

BERBERICH TRAHAN & CO., P.A.

*Certified Public Accountants*

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

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FINANCIAL STATEMENTS  
WITH SUPPLEMENTARY INFORMATION  
YEARS ENDED DECEMBER 31, 2011 AND 2010

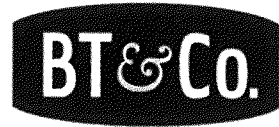
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CITY OF DERBY, KANSAS

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WITH SUPPLEMENTARY INFORMATION

Years Ended December 31, 2011 and 2010

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## INDEPENDENT AUDITOR'S REPORT

El Paso Water Company, Inc.  
City of Derby, Kansas

We have audited the accompanying balance sheets of El Paso Water Company, Inc. (the Company) as of December 31, 2011 and 2010, and the related statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Berberich Trahan & Co., P.A.*

June 5, 2012

BERBERICH TRAHAN & CO., P.A.

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EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

BALANCE SHEETS

December 31, 2011 and 2010

	2011	2010
<u>ASSETS</u>		
Utility plant:		
Land and land improvements	\$ 75,059	\$ 75,059
Wells, pumphouses and equipment	983,222	983,222
Mains and storage tanks	4,457,556	4,457,556
Meters	2,576,089	2,499,755
Warehouse building	58,954	58,954
Office furniture and equipment	24,113	24,113
Automotive and other equipment	256,199	238,192
	8,431,192	8,336,851
Less allowance for depreciation	(5,942,586)	(5,747,487)
Total	2,488,606	2,589,364
Current assets:		
Cash	425,683	304,912
Accounts receivable	272,505	285,577
Unbilled receivables	121,097	122,059
Materials and supplies	85,542	23,540
Prepaid insurance	3,362	18,485
Total current assets	908,189	754,573
	\$ 3,396,795	\$ 3,343,937

See accompanying notes to financial statements.

	<u>2011</u>	<u>2010</u>
<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>		
Current liabilities:		
Accounts payable	\$ 118,997	\$ 106,945
Payables to the City of Derby	-	176,522
	<u>118,997</u>	<u>283,467</u>
Stockholder's equity:		
Common stock, no par value, stated value \$ 25 per share: authorized 40,000 shares; issued and outstanding 34,860 shares	871,500	871,500
Additional paid-in capital	303,053	303,053
Retained earnings	<u>2,703,236</u>	<u>2,485,908</u>
	3,877,789	3,660,461
Treasury stock at cost - 3,545 shares	<u>(599,991)</u>	<u>(599,991)</u>
Total stockholder's equity	3,277,798	3,060,470
	<u>\$ 3,396,795</u>	<u>\$ 3,343,937</u>

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

STATEMENTS OF INCOME

Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues	<u>\$ 3,938,054</u>	<u>\$ 3,438,831</u>
Operating expenses:		
Operation and maintenance	2,616,555	2,202,555
Depreciation	<u>195,099</u>	<u>207,858</u>
Total operating expenses	<u>2,811,654</u>	<u>2,410,413</u>
Net income	<u>\$ 1,126,400</u>	<u>\$ 1,028,418</u>

See accompanying notes to financial statements.

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

STATEMENTS OF RETAINED EARNINGS

Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ 2,485,908	\$ 2,165,991
Net income	1,126,400	1,028,418
Cash dividends to the City of Derby	<u>(909,072)</u>	<u>(708,501)</u>
Balance, end of year	<u>\$ 2,703,236</u>	<u>\$ 2,485,908</u>

See accompanying notes to financial statements.

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Net income	\$ 1,126,400	\$ 1,028,418
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	195,099	207,858
Changes in assets and liabilities:		
Accounts and unbilled receivables	14,034	(140,240)
Materials and supplies	(62,002)	943
Prepaid insurance	15,123	(1,113)
Accounts payable	12,052	(9,590)
City of Wichita - take or pay	-	(205,158)
Payables to the City of Derby	(176,522)	(65,251)
Net cash provided by operating activities	1,124,184	815,867
Cash flows from investing activities:		
Purchases of equipment	(94,341)	(142,943)
Cash flows from financing activities:		
Dividends paid	(909,072)	(708,501)
Net increase (decrease) in cash	120,771	(35,577)
Cash, beginning of year	304,912	340,489
Cash, end of year	\$ 425,683	\$ 304,912

See accompanying notes to financial statements.



EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS

December 31, 2011 and 2010

1 - Nature of Organization and Summary of Significant Accounting Policies

Organization and Operations

El Paso Water Company, Inc. (the Company) is a water utility company serving customers located in Derby, Kansas. Water sales comprise the majority of the Company's operating revenues, which could be adversely affected by the amount of local rainfall, conservation measures by customers or an interruption of service from the City of Wichita water supply. On January 27, 1999, all stock of the company not redeemed as treasury stock was acquired by the City of Derby, Kansas.

Utility Plant

Utility plant assets are reflected at cost as of the time of acquisition. The Company generally capitalizes all expenditures for utility plant assets in excess of \$ 2,500.

Maintenance and repair costs are charged to income as incurred, and significant renewals and betterments are capitalized. When assets are retired or disposed of, the related costs and accumulated depreciation are removed from the respective accounts and any gain or loss is credited or charged to income.

Depreciation is provided for in amounts sufficient to charge the cost of depreciable assets to operations over their estimated service lives. For substantially all capital assets acquired prior to 1987, an accelerated method of depreciation (declining-balance) is used for financial reporting purposes, except for assets acquired prior to January 1, 1976, which are depreciated using the straight-line method for financial reporting purposes. All capital assets acquired subsequent to 1987 are depreciated using the straight-line method. Estimated useful lives are as follows:

	<u>Years</u>
Land improvements	20
Wells, pumphouses and equipment	40
Mains and storage tanks	50
Meters	5 - 15
Warehouse building	40
Office furniture and equipment	5 - 7
Other	3 - 10

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Nature of Organization and Summary of Significant Accounting Policies (Continued)

Accounts Receivable and Revenue Recognition

Revenue is recognized as service is provided to customers. All customers are billed monthly.

Accounts receivable consist of both residential and commercial water sales. Unbilled receivables are recorded for services provided for which customers have not been billed at December 31, 2011. The Company utilizes the direct write-off method of accounting for bad debts. Accounts greater than 90 days past due are considered uncollectible and are written off. Management has determined that an allowance for doubtful accounts is not necessary at December 31, 2011 and 2010.

Materials and Supplies

Inventories of materials and supplies are stated at the lower of cost or market; cost is determined using the last-in, first-out method.

Income Tax Matters

The Company has received a Private Letter Ruling from the Internal Revenue Service concluding that the Company is a public utility for purposes of Internal Revenue Code 115(1) and, accordingly, its income from the operation of the public utility is excludable from taxation.

The Company's policy is to evaluate uncertain tax positions annually. Management evaluated the Company's tax positions and concluded that the Company had taken no uncertain tax positions that require adjustment to the financial statements.

The Company files income tax returns in the U.S. federal jurisdiction and Kansas state jurisdiction. With few exceptions, the Company is no longer subject to U.S. federal or state and local income tax examinations by tax authorities for years before 2008.

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS  
(Continued)

1 - Nature of Organization and Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities recognized and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

2 - Related Party Transactions

The Board of Directors of El Paso Water Company, Inc. is comprised of the Mayor and City Council members of the City of Derby. Through October 2010, the Company billed and collected sewer charges for the City of Derby. In October 2010, the City of Derby took over the billing and now bills the water charges for the Company.

All employees of the Company are employees of the City of Derby. The Company makes a monthly reimbursement to the City of Derby for contract labor. The total contract labor reimbursement from the Company to the City of Derby for the years ended December 31, 2011 and 2010 was \$ 440,894 and \$ 441,960, respectively.

The City of Derby receives dividends from the Company. Cash dividends paid to the City of Derby from the Company were \$ 909,072 and \$ 708,501 for the years ended December 31, 2011 and 2010, respectively.

The amount owed to the City of Derby for unremitted sewer charges, sewer penalties, payroll and dividends at December 31, 2010 was \$ 176,522.

The Company also leases office space from the City of Derby. Total rental expense included in operations was \$ 9,600 for each of the years 2011 and 2010.

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS  
(Continued)

3 - Water Rights

As of December 31, 1996, the Company hired a consultant to prepare a business valuation of the Company. Included in the valuation were water rights with a value of \$ 851,600. This value was based upon transactions in water rights in the area. The Company does not have a cost basis in the water rights, and therefore, in accordance with accounting principles generally accepted in the United States of America, they are not reflected on the balance sheets.

4 - Commitments

In April 2004, the City of Derby issued \$ 9,455,000, 1.10% - 5.00% General Obligation Water System Refunding Bonds, Series 2004-A, with varying maturities up to December 1, 2022. The Company paid dividends to the City of \$ 909,072 and \$ 780,501 for the years 2011 and 2010, respectively, related to principal and interest payments on this bond issue. Future dividend payments to the City are anticipated in order to retire the Series 2004-A bonds.

5 - Water Purchased from City of Wichita

All water sold is purchased from the City of Wichita, Kansas under a twenty year contract. The contract agreement contains a 100% "take or pay" provision. No amounts were paid under the "take or pay" provision for 2011 and 2010.

6 - Subsequent Events

The Company has evaluated subsequent events through the date of the independent auditor's report, which is the date the financial statements are available to be issued.

SUPPLEMENTARY INFORMATION

EL PASO WATER COMPANY, INC.  
CITY OF DERBY, KANSAS

SCHEDULES OF OPERATION AND MAINTENANCE EXPENSES

Years Ended December 31, 2011 and 2010

	2011	2010
Contract labor	\$ 440,894	\$ 441,960
Repairs and maintenance	88,579	62,297
Truck expenses	-	14,737
Wichita water purchases	1,885,857	1,502,235
Electric power	21,048	16,367
Other utilities	4,108	5,146
Office supplies and postage	79,645	60,120
Rentals/operating leases	14,300	20,567
Water treating supplies	2,578	7,321
Insurance	19,582	20,164
Professional fees	24,868	21,929
Dues and subscriptions	1,873	4,039
Other taxes	3,723	27
Miscellaneous	29,500	25,646
	\$ 2,616,555	\$ 2,202,555
Total		

See accompanying independent auditor's report.