

**WINCHESTER MUNICIPAL UTILITIES  
WINCHESTER, KENTUCKY**

**AUDITED FINANCIAL STATEMENTS**

**YEARS ENDED JUNE 30, 2011 and 2010**

**WINCHESTER MUNICIPAL UTILITIES  
WINCHESTER, KENTUCKY  
JUNE 30, 2011 and 2010**

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# SUMMERS, MCCRARY & SPARKS, P.S.C.

CERTIFIED PUBLIC ACCOUNTANTS

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## INDEPENDENT AUDITOR'S REPORT

To the Commissioners  
Winchester Municipal Utilities  
Winchester, KY

We have audited the accompanying financial statements of the business-type activities of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of and for the years ended June 30, 2011 and 2010 as listed in the table of contents. These financial statements are the responsibility of the Utilities' 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 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 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 the 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.

As discussed in Note 1, the financial statements present only the Winchester Municipal Utilities and do not purport to, and do not, present fairly the financial position of the City of Winchester, Kentucky, as of June 30, 2011 and 2010, and the changes in its financial position, or where applicable, its cash flows for the year then ended in conformity with account principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of June 30, 2011 and 2010, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 7, 2011 on our consideration of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control over financial reporting and 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 16 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 principally 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.

Our audit was conducted for the purpose of forming an opinion on the business-type activities of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, financial statements as a whole. The Department Expense and Revenue Bond Debt Schedules shown on pages 41 through 43 are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements. The Department Expenses, Revenue Bond Debt Schedules and the Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate 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 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 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.

*Summers, McCrary & Sparks, PSC*

Summers, McCrary & Sparks, PSC  
Winchester, Kentucky  
November 7, 2011

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
WINCHESTER MUNICIPAL UTILITIES  
JUNE 30, 2011**

**UTILITY PROFILE**

Winchester Municipal Utilities (WMU), an enterprise fund of the City of Winchester, Kentucky (City), was established in 1958 by ordinance of the City to provide water, sanitary sewer (wastewater) and solid waste services for the City and portions of Clark County. WMU is governed by a Board of Commissioners appointed by the Mayor with approval of the Board of Commissioners of the City. The Winchester Municipal Utilities Commission (WMUC) provides direction and oversight of the utility and its operations, adopts the budget, sets the operating policies, hires the General Manager and Counsel of the utility, and recommends to the City utility rates necessary to support the operations of the utility, repair and replacement of the utility's assets, and the utility's debt service.

WMU has 11,790 water customers, 11,494 wastewater customers, and 8,948 solid waste customers.

Fiscal Year 2011/2012 budget reflects annual revenue of \$13,486,000 and annual debt service of \$2,663,463.

• **Water System**

WMU has two sources of raw water – pool No. 10 of the Kentucky River and the Carroll Ecton Reservoir (Reservoir). WMU's primary source of water is Pool No. 10, a 25-mile pool of the river. WMU is the only water utility withdrawing water from this source. WMU is permitted to withdraw up to 15 million gallons per day (MGD) from pool No. 10 under normal river flow conditions, with restrictions being imposed during times of below normal river flow. The Reservoir impounds approximately 500,000,000 gallons of water on an unnamed tributary of Lower Howards Creek. WMU is permitted to withdraw up to 5.3 million gallons per day (MGD) from the Reservoir.

The water treatment plant under special provision is rated to produce 6.0 million gallons per day (MGD). Clearwell storage is 1,000,000 gallons; elevated storage totals 3,500,000 gallons.

There are approximately 164.5 miles of waterlines in the system.

Average day water production for FY 2010/2011 was 4.09 MGD. Peak day water production for FY 2010/2011 was 5.26 MGD. In addition to the provision of service to its retail customers, WMU provides water for resale to the East Clark County Water District (ECCWD) and the Kentucky American Water Company (KAWC).

- **Wastewater System**

WMU maintains approximately 146.9 miles of gravity and force main sanitary sewers, 17 sewage-pumping stations, and a wastewater treatment plant (WWTP) rated at 7.2 MGD. The WWTP is designed to handle a biological load approximately four times greater than typical domestic sewage. In addition, WMU operates a solids processing facility producing and distributing for beneficial reuse Class A biosolids in compliance with 40 Code of Federal Regulations (CFR) §503.

Average day wastewater treatment for FY 2010/2011 was 4.09 MGD. Average day production of Class A biosolids for FY 2010/2011 was 20.4 dry tons.

- **Solid Waste System**

WMU is responsible for the daily collection of solid waste generated within the City and transportation for ultimate disposal in a privately owned and permitted solid waste landfill. In addition, WMU collects and grinds yard waste for beneficial reuse, operates and maintains a voluntary recycling operation for newspaper, white and mixed paper, cardboard, glass, plastics, tin, and aluminum, and maintains a 20-acre, non-operating landfill that is classified as *in post-closure care*.

Average day solid waste collection and disposal for FY 2010/2011 was 51.00 tons and average day yard waste collection for FY 2010/2011 was 5.45 tons.

## **SIGNIFICANT ISSUES**

- **Consent Decree**

The Consent Decree continues to be the single most significant issue facing the utility at this time. The Consent Decree is the settlement agreement between the United States Environmental Agency (EPA), the Kentucky Energy and Environment Cabinet (EEC, formerly known as the Environmental and Public Protection Cabinet), City and WMU detailing actions to be taken by City and WMU for violations of the Clean Water Act , 33 U.S.C. § 1319. The basic tenants of the Consent Decree call for City and WMU to:

- Eliminate existing and recurring sanitary sewer overflows (SSOs)
- Reduce the potential for future SSOs

Such is to be achieved through a defined capital program and structured operation and maintenance (O&M) program.

Deadlines outlined in the Consent Decree for completion of capital projects to eliminate SSO's are shown in the chart below:

Project	Project Area	Proposed Date for Removal from Service
Forest Park Sanitary Sewer Improvements	Maryland Avenue Wabash Smith Manor	July 31, 2012
Lower Howards Creek Sanitary Sewer Improvements	Snowfall Stoneybrook	January 31, 2013
Bel-Air Sanitary Sewer Improvements	Bel-Air Westside	July 31, 2013
Madison, Flanagan, & East Washington Street	Madison, Flanagan, & East Washington Street	January 31, 2021

The Lower Howards Creek Project involves a facilities plan update, construction of sanitary sewer interceptors, force main and construction of a new wastewater treatment plant. The Lower Howards Creek Project is approximately 35% complete. Both the Forest Park and Bel-Air Sanitary Sewer Improvements projects involve construction of an interstate road bore and new interceptor sewers that eliminate five (5) sewage pumping stations in total. Construction of Forest Park is approximately 70% complete and final design is nearing completion for Bel-Air. Construction of the Madison, Flanagan, and East Washington Street project includes the rehabilitation of the East Interceptor Sewer coupled with construction of larger diameter sewers in the downtown area of Winchester to replace aging infrastructure.

Structured O&M programs have been developed, submitted, and reviewed/approved by the EPA. These programs are known as the Capacity, Management, Operation and Maintenance (CMOM) programs. WMU developed 14 required CMOM programs seven of which were submitted, reviewed, and approved by EPA. A list of the CMOM Programs developed and submitted to EPA are as follows:

- Sewer Overflow Response Plan (SORP)
- Inter Jurisdictional Agreement Program
- Public Education Program
- Spill Impact Water Quality Monitoring Program
- Corrosion Control Program
- Routine Hydraulic Cleaning Program
- Root Control Program
- Capacity Assurance Program (CAP)
- Acquisition Consideration Program
- Infrastructure Rehabilitation Program (IRP)
- Sewer System Assessment Program (CSSAP)

- Sewer System Inventory Program
- Fats, Oils, and Grease Control Program (FOG)
- Financial and Cost Analysis Program

Additional requirements of the Consent Decree include a Supplemental Environmental Project (SEP). WMU researched potential projects as part of the SEP project required by EPA. The initial project described in Exhibit "D" to the Consent Decree was begun, and after \$27,000 had been expended to do the testing phase thereof, it was determined that completion of the SEP would not offer significant benefit so it was abandoned. Another stream restoration SEP was studied, but when easements could not be obtained the project had to be discarded.

Presently, WMU has determined that it would be environmentally beneficial to the public to implement a SEP which would commission a study of the streams in the Lower Howards Creek Watershed (LHCW) and develop a Lower Howards Creek Watershed Management Plan (LHCWMP). This plan has been approved by EPA and Kentucky Division of Water officials. Work is expected to be completed June 2012.

- **Water Supply**

WMU continues to face needs with respect to water supply. Normal growth pattern projections have indicated the need for additional potable water capacity in 2011 or 2012. The timeframe for that need may or may not be accelerated or become critical based upon the needs of the industrial community and project growth rates being met. While plans to increase water demand 1,000,000 million gallons per day at Sekisui S-LEC America have been delayed for a period of time, Alltech has purchased facilities at 555 Rolling Hills Lane (previously Martek Biosciences) and initiated production activities. Early indications are that Alltech will be play a significant role in water needs.

As previously stated WMU's current permitted capacity is 6.0 million gallons per day (MGD) with current average day demand of 4.09 MGD and peak day demand of 5.26 MGD. Projections of WMU's 20-year demand are 12.0 MGD based upon normal growth patterns which can be skewed with the addition of any significant industrial or other large user.

Discussions in 2008 between the WMU and City Commissions led to a decision to construct a new water treatment plant. Construction will be phased with the initial capacity being 6.0 MGD to operate in concert with the existing water treatment plant yielding an effective capacity of 8.0 – 9.0 MGD. The final effective capacity will be determined by the Division of Water (DOW). In addition, water transmission improvements are being planned to insure the delivery of the additional capacity. Over time, the existing water treatment plant will be phased out of service and the planned water treatment plant expanded to 12.0 MGD. The total estimated cost of the initial phase of improvements is \$58,900,000. The timetable for construction of the improvements ranges from 2012 through 2017. Preliminary grade work and siting of the facilities is being performed as

part of the Lower Howards Creek Inflow Pump Station and Wastewater Treatment Plant project at a cost of \$2,189,500.

- **Kentucky River Lock and Dam No. 10**

Construction of the Kentucky River Lock and Dam No. 10 were completed in 1905. The lock and dam were owned and operated by the United States Army Corps of Engineers (COE) until 1996 at which time ownership and the responsibility for maintenance and replacement of the lock and dam were transferred to the Commonwealth of Kentucky. The General Assembly created by statute the Kentucky River Authority (KRA) to oversee the operation, maintenance and replacement of the 14 locks and dams on the Kentucky River. Implicit in that charge of authority is the maintenance of the 14 pools of water for water supply. The Kentucky River supplies water to approximately 22% of Kentucky's population. WMU, like all other water utilities that withdraw water from the Kentucky River, pays a withdrawal fee for each gallon of water withdrawn from the Kentucky River and the reservoir and passes that cost to its customers. The withdrawal fees are used by KRA for repair and replacement of the 14 locks and dams.

Dam No. 10 was built as a timber crib dam with a plain concrete face, i.e., the dam is a series of timber boxes, stacked and filled with large rock and covered with a concrete skin that has no reinforcement. The dam is over 100 years old and has had no substantial rehabilitation during its service life. The dam impounds pool No. 10 which creates the water supply for Winchester and most of Clark County.

Pool No. 10 is the longest pool on the Kentucky River stretching more nearly 25 miles. The East Kentucky Power (EKP) J. K. Smith Generating Plant and the Dale Generating Plant withdraw cooling water for the two power generating plants from this pool. Approximately 95% of that cooling water is returned to the river. The two EKP withdrawals and the WMU withdrawal are the only permitted withdrawals from Pool No. 10. The City of Richmond Utilities has constructed a new wastewater treatment plant (WWTP) which discharges to Otter Creek in Madison County upstream from WMU's water intake in Pool 10. The permitted WWTP discharge meets the Kentucky, five-mile separation rule between a WWTP discharge and a WTP intake.

The Kentucky River is subject to wide variations in flow from 0 flows to 1 billion gallons per day. The wide variations in flow and resulting stress on the dam and scour below the dam make Dam No. 10 vulnerable to overturning. KRA has ranked replacement of Dam No. 10 as a top priority and has allocated funding in its budget to design and construct replacement facilities. The Board of the Kentucky River Authority has approved a six-year capital plan that includes approximately \$2.5 million in the 2012-14 biennium for design and \$46 million in the 2014-16 biennium for construction of a new dam. Anticipation is that the KRA's capital plan will be approved by the Kentucky Legislature during the 2012 General Assembly. The Clark County Fiscal Court, City of Winchester, and WMU Commission have passed resolutions requesting the Kentucky Legislature to approve such. A failed dam would leave Winchester without its primary water

supply. WMU's reservoir would yield, without mandatory conservation measures, approximately a 60-75 day supply of water under normal weather patterns.

The Kentucky River is a non-protected watershed. It is subject to contamination from straight pipes (unauthorized sewer discharges), agricultural runoff (chemical contamination), chemical spills, and drought. Yet approximately one quarter of the state's population relies upon the river for water supply.

- **Carroll Ecton Reservoir**

The Carroll Ecton Reservoir serves as a secondary source of water supply for the City of Winchester and Clark County. As previously mentioned the Reservoir impounds approximately 500,000,000 gallons of water on an unnamed tributary in Lower Howards Creek. Excess raw water flow from the Kentucky River can be pumped to the Reservoir during normal operation. Over the years significant leakage has developed out of the hillside (rock face) just below the dam and an unknown amount of silt has accumulated within the body of water both of which effect storage volumes. With construction of a new Water Treatment Plant and phasing the existing Water Treatment Plant out of service maintaining the Reservoir as a water source will require significant rehabilitation. WMU has placed \$5,000,000 in the capital budget plan to be expended from 2016-2019 in an effort to address these issues.

- **Affordability**

Affordability of services continues to be a major concern of the City Commission, the Utility Commission and to management. The WMU service area population is approximately 27,000 of which 51% fall in the low to moderate income (LMI) level. A continued depressed world-wide economy further impacts the affordability of WMU's services.

The primary costs in WMU's budget are capital costs including renewals and replacements. The cost of compliance with the Consent Decree, cost for upgrading and expanding WMU's water system capacity, and additional capital needs will exceed \$100 million. Renewals and replacements exceed \$1,000,000 each year. The driving factors in WMU's operations and maintenance budget are power, fuel, chemical, and personnel costs. WMU's personnel and related benefit costs total 52% of the total budget.

The City and WMU Commissions, in concert with management, have continuously worked to reduce the financial burden of rate increases. Cost-effective decisions must be considered and made with respect to capital needs. Management is focused on cost-effective operations while taking into consideration the high level of service demanded by WMU's customers.

The City and WMU Commissions, passed rate increases that became effective in February 2010. Rates will be adjusted annually with the last increase to be effective January 2015. These rate increases were necessary despite a depressed economy, high unemployment, and a declining stock market. Implementation of the rate increases will allow WMU to comply with the Consent

Decree, upgrade and improve WMU's water system capacity, and replace WMU's aging water and wastewater infrastructure to ensure service to existing customers and to position the community to be able to attract and retain residential, commercial, and industrial development while balancing the affordability of providing a prescribed level of service.

Previously, the City and WMU Commissions passed an annual adjustment to the rate structure tied to the Consumer Price Index (CPI). This adjustment allows WMU to maintain its operating and maintenance budget current with the cost of living through annual adjustments to the rate versus the historical flat line approach with infrequent but significant adjustments. This approach was favored in a community survey by 73.5 % of the respondents.

The City and WMU Commissions, in concert with the Fiscal Court, have adopted legislation (Privilege Fee) that will ensure that the costs of growth for WMU's sanitary sewer system are apportioned to all benefitted properties versus being solely supported by the existing customer base. The privilege fee approach is favored for its equity and for the benefit to the community by insuring that sanitary sewers are sized on a watershed basis versus the historical "first in, one size fits all approach". The Privilege Fee Ordinance and Policies are currently being considered for amendment due to input from local developers and property owners.

The City and WMU Commissions have secured grants and sought the best possible financing for WMU's capital needs. The City and WMU received a \$36,600,000 low interest (2.2%; 20 years) loan for the Lower Howards Creek Wastewater System Improvements. The City and WMU received a \$750,000 Community Development Block Grant and \$750,000 Economic Development Grant to construct the Forest Park Sanitary Sewer Improvements project. Management applied for but did not receive grant funds to construct the Bel-Air Sanitary Sewer Improvements project. Funding for the Bel-Air project will likely be a low interest loan from the Kentucky Infrastructure Authority. The likelihood for financing of the water system improvements will be the sale of revenue bonds in the range of 4-5% for 20 years.

## **BUSINESS FACTORS**

- **Facilities Planning**

WMU is required by federal and state regulation to maintain a Facilities Plan that outlines the long-term plan for growth of the sanitary sewer system and treatment works. A Facilities Plan Update was completed and approved by the Energy and Environmental Cabinet (EEC) for the upgrade of the Strodes Creek Wastewater Treatment Plant. The last Facilities Plan with respect to the collection system was completed in 1973. The plan should be updated on a minimum 20-year cycle. The WMU Commission authorized a Facilities Plan Update for the sanitary sewer collection system in August 2008. The Facilities Plan Update was necessary to determine the recommended end-of-pipe sewage management plan for the Lower Howards Creek Sanitary Sewer Improvements which was a requirement of the Consent Decree. The Facilities Plan Update was completed

at a cost of \$189,000, approved by the Kentucky Division of Water on August 11, 2010 and identifies and addresses sanitary sewer collection recommendations for WMU's 14 sub-watersheds listed below:

- Strodes Creek Basins A, B, C, and D
- Lower Howards Creek Basins A, B, and C
- Hancock Creek Basins A, B, and C
- Hoods Creek
- Four Mile Creek Basins A, B, and C

Conversely, there is no such mandate for the drinking water system with respect to planning. However, in November 2009 Hazen & Sawyer prepared a Water System Planning Study outlining recommendations for significant improvements needed to meet current and future needs for the utility. Recommendations included conceptual cost estimates for a new water treatment plant, raw water pump station upgrades, raw water transmission main upgrades, finished water transmission upgrades, and reservoir improvements. The conceptual cost summary totaled \$58,700,000 of improvements excluding any reservoir improvements.

In response to initiatives identified in the Clark County Community (CCC) Action Plan, the Winchester Recycling Task Force (RTF) was established in 2009. In the same year, the RTF developed and coordinated a county-wide Recycling Survey mailed to approximately 12,000 customers of WMU, Rumpke, and S&G Sanitation within the December 2009 and January 2010 billing cycle. A total of 2,167 survey responses were received representing a response rate of 22 percent. Of the 2,167 respondents, 1,447 (67%) were WMU customers. Based on the survey results and research efforts of the RTF, the Winchester City Commission and WMU Commission implemented Phase I of single stream curb side recycling for WMU customers the week of August 1, 2011. Data tracking of specific deliverables will provide valuable information to incorporate into the long-term plan for full implementation of single stream, curb-side recycling throughout the WMU solid waste customer service area. Results of Phase I and budgetary restrictions will dictate efforts moving forward for any additional phases. Currently, Phase II has not been identified. It is expected that Phase II will be the inclusion of another neighborhood similar in size and demographics to Phase I. Implementation of additional phases may necessitate the need for a cost of service rate study to determine the actual costs for WMU and its customers.

- **Rate Studies**

The WMU Commission authorized rate studies of WMU's three utility functions. The rate studies proposed cost of service rates to support WMU's operations, including the expanded operations as required by CMOM, the operations of the Strodes Creek WWTP and the planned WTP, the capital needs as required by the Consent Decree and the planned water system improvements. Results of the rate study are reflective of the rates recommended, approved, and implemented February 2010.

The WMU Commission authorized a wholesale cost of service study to support WMU's wholesale cost of service rate to its only wholesale customer, East Clark County Water District. The rate study has been completed and received Public Service Commission (PSC) approval on October 5, 2010 to increase the cost from \$1.62 to \$1.72 per hundred cubic feet of water sold.

- **Work Force**

Key issues facing WMU in the coming years with respect to workforce include *Baby Boomer* retirements, loss of institutional and industry knowledge, finding and attracting qualified replacement employees, paying competitive wages based on industry standards, and training of employees to meet the increasingly sophisticated needs of water, wastewater, and solid waste utility operations including customer service, finance, information systems, administrative services and engineering.

WMU has 81 budgeted staff positions of which 74 are filled. The average age for WMU employees is 40 years. The number of eligible retirements at WMU over the next five years, due to age, years of service, or both, is seven or 9% of the workforce. Since 2002, there have been 24 retirements or 29% of the WMU workforce. Large scale retirement numbers often enable entities to renew and refresh operations, systems, and business philosophies. Transition planning has been successful for most key positions, however, such changeover carries the load of loss of institutional and industry knowledge, and challenges management to find, attract, train, and retain replacements particularly for supervisory positions. As WMU moves forward with construction of additional facilities staffing of those facilities will be of concern.

WMU's attractiveness as an employer is its benefits package. Salaries average below the private sector and other government utilities. Training for utility operations is typically on-the-job. Certification in operations and driver's licensing (commercial) is a job requirement for all three utility functions. Support functions, customer service and vehicle maintenance, as well as engineering and finance, will require on-the-job training specific to WMU's business operations. Workforce development is key in maintaining the quality of service delivered by WMU and for compliance with enforcement and regulatory activities.

- **Infrastructure Renewal**

A structured approach for infrastructure renewal spreads costs over the long-term and can increase the service life of assets. WMU continues to be a leader in Kentucky in the area of asset management and infrastructure renewal. WMU's infrastructure renewal program includes a prioritization methodology to maximize capital investment, and annual allocations for defined asset categories. WMU annually allocates an average of \$1,458,745 of its capital investment for this effort. Program elements include:

- Main Replacement Program – Water
- Fire hydrant Replacement
- Gate Valve Box Adjustment – Pavement Overlay

- Elevated Storage Tank Rehabilitation
- Meter Change Out
- Main Replacement Program – Sewer
- Private Sewer Replacement
- Manhole Grade Adjustment – Pavement Overlay
- Inflow and Inflow (I/I) Rehabilitation
- Curbit Replacement
- Container Replacement
- Vehicles
- Plant & Equipment Improvements

While WMU's program of infrastructure renewal is a model for other utilities and public works agencies in Kentucky, the program is limited in its scope by funding. Infrastructure renewal funding should be based upon a mathematical model that addresses asset category inventory and asset category service life. WMU's program is based upon funds available. As an example and simply stated, for the waterline asset category, funding for waterline replacement should be based upon the cost for replacing the number of miles of waterline divided by the service life of the pipe. In this example, if WMU owns and maintains 160.8 miles of waterline with the waterlines having a service life of 60 years, the allocation for waterline replacement should be the average cost of replacing 2.68 miles of waterline per year. At \$60 per foot for replacement of a waterline this calculates to an annual allocation of \$849,025. WMU allocates \$125,000. Likewise, if WMU owns and maintains 147.5 miles of sanitary sewer lines having a service life of 60 years, the allocation for sewer line replacement should be the average cost of replacing 2.45 miles of sewer line per year. At \$70 per foot for replacement of a sewer line, the annual allocation calculates to be \$924,000. WMU allocates \$125,000.

- **Regulations**

WMU and its utility functions are highly regulated. Regulation is a necessary part of the utility business to ensure a service delivery level and to protect the public's safety, health, and welfare. Regulations serve to protect the environment for future generations. Regulations ensure conservation and protection of our natural resources.

Regulations are regularly considered and promulgated by state and federal governments. WMU staff is active in monitoring proposed regulations and the impacts such regulations have on a local basis. Comment and impact on the promulgation of regulations on a federal level is limited, however, WMU staff communicate with state and national industry organizations and through direct contact with federal officials elected from Kentucky. On a state level, WMU staff participates on numerous committees and task forces to provide a voice for city-owned water, wastewater, and solid waste utilities.

State regulations typically result as mandates on state regulatory agencies from federal legislation. Kentucky is a primacy state meaning that the state is

responsible for implementing and enforcing federal regulation. Staff works to ensure that state regulations, when promulgated, are reasonable and practicable.

- **Vulnerability**

The impacts of 9/11 and the resulting passage of the Bioterrorism Act in 2002 required utilities to consider their vulnerabilities as a primary consideration versus a secondary consideration. For mid-size and smaller utilities such as WMU the probability of an act of international violence or terrorism is extremely low.

However, WMU's vulnerabilities are real and must be considered. Planning must be in place to address catastrophic events, violence, or contamination. Potential threats to WMU include severe weather (tornado, lightning, ice or snow), earthquake, prolonged power outage, contamination of the raw or potable water supply, workplace or customer violence, hazardous chemical spills, contamination or contact, and regular job safety hazards including confined space, vehicular accidents, and personal injury accidents.

- **Growth**

It has been the policy of the WMU Commission to be neither pro nor con with respect to growth. Rather the Commission has placed as a part of its mission to accommodate growth as approved by the Planning Commission, the City Commission and the Fiscal Court with specified required levels of service. WMU and the City continue to examine and develop policies such as the Privilege Fee Ordinance and Policy that provide for growth and that protect the existing customer base from the costs of serving growth. Growth has been relatively nonexistent in this depressed economy.

The Consent Decree will impact future extensions to the sanitary sewer system, as a detailed, engineering-capacity analysis per the Capacity Assurance Program (CAP) will be required for each extension. The capacity analysis will thus become a defacto growth management tool.

WMU avails itself of every opportunity to add to and to strengthen the water transmission system and backbone sanitary sewer system taking into consideration long range growth needs.

### **UTILITY HIGHLIGHTS**

- **Renewals and Replacements**

WMU began its program of infrastructure renewals in 1996 with emphasis on improving service delivery and ensuring that all customers are afforded a comparable level of service delivery. Historically, WMU never attempted these types of improvements without incurring new debt. The infrastructure renewal program has been implemented and managed without additional funding allocations or rate increases. Funding for the program was achieved through management of WMU's depreciation funds. To date, this program has resulted in the following replacement totals:

- Waterline Replacements 36,411 feet

- Sanitary Sewer Replacements 40,102 feet
- Fire Hydrant Replacements 64
- Gate Valve Replacements 166
- Manhole Replacements 170
- Elevated Storage Tank Rehabilitations 3

### **UTILITY HIGHLIGHTS: FINANCIAL**

Total Assets increased from \$89,990,971, June 30, 2010, to \$101,509,060 June 30, 2011, a net increase of \$11,518,089 or 12.80%. The large number of water & wastewater construction projects, including costs associated with the construction of the new Lower Howards Creek wastewater treatment plant is a main contributing factor to the increase of total assets. The increase is also partly due to donated capital of ownership and perpetual maintenance of system water and sewer lines and related appurtenances by developers. An investment balance from the sale of 2011 Bonds increased assets which was offset slightly by the elimination of the BAN investment account. The 2011 Bonds were initiated to eliminate the intermediate BAN debt and to fund planned construction projects including engineering costs associated with the new planned water treatment plant.

Operating Revenues increased from \$10,231,493, June 30, 2010, to \$11,983,445, June 30, 2011, a net increase of \$1,751,952 or 17.12%. The increase in revenues was attributable to a rate increase effective in January. This increase is part of a phased process that will have an increase every January until 2015.

Operating Expenses increased from \$10,237,203, June 30, 2010, to \$10,841,985, June 30, 2011, a net increase of \$604,782 or 5.91%. The increase is due to salaries and related benefit costs as well as increased electrical and chemical costs. Many open positions existing during the fiscal year 2010 were filled during the fiscal year 2011. The utility experienced an increase in electricity and chemical cost due to the demand at the treatment plants.

Net Income to Retained Earnings changed from a loss of \$236,371, June 30, 2010, to a profit of \$761,032, June 30, 2011, a net change of \$997,403 or 421.97%. This change in Net Income to Retained Earnings is due to the cost of service rate increase that was effective in January . The continued phased rate increases are expected to result in positive net incomes in the future years and to pay for the increased debt that is expected with the long term capital needs.

#### **• Statement of Net Assets**

##### Condensed Statement of Net Assets - Assets

	2011	2010	Difference	Percent
Current Assets	\$9,217,491	\$7,651,732	\$1,565,759	20.46
Restricted Assets	\$15,103,301	\$10,164,007	\$4,939,294	48.60
Property, Plant & Equip	\$77,044,491	\$71,807,420	\$5,237,071	7.29
Other Assets	\$143,777	\$367,812	\$(224,035)	-60.91
Total Assets	\$101,509,060	\$89,990,971	\$11,518,089	12.80

## Condensed Statement of Net Assets – Liabilities and Net Assets

	2011	2010	Difference	Percent
Current Liabilities	\$3,011,091	\$7,493,376	\$(4,482,285)	-59.82
Long-term Debt, less current portion	\$40,512,290	\$26,456,182	\$14,056,108	53.13
Net Assets:				
Invested in Capital Assets, Net of Related Debt	\$34,841,538	\$39,327,954	\$(4,486,416)	-11.41
Restricted Net Assets	\$17,186,249	\$12,121,409	\$5,064,840	41.78
Unrestricted Net Assets	\$5,957,892	\$4,592,050	\$1,365,842	29.74
Total Liabilities & Net Assets	\$101,509,060	\$89,990,971	\$11,518,089	12.80

## • Statement of Revenues, Expenses and Changes in Net Assets

### Condensed Statement of Revenues, Expenses and Changes in Net Assets

	2011	2010	Difference	Percent
Operating Revenues				
Water	\$4,233,483	\$3,587,847	\$645,636	18.00
Wastewater	\$5,196,310	\$4,385,138	\$811,172	18.50
Solid waste	\$2,553,652	\$2,205,898	\$347,754	15.76
Other Income	\$0	\$52,610	\$(52,610)	-100
Total Operating Revenues	\$11,983,445	\$10,231,493	\$1,751,952	17.12
Operating Expenses including Depreciation	\$10,841,985	10,237,203	\$604,782	5.91
Operating Income	\$1,141,460	\$(5,710)	\$1,147,170	-20090.54
Non-Operating Income	\$369,477	\$448,185	\$(78,708)	-17.56
Interest Expense	\$(749,905)	\$(678,846)	\$(71,059)	10.47
Net Income to Retained Earnings	\$761,032	\$(236,371)	\$997,403	-421.97
Capital Grants and Contributions	\$1,183,234	\$4,127,738	\$(2,944,504)	-71.33
Changes in Net Assets	\$1,944,266	\$3,891,367	\$(1,947,101)	-50.04
Net Assets, Beginning of Year	\$56,041,413	\$52,150,046	\$3,891,367	7.46
Net Assets, End of Year	\$57,985,679	\$56,041,413	\$1,944,266	3.47

## • Five-Year Capital Plan

The WMU Commission maintains and annually updates a five-year capital plan that identifies and prioritizes the capital requirements of WMU necessary for customer service, regulatory compliance, and to accommodate growth. The five-year investment totals in excess of \$8,394,927. Of these planned expenditures, \$7,293,725 will be invested in infrastructure renewal and administrative support with the remaining \$1,101,202 allocated for one-time, and intermittent investments. Additionally \$275,000 is reserved for emergency and / or unexpected expenditures.

## • Debt Administration

As of July 1, 2011, WMU maintained the following debt:

- Series 2002 Bonds \$7,500,000
- Series 2011 Bonds \$8,965,556
- KIA loan Strodes Creek \$18,987,705
- KIA loan Vaught \$275,583
- KIA loan Tank \$333,364

The Debt Service coverage factor for Bonds of 6.28 in FY 2010/2011 is favorable to the required 1.4 coverage limit. The Debt Service coverage factor for KIA debt of 2.74 in FY 2010/2011 is favorable to the required 1.0 coverage limit. Debt Service coverage is based upon the revenue of the combined utility functions – Water, Sewer, and Solid Waste. The Series 2003 Bonds retired in 2010. The balance of the existing debt will retire in 2029 thru 2032.

- **FY 2010/2011 Budget Assumptions**

Total combined revenues for FY 2011/2012 are projected to increase from FY 2010/2011 actual revenues by 20.27%. No annual adjustment to rates based upon the CPI index is expected this year, however, a rate increase is budgeted in January 2012 based upon the approved rate ordinance passed by the City in 2010. Operating expenses excluding depreciation for FY 2011/2012 are projected to increase over budgeted FY 2010/2011 operating expenses by approximately 7.64%. Operating expenses will be impacted by increased power, employee benefits, chemical, vehicle operations and insurance costs.

The debt service coverage ratio is required to be 1.40 for bonds and 1.00 for KIA. Both formulas calculate by adding depreciation, a non cash expense back to income available for debt service. The budgeted debt service coverage ratio is 2.78 for Bond debt and 1.90 for KIA debt.

### **CONTACTING THE COMPANY'S FINANCIAL MANAGEMENT**

This report is designed to provide the WMU Commission, the City Commission, the customers of WMU, and WMU's creditors a general overview of WMU's finances and to demonstrate WMU's financial accountability. Questions should be addressed to:

Michael H. Flynn  
General Manager

Or

Jennifer Sparks  
Director of Finance and Accounting

150 North Main Street  
P.O. Box 4177  
Winchester, KY 40392-4177  
859-744-5434

**WINCHESTER MUNICIPAL UTILITIES  
STATEMENTS OF NET ASSETS  
PROPRIETARY FUND  
JUNE 30, 2011 AND 2010**

<b>ASSETS</b>	<b>2011</b>	<b>2010</b>
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 3,693,753	\$ 2,246,849
Restricted Cash and Cash Equivalents	557,280	433,800
Restricted Investments	1,700,000	1,702,671
Accounts Receivable, Customers (Net of Allowance for Doubtful Accounts, 2011 and 2010, \$14,689 and \$21,114)	1,394,757	1,274,676
SDC Assessments Receivable	945,155	948,000
Due From Other Governments	-	139,030
Other Accounts Receivable	15,502	47,420
Materials and Supplies	306,656	324,078
Prepaid Expenses	604,388	535,208
<b>Total Current Assets</b>	<b>9,217,491</b>	<b>7,651,732</b>
<b>NONCURRENT ASSETS</b>		
<b>RESTRICTED ASSETS:</b>		
Cash and Cash Equivalents	10,513,223	10,164,007
Investments	4,590,078	-
<b>Total Restricted Assets</b>	<b>15,103,301</b>	<b>10,164,007</b>
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Utility Systems, Net of Depreciation	63,136,883	60,613,761
Land	1,051,011	1,051,011
Construction in Progress	12,856,597	10,142,648
<b>Total Property, Plant and Equipment</b>	<b>77,044,491</b>	<b>71,807,420</b>
<b>OTHER ASSETS:</b>		
Bond Issue Costs	140,303	58,097
Other Receivable	3,474	309,715
<b>Total Other Assets</b>	<b>143,777</b>	<b>367,812</b>
<b>Total Noncurrent Assets</b>	<b>92,291,569</b>	<b>82,339,239</b>
<b>TOTAL ASSETS</b>	<b>\$ 101,509,060</b>	<b>\$ 89,990,971</b>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES**  
**STATEMENTS OF NET ASSETS (CONTINUED)**  
**JUNE 30, 2011 AND 2010**

<b>LIABILITIES AND NET ASSETS</b>	<u><b>2011</b></u>	<u><b>2010</b></u>
<b>CURRENT LIABILITIES</b>		
Accounts Payable	\$ 222,285	\$ 249,159
Other Accrued Liabilities	389,915	389,099
Compensated Absences	398,425	327,451
Current Portion of Capital Lease Payable	<u>-</u>	<u>5,324</u>
<b>Total Current Liabilities</b>	<u>1,010,625</u>	<u>971,033</u>
<b>CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS</b>		
Accounts Payable - Construction	97,188	226,040
Accounts Payable - Retainage	-	114,495
Customer Deposits	157,096	163,848
Accrued Interest Payable	55,519	-
Current Portion of Long-Term Debt	<u>1,690,663</u>	<u>6,017,960</u>
<b>Total Current Liabilities Payable from Restricted Assets</b>	<u>2,000,466</u>	<u>6,522,343</u>
<b>NONCURRENT LIABILITIES</b>		
Noncurrent Portion of Long-Term Debt	40,512,290	26,455,450
Noncurrent Portion of Capital Lease Payable	<u>-</u>	<u>732</u>
<b>Total Noncurrent Liabilities</b>	<u>40,512,290</u>	<u>26,456,182</u>
<b>TOTAL LIABILITIES</b>	<u>43,523,381</u>	<u>33,949,558</u>
<b>NET ASSETS</b>		
Invested in Capital Assets, Net of Related Debt	34,841,538	39,327,954
Restricted for Capital Projects (Expendable)	16,280,685	11,050,875
Restricted for Debt Service (Expendable)	905,564	1,070,534
Unrestricted	<u>5,957,892</u>	<u>4,592,050</u>
<b>TOTAL NET ASSETS</b>	<u>57,985,679</u>	<u>56,041,413</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 101,509,060</u>	<u>\$ 89,990,971</u>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<b>2011</b>	<b>2010</b>
<b>OPERATING REVENUES</b>		
Water	\$ 4,233,483	\$ 3,587,847
Wastewater	5,196,310	4,385,138
Solid Waste	2,500,490	2,169,087
Transfer Station	53,162	36,811
Other Income	-	52,610
	<b>11,983,445</b>	<b>10,231,493</b>
<b>OPERATING EXPENSES</b>		
Administrative	1,766,620	1,584,465
Solid Waste	1,581,153	1,607,906
Water	2,825,955	2,606,074
Wastewater	4,543,138	4,324,697
Vehicle Maintenance	125,119	114,061
	<b>10,841,985</b>	<b>10,237,203</b>
<b>OPERATING INCOME (LOSS)</b>	<b>1,141,460</b>	<b>(5,710)</b>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Interest Income	183,425	237,004
Interest Expense	(738,948)	(628,405)
Other Income	169,773	188,747
Change in the Fair Value of Investments	(11,705)	-
Gain on Sale of Capital Assets	27,984	22,434
Amortization Expense of bond issue costs & bond discount	(10,957)	(50,441)
	<b>(380,428)</b>	<b>(230,661)</b>
<b>NET INCOME (LOSS) BEFORE CAPITAL GRANTS &amp; CONTRIBUTIONS</b>	<b>761,032</b>	<b>(236,371)</b>
<b>CAPITAL GRANTS AND CONTRIBUTIONS</b>	<b>1,183,234</b>	<b>4,127,738</b>
<b>CHANGE IN NET ASSETS</b>	<b>1,944,266</b>	<b>3,891,367</b>
<b>NET ASSETS, BEGINNING OF YEAR</b>	<b>56,041,413</b>	<b>52,150,046</b>
<b>NET ASSETS, END OF YEAR</b>	<b>\$ 57,985,679</b>	<b>\$ 56,041,413</b>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from Customers	\$ 11,859,457	\$ 9,917,103
Payments to Suppliers	(5,475,479)	(5,290,067)
Payments to Employees	(2,331,302)	(2,265,589)
Other Receipts	393,687	81,560
	<b>4,446,363</b>	<b>2,443,007</b>
<b>CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Proceeds from Sale of Equipment	29,011	44,254
Proceeds from Long-Term Debt	15,967,881	69,320
Principal Payments	(6,246,664)	(1,671,561)
Interest Payments	(798,232)	(588,910)
Purchase of Property, Plant and Equipment	(8,316,590)	(5,486,804)
Proceeds from Federal and State Grants - Capital items	999,801	2,807,554
Contributed Capital Received	85,720	196,835
Cash from Other Income	169,773	188,747
	<b>1,890,700</b>	<b>(4,440,565)</b>
<b>CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>		
Proceeds from Sales and Maturities of Investments	4,163,791	5,966,553
Purchase of Investments	(8,764,709)	-
Cash from Interest	183,425	237,004
	<b>(4,417,493)</b>	<b>6,203,557</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>1,919,570</b>	<b>4,205,999</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>12,844,686</b>	<b>8,638,657</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 14,764,256</b>	<b>\$ 12,844,656</b>
<b>Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets:</b>		
Cash and Cash Equivalents - unrestricted	\$ 3,693,753	\$ 2,246,849
Cash and Cash Equivalents - restricted current	557,280	433,800
Cash and Cash Equivalents - restricted noncurrent	10,513,223	10,164,007
	<b>14,764,256</b>	<b>12,844,656</b>
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 14,764,256</b>	<b>\$ 12,844,656</b>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES  
STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>		
Operating Income (Loss)	\$ 1,141,460	\$ (5,710)
<b>Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:</b>		
Depreciation/Amortization	3,285,394	3,006,458
<b>(Increase) Decrease in Current Assets:</b>		
Accounts Receivable, Customers	(120,081)	(209,713)
SDC Receivables	2,854	(63,320)
Other Accounts Receivable	31,918	4,893
Other Receivable	306,241	24,058
Material and Supplies	17,422	22,255
Prepaid Expenses	(69,181)	100,642
<b>Increase (Decrease) in Current Liabilities:</b>		
Accounts Payable	(26,874)	(357,432)
Accounts Payable - Construction	(128,852)	(163,923)
Accounts Payable - Retainage	(114,495)	21,114
Accrued Liabilities	816	11,907
Accrued Vacation	70,974	40,525
Accrued Interest on Bonds	55,519	-
Customer Deposits	(6,752)	11,253
	<u>                    </u>	<u>                    </u>
<b>Net Cash Provided (Used) by Operating Activities</b>	<u>\$ 4,446,363</u>	<u>\$ 2,443,007</u>
<b>NONCASH TRANSACTIONS AFFECTING FINANCIAL POSITION</b>		
Capital assets were acquired through contributions from developers and Governmental Entities	\$ 236,473	\$ 43,000
Principal, interest and fees were paid through contributions from Governmental Entities	-	941,319
	<u>                    </u>	<u>                    </u>
	<u>\$ 236,473</u>	<u>\$ 984,319</u>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Introduction**

Winchester Municipal Utilities (WMU) is a component unit of the City of Winchester, Kentucky and is accounted for as a governmental enterprise fund. The purpose of WMU is to operate the City's water, sewer and solid waste utility services. It is financed and operated in a manner similar to a private business enterprise where the intent of the governing body is that costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed primarily through user charges. The accounts are maintained on the accrual basis of accounting.

In accordance with paragraph 7 of Governmental Accounting Standards Board (GASB) Statement No. 20, WMU applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

**Cash and Cash Equivalents**

For the purposes of the Statement of Cash Flows, WMU considers all short-term highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

**Investments**

Investments consist principally of certificates of deposit with a maturity of more than three months and are carried at cost, and debt securities which are carried at fair market value. The majority of the investments are restricted as to use.

**Accounts Receivable**

Accounts receivable - Customers, are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense. An adjustment to an allowance for doubtful accounts is based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

SDC assessments and other receivables are stated at the amount management expects to collect from outstanding balances and management expects to fully collect all of these receivables.

Other receivable consists of a note receivable dated April 20, 2005 from a Corporation in the amount of \$603,000. As of June 30, 2011 and 2010, the balance was \$3,474 and \$309,715, respectively. The note receivable bears an interest rate of 5.00% and matures on April 20, 2020, but was paid in full during the current year. Interest income received as of June 30, 2011 and 2010 was \$3,846 and \$16,142 respectively.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Materials and Supplies**

Materials and supplies are stated at cost. Cost is determined using the “first-in, first-out” method.

**Prepaid Expenses**

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses.

**Property, Plant and Equipment**

Property, plant, and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method. Donated capital assets are recorded at estimated fair market value at the date of donation. WMU’s capitalization policy is \$500.

Major outlays for capital assets and improvements are capitalized when assets constructed are completed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

**Accrued Compensated Absences**

Accumulated vacation, sick leave and compensatory time are recorded as an expense and liability as these benefits accrue to employees in accordance with the provisions of Statement No. 16 of the Governmental Accounting Standards Board.

**Long-Term Debt**

Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. Amortization expense for bond issue costs as of June 30, 2011 and 2010 was \$2,630 and \$38,040, respectively. Amortization expense for bond discount was \$8,327 and \$13,044, respectively.

**Net Assets**

Net assets are comprised of three categories: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The first category consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds. The second category consists of constraints placed on net asset use through external constraints imposed by creditors (example: debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The third category consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Net Assets (Continued)**

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

**Revenues and Expenses**

Revenues and expenses are distinguished between operating and non-operating items. Operating revenues generally result from providing services and producing, and delivering goods in connection with WMU's principal ongoing operations. The principal operating revenues of WMU are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**Nonmonetary Transaction**

WMU accepts utility installations built by contractors upon inspection. The utility installations are added to fixed assets and contributed capital at contractor's cost.

**Capital and Operating Grants and Subsidies**

Operating grants and subsidies that may be used to pay operating expenses are recorded as other income. Grants that are restricted to the purchase of property, plant and equipment are recorded as contributed capital.

**Tap Fees**

Tap Fees are restricted by ordinance for the use of capital improvements.

**System Development Charges**

WMU assesses system development charges to developers as a means to help finance new construction of systems required to facilitate growth. The charges are restricted by policy for capital construction.

**Basis of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Joint Venture**

A joint venture is a legal entity or other organization that results from a contractual agreement and that is owned, operated or governed by two or more participants as a separate and specific activity subject to joint control in which the participants retain (a) an ongoing financial interest or (b) an ongoing financial responsibility. WMU participates in the following joint venture:

Clark County Geographic Information System Consortium (CCGIS), is a governmental agency created by an inter-local agreement between the Clark County PVA, City of Winchester and WMU. CCGIS was created to provide a geographic system to serve the needs of Winchester and Clark County. The operations are funded by the City and WMU and WMU provides management services. WMU contributed \$70,555 and \$94,491 for the years ended 2011 and 2010, respectively. CCGIS had accounts payables to WMU of \$0 and \$15,767 for they years ended 2011 and 2010, respectively, for reimbursements of payroll and other expenses. CCGIS had accounts receivable from WMU of \$9,282 and \$0 for they years ended 2011 and 2010, respectively, for excess reimbursements of payroll and other expenses. Complete financial statements for CCGIS can be obtained from WMU's Director of Finance.

**NOTE 2 – DEPOSITS AND INVESTMENTS**

For note disclosure purposes, GASB No. 3 considers WMU's cash, cash equivalents and investments (certificates of deposit with maturities of more than three months) to be deposits while for the Statement of Cash Flows purpose, GASB No. 9 considers WMU's certificates of deposit with maturities of more than three months to be investments.

Kentucky Revised Statutes authorize municipalities to invest in obligations of the United States and its agencies, obligations of the Commonwealth of Kentucky and its agencies and shares in savings and loan associations insured by federal agencies. Larger amounts can be deposited in savings and loan associations and banks provided such institutions pledge obligations of the United States government or its agencies as security. As of June 30, 2011 and 2010, WMU was in compliance with this requirement.

WMU's investments at June 30, 2011 are presented below:

Investment Type	Fair Value	Investment Maturities (in Years)			
		< Than 1	1 - 5	6 - 10	> Than 10
Cash and Cash Equivalents	\$ 3,857,999	\$ 3,857,999	\$ 0	\$ 0	\$ 0
<i>Debt Securities</i>					
U.S. Treasuries	768,137	768,137	0	0	0
Federal Home Loan Mtg Corp	620,405	108,149	512,256	0	0
Federal National Mtg Assn	815,649	108,921	706,728	0	0
Federal Home Loan Bank	227,888	0	227,888	0	0
Total Investments	\$ 6,290,078	\$ 4,843,206	\$ 1,446,872	\$ 0	\$ 0

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)**

WMU's investment ratings at June 30, 2011 are presented below:

Investment Type	Fair Value	Investment Maturities (in Years)			
		AAA	AA	A	Unrated
Cash and Cash Equivalents	\$ 3,857,999	\$ 0	\$ 0	\$ 0	\$ 3,857,999
<i>Debt Securities</i>					
U.S. Treasuries	768,137	768,137	0	0	0
Federal Home Loan Mtg Corp	620,405	620,405	0	0	0
Federal National Mtg Assn	815,649	815,649	0	0	0
Federal Home Loan Bank	227,888	227,888	0	0	0
Total	<u>\$ 6,290,078</u>	<u>\$ 2,432,079</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 3,857,999</u>

WMU's investments at June 30, 2010 are presented below:

Investment Type	Fair Value	Investment Maturities (in Years)			
		< Than 1	1 - 5	6 - 10	> Than 10
Cash and Cash Equivalents	\$ 1,702,671	\$ 1,702,671	\$ 0	\$ 0	\$ 0
Total Investments	<u>\$ 1,702,671</u>	<u>\$ 1,702,671</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

WMU's investment ratings at June 30, 2010 are presented below:

Investment Type	Fair Value	Investment Maturities (in Years)			
		AAA	AA	A	Unrated
Cash and Cash Equivalents	\$ 1,702,671	\$ 0	\$ 0	\$ 0	\$ 1,702,671
Total	<u>\$ 1,702,671</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,702,671</u>

Custodial credit risk is the risk that, in the event of the failure of the counterparty, WMU will not be able to recover the value of its deposits that are in possession of an outside party. Consistent with WMU's investment policy, as of June 30, 2011 and 2010 all deposits were either fully collateralized by federal depository insurance or by the pledging institution in WMU's name or obligations of the U. S. Government.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 3 – RESTRICTED ASSETS**

The restricted assets in the accompanying financial statements are restricted as to use by bond ordinance or by external parties at June 30, 2011 and 2010 follows:

	<u>Cash</u>	<u>Investments</u>	<u>Accrued Interest</u>	<u>Total 2011</u>
<b>Restricted by Ordinance</b>				
With Paying Agents	\$ 295,717	\$ 0	\$ 0	\$ 295,717
Reserve Accounts	606,324	0	0	606,324
Depreciation Account	4,455,793	0	0	4,455,793
Subtotal	<u>5,357,834</u>	<u>0</u>	<u>0</u>	<u>5,357,834</u>
<b>Other Restricted Assets</b>				
SDC Water Fund	2,477,380	0	0	2,477,380
SDC Wastewater Fund	2,058,184	0	0	2,058,184
Customer Deposits	174,334	0	0	174,334
KIA Reserve	3,523	0	0	3,523
2011 Bond Funds	0	6,290,078	0	6,290,078
2008 BAN	261,564	0	0	261,564
Capital Accumulation- water	510,483	0	0	510,483
Capital Accumulation- wastewater	227,203	0	0	227,203
Total	<u>\$ 11,070,505</u>	<u>\$ 6,290,078</u>	<u>\$ 0</u>	<u>\$ 17,360,583</u>
	<u>Cash</u>	<u>Investments</u>	<u>Accrued Interest</u>	<u>Total 2010</u>
<b>Restricted by Ordinance</b>				
With Paying Agents	\$ 296,811	\$ 0	\$ 0	\$ 296,811
Reserve Accounts	773,723	0	0	773,723
Depreciation Account	3,956,845	0	0	3,956,845
Subtotal	<u>5,027,378</u>	<u>0</u>	<u>0</u>	<u>5,027,378</u>
<b>Other Restricted Assets</b>				
SDC Water Fund	2,630,153	0	0	2,630,153
SDC Wastewater Fund	1,938,145	0	0	1,938,145
Customer Deposits	179,070	0	0	179,070
2008 BAN	136,989	1,702,671	0	1,839,660
Capital Accumulation- water	442,767	0	0	442,767
Capital Accumulation- wastewater	243,304	0	0	243,304
Total	<u>\$ 10,597,807</u>	<u>\$ 1,702,671</u>	<u>\$ 0</u>	<u>\$ 12,300,478</u>

**WINCHESTER MUNICIPAL UTILITIES**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 4 – PROPERTY, PLANT AND EQUIPMENT**

WMU's systems as of June 30, 2011 and 2010 consist of the following:

<u>June 30, 2011</u>	<u>Beginning</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending</u>
Non-depreciable Assets:				
Land	\$ 1,051,011	\$ 0	\$ 0	\$ 1,051,011
Construction in Progress	10,142,648	10,534,767	(7,820,818)	12,856,597
	<u>11,193,659</u>	<u>10,534,767</u>	<u>(7,820,818)</u>	<u>13,907,608</u>
Depreciable Assets:				
Administrative	2,814,704	250,990	(34,728)	3,030,966
Water System	35,227,582	2,286,305	(14,109)	37,499,778
Wastewater System	60,620,527	2,549,990	(2,933)	63,167,584
Solid Waste	5,342,606	731,630	(259,472)	5,814,764
Vehicle Maintenance	408,794	20,200	0	428,994
Equipment Capital Lease	62,004	0	0	62,004
	<u>104,476,217</u>	<u>5,839,115</u>	<u>(311,242)</u>	<u>110,004,090</u>
Total	<u>115,669,876</u>	<u>16,373,882</u>	<u>(8,132,060)</u>	<u>123,911,698</u>
Accumulated Depreciation:				
Administrative	(1,107,178)	(126,829)	34,728	(1,199,279)
Water System	(8,704,582)	(928,755)	13,865	(9,619,472)
Wastewater System	(13,124,545)	(2,026,173)	2,933	(15,147,785)
Solid Waste	(1,433,936)	(184,943)	229,856	(1,389,023)
Vehicle Maintenance	(261,459)	(19,433)	0	(280,892)
Prior years accumulated	(19,230,756)	0	0	(19,230,756)
	<u>(43,862,456)</u>	<u>(3,286,133)</u>	<u>281,382</u>	<u>(46,867,207)</u>
Total Net Property, Plant and Equipment	<u>\$ 71,807,420</u>	<u>\$ 13,087,749</u>	<u>\$ (7,850,678)</u>	<u>\$ 77,044,491</u>

**WINCHESTER MUNICIPAL UTILITIES**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 4 – PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

<u>June 30, 2010</u>	<u>Beginning</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending</u>
Non-depreciable Assets:				
Land	\$ 1,051,011	\$ 0	\$ 0	\$ 1,051,011
Construction in Progress	7,837,162	9,779,250	(7,473,764)	10,142,648
	<u>8,888,173</u>	<u>9,779,250</u>	<u>(7,473,764)</u>	<u>11,193,659</u>
Depreciable Assets:				
Administrative	2,854,318	13,382	(52,996)	2,814,704
Water System	34,706,612	545,516	(24,546)	35,227,582
Wastewater System	58,391,581	2,486,684	(257,738)	60,620,527
Solid Waste	5,311,272	178,738	(147,404)	5,342,606
Vehicle Maintenance	408,794	0	0	408,794
Equipment Capital Lease	62,004	0	0	62,004
	<u>101,734,581</u>	<u>3,224,320</u>	<u>(482,684)</u>	<u>104,476,217</u>
Total	<u>110,622,754</u>	<u>13,003,570</u>	<u>(7,956,448)</u>	<u>115,669,876</u>
Accumulated Depreciation:				
Administrative	(1,043,094)	(117,080)	52,996	(1,107,178)
Water System	(7,929,514)	(799,308)	24,240	(8,704,582)
Wastewater System	(11,498,127)	(1,884,156)	257,738	(13,124,545)
Solid Waste	(1,369,670)	(186,061)	121,795	(1,433,936)
Vehicle Maintenance	(241,606)	(19,853)	0	(261,459)
Prior years accumulated	(19,230,756)	0	0	(19,230,756)
	<u>(41,312,767)</u>	<u>(3,006,458)</u>	<u>456,769</u>	<u>(43,862,456)</u>
Total Net Property, Plant and Equipment	<u>\$ 69,309,987</u>	<u>\$ 9,997,112</u>	<u>\$ (7,499,679)</u>	<u>\$ 71,807,420</u>

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 4 – PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

Depreciation is recorded on a straight-line basis over the useful lives of the assets as follows:

Buildings and Concrete	40-50 years
Main Replacement Program	40 years
Equipment	2-7 years
Vehicles	5-10 years

Depreciation expense in total and per function follows:

<b>Function</b>	<b>2011</b>	<b>2010</b>
Administrative	\$ 126,829	\$ 117,080
Water System	928,755	799,308
Wastewater System	2,026,174	1,884,156
Solid Waste	184,203	186,061
Vehicle Maintenance	19,433	19,853
Total Depreciation Expense	\$ <u>3,285,394</u>	\$ <u>3,006,458</u>

**NOTE 5 – LONG-TERM DEBT**

Long-Term Debt consists of bonds and other indebtedness for which the changes in the years ended June 30, 2011 and 2010 are as follows:

<b>Description</b>	<b>Beginning</b>	<b>Borrowings Additions</b>	<b>Repayments Reductions</b>	<b>2011 Ending</b>	<b>Current</b>
Compensated Absences	\$ 327,451	\$ 78,961	\$ (7,987)	\$ 398,425	\$ 398,425
Bonds	7,593,399	9,018,327	(404,900)	16,206,826	494,043
KIA Loan	19,810,691	0	(822,986)	18,987,705	1,170,433
2008 BAN	5,000,000	0	(5,000,000)	0	0
Capital Lease	6,056	0	(6,056)	0	0
KIA-Lower Howards	0	6,399,475	0	6,399,475	0
KIA-Storage Tank	0	340,326	(6,962)	333,364	14,133
KIA-Vaught Court Loan	69,320	218,080	(11,817)	275,583	12,054
Total Long-Term Debt	\$ <u>32,806,917</u>	\$ <u>16,055,169</u>	\$ <u>(6,260,708)</u>	\$ <u>42,601,378</u>	\$ <u>2,089,088</u>

<b>Description</b>	<b>Beginning</b>	<b>Borrowings Additions</b>	<b>Repayments Reductions</b>	<b>2010 Ending</b>	<b>Current</b>
Compensated Absences	\$ 286,926	\$ 50,238	\$ (9,713)	\$ 327,451	\$ 327,451
Bonds	9,245,998	0	(1,652,599)	7,593,399	195,154
KIA Loan	20,528,943	0	(718,252)	19,810,691	822,806
2008 BAN	5,000,000	0	0	5,000,000	5,000,000
Capital Lease	12,617	0	(6,561)	6,056	5,324
KIA-Vaught Court Loan	0	69,320	0	69,320	0
Total Long-Term Debt	\$ <u>35,074,484</u>	\$ <u>119,558</u>	\$ <u>(2,387,125)</u>	\$ <u>32,806,917</u>	\$ <u>6,350,735</u>

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 5 - LONG-TERM DEBT (CONTINUED)**

The Winchester Municipal Utilities bonded indebtedness and other long-term notes at June 30, 2011 and 2010, are summarized as follows:

	<u>Rate</u>	<u>Maturity</u>	<u>Original Issue</u>	<u>Total 2011</u>	<u>Total 2010</u>
2002 Issue	4.50 – 5.125%	07/01/32	\$ 9,025,000	\$ 7,500,000	\$ 7,700,000
2011 Issue	5.2656174%	01/01/31	9,010,000	8,965,555	0
				<u>16,465,555</u>	<u>7,700,000</u>
Less unamortized bond discount				<u>258,729</u>	<u>106,601</u>
				<u>16,206,826</u>	<u>7,593,399</u>
KIA Loan	1.00%	12/01/28	21,000,000	18,987,705	19,810,691
2008 Bond Anticipation Note	3.19%	06/15/11	5,000,000	0	5,000,000
KIA-Lower Howards Creek	2.00%	01/01/31 Estimate	36,600,000	6,399,475	0
KIA-Industrial Elev Storage Tanks	2.00%	12/01/30	340,326	333,364	0
KIA-Vaught Court Loan	2.00%	06/01/31	287,400	275,583	69,320
				<u>42,202,953</u>	<u>32,473,410</u>
Less current maturities				<u>1,690,663</u>	<u>6,017,960</u>
				<u>\$ 40,512,290</u>	<u>\$ 26,455,450</u>

The annual bond and long-term debt service requirements, as of June 30, 2011, are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 1,690,663	\$ 780,521	\$ 2,471,184
2013	1,738,153	749,887	2,488,040
2014	1,575,979	723,330	2,299,309
2015	1,608,607	697,467	2,306,074
2016	1,647,180	670,781	2,317,961
2017-2021	8,780,147	2,906,998	11,687,145
2022-2026	9,955,635	1,974,318	11,929,953
2027-2031	8,254,641	762,777	9,017,418
2032-2033	552,473	14,478	566,951
	<u>\$ 35,803,478</u>	<u>\$ 9,280,557</u>	<u>\$ 45,084,035</u>

The above schedule does not include future payments towards the KIA-Lower Howards Creek financing, as this is interim financing, and payments will not be scheduled until after completion.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 5 – LONG-TERM DEBT (CONTINUED)**

**Series 2002 Bonds**

On March 1, 2002, the City issued \$9,025,000 of utilities revenue bonds for WMU secured by a first pledge of a fixed portion of the gross revenues to be derived from the operation of the system, which fixed portion shall be sufficient to pay the principal and interest of the bonds. The 2002 bond issue financed the acquisition, construction and installation of major new municipal sanitary sewer (wastewater) facilities and paying and discharging the outstanding Utilities Revenue Bond Anticipation Note, Series 1997. The bonds carry interest rates of 4.5% to 5.125% and mature on July 1, 2032. The interest payments are to be made on July 1 and January 1 and the principal payments are to be made on July 1.

**Series 2003 Bonds**

On March 1, 2003, the City issued \$9,070,000 of utilities refunding revenue bonds for WMU secured by a first pledge of a fixed portion of the gross revenues to be derived from the operation of the system, which fixed portion shall be sufficient to pay the principal and interest of this bond and the series of which it forms a part and such outstanding parity bonds as and when the same become due and payable and which shall be set aside as a special fund for that purpose. The 2003 bonds refinanced Series 1993 bonds to refinance water and wastewater system improvements. The bonds carry interest rates of 2.00% to 2.50% and mature on July 1, 2010. The interest payments are to be made on July 1 and January 1 and the principal payments are to be made on July 1. The bonds were paid in full on June 30, 2010.

**Series 2011 Bonds**

On April 14, 2011, the City issued \$9,010,000 of utilities revenue bonds for WMU. The 2011 bond issues financed the extensions and improvements to the combined and consolidated municipal waterworks, sanitary sewer and solid waste disposal system. The bonds carry an interest rate of 5.2656174% and mature on January 1, 2031. The interest and principal payments are to be made monthly.

**KIA Loan**

On July 1, 2005, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for the construction of a new wastewater treatment plant, \$21,000,000. This agreement calls for interest to be paid every six months starting December 1, 2005 at the rate of 1% of the outstanding balance. The amount of interest due will vary from due date to due date based upon the amount of funds drawn down to fund construction of the wastewater treatment plant. Principal payments are due to be paid every December 1 and June 1 starting after the wastewater treatment plant goes online. The online date for the plant was July, 2008, with principal payments due to begin on June 1, 2009, and be due every December 1 and June 1 thereafter until maturity on December 1, 2028.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 5 – LONG-TERM DEBT (CONTINUED)**

The Kentucky Infrastructure Authority has made the loan inferior and subordinate to the security interest and source of payment for the Debt Obligations of Winchester Municipal Utilities payable from the revenues of the System outstanding at the time of the execution of the “Assistance Agreement”. The Agreement also further states that the Kentucky Infrastructure Authority must be notified no less than thirty days (30), in writing, prior to the issuance of any further debt obligations on parity with the current debt obligations.

**2008 Bond Anticipation Note**

On June 19, 2008, the Utility entered into a Series 2008 Combined Utilities Revenue Bond Anticipation Note with Branch Banking and Trust Company for \$5,000,000. The bond anticipation note matures on June 15, 2011 at which time the principal is to be paid in full. The interest payments are to begin December 15, 2008 and are payable on each June 15 and December 15 to maturity at an interest rate of 3.19%. The note was issued in anticipation of the issuance of the City of Winchester, Kentucky’s Combined Utilities Revenue Bonds, Series 2008, for the purpose of providing interim financing of certain capital costs related to the City’s combined municipal waterworks, sanitary sewer and solid waste disposal system (the “System”). The BAN, upon maturity, will either be paid off with the issuance of bonds or the renewal of the BAN.

Pledged against this note as the sources of payment of the principal of and the interest on the Note (a) the proceeds of the Bonds, when sold and issued, and (b) the income and revenues of the System, but on a basis subordinate and subject in all respects to the prior and superior pledges, liens, rights and contractual commitments securing the WMU’s outstanding bonds and Kentucky Infrastructure Authority loans payable from the income and revenues of the System. The note was paid in full on April 30, 2011.

**KIA – Vaught Court Loan**

On December 1, 2009, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for construction of the Vaught Court Outfall Sewer Project, \$600,000 with a principal forgiveness of \$312,600 and a loan amount of \$287,400. This agreement calls for interest payments to commence within six months from the first draw of funds estimated to be June 1, 2010 with full principal and interest payments to commence within one year of initiation of operation estimated to be June 1, 2011. During the year ended June 30, 2010, \$312,600 of principal was forgiven and \$69,320 of the loan amount was drawn down. During the year ended June 30, 2011, \$218,080 was drawn down, and the project was completed. The loan carries a 2.00% interest rate, with principal and interest payments due on December 1 and June 1 every year until maturity on June 1, 2030. The loan is required to establish a replacement reserve account where \$1,500 is to be added to the account each December 1 until the balance reaches \$15,000 and is to be maintained for the life of the loan.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 5 – LONG-TERM DEBT (CONTINUED)**

The Kentucky Infrastructure Authority has made the loan inferior and subordinate to the security interest and source of payment for the Debt Obligations of Winchester Municipal Utilities payable from the revenues of the System outstanding at the time of the execution of the “Assistance Agreement”. The Agreement also further states that the Kentucky Infrastructure Authority must be notified no less than thirty days (30), in writing, prior to the issuance of any further debt obligations on parity with the current debt obligations.

**KIA – Industrial Elevated Storage Tank**

On December 1, 2009, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for construction of an Elevated Storage Tank Rehabilitation, \$800,000 with a principal forgiveness of \$432,800 and a loan amount of \$367,200. This agreement calls for interest payments to commence within six months from the first draw of funds estimated to be June 1, 2010 with full principal and interest payments to commence within one year of initiation of operation estimated to be June 1, 2011. During the year ended June 30, 2010, \$432,800 of principal was forgiven. During the year ended June 30, 2011, \$340,326 was drawn down, and the project was completed. The loan carries a 2.00% interest rate, with principal and interest payments due on December 1 and June 1 every year until maturity on December 1, 2030. The loan is required to establish a replacement reserve account where \$2,000 is to be added to the account each December 1 until the balance reaches \$20,000 and is to be maintained for the life of the loan.

The Kentucky Infrastructure Authority has made the loan inferior and subordinate to the security interest and source of payment for the Debt Obligations of Winchester Municipal Utilities payable from the revenues of the System outstanding at the time of the execution of the “Assistance Agreement”. The Agreement also further states that the Kentucky Infrastructure Authority must be notified no less than thirty days (30), in writing, prior to the issuance of any further debt obligations on parity with the current debt obligations.

**KIA – Lower Howards Creek**

On February 5, 2010, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for the Lower Howards Creek Sewershed project, \$36,600,000. This agreement calls for interest payments to commence within six months from the first draw of funds with full principal and interest payments to commence within one year of initiation of operation estimated to be October 30, 2012. During the current year, \$6,399,475 of the loan was drawn down. Upon completion of the project, the loan will carry a 2.00% interest rate and mature in twenty years. The loan is required to establish a replacement reserve account where \$91,500 is to be added to the account each December 1 until the balance reaches \$915,000 and is to be maintained for the life of the loan.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 5 – LONG-TERM DEBT (CONTINUED)**

The Kentucky Infrastructure Authority has made the loan inferior and subordinate to the security interest and source of payment for the Debt Obligations of Winchester Municipal Utilities payable from the revenues of the System outstanding at the time of the execution of the "Assistance Agreement". The Agreement also further states that the Kentucky Infrastructure Authority must be notified no less than thirty days (30), in writing, prior to the issuance of any further debt obligations on parity with the current debt obligations.

**Capital Lease**

On May 14, 2008, the Utility entered into a capital lease agreement with Oce' Financial Services, Inc. for a copier in the amount of \$18,169. Payments are for \$561 per month for 36 months at an interest rate of 7.00%. The capital lease was paid in full on May 28, 2011.

The assets held under capital leases at June 30, 2010 are included in equipment and total \$18,169 less accumulated amortization of \$7,274 as of the end of 2010. Amortization of capital leased equipment is included with depreciation expense.

**NOTE 6 – COMPLIANCE WITH COVENANTS**

The bonds and KIA loan requires WMU to establish and maintain certain reserves and restricted assets as follows:

**Bond Debt Service - Bonds**

Monthly deposits equal to one-sixth of the next interest payment and one-twelfth of the next principal payment shall be set aside monthly so as to accumulate in the Bond Fund in order to pay interest and principal on the bonds. In addition, the Bond Ordinance requires that a specific amount be maintained in the Debt Service Reserve Account defined as the "Reserve Amount." The account is to be reviewed each year and funded based on the least of three factors: 1) maximum annual principal and interest requirement, 2) 125% of the average annual principal and interest requirement or 3) 10% of the outstanding loan proceeds. The first factor was applicable for June 30, 2011 and required a balance of \$596,631. The first factor was applicable for June 30, 2010 and required a balance of \$596,631.

**Depreciation Reserve – Bonds and KIA Loan**

The Winchester Municipal Utilities is required to transfer 12% of annual gross revenues or \$42,000, whichever is greater, in equal monthly installments to the Depreciation Fund. These funds are to be used for renewals, replacements and/or additions to property, plant and equipment.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 6 – COMPLIANCE WITH COVENANTS (CONTINUED)**

**Interest Coverage Ratio – Bonds and KIA Loan**

The Winchester Municipal Utilities is required to maintain an interest coverage ratio of 1.4 times – annual debt service requirements for bonds and 1.0 time – annual debt service requirements for KIA loan. The City of Winchester is required by bond ordinance to adjust rates as necessary to maintain such minimum coverage.

Computed as follows:

<b>Bonds:</b>	<u>2011</u>	<u>2010</u>
Income Available for Debt Service	\$ 1,510,937	\$ 442,475
Add: Depreciation	3,285,394	3,006,458
Subtract: Interest & Principal Payments On Bonds	(1,047,607)	0
Cash Available for Bond Debt Service	<u>\$ 3,748,724</u>	<u>\$ 3,448,933</u>
Maximum Debt Service On Bonds	<u>596,631</u>	<u>596,631</u>
Coverage Ratio	<u>6.28</u>	<u>5.78</u>
<b>KIA:</b>	<u>2011</u>	<u>2010</u>
Income Available for Debt Service	\$ 1,510,937	\$ 442,475
Add: Depreciation	3,285,394	3,006,458
Cash Available for Bond Debt Service	<u>\$ 4,796,331</u>	<u>\$ 3,448,933</u>
Maximum Debt Service On Bonds	<u>1,753,297</u>	<u>1,603,854</u>
Coverage Ratio	<u>2.74</u>	<u>2.15</u>

The Winchester Municipal Utilities are in compliance with all of the covenants of the bond ordinance and KIA loan agreement as of June 30, 2011 and 2010.

**NOTE 7 – CAPITALIZED INTEREST**

WMU follows the policy of capitalizing interest as a component of construction in progress. For the years ended June 30, 2011 and 2010, total interest incurred was \$870,091 and \$787,905, respectively, of which \$131,144 and \$159,500 was capitalized and \$738,947 and \$628,405 was expensed, respectively.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 8 – FIVE YEAR CAPITAL CONSTRUCTION PLAN**

Winchester Municipal Utilities' five year capital plan includes major capital construction of new wastewater treatment plant, pump station and force mains which are projected to be funded as follows:

Water System Improvements	\$ 61,566,625
Utility Improvements	203,000
Wastewater System Improvements	<u>59,689,000</u>
Total projected financing requirement	<u>\$ 121,458,625</u>

Winchester Municipal Utilities' five year capital plan of depreciation funded projects consists of the following annual allocations in addition to other specifically identified projects:

Finance and Administration:	
Copiers	\$ 8,000
Upgrade/Renew Network Virus Protection	1,600
Upgrade local area network	2,500
Replace microcomputers	8,000
Engineering Software Upgrades	5,000
Field Operation vehicles	365,000
Solid Waste Collection:	
Cubit inventory	20,000
Container replacement	15,000
Replace compactor ejector box	12,000
Solid Waste Recycling	30,000
Water Treatment Plant Equipment Improvements	70,000
Water Distribution:	
Main replacement	125,000
Meter Change-Out/AMR Equipment	165,000
Elevated tank rehabilitation	90,000
Meter change-out	30,000
Gate valve replacement	22,500
Gate valve grade adjustment	8,000
Fire hydrant replacement	15,000
Wastewater Collection:	
Manhole grade adjustment	125,000
Manhole Grade Adjustment – New Paving	25,000
I&I Rehabilitation	35,000
Rehabilitation of Private Sewers	35,000
Flow Meters	10,000
Infrastructure Rehabilitation Program	75,000
System Capacity Assurance Program	25,000
Continuous Sewer System Assessment Program	7,000
Routine Hydraulic Cleaning	57,145
Wastewater Treatment Plant:	
Replacement of Laboratory Equipment	2,000
WWTP Equipment Improvements	35,000
Solids Processing Improvements	<u>35,000</u>
Total annual allocations for infrastructure investment	<u>\$ 1,458,745</u>

All annual allocation programs are funded in each year of the five year capital plan.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 9 – PENSION FUND**

The Winchester Municipal Utilities Commission adopted a resolution authorizing participation in the Kentucky Retirement Systems sponsored retirement program for County Employees Retirement System (CERS) effective July 1, 1998. The County Employees Retirement System (CERS) is a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems. CERS was established in 1958 under Kentucky Revised Statutes 78.510 to 78.852. The Plan provides retirement, disability, and death benefits to plan members and beneficiaries with annual cost-of-living adjustments. The retirement benefits are guaranteed by state law and cannot be reduced. By contributing to the retirement systems, the employee is assured a percentage of average salary for each year he is employed. The employee's contributions are currently tax-deferred. The Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and required supplementary information for CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, and 1260 Louisville Road, Frankfort, KY 40601.

Retirement benefits are provided for through legislative action of the Kentucky General Assembly and are funded by employee contributions which are deducted from employees' wages and by employer-paid contributions. The General Assembly sets the employee contribution rates, currently 5% for fiscal year ending 2011 and 2010, and the Retirement Systems' Board of Trustees sets the employer contribution rates, currently 16.93% and 16.16% for fiscal year ending 2011 and 2010, respectively. Each employer is notified prior to each fiscal year of any change in the contribution rates. The Retirement System's administrative expenses are subject to approval by the Kentucky General Assembly and are paid from the State's Retirement Allowance Account.

Employer contributions for the years ended June 30, 2011, 2010 and 2009, under the current plan amounted to \$432,605, \$407,933 and \$389,350, respectively, which represents 100% of the required contributions.

In a prior year, the WMU Commission agreed to pay \$381,296 in prior service costs. This cost will be expensed equally over 19 years, based upon the average remaining service lives of all involved employees. Prior service costs expensed amounted to \$21,934 and \$21,934 for the years ended June 30, 2011 and 2010, respectively.

WMU offers employees the option to participate in a defined contribution plan under Section 403(B) and 401(K) of the Internal Revenue Code. All regular full time and part time employees are eligible to participate and may contribute up to the maximum amount allowable by law.

Also, WMU offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. This deferred compensation is not available to employees until their termination, retirement, death or unforeseeable emergency.

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 9 – PENSION FUND (CONTINUED)**

GASB Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans, allows entities with little or no administrative involvement and who do not perform the investing function for these plans to omit plan assets and related liabilities from their financial statements. WMU, therefore, does not report these assets and liabilities on its financial statements.

Employee contributions made to the 401k and 457 plans as of June 30, 2011 and 2010 were \$17,427 and \$27,003, respectively. WMU does not contribute to these plans.

**NOTE 10 – CONTINGENCY**

Kentucky-American Water v Natural Resources and Environmental Protection Cabinet and WMU – this is an administrative proceeding brought by Kentucky American Water Company against the NREPC as a result of its refusal to reissue the operating permit for the Rockwell Village package treatment plant. This matter concerns the requirement that Kentucky American Water connect its Rockwell Village package treatment plant to the WMU system and Emu's position that it will allow the connection to its system on the same terms and conditions that apply to all of its customers. The Franklin Circuit Court has ordered Kentucky American to make the connection at its expense in 2002 and WMU to allow the connection, but reserving the issue of payment of tap fees and SDC fees. The connection still has not been made due to design and feasibility problems and the court still needs to rule whether WMU can collect its tap on and SDC fees totaling \$175,000. The case is pending and we will make every effort to collect our fees when the connection is finally made to our system.

Due to Winchester Municipal Utilities current rate structure and debt service availability, the Winchester/Clark County Industrial Authority board made a commitment to donate a portion of the amounts necessary to pay all principal payments due June 1, 2009 through June 1, 2010, not to exceed \$1,435,000. The unpaid balance on the commitment as of June 30, 2011 and June 30, 2010 is \$0 and \$245,691, respectively. Due to the current financial environment and economic uncertainty, this commitment has not been recorded on Emu's financial statements.

**NOTE 11 – ECONOMIC DEPENDENCY**

WMU is economically dependent for revenues from the following four entities:

<u>Name</u>	<u>2011</u>	<u>2010</u>
Sekisui	\$ 541,362	\$ 431,666
The Kroger Company	452,019	428,866
East Clark County WD	304,656	270,877
Martek/Alltech	257,745	262,283
	<u>\$ 1,555,782</u>	<u>\$ 1,393,692</u>

**WINCHESTER MUNICIPAL UTILITIES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

**NOTE 12 – RISK OF LOSS**

WMU is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. WMU carries commercial insurance for the risks of loss, including worker's compensation, and property and casualty loss insurance.

**NOTE 13 – LANDFILL POST-CLOSURE COSTS**

In 1992, WMU discontinued its landfill operations and ceased accepting solid waste. Under 401 KAR 47:080, WMU presented a closure plan. The final cap, leachate collection systems, surface water drainage systems, gas vent systems and groundwater monitoring systems have been constructed. On June 4, 1998, the Clark County Fiscal Court entered into a lease agreement with WMU for the rental of county property upon which the County and WMU formerly operated landfills, the term of the lease was for 20 years at \$1 per year. The lease provides provision for the post-closure monitoring requirements of state and federal law to be provided by WMU. The post-closure costs are allocated 30% WMU and 70% Clark County Fiscal Court. The state and federal monitoring and maintenance regulations must be performed at the site for 30 years after closure. A liability was not recorded on WMU's general ledger in the year of closure; instead the actual post-closure expenses have been recorded in operations each year.

On October 16, 2008, WMU received notice from the Kentucky Division of Waste Management that the site had been released from groundwater monitoring. In applying GASB 18, WMU believes these costs were the most significant of the post-closure expenses. The effect of any remaining projected costs will be offset by the lease agreement with Clark County.

The Division of Waste Management has finished construction of a new wetlands treatment system for treating the landfill leachate at the WMU and Clark County Landfills. With construction of this treatment facility a new Kentucky Pollution Discharge Elimination System (KPDES) Permit was required. Laboratory testing/Monitoring required as part of the conditions of this permit were unexpectedly more stringent than the previous permit resulting in a higher monthly cost for operation. WMU expects that permit limits will be relaxed in the coming months allowing monthly costs to return to what would be considered normal for this operation.

**NOTE 14 – UTILITY REVENUES PLEDGED**

WMU has pledged future revenues from water, wastewater and solid waste to repay the 2002, 2003 and KIA outstanding debt referenced in Note 5. Proceeds from these debt obligations provided financing of the water and wastewater infrastructure, including a new wastewater treatment plant. The debt obligations will be repaid from the previously mentioned utility revenues through the year 2032. Principal and interest paid and total customer revenues for each year were as follows: 2011 year, \$1,631,492 and \$11,930,283 and 2010 year, \$2,253,910 and \$10,142,072, respectively.

## **SUPPLEMENTAL INFORMATION**

**WINCHESTER MUNICIPAL UTILITIES  
SCHEDULE 1 - DEPARTMENT EXPENSES  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>ADMINISTRATIVE</b>		
Salaries	\$ 828,373	\$ 729,987
Employee Benefits	387,202	356,977
Repairs and Maintenance	67,681	54,559
Supplies	32,832	28,266
Small Tools	4,065	2,827
Utilities and Telephone	36,273	31,603
Property Insurance	40,195	35,204
Other	32,728	19,112
Postage and Freight	62,245	65,508
Bad Debts	15,000	15,000
Professional Fees	133,197	128,342
Depreciation/Amortization	126,829	117,080
	<u>1,766,620</u>	<u>1,584,465</u>
<b>SOLID WASTE</b>		
Salaries	434,147	443,892
Employee Benefits	281,028	286,431
Repairs and Maintenance	298,498	318,374
Supplies	17,483	13,922
Small Tools	5,733	2,255
Utilities and Telephone	17,650	17,423
Property Insurance	44,896	58,602
Other	32,612	30,905
Postage	-	-
Depreciation	184,203	186,061
Landfill Charges	264,903	250,041
	<u>1,581,153</u>	<u>1,607,906</u>
<b>WATER</b>		
Salaries	573,555	522,496
Employee Benefits	286,165	262,428
Repairs and Maintenance	126,807	179,340
Supplies	364,780	357,393
Small Tools	12,050	7,097
Utilities and Telephone	436,599	396,089
Property Insurance	62,421	59,029
Other	26,182	19,021
Postage	58	131
Professional Fees	-	-
Depreciation/Amortization	928,755	799,308
New Services	8,583	3,436
Meter Replacements	-	306
	<u>2,825,955</u>	<u>2,606,074</u>
	\$	\$

**WINCHESTER MUNICIPAL UTILITIES  
SCHEDULE 1 - DEPARTMENT EXPENSES (CONTINUED)  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>WASTEWATER</b>		
Salaries	\$ 564,150	\$ 612,311
Employee Benefits	330,873	335,864
Repairs and Maintenance	243,970	215,053
Supplies	391,406	326,338
Small Tools	13,840	7,484
Utilities and Telephone	718,557	588,639
Property Insurance	73,853	98,647
Other	22,858	27,070
Postage	665	445
Professional Fees	156,450	228,690
Depreciation/Amortization	2,026,174	1,884,156
New Services	342	-
	<u>4,543,138</u>	<u>4,324,697</u>
 <b>VEHICLE MAINTENANCE</b>		
Salaries	23,985	19,362
Employee Benefits	39,408	43,515
Repairs and Maintenance	5,642	3,331
Supplies	3,079	2,953
Small Tools	6,414	1,892
Utilities and Telephone	18,523	11,989
Property Insurance	7,261	10,355
Other	1,374	811
Depreciation/Amortization	19,433	19,853
	<u>125,119</u>	<u>114,061</u>
 <b>TOTAL OPERATING EXPENSES</b>	 <u>\$ 10,841,985</u>	 <u>\$ 10,237,203</u>

**WINCHESTER MUNICIPAL UTILITIES  
SCHEDULE II - REVENUE BOND DEBT SERVICES  
FOR THE YEAR ENDED JUNE 30, 2011**

Maturity Date	2002 Issue		2011 Issue		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2011-2012	\$ 210,000	\$ 370,160	\$ 288,889	\$ 394,073	\$ 498,889	\$ 764,233
2012-2013	220,000	360,485	324,167	380,419	544,167	740,904
2013-2014	230,000	350,245	334,167	370,694	564,167	720,939
2014-2015	240,000	339,315	346,250	360,669	586,250	699,984
2015-2016	255,000	327,619	359,166	350,281	614,166	677,900
2016-2017	265,000	315,269	369,167	339,506	634,167	654,775
2017-2018	280,000	302,325	381,250	328,431	661,250	630,756
2018-2019	290,000	288,425	396,250	315,369	686,250	603,794
2019-2020	305,000	273,550	411,250	299,519	716,250	573,069
2020-2021	325,000	257,800	428,333	283,069	753,333	540,869
2021-2022	340,000	241,175	448,333	265,706	788,333	506,881
2022-2023	355,000	223,578	468,333	246,733	823,333	470,311
2023-2024	375,000	204,872	490,417	226,994	865,417	431,866
2024-2025	395,000	185,141	515,417	203,399	910,417	388,540
2025-2026	415,000	164,384	540,417	178,365	955,417	342,749
2026-2027	440,000	142,475	567,500	151,344	1,007,500	293,819
2027-2028	460,000	119,413	597,500	122,664	1,057,500	242,077
2028-2029	485,000	95,197	629,583	91,722	1,114,583	186,919
2029-2030	510,000	69,700	666,667	58,330	1,176,667	128,030
2030-2031	540,000	42,794	402,500	22,138	942,500	64,932
2031-2032	565,000	14,474	0	0	565,000	14,474
	<u>\$ 7,500,000</u>	<u>\$ 4,688,396</u>	<u>\$ 8,965,556</u>	<u>\$ 4,989,425</u>	<u>\$ 16,465,556</u>	<u>\$ 9,677,821</u>

**WINCHESTER MUNICIPAL UTILITIES  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2011**

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures</u>
<b>U.S. Environmental Protection Agency</b>			
Passed through Kentucky Infrastructure Authority:			
Capitalization Grants for Clean Water revolving funds -ARRA	66.458	A2 09-38	140,688
Federal Assisted Wastewater revolving funds	66.458	A 10-03	6,399,475
Capitalization Grants for Drinking Water revolving funds-ARRA	66.468	F2 09-16	561,000
<b>Total Federal Awards</b>			<b>\$ <u>7,101,163</u></b>

The above schedule of expenditures of federal awards includes the federal grant activity of WMU and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organization.

**SUMMERS, MCCRARY & SPARKS, P.S.C.**  
CERTIFIED PUBLIC ACCOUNTANTS

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MEMBERS:

AMERICAN INSTITUTE  
OF CERTIFIED PUBLIC ACCOUNTANTS

KENTUCKY SOCIETY  
OF CERTIFIED PUBLIC ACCOUNTANTS

PRIVATE COMPANIES  
PRACTICE SECTION OF THE AMERICAN INSTITUTE  
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STUART K. McCRARY, JR., CPA  
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SUSAN A. LACY, CPA  
DEBORAH L. MAYNARD, CPA  
RYAN R. LASKI, CPA

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LAURENCE T. SUMMERS  
1961-1992

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 Commissioners  
Winchester Municipal Utilities  
Winchester, KY

We have audited the financial statements of the business-type activities of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of and for the year ended June 30, 2011, which comprise the Winchester Municipal Utilities' basic financial statements and have issued our report thereon dated November 7, 2011. 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

Management of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, 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 Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, 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 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.

Our consideration of 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 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.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, financial statements are free of 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*.

This report is intended solely for the information and use of the Commissioners, management, others within the organization, federal awarding agencies and pass through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Summers, McCrary & Sparks, PSC*

Summers, McCrary & Sparks, PSC  
Winchester, Kentucky  
November 7, 2011

**SUMMERS, MCCRARY & SPARKS, P.S.C.**  
CERTIFIED PUBLIC ACCOUNTANTS

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---

LAURENCE T. SUMMERS  
1961-1992

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS  
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR  
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE  
WITH OMB CIRCULAR A-133**

To the Commissioners  
Winchester Municipal Utilities  
Winchester, Kentucky

Compliance

We have audited Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Winchester Municipal Utilities' major federal programs for the year ended June 30, 2011. Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, management. Our responsibility is to express an opinion on Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, 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. Our audit does not provide a legal determination of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, compliance with those requirements.

In our opinion, Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

### Internal Control Over Compliance

Management of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, 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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, Commissioners, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Summers, McCrary & Sparks, PSC*  
Winchester, Kentucky  
November 7, 2011

WINCHESTER MUNICIPAL UTILITIES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
JUNE 30, 2011

**Section I - Summary of Auditor's Results**

1. The auditor's report expresses an unqualified opinion on the financial statements of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky.
2. No significant deficiencies were disclosed during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, were disclosed during the audit.
4. No significant deficiencies were reported in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Controls Over Compliance in Accordance with OMB Circular A-133.
5. The auditor's report on compliance for the major federal awards programs for Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, expresses an unqualified opinion.
6. No audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this Schedule.
7. The programs tested as major programs includes: EPA Capitalization Grant for Clean Water Revolving Funds - CFDA #66.458 and EPA Capitalization Grant for Drinking Water Revolving Funds - CFDA #66.468
8. The threshold for distinguishing Types A and B programs was \$300,000.
9. Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, was determined to be a low-risk auditee.

**Section II – Financial Statement Findings**

No Findings

**Section III – Federal Award Findings and Questioned Costs**

No Findings