	2,952,064
Construction in Process	362,444	1,696,302	(573,004)	1,485,742
Totals at Historical Cost	<u>\$ 20,960,420</u>	<u>\$ 2,403,791</u>	<u>\$ (641,472)</u>	<u>\$ 22,722,739</u>
Less: Accumulated Depreciation				
Structures & Improvements	\$ (111,098)	\$ (12,967)	\$ -	\$ (124,065)
Distribution System	(6,267,470)	(319,856)	15,959	(6,571,367)
Machinery & Equipment	(1,288,486)	(149,708)	52,509	(1,385,685)
Total Accumulated Depreciation	<u>\$ (7,667,054)</u>	<u>\$ (482,531)</u>	<u>\$ 68,468</u>	<u>\$ (8,081,117)</u>
Capital Assets, Net	<u>\$ 13,293,366</u>	<u>\$ 1,921,260</u>	<u>\$ (573,004)</u>	<u>\$ 14,641,622</u>

Included under the Water Company's capital assets at December 31, 2017 and 2016, were \$1,339,090 and \$1,446,700 of fully depreciated assets, respectively. Land and land rights, and construction in process are capital assets not being depreciated.

Depreciation expense aggregated \$553,270 and \$482,531 in 2017 and 2016, 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, 2017 and 2016, accrued interest on customer deposits was \$2,671 and \$169, 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, 2017 and 2016

NOTE 9 – LONG TERM DEBT

As of December 31, 2017 and 2016, the long-term debt payable consisted of the following:

Notes Payable:

	<u>December 31, 2017</u>	<u>December 31, 2016</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.	\$ 31,725	\$ 43,128
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.	196,733	204,286
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.	213,557	219,658
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.	442,623	453,703
2012 RECD note, original loan amount of \$1,069,758, secured by water revenues. Interest is charged at 3.5% per annum. Final maturity is November, 2052.	1,028,359	1,043,198
2013 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.	2,070,432	2,100,000
2014 RECD note, approved for \$2,755,000, secured by water revenues. Interest is charged at 2.375% per annum. Final maturity is October, 2056. Total draws through the end of 2016 were \$1,169,035.	2,550,477	1,169,035
Total Notes Payable	\$ 6,533,906	\$ 5,233,008
Current Portion	\$ 83,741	\$ 80,543
Noncurrent Portion	6,450,165	5,152,465
Total Notes Payable	\$ 6,533,906	\$ 5,233,008

Accrued Compensated Absences:

All Classified as Current	\$ 9,435	\$ 9,383
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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, 2017 and 2016.

December 31, 2017

	<u>Balance at January 1, 2017</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance at December 31, 2017</u>	<u>Current Portion</u>
Notes Payable	\$ 5,233,008	\$ 1,381,440	\$ 80,542	\$ 6,533,906	\$ 83,741
Accrued Compensated Absences	9,383	52	-	9,435	9,435
Total Long-Term Debt	\$ 5,242,391	\$ 1,381,492	\$ 80,542	\$ 6,543,341	\$ 93,176

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

NOTE 9 – LONG TERM DEBT (Continued)

Changes in Long-term Debt (Continued)

December 31, 2016

	Balance at January 1, 2016	Additions	Repayments	Balance at December 31, 2016	Current Portion
Notes Payable	\$ 4,112,774	\$ 1,169,035	\$ 48,801	\$ 5,233,008	\$ 80,543
Accrued Compensated Absences	8,935	448	-	9,383	9,383
Total Long-Term Debt	<u>\$ 4,121,709</u>	<u>\$ 1,169,483</u>	<u>\$ 48,801</u>	<u>\$ 5,242,391</u>	<u>\$ 89,926</u>

The annual requirements for all notes payable outstanding at December 31, 2017 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 83,741	\$ 202,894	\$ 286,635
2019	144,556	199,574	344,130
2020	128,841	194,549	323,390
2021	133,018	190,372	323,390
2022	137,343	186,048	323,391
2023-2027	757,149	859,801	1,616,950
2028-2032	890,899	726,051	1,616,950
2033-2037	964,557	573,348	1,537,905
2038-2042	974,306	419,054	1,393,360
2043-2047	1,008,200	278,960	1,287,160
2048-2052	1,129,792	126,476	1,256,268
2053-2057	181,504	8,547	190,051
	<u>\$ 6,533,906</u>	<u>\$ 3,965,674</u>	<u>\$ 10,499,580</u>

The annual requirements for all notes payable outstanding at December 31, 2016 are as follows:

<u>Due</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 80,543	\$ 171,103	\$ 251,646
2018	102,315	170,140	272,455
2019	113,264	166,371	279,635
2020	96,806	162,089	258,895
2021	100,222	158,673	258,895
2022-2026	557,072	737,404	1,294,476
2027-2031	664,261	630,214	1,294,475
2032-2036	731,208	504,266	1,235,474
2037-2041	740,574	377,225	1,117,799
2042-2046	698,750	265,935	964,685
2047-2051	811,839	152,846	964,685
2052-2056	536,154	34,468	570,622
	<u>\$ 5,233,008</u>	<u>\$ 3,530,734</u>	<u>\$ 8,763,742</u>

NOTE 10 – INTEREST EXPENSE

Interest expense incurred for the years ended December 31, 2017 and 2016 was \$200,496 and \$151,782, respectively. \$43,968 and \$2,945 of construction related interest expense was capitalized in 2017 and 2016, respectively.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

NOTE 11 – FUND EQUITY – RESTRICTED NET POSITION

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Restricted for Capital Projects:		
Monies Restricted for Construction	\$ 129,332	\$ 418,212
Total Restricted for Capital Projects	<u>\$ 129,332</u>	<u>\$ 418,212</u>
Restricted for Debt Service:		
RECD Notes Payable		
Cash	\$ 878,640	\$ 1,038,464
Less: Accrued Interest Payable	(59,449)	(52,385)
Total Restricted for Debt Service	<u>\$ 819,191</u>	<u>\$ 986,079</u>

NOTE 12 – BAD DEBT EXPENSE

Water revenue charges have been netted with an estimated bad debt expense of \$10,105 and \$5,035 at December 31, 2017 and 2016, 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 Commissioners. 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, 2017, may be obtained from <https://kyret.ky.gov/About/Internal-Audit/Documents/2017%20Audited%20Financial%20Statements%20and%20Independent%20Auditor's%20Reports.pdf>. Additionally, the Kentucky Retirement System issues a publicly available financial report that includes the Schedules of Employer Allocations and Pension amounts by Employer. The most recent report, dated June 30, 2017 may be obtained from <https://kyret.ky.gov/Employers/GASB/Audited%20Reports/DRAFT%202017%20Pension%20Proportionate%20Share%20Audit%20Report.pdf>. The Kentucky CERS GASB 68 Actuarial Report prepared by Gabriel, Roeder, Smith and Co. (GRS) may be obtained at [https://kyret.ky.gov/Employers/GASB/GASB%2068%20and%2075%20Actuary%20Reports/GASB68 Actuarial Information CERS FY2017.pdf](https://kyret.ky.gov/Employers/GASB/GASB%2068%20and%2075%20Actuary%20Reports/GASB68%20Actuarial%20Information%20CERS%20FY2017.pdf).

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. After July 1, 2009, 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.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016**

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

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.

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. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the dividend date. Gain (loss) on investments includes KRS' gains and losses on investments bought and sold as well as held during the fiscal year.

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 - Participating employers are 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, 2017 and 2016, participating employers contributed 18.68% and 17.06%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2017 and 2016, were 18.68% and 17.06%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

Employer contributions for the year ended June 30, 2017, were allocated 13.95% to CERS's pension fund and 4.73% to CERS' OPEB (health insurance) fund, respectively. Employer contributions for the year ended June 30, 2016, were allocated 11.91% to CERS's pension fund and 5.15% to CERS' OPEB (health insurance) fund, respectively.

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016**

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

For the fiscal years ended June 30, 2017 and 2016, 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. 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 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, for plan members who began participating on, or after, September 1, 2008, 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 an additional 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.

Methods and Assumptions Used in Calculation of Actuarially Determined Contributions

Per the GASB Statement No. 68 Report for the County Employees Retirement System prepared as of June 30, 2017, the actuarially determined contribution rates effective for fiscal year ending 2017 are calculated as of June 30, 2015. Based on the June 30, 2015 actuarial valuation report (produced by the prior actuary, Cavanaugh Macdonald Consulting, LLC), the actuarial methods and assumptions used to calculate these contribution rates are as follows:

Item	CERS Non-Hazardous
Actuarial Cost Method:	Entry Age Normal
Asset Valuation Method:	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized.
Amortization Method:	Level Percent of Pay
Amortization Period:	28 Years, Closed
Investment Return:	7.50%
Inflation:	3.25%
Salary Increases:	4.00%, average
Mortality:	RP-2000 Combined Mortality Table, projected to 2013 with Scale BB (set back 1 year for females)

**NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016**

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

Methods and Assumptions Used in Calculation of Actuarially Determined Contributions (Continued)

In general, the assumptions and methods used in the valuation (as shown above) are based on the actuarial experience study for the five-year period ending June 30, 2013, submitted April 30, 2014, and adopted by the Board on December 4, 2014. The investment return, price inflation, and payroll growth assumption were adopted by the Board in May and July 2017 for use with the June 30, 2017 valuation in order to reflect future economic expectations.

These changes in assumptions since the prior valuation are as follows:

The assumed investment return was changed from 7.50% to 6.25%. The price inflation assumption was changed from 3.25% to 2.30%, which also resulted in a 0.95% decrease in the salary increase assumption at all years of service. The payroll growth assumption (applicable for the amortization unfunded actuarial accrued liabilities) was changed from 4.00% to 2.00%.

There were no changes in benefit terms during the years ended June 30, 2017 and 2016.

The investment objectives of the portfolios are to produce results that exceed the stated goals over both short-term and long-term periods.

- **Shorter-Term (5 years and less):** The returns of the particular asset classes of the managed funds of the Systems, measured on an annual basis, should exceed the return achieved by a policy benchmark portfolio composed of comparable unmanaged market indices.
- **Medium-Term (5 to 30 years):** The returns of the particular asset classes of the managed funds of the Systems, measured on a rolling year basis should exceed the returns achieved by a policy benchmark portfolio composed of comparable unmanaged market indices and perform above the median of an appropriate peer universe, if there is one.
- **Longer-Term:** The total assets of the Systems should achieve a return of 6.25% for CERS pension and insurance plans. This is measured over 30 to 40 years which exceeds the actuarially required rate of return while also exceeding the return achieved by its total fund benchmark.

Asset Allocation Board Policy as of June 30, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Combined Equity	50.80%	44.00%
Combined Fixed Income	14.00%	19.00%
Private Equity	10.00%	10.00%
Absolute Return	10.00%	10.00%
Real Return	8.00%	10.00%
Real Estate	5.00%	5.00%
Cash	2.20%	2.00%
	<u>100.00%</u>	<u>100.00%</u>

Total fund return for the years ended June 30, 2017 and 2016 were 13.47% and (0.52%), respectively.

The total pension liability is based on an actuarial valuation date of June 30, 2016. The total pension liability was rolled-forward from the valuation date to the plan's fiscal year ending June 30, 2017, using generally accepted actuarial principles. Gabriel, Roeder, Smith & Co (GRS) did not conduct the June 30, 2016, actuarial valuation; however, GRS did replicate the prior actuary's valuations results on the same assumption, methods, and data, as of that date. The roll-forward is based on the results of their replication. Information disclosed for years prior to June 30, 2017, was prepared by KRS's prior actuary, Cavanaugh Macdonald Consulting, LLC.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

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

Methods and Assumptions Used in Calculation of Actuarially Determined Contributions (Continued)

For the year ended June 30, 2016 the actuarial valuation date upon which the total pension liability was based was June 30, 2015. An expected total pension liability was determined as of June 30, 2016, using standard roll forward techniques. The roll forward calculation adds the annual cost (also called the service cost), subtracts the actual benefit payments and refunds for the plan year, then applies the expected investment rate of return for the year. No update procedures were used to determine the total pension liability as of June 30, 2015.

Mortality Assumption:

Pre-retirement mortality: RP-2000 Combined Mortality Table projected with Scale BB to 2013. Male mortality rates are multiplied by 50% and female mortality rates are multiplied by 30%.

Post-retirement mortality (non-disabled): RP-2000 Combined Mortality Table projected with Scale BB to 2013. Female mortality rates are set back one year.

Post-retirement mortality (disabled): RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013. Male mortality rates are set back four years.

These mortality assumptions assume a margin for future mortality improvement.

The single discount rate of 6.25% was used to measure the total pension liability for the fiscal year ending June 30, 2017. This single discount rate was based on the expected rate of return on pension plan investments. Based on the stated assumptions and the projection of cash flows as of each fiscal year ending, the pension plan's fiduciary net position and future contributions were projected to be sufficient to finance all the future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of the projected benefit payments to determine the total pension liability. The projection of cash flows used to determine the single discount rate assumes that the participating employers in the System contribute the actuarially determined contribution rate in all future years. The discount rate of 7.50% was used for the year ended June 30, 2016. The discount rate determination does not use a municipal bond rate.

Sensitivity of the Water Company's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following table presents the net pension liability of CERS [as reported in its publicly available financial statements for the years ended June 30, 2017 and 2016], calculated using the discount rates of 6.25% and 7.5% for the years ended June 30, 2017 and 2016, respectively, as well as what CERS' net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the approved rate:

<u>As of June 30, 2017</u>	<u>1% Decrease [5.25%]</u>	<u>Current Discount [6.25%]</u>	<u>1% Increase [7.25%]</u>
Net Pension Liability	\$ 7,382,285,860	\$ 5,853,307,443	\$ 4,574,328,530
Water Company's Proportionate Share	1,379,011	1,093,398	854,485
<u>As of June 30, 2016</u>	<u>1% Decrease [6.5%]</u>	<u>Current Discount [7.5%]</u>	<u>1% Increase [8.5%]</u>
Net Pension Liability	\$ 6,135,625,606	\$ 4,923,618,237	\$ 3,884,686,628
Water Company's Proportionate Share	1,155,557	927,293	731,625

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

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

At December 31, 2017, and 2016 the Water Company reported a liability of \$1,093,398 and \$927,293, respectively for its proportionate share of the net pension liability. The net pension liability for CERS was measured as of June 30, 2017, and 2016 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, 2017, and 2016 the Water Company's proportion was 0.018680 and 0.018834 percent, respectively, which is a decrease of 0.00015 percent for the year ended June 30, 2017 and an increase of 0.00061 percent for the year ended June 30, 2016.

The Water Company's total payroll for the fiscal year ended December 31, 2017 was \$467,177. Contributions to CERS were based on \$458,377 (eligible gross wages). The total employer contributions for the year ended December 31, 2017 were \$86,805.

The Water Company's total payroll for the fiscal year ended December 31, 2016, was \$457,484. Contributions to CERS were based on \$448,684 (eligible gross wages). The total employer pension contributions for the year ended December 31, 2016, were \$80,311.

All contributions were made as required during these years.

The Water Company's contribution for the County Employees' Retirement System's year(s) ended June 30, 2017, and 2016 was 0.018680 and 0.01883 percent, respectively, of the System's total contribution requirements for all employers.

For the year ended December 31, 2017, and December 31, 2016, the Water Company recognized pension expense of \$216,843 and \$160,034, respectively. At December 31, 2017 and 2016 the Water Company reported deferred outflows of resources and deferred inflows of resources related to CERS pensions from the following sources:

	December 31, 2017		December 31, 2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Expected and Actual Experience	\$ 1,356	\$ 27,755	\$ 4,048	\$ -
Change in Assumptions	201,762	-	49,123	-
Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	11,520	3,771	22,071	-
Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	13,524	-	87,175	-
Water Company Contributions Made Subsequent to the NPL Measurement Date	45,271	-	43,423	-
Total	<u>\$ 273,433</u>	<u>\$ 31,526</u>	<u>\$ 205,840</u>	<u>\$ -</u>

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

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)

\$45,271 and \$43,423 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, 2017 and 2016. 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 netted and amortized over five years and recognized in pension expense. 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 and recognized in pension expense over the expected remaining service lives of all employees. Total amortization to be recognized in pension expense is presented below as follows:

Year Ended December 31, 2017:		Increase (Decrease) to Pension Expense
	2018	\$ 90,788
	2019	83,962
	2020	35,925
	2021	(14,039)
		\$ 196,636

Year Ended December 31, 2016:		Increase (Decrease) to Pension Expense
	2017	\$ 61,772
	2018	44,984
	2019	36,201
	2020	19,460
		\$ 162,417

Payable to the Pension Plan

At December 31, 2017 and 2016, the Water Company reported a payable of \$7,881 and \$10,214, respectively for the outstanding amount of contributions required for the years then ended. These amounts represent the employee withholding and employer match for the last month of the years then ended. The payable includes both pension and insurance contributions.

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, 2017, and 2016, the Water Company had accrued compensated absence liabilities of \$9,435 and \$9,383, respectively.

Sick Days

Sick leave accrues at the rate of twelve days per year and shall accumulate without limit. At December 31, 2017, the Water Company had an unrecorded sick pay liability of \$116,685. At December 31, 2016, the Water Company had an unrecorded sick pay liability of \$106,977.

NORTH SHELBY WATER COMPANY
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
December 31, 2017 and 2016

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 District. The Company received \$289,148 and \$289,245 for these services for the years ended December 31, 2017 and 2016, respectively. There was a receivable due from U.S. 60 Water District in the amount of \$25,005 and \$3,313 at December 31, 2017 and 2016, respectively. The December, 2017 receivable from U.S. 60 Water District of \$19,832 was increased by \$5,173 for an undercharge by the Water Company during the year. The December 2016 receivable from U.S. 60 Water District of \$28,484 was reduced by \$5,173 for an overcharge by the Water Company during the year. The operation and maintenance agreement was updated in 2017.

NOTE 18 – COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS

North Shelby Water Company continues work on the East-West Connector project. North Shelby Water Company completed Phase III of the project during calendar year 2017. 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 project. The third phase of the project consisted of a line and booster pump station, the construction of a 400,000 gallon elevated storage tank at Todd's Point, and the Jacksonville water storage tank rehabilitation.

On May 15, 2017, the members of North Shelby Water Company authorized the borrowing of funds by the Company from USDA Rural Development for the construction of the water system improvements known as the East-West Connector – Phase IV in an amount not to exceed \$2,525,000. Phase IV of the East-West Connector project entails the construction of a new 750,000 gallon elevated water storage tank. Construction on the project had not begun as of December 31, 2017.

NOTE 19 – 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 [Water Company year beginning January 1, 2018]. 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.

Reporting requirements in regards to OPEB became effective for the Kentucky Retirement System for its year ended June 30, 2017. In its financial report including Schedules of Employer Allocations a net OPEB liability of \$375,532 was reported as attributable to the North Shelby Water Company.

NORTH SHELBY WATER COMPANY

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

Last Four Fiscal Years*

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Water Company's proportion of the net pension liability (asset)	0.018680%	0.01883%	0.018220%	0.017846%
Water Company's proportionate share of the net pension liability (asset)	\$ 1,093,398	\$ 927,293	\$ 783,379	\$579,000
Water Company's covered-employee payroll	\$ 458,377	\$ 448,684	\$ 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	238.54%	206.60%	180.56%	135.62%
Plan fiduciary net position as a percentage of the total pension liability	53.3%	55.5%	59.97%	66.80%

*Calculations are based on reports of the Kentucky Retirement Systems', County Employees Retirement Systems' Schedule of Employer Allocations and Pension Amounts by Employer for the fiscal years ended June 30, shown. Water Company payroll is reported for its' covered calendar years ending December 31, 2014 through 2017.

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 investment return, price inflation and payroll growth assumptions were adopted by the Board of Trustees in May and July, 2017 for use with the June 30, 2017 valuation.

- The assumed investment rate of return was decreased from 7.50% to 6.25%.
- The assumed rate of inflation was reduced from 3.25% to 2.30%.
- Payroll growth assumption was reduced from 4.0% to 2.0%.
- 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.

NORTH SHELBY WATER COMPANY

SCHEDULE OF THE WATER COMPANY'S CONTRIBUTIONS

County Employees Retirement System

Fiscal Years Ended December 31

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Contractually required contributions	\$ 86,805	\$ 80,311	\$ 75,240	\$ 78,386	\$ 77,793
Contributions in relation to the contractually required contributions	86,805	80,311	75,240	78,386	77,793
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Water Company's covered-employee payroll	\$ 458,377	\$ 448,684	\$ 433,851	\$ 426,930	\$ 404,907
Contributions as a percentage of covered-employee payroll	18.93%	17.89%	17.34%	18.36%	19.21%

The Water Company's contributions above include the total contributions to the County Employees Retirement System. No allocation has been made between contributions to the CERS Pension Fund and the CERS Insurance Fund.

RAISOR, ZAPP & WOODS, PSC

Certified Public Accountants

P.O. Box 354 • 513 Highland Ave • Carrollton, KY 41008
502-732-6655 • taxes@rzwcpas.com

Dennis S. Raisor, CPA
Jerilyn P. Zapp, CPA
Jeffery C. Woods, CPA
Susan A. Dukes, CPA

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, 2017, 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 28, 2018.

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 have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as Items 2017-001 and 2017-002 that we consider to be material weaknesses.

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 results 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, PSC

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

June 28, 2018

RAISOR, ZAPP & WOODS, PSC

Certified Public Accountants

P.O. Box 354 • 513 Highland Ave • Carrollton, KY 41008
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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, 2016. 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; and 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, 2016.

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 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 have not been 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, described in the accompanying schedule of findings and questioned costs as Item 2017-003 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 and corrective action plan. 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 28, 2017

**NORTH SHELBY WATER COMPANY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2017**

<u>Federal Grantor/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	\$ 1,119,846
Total United States Department of Agriculture		\$ 1,119,846
Total Expenditures of Federal Awards		\$ 1,119,846

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, 2017. 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, 2017.

Note D: Notes Payable

At December 31, 2017, including the above total expenditures, North Shelby Water Company had loans outstanding and payable to the USDA Rural Development in the amount of \$6,533,906. These loans impose no continuing compliance requirements other than to repay the loans.

Note E: Passed Through to Sub-Recipients

There were no awards passed through to sub-recipients.

Note F: Indirect Cost Rate

North Shelby Water Company has not included indirect costs in the schedule.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2017**

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 2017-001 and 2017-002 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 2017-003 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:

United States Department of Agriculture:
Water and Waste Disposal Systems
for Rural Communities

CFDA No.

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

2017-001 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, 2016 as Item 2016-001.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2017**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

**2017-001 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. Adequate debt service transfers were not made as required. Improper rate implementation for the joint operations maintenance agreement occurred.

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. Periodic reviews of debt service requirements should also occur.

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.

**2017-002 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 questioned costs for the year ended December 31, 2016 as Item 2016-002.

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, 2017**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT (Continued)

GOVERNMENT AUDITING STANDARDS (Continued)

DEFICIENCIES IN INTERNAL CONTROL (Continued)

**2017-002 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

2017-003 Checking and Review Procedures

U.S. Department of Agriculture: Direct Program, Water and Waste Disposal Systems for Rural Communities - CFDA #10.760; loan dated October 24, 2016.

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.

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.

CONTEXT:

A review of controls over federal expenditures and the Company's reliance on outside entities in its oversight of federal program expenditures was performed.

**NORTH SHELBY WATER COMPANY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
For the Year Ended December 31, 2017**

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

SIGNIFICANT DEFICIENCIES (Continued)

2017-003 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 October 24, 2016 (Continued)

EFFECT:

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.

CAUSE:

Responsibilities of the Water Company staff for federal program requirements have not been clearly defined and communicated. A budget was not formally approved by the water company as required by the loan agreements. Short lived asset accounts have not been established. Sufficient debt service transfers were not made as required by note agreements.

RECOMMENDATION:

Employees should be fully trained on compliance requirements associated with the federal programs and responsibility should be assigned. Management should continue to contract with parties knowledgeable of federal program compliance, but should be aware that the Company, itself, is the entity with ultimate responsibility. Staff should annually review all debt and depreciation reserves timely to determine appropriate transfers and balances as required by the loans.

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTION:

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, 2017**

Finding 2016-001: 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 could affect the Company's ability to timely record, process, summarize and report financial data.

Recommendation: It was recommended that procedures be implemented to ensure cross training and checking procedures are in place to allow proper wording of transactions.

Current Status: Management continues to implement checking and review procedures.

Finding 2016-002: 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 2017-002, the Water Company continues to outsource this service as a result of management's cost benefit decision.

U.S. Department of Agriculture

Finding 2016-003: 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 2017-003 has identified a continued need for checking procedures and federal program requirement training.

North Shelby Water Company
PO Box 97
Bagdad, KY 40003
Toll Free 1-800-870-4148
(502) 747-8942
Fax: (502) 747-5048

Jerry Ruble, President
Bryan Franklin, Vice President
Tom Miginnis, Secretary/Treasurer
Loyd Eades, Director

Kevin Armstrong, Director
Herb McCoun, Director
Jimmy Anglin, Director
Jim Smith, Director

U. S. Department of Agriculture

North Shelby Water Company respectfully submits the following corrective action plan for the year ended December 31, 2017.

Name and Address of the independent public accounting firm: Raisor, Zapp & Woods, PSC, 513 Highland Avenue, P. O. Box 354, Carrollton, KY 41008.

Audit Period: As of and for the year ended December 31, 2017

The findings from the December 31, 2017 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS-FINANCIAL STATEMENT AUDIT

Material Weakness 2017-001 - Size of Entity, Cross-training, Checking Procedures and Documentation

- In response to this item, the Water Company will do its best to address this issue through enhanced management oversight and checking procedures. We believe that we have an office staff commensurate with the size and needs of the Water Company. Financial considerations have been taken into consideration in meeting those needs. We will continue to cross train office staff members to protect the Water Company from unforeseen circumstances.

Material Weakness 2017-002 – Failure to Prepare a Complete Set of Financial Statements Including Required Note Disclosures

- In response to this item, the Water Company's decision to outsource the preparation of the complete set of financial statements and required note disclosures is a cost-benefit decision. The Water Company is aware of its role in oversight of this process and is conscientious in its efforts to review the reporting package. It is anticipated that the Water Company will continue to outsource this procedure.

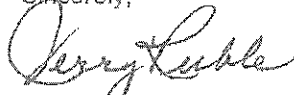
FINDINGS-FEDERAL AWARD PROGRAMS AUDITS

Significant Deficiency in Internal Control Over Compliance - 2017-003 - Checking & Review Procedures

- In response to this item, the Water Company is aware of its responsibility to comply with the specific requirements of the Rural Development financing as set forth in its letter of conditions. The Water Company will seek to implement further review procedures for all compliance requirements. The Water Company will annually review debt and depreciation reserve accounts to determine appropriate transfers and balances. The 2018 Budget of North Shelby Water Company has been formally approved.

If the U. S. Department of Agriculture has questions regarding this plan, please call Jerry Ruble at (502) 747-8942.

Sincerely,



Jerry Ruble

Chairman

June 28, 2018