

SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION

Basic Financial Statements,
Required Supplementary Information, And
Independent Auditor's Report

For The Year Ended June 30, 2014

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TABLE OF CONTENTS

Independent Auditor's Report	1
Basic Financial Statements	
Statements of Net Position	4
Statements of Revenues, Expenses and Changes in Net Assets.....	6
Statement of Cash Flows	7
Notes to Basic Financial Statements	8
Report On Internal Control over Financial Reporting and on Compliance and Other Matters Based On an Audit of Financial Statements Performed In Accordance With <u>Government</u> <u>Auditing Standards</u>	20
Schedule of Findings.....	22
Required Supplementary Information	
Budgetary Comparison Schedule.....	25

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Independent Auditor's Report

To the Board of Commissioners
Shelbyville Municipal Water and Sewer Commission
Shelbyville, KY

We have audited the accompanying financial statements of the business-type activities of Shelbyville Municipal Water and Sewer Commission, component unit of the City of Shelbyville, Kentucky, as of and for the year ended June 30, 2014, which collectively comprise the Shelbyville Water and Sewer Commission'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 opinions 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. 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 opinions.

INDEPENDENT AUDITOR'S REPORT
Shelbyville Municipal Water and Sewer
(Continued)

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Shelbyville Water and Sewer Commission as of June 30, 2014, and the respective changes in financial position and cash flows thereof for the year 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 management's discussion and analysis and budgetary comparison information on pages 23 through 26 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.

The introductory section and accompanying supplementary financial information as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The introductory section and accompanying supplementary financial information as listed in the table of contents have not been subjected to the auditing procedures applied to the audit of the basic financial statements and, accordingly, we express no opinion on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 23, 2015, on our consideration of the Shelbyville Municipal Water and Sewer Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Shelbyville Municipal Water and Sewer Commission's internal control over financial reporting and compliance.

Respectfully submitted,

A handwritten signature in cursive script that reads "Ross & Company".

Ross & Company, PLLC
January 23, 2015

SHELBYVILLE WATER AND SEWER

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION JUNE 30, 2014

Operating Revenues	
Water sales	\$ 2,721,564
Sewer service	2,661,215
Other revenues	<u>163,676</u>
Total Operating Revenue	5,546,455
Operating Expenses	
Direct water expenses	982,235
Direct sewer expenses	795,346
Administrative expenses	1,399,243
Amortization-debt issue expense	54,053
Depreciation-water plant	603,307
Depreciation-sewer plant	803,772
Depreciation-office building	<u>51,941</u>
Total Operating Expenses	4,689,897
Operating Income	856,558
Non-Operating Revenues (Expenses)	
Interest income	13,625
Interest expense-long term debt	(479,946)
Debt administration fees	<u>(67,320)</u>
Total Non-Operating Revenues(Expenses)	(533,641)
Income Before Contributions and Transfers	322,917
Capital Contributions	312,017
Transfers out-City of Shelbyville	<u>(140,648)</u>
Change in Net Position	494,286
Net Position, July 1, 2013	<u>25,415,475</u>
Net Position, June 30, 2014	<u><u>\$ 25,909,761</u></u>
Debt Service Coverage	
Current year debt service coverage	1.61
Maximum year debt service coverage	1.61

SHELBYVILLE WATER AND SEWER

The accompanying notes are an integral part of these financial statements.

SHELBYVILLE WATER AND SEWER
STATEMENT OF CASH FLOWS
FOR FISCAL YEAR ENDED JUNE 30, 2014

<u>Cash Flows from Operating Activities</u>	
Receipts from customers	\$ 5,558,217
Payments to suppliers	(1,893,795)
Payments to employees	(1,239,874)
Net cash provided by operating activities	<u>2,424,548</u>
<u>Cash Flows from Noncapital Financing Activities</u>	
Transfer to City	(140,648)
Net cash (used) by noncapital financing activities	<u>(140,648)</u>
<u>Cash Flows from Capital and Related Financing Activities</u>	
Capital contributions	312,017
Purchases of capital assets	(355,142)
Principal paid on long term debt	(1,008,658)
Interest paid on long term debt	(479,946)
Administrative fees paid on long term debt	(67,320)
Net cash (used) by capital and related financing activities	<u>(1,599,049)</u>
<u>Cash Flows from Investing Activities</u>	
Interest received	13,625
Purchase of investments	(608,091)
Net cash (used) by investing activities	<u>(594,466)</u>
Net Increase in Cash and Cash Equivalents	90,385
Cash and Cash Equivalents, Beginning of Year	<u>452,668</u>
Cash and Cash Equivalents, End of Year	<u><u>543,053</u></u>
<u>RECONCILIATION OF OPERATING INCOME TO NET CASH</u>	
<u>PROVIDED BY OPERATING ACTIVITIES</u>	
Operating income	969,935
Adjustment to reconcile operating income to net cash provided by operating activities	
Depreciation expense	1,459,020
Amortization expense	54,053
Net changes in assets and liabilities	
Accounts receivable	(3,313)
Prepaid expenses	(6,465)
Due from others	(3,836)
Inventory	(5,350)
Accounts payable	63,218
Customer deposits	15,075
Other accrued liabilities	(117,789)
Net cash provided by operating activities	<u><u>\$ 2,424,548</u></u>

SHELBYVILLE WATER AND SEWER

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SHELBYVILLE WATER AND SEWER

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SHELBYVILLE WATER AND SEWER COMMISSION
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business activity

The Shelbyville Municipal Water and Sewer Commission (a component unit of the City of Shelbyville, KY) operates a combined water and sewer system which serves Shelbyville and the surrounding area. The original Commission established in 1955 was dissolved, reestablished, and restructured during 1993. During 2000 the Shelby County Fiscal Court conveyed all property and assets of Sanitation District No. 1 to the Commission and the Commission assumed the debts and obligations of Sanitation District No. 1 to form a newly constituted Commission. The new Commission consists of seven voting members. The Mayor of the City of Shelbyville shall be one voting member and serve as chairperson. Three other members are to be appointed by the Mayor, with approval of the City Council. One of the three members appointed by the Mayor shall be a member of the City Council. Three members are to be appointed by the Shelby County Judge Executive, with approval of the Fiscal Court. One of the three members appointed by the Judge Executive shall be a member of the Fiscal Court.

Accrual basis

Customer meters are read and billed monthly at which time the receivable is recorded and revenue is recognized. No provision has been provided for doubtful accounts due to the amount determined to be uncollectible.

Financial statement presentation

The financial statements of the Commission are prepared in accordance with generally accepted accounting principles (GAAP). The Commission's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The Commission's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

Operating revenue and expenses

Operating revenue and expenses for proprietary funds are those that result from providing services and producing and delivering goods and/or services. It also includes all revenue and expenses not related to capital and related financing, noncapital financing, or investing activities.

When both restricted and unrestricted resources are available for use, it is the Commission's policy to use restricted resources first, then unrestricted resources as needed.

Budget

The Chairman shall submit an annual budget to the Commission at the May monthly meeting. The budget shall provide for any request by the Commission for surplus funds deposited in the name of the City. The annual budget shall be approved no later than June 30 of each year. Surplus funds in excess of the amount required to be maintained under the provision of the lease agreements between Kentucky Municipal Finance Corporation and the City of Shelbyville shall be deposited in the name of the City as provided in the lease agreements and may be transferred to the general fund of the City as provided in the lease agreements.

Inventory

The inventory is priced at cost on the first-in, first-out basis.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Trade accounts receivable

Trade accounts receivable are reported at the amount management expects to collect from outstanding balances. Management considers all accounts receivable as collectible at year end.

Amortization

The debt issue expense is amortized by the debt outstanding method over the term of the issue.

Utility assets

All property and equipment is recorded at cost. Interest and loan fees incurred on funds borrowed for construction is capitalized during the construction period.

Depreciation

The Commission uses the straight-line method for property, plant and equipment based on the following estimated useful life by major class of depreciable assets:

<u>Class</u>	<u>Life</u>
Building and improvements	20-50 years
Machinery and equipment	5-10 years
Water and sewer systems	50 years
Infrastructures	20-50 years

Customer deposits

Interest is accrued at the rate of 6% but not paid until service is discontinued.

New customers

New service connection fees are recorded as an addition to the equity of the water and sewer system. The cost of installation of the new service is recorded as an addition to water or sewer plant in service and is subject to depreciation.

Debt service coverage

The debt service coverage is computed by dividing operating income before depreciation and interest on long term debt by the maximum annual principle and interest coming due on all system debt outstanding in any year (including base rentals.) The fixed rate lease purchase agreements require debt service coverage of 1.20.

Accumulated vacation and sick leave

Vacation is earned at rates varying between 1 to 15 days per year depending on the length of service. Vacations must be taken during the year earned. Sick leave accrues at the rate of 1 day per month and shall accumulate to a maximum of 126 days. Unused sick days are not payable upon retirement or termination. The only benefit available for unused sick leave is limited to retirement credit by the CERS at a maximum of six months credit for 116-126 sick days accumulated at retirement. Any amount of accrued sick leave above 126 days will not be credited for retirement.

Retirement system

The Commission participates in the County Employees Retirement System. All eligible regular full-time employees are authorized and directed to participate in the system.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash equivalents

For the purpose of the statement of cash flows the Commission considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of 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.

Transfers

Pursuant to an Inter-local Cooperation Agreement dated January 31, 2000 between the City of Shelbyville, the Shelbyville Municipal Water and Sewer Commission, and the County of Shelby, the City of Shelbyville shall receive no more than 7% of the annual gross water and sewer revenues of the Commission, and any amounts transferred to the City of Shelbyville shall represent surplus funds of the Commission.

NOTE 2 - CASH INVESTMENTS

The Commission maintains numerous operating and restricted cash and cash investment accounts at various depository banks.

State statute limits investments of public funds generally to obligations of the United States and certain of its agency and instrumentality, certificates of deposits or other interest-bearing accounts of FDIC insured banks or savings and loan institutions.

At June 30, 2014, the carrying amount of the Commission's cash investments were \$6,515,391 and the various bank balances were \$6,620,524. All cash investments were treasury certificates or were covered by collateral in the form of pledged treasury certificates. All of the bank balances were covered by the \$250,000 federal depository insurance or pledged treasury certificates.

NOTE 3 - RESTRICTED FUNDS AND INVESTMENTS

Following is a schedule of the restricted funds and investments.

	Debt Service Fund	Debt Service Reserve Fund	Depreciation Fund	Construction Fund	Surplus Fund
Cash	\$498,258	-	\$2,296,628	\$2,248,107	\$180,294
Gov Sec	-	\$749,052	-	-	-
Total	\$498,258	\$749,052	\$2,296,628	\$2,248,107	\$180,294

The series 1998A, 2002A, and 2008 fixed rate lease purchase agreements dated June 1, 1998, October 10, 2002, and June 30, 2008 respectively require that the Commission establish various funds and accounts and make various monthly transfers. The Commission is in compliance with these requirements; except for their debt service fund is under-funded by \$138,841.

NOTE 4 – UTILITY PLANT

The water system acquired from the Kentucky Water Service Company and all subsequent additions are recorded at cost. The sewer system is not recorded at cost. The actual cost to the Commission was the payment of outstanding Sewerage System Revenue Bonds in the amount of \$9,000. An appraisal made at the time of acquisition showed the system to have a net sound value of \$200,000. Consequently, entries were made in the Commission's records recording this amount as an asset. Subsequent additions have been recorded at cost. April 1, 2000 the Sanitation District's assets were transferred to the Commission with a net book value of \$2,403,525.

Following is a schedule of the utility plant:

<u>Water plant</u>	
Source of supply land	\$5,000
Power and pumping land	21,500
Source of supply structures	4,582,737
Pumping structures	417,840
Standpipes	3,402,148
Purification system	2,955,522
Dam and line	300,409
Miscellaneous structures	35,546
Pumping equipment	2,391,065
Distribution mains	5,859,782
Services and meters	2,674,779
Hydrants	<u>346,885</u>
Total water plant	\$22,997,451

<u>Sewer plant</u>	
Land	\$124,126
Structures	9,389,283
Distribution lines	12,304,101
Manholes	863,852
Disposal plant equipment	6,804,228
Office furniture and fixtures	<u>7,568</u>
Total sewer plant	\$29,404,843

<u>Administrative and general</u>	
Land and building	\$714,813
Office furniture and fixtures	321,193
Transportation equipment	484,839
Shop equipment	<u>193,856</u>
Total administrative and general	\$1,714,701

<u>Construction in Progress</u>	
Water plant	\$269,906
Sewer plant	<u>47,643</u>
Total construction in progress	\$317,549

NOTE 4 – UTILITY PLANT (CONTINUED)

The construction in progress water plant includes the following projects:

1) Interstate 64 regional pipeline study	
Engineering	\$159,795
Other	46,166
Total	<u>\$205,961</u>
This contract is in the design phase and has not been awarded.	
2) Downtown water storage tank alternatives	
Other	\$30,369
3) Water plant filter improvements study and filter investigation	
Engineering	\$17,425
Other	501
Total	<u>\$17,926</u>
4) Possible relocation of water line at Mt. Eden Road (DOT)	
Engineering	\$770
Other	111
Total	<u>\$881</u>
5) Water line extension from Clear Creek Park to Spring Oaks (to improve hydraulics)	
Engineering	\$1,080
6) Water treatment plant rehab	
Engineering	\$770
Other	111
Total	<u>\$881</u>

The construction in progress sewer plant includes the following projects:

1) KY 55 force main	
Engineering	\$4,341
This contract is in design phase and has incurred only engineering cost.	
2) Possible relocation of sewer line at Mt. Eden Road (DOT)	
Engineering	\$770
3) Sanitary replacement near Bradshaw Street	
Engineering	\$27,440
Other	6,863
Total	<u>\$34,303</u>

NOTE 4 – UTILITY PLANT (CONTINUED)

4) Sanitary sewer extension and provision of sanitary sewer service to Diageo	
Engineering	\$2,970
Other	1,130
Total	<u>\$4,100</u>
5) Benson Road Sewer Gravity Sewer Line	
Engineering	\$3,065
Other	1,065
Total	<u>\$4,130</u>

Capital assets activity for the year ended June 30, 2014:

	Balance July 1, 2013	Additions	Deductions	Balance June 30, 2014
Capital assets, not being depreciated:				
Land	189,838	-	-	189,838
Water rights	165,652	-	-	165,652
Construction work in progress	346,035	144,833	(173,315)	317,553
Total capital assets, not being depreciated	701,525	144,833	(173,315)	673,043
Capital assets, being depreciated:				
Water Plant	22,670,660	269,053	-	22,939,713
Sewer Plant	29,280,716	88,557	-	29,369,273
Administrative and shop buildings	640,925	3,438	-	644,363
Machinery and equipment	977,309	22,580	-	999,889
Total capital assets being depreciated:	53,569,610	383,628	-	53,953,238
Less accumulated depreciation:				
Water Plant	10,654,805	603,307	-	10,654,805
Sewer Plant	10,665,900	803,772	-	10,665,900
Administrative and shop buildings	351,289	12,056	-	351,289
Machinery and equipment	730,457	39,885	-	730,457
Total accumulated depreciation	22,402,451	1,459,020	-	23,861,471
Total capital assets being depreciated, net	31,167,159	(1,075,392)	-	30,091,767
Business-type activities capital assets, net	\$31,868,684	\$(930,559)	\$(173,315)	\$30,764,810

NOTE 5 - UNAMORTIZED DEBT ISSUE EXPENSE

The 1998A, 2002A, and 2004C debt issuance cost and unamortized expenses of the 1991 issue, that the 1998A and 2002A retired, are being amortized over the lives of the lease agreements. On April 1, 2000 the Sanitation District's assets and liabilities were merged with the Commission. This resulted in additional unamortized debt issue expense that is being amortized over a 20-year period. On July 14, 2000 new revenue bonds were issued. The new issuance cost is also being amortized over a 20-year period. On June 30, 2008 the refinancing of 1998A debt resulted in additional unamortized debt that is being amortized over a 10-year period.

NOTE 6 - FIXED RATE LEASE OBLIGATION

On June 1, 1998 the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky Municipal Finance Corporation as lessor. Under the agreement, revenue bonds of \$9,540,000 were sold at par. \$3,607,880 of these funds were used to purchase US government securities. Those securities are deposited in an irrevocable trust with an escrow agent to provide for all future debt payments on a portion of the 1991 lease purchase agreement. As a result the fixed rate lease portion held in escrow is considered deceased and the liability has been removed from the statement of net assets.

The bonds sold under the 1998 lease agreement will be retired over a period of twenty (20) years with interest rates from 4.0% to 5.15%. The annual base period rentals, including interest, under the agreement range from \$680,515 to \$1,025,213. These bonds were paid in full with the new (2008) lease agreement. On June 30, 2008 the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky Municipal Finance Corporation for the refunding of prior 1998 lease. Under the agreement, revenue bonds of \$7,230,000 were sold at par. The bonds sold under the new 2008 lease agreement will be retired over a period of ten (10) years with interest rates from 2.75% to 4.0%. The annual base period rentals including interest, under the agreement range from \$655,241 to \$998,400.

On July 14, 2000 the City of Shelbyville entered into a fixed rate lease purchase agreement with the Kentucky League of Cities Funding Trust as lessor. Under the agreement, revenue bonds of \$715,000 were sold at par. Proceeds were used for water and sewer line extension and expansion.

The bonds sold under the lease agreement will be retired over a period of twenty (20) years with variable interest rates. The assumed rate of interest for base rental payments is 4.18%. After notice from the lessor, the Commission will either receive a credit against base rental payable on July 15, of each fiscal year in an amount equal to the excess, if any, of the aggregate of the interest components of base rentals paid by the Commission during the preceding fiscal year (at the assumed interest rate) over the Commission's proportionate share of all interest paid on variable rate bonds or the Commission will immediately pay as additional rentals, an amount equal to the excess, if any, of the Commission's proportionate share of all interest paid or to be paid on variable rate bonds over the aggregate of the interest components of base rentals then required to be paid by the Commission (at the assumed interest rate). Prior to May 1 of each fiscal year during the lease term, the lessor will inform the Commission of the amount of additional rentals that are estimated to be payable during the next ensuing fiscal year. The annual base period rentals, including interest and fiduciary fees, under the agreement range from \$40,729 to \$68,591.

NOTE 6 - FIXED RATE LEASE OBLIGATION (CONTINUED)

On September 9, 2004 the City of Shelbyville entered into a variable rate lease agreement with the Kentucky League of Cities Funding Trust as lessor. Under the agreement revenue bonds of \$8,500,000 were sold at par. Proceeds were used for water treatment plant improvements and wastewater treatment plant expansion and improvements.

The bonds sold under the lease agreement will be retired over twenty-four (24) years with variable interest rates. The assumed rate of interest for base rental payments is 3.75%. After notice from the lessor, the Commission will pay additional rentals within fifteen (15) days. Any lease rental payment not paid within ten (10) days of the date due shall bear interest thereon up to a maximum rate of fifteen percent per annum. The Lessee will receive credit against the base rental payable on September 20th of each fiscal year in an amount equal to the excess, if any, of the aggregate of the interest components of base rentals paid by the Lessee during the preceding fiscal year (at such assumed rate) over the Lessee's proportionate share of all interest paid on variable rate bonds, and after notice from the Lessor, the Lessee will immediately pay as additional rentals, an amount equal to the excess, if any, of the Lessee's proportionate share of all interest paid or to be paid on variable rate bonds over the aggregate of the interest components of base rental then required to be paid by the Lessee (at the then assumed rate). Prior to May 1st of each fiscal year during the lease term, the Lessor will inform the Lessee of the amount of additional rentals that are estimated to be payable during the next ensuing fiscal year.

The annual base period rentals, including interest and fiduciary fees, under the agreement range from \$17,372 to \$97,637.

Outstanding revenue bonds under the lease agreements as of July 1, 2013	\$12,550,000
Less bonds retired during the fiscal year	<u>865,000</u>
Bonds outstanding June 30, 2014	11,685,000
Less current bonds outstanding	<u>890,000</u>
Long term bonds outstanding	\$11,685,000

Future maturities of long term debt:

Year Ending	Principal	Interest	Amount
2015	890,000	443,837	1,333,837
2016	925,000	410,921	1,335,921
2017	965,000	375,029	1,340,029
2018	1,020,000	336,690	1,356,690
2019-2023	3,531,256	1,212,626	4,742,882
2024-2028	<u>4,353,744</u>	<u>391,131</u>	<u>4,744,875</u>
Totals	<u>\$11,685,000</u>	<u>\$3,170,234</u>	<u>\$14,855,342</u>

NOTE 7 - NOTES PAYABLE - KY INFRASTRUCTURE AUTHORITY

On March 7, 2000 the Commission assumed the remaining unpaid portion of the debt as part of the Commission's assumption of the obligation to provide sewer service to the territory of the Sanitation District. The unpaid portion at March 7, 2000 was \$1,799,494. The KIA loan consists of two separate loans. Fund A original loan was \$1,402,737 at 2.6% with semi-annual principal and interest payments due on June 1 and December 1. Fund C original loan was \$774,511 at 4.5% to 6.375% with payments due January 1 and July 1. June 18, 2004 the Kentucky Infrastructure Authority restructured the Fund C Program. The Commission will now make monthly loan payments instead of semi-annual payments. The interest rates on the restructured loan are 2.25% to 5.290% with payments due the first day of every month.

Outstanding note as of July 1 , 2013	\$143,658
Principal paid during the fiscal year	<u>143,658</u>
Outstanding note as of June 30, 2014	143,658
Less: current note outstanding	<u>-</u>
Long term note outstanding	\$ -

NOTE 8 – LONG-TERM LIABILITIES

Changes during fiscal year 2014 and balances as of June 30, 2014 of the Commission were as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Fixed Rate					
Lease Obligation:					
KLC 2000	\$360,0	-	\$40,000	\$320,000	\$40,000
KLC 2004-A	7,775,000	-	-	7,750,000	-
Series 2008 Rev	4,440,000	-	825,000	3,615,000	825,000
	<u>12,550,000</u>	-	<u>865,000</u>	<u>11,658,000</u>	<u>865,000</u>
N/P-KIA:					
KIA Loan A94-05	88,658	-	88,658	-	-
KIA Loan C94-01	55,000	-	55,000	-	-
	<u>143,658</u>	-	<u>143,658</u>	-	-
Total	<u>\$12,693,658</u>	-	<u>\$1,008,658</u>	<u>\$11,658,000</u>	<u>\$865,000</u>

NOTE 9 - PENSION PLAN

The Commission provides pension benefits for regular full-time employees with at least 100 hours of work per month. These benefits are provided under the County Employee Retirement System of the state of Kentucky. Regular full-time employees are required to participate. The plan is included in the Annual Report of the Kentucky Retirement Systems. A copy may be obtained from Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601 or <http://kyret.ky.gov>.

NOTE 9 - PENSION PLAN (CONTINUED)

Plan description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rate basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky General Assembly reserves the right to suspend or reduce cost-of-living adjustments if, in its judgment, the welfare of the Commonwealth so demands. On July 1, 2012 the COLA was not granted.

Contributions - For the year ended June 30, 2014, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board 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 year ended June 30, 2014, participating employers contributed 18.89% of each employee's creditable compensation. The actuarially determined rate set by the Board for the year ended June 30, 2014 was 18.89% of creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

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

The Commission and covered employees made the required contributions for the fiscal year amounting to \$250,368 on covered payroll of \$1,152,099. \$252,517 and \$243,910 were contributed for June 30, 2013 and 2012 respectively.

NOTE 10- EMPLOYEE HEALTH BENEFIT PLAN

Effective July 1, 2006 the City of Shelbyville implemented an employee health and welfare benefit plan, providing medical benefits utilizing a preferred provider network, and prescription drug benefits. A copy of the plan documents and insurance contracts, if any, are on file at the plan administrator's office and may be read by any covered person at any reasonable time.

The plan is fully funded by the employer. Funds for payment of claims considered under the plan are forwarded to accounts from which claims are to be paid. The City of Shelbyville maintains this fund and is the administrator, fiduciary and legal agent. Medical Benefits Administrators, Inc, 1975 Tamarack Road, P O Box 1099, Newark, Ohio 43058-1099 is the benefit manager.

The plan is funded by contributions made by the employer and employees who are participating under the plan. Participation contributions are currently required for both participant and dependent coverage. The Commission through the City of Shelbyville has purchased excess stop-loss insurance for medical expenses that exceed \$55,000 per covered individual for fiscal year June 30, 2014.

NOTE 11- FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the City in estimating its fair value disclosures for financial instruments:

- Operating Cash: The carrying amounts reported in the statements of net assets approximate fair values because of the short maturities of those instruments.
- Restricted Assets: The carrying amounts reported in the statement of net assets approximate fair values because of the short maturities of those instruments.

The estimated fair values of the City's financial instruments are as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial Assets:		
Operating cash	\$ 543,053	\$ 543,053
Debt service fund	498,258	498,258
Debt service reserve fund	749,052	749,052
Depreciation fund	2,296,628	2,296,628
Special construction fund	2,248,107	2,248,107
Surplus fund	180,294	180,294

NOTE 11 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following table presents the City’s fair value hierarchy for the financial assets measured at fair value on a recurring basis:

June 30, 2014	<u>Fair Value Measurements at Reporting Date Using:</u>	
	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>
Money Market Investments	\$749,052	\$749,052

NOTE 12– SUBSEQUENT EVENT POLICY

The Commission has evaluated subsequent events for the period from June 30, 2014 to January 23, 2015, (the date which the financial statements were available to be issued) for items requiring recognition or disclosure in the financial statements. There were no events occurring during the evaluation period that require disclosure, and there were no events that require recognition in the financial statements.

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Board of Commissioners
Shelbyville Municipal Water and Sewer Commission
Shelbyville, KY

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

We have audited the basic financial statements of the business activities of the Shelbyville Water and Sewer Commission, Component Unit of the City of Shelbyville, Kentucky, as of and for the year ended June 30, 2014, which collectively comprise the Shelbyville Water and Sewer Commission's basic financial statements and have issued our report thereon dated November 21, 2014. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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 combination of significant deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

**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
(Continued)**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Shelbyville Water and Sewer Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under Government Auditing Standards.

Respectively Submitted,

A handwritten signature in cursive script that reads "Ross & Company".

Ross & Company, PLLC
January 23, 2015

**SHELBYVILLE MUNICIPAL WATER AND SEWER COMMISSION
SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2014**

FINDINGS:

2014-01

The Commission is required to have internal controls in place that enable it to prepare complete financial statements, including note disclosures, in compliance with generally accepted accounting principles.

The Commission lacks personnel with the expertise to apply generally accepted accounting principles in preparing its financial statements including note disclosures and thus, does not have the internal control procedures required to take responsibility for the financial statements in conformity with generally accepted accounting principles.

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

We recommend management review the costs and benefits involved to retain a consultant with the required expertise to prepare the financial statements or review the financial statements as prepared by the auditor for compliance with generally accepted accounting principles.

Response:

This is an ongoing finding. Management has determined that it is the most cost effective to continue to engage the auditor to draft the financial statements and related notes.

2014-02

The Commission is required to have internal controls in place that enable it to apply generally accepted accounting principles to its transactions. Specifically, this includes interfund transactions, payments-on-behalf of the Commission, accounting for water billing and year-end accrual transactions.

The Commission executes basic and routine transactions throughout the year; however, the Commission does not apply generally accepted accounting principles to certain non-routine transactions recorded during the year and in making its year-end accruals. Management relied on the auditor's year-end adjustments to bring the Commission's accounting records into compliance with generally accepted accounting principles. Management reviewed, approved and accepted responsibility for the adjusting journal entries prior to the issuance of the financial statements.

We recommend management review the costs and benefits involved to retain a consultant with the required expertise to advise the Commission during the year concerning non-routine transactions and to assist the Commission with its year-end close so that the Commission's accounting records will be in compliance with generally accepted accounting principles.

Response:

This is an ongoing finding. Management has determined that it is the most cost effective to continue to rely on the auditor's adjustments to bring the Commission's accounting records into compliance with generally accepted accounting principles.

REQUIRED SUPPLEMENTARY INFORMATION

SHELBYVILLE WATER AND SEWER
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
ACTUAL COMPARED TO BUDGET
FOR FISCAL YEAR ENDED JUNE 30, 2014

	<u>BUDGET</u>		<u>ACTUAL</u>	<u>VARIANCE - OVER (UNDER)</u>
	<u>ORIGINAL</u>	<u>FINAL</u>		
OPERATING REVENUES				
Water sales		\$ 2,734,559	\$ 2,721,564	\$ (12,995)
Sewer service		2,649,764	2,661,215	11,451
Other revenues		143,200	163,676	20,476
TOTAL OPERATING REVENUE	-	5,527,523	5,546,455	18,932
OPERATING EXPENSES				
Direct water expenses		\$1,064,195	\$982,235	(\$81,960)
Direct sewer expenses		826,100	795,346	(30,754)
Administrative expenses		1,292,680	1,399,243	106,563
Amortization-debt issue exp		81,646	54,053	(27,593)
Depreciation-water plant		600,177	603,307	3,130
Depreciation-sewer plant		800,363	803,772	3,409
Depreciation-office building		59,460	51,941	(7,519)
TOTAL OPERATING EXPENSES	-	4,724,621	4,689,897	(34,724)
OPERATING INCOME	-	802,902	856,558	53,656
NON OPERATING REVENUES (EXPENSES)				
Interest income		\$13,500	\$13,625	\$125
Interest exp-long term debt		(505,252)	(479,946)	25,306
Debt administration fees		(68,000)	(67,320)	680
Total Non Operating Revenue (Expenses)	-	(559,752)	(533,641)	26,111
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS				
	-	243,150	322,917	79,767
Capital contributions			312,017	312,017
Transfers out - City of Shelbyville		(165,000)	(140,648)	24,352
Change in Net Position	-	78,150	494,286	416,136
Net Position, July 1, 2013		25,415,475	25,415,475	25,415,475
Net Position, June 30, 2014	\$	25,415,475	\$	25,493,625
			\$	25,909,761
			\$	416,136

SHELBYVILLE WATER AND SEWER

SHELBYVILLE WATER AND SEWER

SHELBYVILLE WATER AND SEWER COMISSION

**STATEMENT OF OPERATING REVENUES
ACTUAL COMPARED TO BUDGET
FOR FISCAL YEAR ENDED JUNE 30, 2014**

	BUDGET		ACTUAL	VARIANCE OVER (UNDER)
	<u>ORIGINAL</u>	<u>FINAL</u>		
WATER SALES				
Industrial sales	\$ 266,267	\$ 266,267	\$ 264,721	\$ (1,546)
Residential sales	1,943,008	1,943,008	1,908,655	(34,353)
Commercial sales	261,059	261,059	271,752	10,693
Sales to West Shelby Water Dist	118,625	118,625	129,574	10,949
Sales to North Shelby Water Dist	23,320	23,320	21,096	(2,224)
Sales to East US60 Water	5,000	5,000	0	(5,000)
Private fire protection	73,860	73,860	74,436	576
Public fire protection	5,419	5,419	5,418	(1)
Other water sales	38,000	38,000	45,912	7,912
TOTAL WATER SALES	2,734,558	2,734,558	2,721,564	(12,994)
SEWER SERVICE				
Industrial service	368,471	368,471	364,799	(3,672)
Residential service	899,785	899,785	890,237	(9,548)
Commercial service	172,122	172,122	186,410	14,288
Sanitation district industrial	10,211	10,211	12,545	2,334
Sanitation district residential	907,963	907,963	903,010	(4,953)
Sanitation district commercial	195,678	195,678	194,831	(847)
Sanitation district public auth	65,535	65,535	75,539	10,004
Sewer pretreatment program	16,000	16,000	21,173	5,173
Other sewer service	14,000	14,000	12,672	(1,328)
TOTAL SEWER SERVICE	2,649,765	2,649,765	2,661,216	11,451
Other Revenues				
Water meter turn ons	43,000	43,000	38,825	(4,175)
Miscellaneous income	31,000	31,000	52,575	21,575
Handling late fee	51,000	51,000	54,126	3,126
Rental income	18,200	18,200	18,150	(50)
Total other Revenues	\$ 143,200	\$ 143,200	\$ 163,676	\$ 20,476

SHELBYVILLE WATER AND SEWER COMISSION

SHELBYVILLE WATER AND SEWER COMISSION

SHELBYVILLE WATER AND SEWER COMMISSION

**STATEMENT OF OPERATING EXPENSES
ACTUAL COMPARED TO BUDGET
FOR FISCAL YEAR ENDED JUNE 30, 2014**

	<u>BUDGET</u>		
	<u>ORIGINAL</u>	<u>FINAL</u>	<u>ACTUAL</u>
DIRECT WATER EXPENSES			
General, supervision and engineering	\$ 11,000	\$ 11,000	\$ 11,143
Source of supply and pumping labor	179,000	179,000	172,986
Laboratory expense	48,000	48,000	49,826
Operating supplies	203,000	203,000	173,044
Maintenance-structures	47,000	47,000	50,176
Maintenance-pumping and filtering	47,500	47,500	51,129
Power	148,000	148,000	147,557
Maintenance-water mains	59,800	59,800	56,631
Maintenance-services and meters	96,195	96,195	77,850
Maintenance-hydrants	8,700	8,700	7,589
Meter readings	73,000	73,000	74,876
Vacation, holiday, sick pay	65,000	65,000	60,836
Sludge removal	10,000	10,000	3,749
Misc Labor	68,000	68,000	44,844
TOTAL DIRECT WATER EXPENSES	1,064,195	1,064,195	982,236
DIRECT SEWER EXPENSES			
Vacation, holiday, sick pay	26,000	26,000	28,834
General, supervision and engineering	600	600	
Laboratory expense	14,000	14,000	10,771
Sewer plant labor	107,000	107,000	107,108
Operating supplies	122,000	122,000	137,468
Maintenance-structures	20,600	20,600	20,977
Maintenance-disposal plant equip	54,000	54,000	52,030
Labor - Comm Pump Station	16,000	16,000	14,058
Power	120,000	120,000	129,405
Power-Joint pump station	34,000	34,000	39,816
Maintenance-sewer mains	25,600	25,600	21,862
Maintenance-sewer manholes	7,200	7,200	1,284
Pretreatment outside lab exp	17,000	17,000	15,107
Chronic tox testing	16,000	16,000	7,528
Pretreatment sampl. Labor/equip	18,500	18,500	16,110
Matl's comm pump station	16,000	16,000	9,786
Maintenance-pump stations	22,200	22,200	14,608
Labor sludge removal	20,000	20,000	19,056
Landfill	122,000	122,000	108,818
Legal pretreatment	600	600	-
Maintenance-flow monitors	3,000	3,000	2,780
Maintenance-SD pump station	20,400	20,400	16,584
Maintenance-SD Mains	3,600	3,600	354
Power-SD pump station	19,800	19,800	21,003
TOTAL DIRECT SEWER EXPENSES	\$ 826,100	\$ 826,100	\$ 795,347

SHELBYVILLE WATER AND SEWER COMMISSION

**STATEMENT OF OPERATING EXPENSES
ACTUAL COMPARED TO BUDGET(continued)
FOR FISCAL YEAR ENDED JUNE 30, 2014**

	<u>BUDGET</u>		<u>ACTUAL</u>
	<u>ORIGINAL</u>	<u>FINAL</u>	
ADMINISTRATIVE EXPENSES			
Holiday, vacation, sick pay	\$ 24,000	\$ 24,000	\$ 16,913
Office salaries	93,700	93,700	97,753
Office supplies and expenses	72,000	72,000	69,022
Uncollectible revenue	3,600	3,600	1,153
Management salary	150,000	150,000	135,826
Legal and accounting	48,000	48,000	53,529
Commission member fees	31,500	31,500	29,250
Insurance	119,000	119,000	129,431
Employee insurance	265,000	265,000	339,681
Employee retirement	188,000	188,000	197,017
Miscellaneous expenses	76,000	76,000	69,247
Labor safety training	3,600	3,600	1,518
Maintenance-general properties	5,600	5,600	10,894
Maintenance-safety equipment	7,200	7,200	14,148
Truck and equipment expenses	86,000	86,000	119,300
Distribution shop supplies	11,000	11,000	9,690
Cash short & over	600	600	(569)
Management training	4,800	4,800	11,825
Office utilities	7,800	7,800	6,177
Office janitorial	7,200	7,200	6,000
Office cleaning supplies	480	480	-
Office maintenance	3,600	3,600	4,405
Payroll taxes	84,000	84,000	77,032
TOTAL ADMINISTRATIVE EXPENSES	\$ 1,292,680	\$ 1,292,680	\$ 1,399,242

SHELBYVILLE WATER AND SEWER COMMISSION

SHELBYVILLE WATER AND SEWER COMMISSION

VARIANCE
OVER (UNDER)

\$ 143
(6,014)
1,826
(29,956)
3,176
3,629
(443)
(3,169)
(18,345)
(1,111)
1,876
(4,164)
(6,251)
(23,156)
(81,959)

\$2,834

(600)
(3,229)
108
15,468
377
(1,970)
(1,942)
9,405
5,816
(3,738)
(5,916)
(1,893)
(8,472)
(2,390)
(6,214)
(7,592)
(944)
(13,182)
(600)
(220)
(3,816)
(3,246)
1,203
\$ (30,753)

SHELBYVILLE WATER AND SEWER COMMISSION

**VARIANCE
OVER (UNDER)**

\$	(7,087)
	4,053
	(2,978)
	(2,447)
	(14,174)
	5,529
	(2,250)
	10,431
	74,681
	9,017
	(6,753)
	(2,082)
	5,294
	6,948
	33,300
	(1,310)
	(1,169)
	7,025
	(1,623)
	(1,200)
	(480)
	805
	(6,968)
<hr/>	
\$	106,562

SHELBYVILLE WATER AND SEWER COMMISSION