

**WINCHESTER MUNICIPAL UTILITIES
WINCHESTER, KENTUCKY**

AUDITED FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2012 and 2011

**WINCHESTER MUNICIPAL UTILITIES
WINCHESTER, KENTUCKY
JUNE 30, 2012 and 2011**

CONTENTS

| | <u>Page</u> |
|---|-------------|
| Independent Auditor's Report | 1-2 |
| Management's Discussion & Analysis | 3-19 |
| Statements of Net Assets | 20-21 |
| Statements of Revenue, Expenses and Changes in Fund Net Assets | 22 |
| Statements of Cash Flows | 23-24 |
| Notes to the Financial Statements | 25-43 |
| Supplemental Information: | |
| Department Expenses | 44-45 |
| Revenue Bond Debt Service | 46 |
| Schedule of Expenditures of Federal Awards | 47 |
| Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with <i>Government Auditing Standards</i> | 48-49 |
| 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 | 50-51 |
| Schedule of Findings and Questioned Costs | 52 |

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

CERTIFIED PUBLIC ACCOUNTANTS

MEMBERS:

AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

KENTUCKY SOCIETY
OF CERTIFIED PUBLIC ACCOUNTANTS

PRIVATE COMPANIES
PRACTICE SECTION OF THE AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

STUART K. McCRARY, JR., CPA
THOMAS S. SPARKS, CPA
JAMES R. WHITTEN, CPA

SUSAN A. LACY, CPA
DEBORAH L. MAYNARD, CPA
RYAN R. LASKI, CPA

LAURENCE T. SUMMERS
1961-1992

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, 2012 and 2011 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, 2012 and 2011, 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 respective financial position of the business-type activities of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of June 30, 2012 and 2011, and the respective changes in financial position and where applicable 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 15, 2012 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 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 financial statements that collectively comprise the Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, financial statements. The Department Expenses, Revenue Bond Debt Schedules and Schedule of Expenditures of Federal Awards, as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Department Expenses, Revenue Bond Debt Schedules and Schedule of Expenditures of Federal Awards are 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 15, 2012

**MANAGEMENT'S DISCUSSION AND ANALYSIS
WINCHESTER MUNICIPAL UTILITIES
JUNE 30, 2012**

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 11,758 water customers, 11,475 wastewater customers, and 8,923 solid waste customers.

Fiscal Year 2012/2013 budget reflects annual revenue of \$15,984,750 and annual debt service of \$2,604,128.

• **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. WMU maintains approximately 164.5 miles of water line in the distribution system.

Average day water production for FY 2011/2012 was 4.23 MGD. Peak day water production for FY 2011/2012 was 5.80 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 153.8 miles of gravity and force main sanitary sewers, 14 sewage-pumping stations (excluding the landfill pump 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 2011/2012 was 3.72 MGD. Peak day wastewater treatment for FY 2011/2012 was 15.57. Average day production of Class A biosolids for FY 2011/2012 was 23.7 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 2011/2012 was 52.00 tons and average day yard waste collection for FY 2011/2012 was 5.51 tons.

SIGNIFICANT ISSUES

- **Consent Decree**

The Consent Decree continues to be the single most significant issue facing the utility at this time. However, much progress has been made in the last several years to comply with the requirements of this enforcement action. 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 the City and WMU to:

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

Such is being 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 To be Removed | Proposed Project Completion Date |
|---|---|----------------------------------|
| 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 85% complete. The Bel-Air Sanitary Sewer Improvements project involves construction of an interstate road bore and new interceptor sewer that eliminates two (2) sewage pumping stations. Construction of Bel-Air is approximately 16% complete. 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.

As a result, it was determined to 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 (KDOW) officials. Work on this plan was completed June 14, 2012 and submitted to the EPA and KDOW for approval and comments. Comments have been received and are being incorporated into the plan. The final public meeting for the SEP will be conducted on October 11, 2012. The plan is expected to receive formal approval by the end of calendar year 2012.

- **Water Supply**

WMU continues to face needs with respect to water supply. This need will quickly become the most significant issue facing the utility upon completion of the Lower Howards Creek Sanitary Sewer Improvements project. Normal growth pattern projections have indicated the need for additional potable water capacity now. 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 initiated production activities at 555 Rolling Hills Lane (previously Martek Biosciences) and will play a significant role in water needs along with Winchester Farms Dairy, Sekisui and other large water users. Currently, several lots within the Industrial Park, Phase VI development, are under construction or are under contract negotiations. Determination of water needs for these lots will factor into defining the ultimate water needs.

As previously stated WMU's current permitted capacity is 6.0 million gallons per day (MGD) with current average day demand of 4.23 MGD and peak day demand of 5.80 MGD. Projections of WMU's 20-year demand are 12.0 MGD based upon normal growth patterns which can be skewed with the addition or loss 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 was proposed to 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 ensure the delivery of the additional capacity. Over time, the existing water treatment plant was proposed to be phased out of service and the planned water treatment plant expanded to 12.0 MGD. A final determination on maintaining the existing water treatment plant or removing it from service has not been finalized. The total estimated cost (preliminary engineering costs) of the initial phase of improvements is \$58,700,000. 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 Influent 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 was 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 bienniums for design and \$46 million in the 2014-16 bienniums for construction of a new dam. KRA's capital plan which included this funding was approved by the Kentucky Legislature during the 2012 General Assembly. A failed dam would leave Winchester without its primary water supply and KRA has indicated their emergency action plan to repair a failed dam would place the burden on the water withdrawer for a minimum of 7-14 days until equipment could be mobilized. WMU's reservoir would yield, without mandatory conservation measures, approximately a 30-45 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 as proposed, maintaining the Reservoir as a water source will require significant rehabilitation. Previously allocated capital budget dollars have been removed from the most recent budget plans that were intended to address these issues.

- **Solid Waste Study**

The WMU Commission authorized a comprehensive solid waste study of the solid waste operations for WMU on May 31, 2012. The scope of services is

comprised of four (4) phases of work that include 1) Compilation and review of existing information, 2) Cost and rate analysis, 3) Review of alternatives (optional), and 4) Reporting. A final report will outline the findings of the study and establish direction for WMU and its customers moving forward as it relates to existing and expanded services. Future budgets will be impacted by any changes that are made as a result of the findings of the study.

- **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. While the economy continues to slowly recover, 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 are expected to 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 51% 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. One of the cost effective measures included in the budgeting process for Fiscal Year 2012/2013 included setting aside 40% of the Depreciation budget to fund new water system improvements. Total accumulated funds are expected to be approximately \$4.4 million within five (5) years.

The City and WMU Commissions passed rate increases that became effective in February 2010. Rates continue to 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 ensuring 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 have been approved by the respective legislative bodies and WMU's first Privilege Fee Agreement, located in the Strodes Creek, Basin B is in the process of approval.

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 has been secured via a low interest loan from the Kentucky Infrastructure Authority (2.2%; 20 years). Financing of the water system improvements is expected to be a combination of accumulated funds that include Depreciation funds as previously mentioned, System Development Charge funds and 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. Recent trends in daily water production dictate the need to move the water system improvements projects forward. Management expects to present a plan to the WMU Commission by the end of calendar year 2012. The plan will allow WMU to secure engineering services for design of the water system improvements beginning in calendar year 2013. Funds to pay for the engineering services were acquired in the 2011 Bond issue.

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. During this time the WMU Commission authorized a comprehensive solid waste study of the solid waste operations for WMU on May 31, 2012 as mentioned above. The final report will outline the findings of the study and establish direction for WMU moving forward regarding implementation of additional phases.

- **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.

As part of the Solid Waste Study initiated in May 2012 a cost and rate analysis will be conducted of WMU's current cost of service rates as well as expanded service rates. It is anticipated that with completion of this analysis there will be some change in WMU's current level of service. Any changes will impact future budgets.

- **Work Force**

Key issues that continue to face WMU 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 83 budgeted staff positions of which 73 are filled. The average age for WMU employees is 38 years. The number of eligible retirements at WMU over the next five years, due to age, years of service or both, is 3 or 5% of the workforce. Since 2002, there have been 29 retirements which equates to a loss of 35% 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 burden of losing 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 for both water and wastewater, staffing of those facilities will be of concern. In an effort to screen and find quality employees, WMU has acquired the help of a local temporary staffing service agency.

WMU's attractiveness as an employer continues to be 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 \$2,369,300 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, especially with large water system improvements looming on the horizon. 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 164.5 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 2.74 miles of waterline per year. At \$60 per foot for replacement of a waterline this calculates

to an annual allocation of \$868,032. WMU allocates \$200,000. Likewise, if WMU owns and maintains 153.8 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 2.56 miles of sewer line per year. At \$70 per foot for replacement of a sewer line, the annual allocation calculates to be \$940,800. WMU allocates \$200,000. Without adequate funding for infrastructure renewal WMU is susceptible to interruption of service to its customers and a reduced level of service provided to its customers.

- **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. Management

continues to explore opportunities to reduce vulnerabilities of the utility through upgrades to its systems.

- **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 other policies 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 during the development process 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 | 37,221 feet |
| • Sanitary Sewer Replacements | 43,160 feet |
| • Fire Hydrant Replacements | 67 |
| • Gate Valve Replacements | 169 |
| • Manhole Replacements | 194 |
| • Elevated Storage Tank Rehabilitations | 4 |

UTILITY HIGHLIGHTS: FINANCIAL

WMU, an enterprise fund of the City of Winchester, accounts for operations that are financed and operated in a manner similar to private business enterprises.

The Statement of Net Assets presents information on all of WMU's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of WMU is improving or deteriorating.

The Statement of Revenue, Expenses and Change in Net Assets presents information showing how WMU's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 25 to 43.

In addition to the financial statements and accompanying notes, this report also presents certain supplemental information following the notes: Department Expenses and Revenue Bond Debt Service on pages 44 through 46.

Total Assets increased from \$101,536,849, June 30, 2011, to \$123,898,334 June 30, 2012, a net increase of \$22,361,485 or 22.02%. The construction of the Lower Howards Creek wastewater plant, outfall sewer and force main is the main contributing factor to the increase of total assets. The Forest Park sanitary sewer improvement project was also constructed in this fiscal year. Both of these are consent decree required projects. The site work for the new planned water treatment plant was ongoing in coordination with the new wastewater treatment plant. The donated capital of ownership and perpetual maintenance of system water and sewer lines and related appurtenances by developers also increased.

Operating Revenues increased from \$11,983,445, June 30, 2011, to \$13,995,169, June 30, 2012, a net increase of \$2,011,724 or 16.79%. 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 \$10,841,985, June 30, 2011, to \$11,620,270, June 30, 2012, a net increase of \$778,285 or 7.18%. The increase is due to salaries and related benefit costs as well as increased property insurance, professional fees and chemical costs. Many open positions existing during the fiscal year 2011 were filled during the fiscal year 2012. The ongoing

replacement of older equipment and new construction resulted in increased insurance costs. The ongoing CMOM related responsibilities resulted in increased professional fee expenses. The utility experienced an increase in chemical cost due to the demand at the treatment plants and weather conditions.

Net Income to Retained Earnings changed from \$761,032, June 30, 2011, to \$1,581,245, June 30, 2012, a net change of \$820,213 or 107.78%. 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

| | 2012 | 2011 | Difference | Percent |
|-------------------------|---------------|---------------|--------------|---------|
| Current Assets | \$14,171,250 | \$12,391,960 | \$1,779,290 | 14.36 |
| Non-Current Assets | \$11,018,892 | \$11,960,095 | \$-941,203 | -7.87 |
| Property, Plant & Equip | \$98,539,839 | \$77,044,491 | \$21,495,348 | 27.90 |
| Other Assets | \$168,353 | \$140,303 | \$28,050 | 19.99 |
| Total Assets | \$123,898,334 | \$101,536,849 | \$22,361,485 | 22.02 |

Condensed Statement of Net Assets – Liabilities and Net Assets

| | 2012 | 2011 | Difference | Percent |
|---|---------------|---------------|--------------|---------|
| Current Liabilities | \$3,831,542 | \$3,038,880 | \$792,662 | 26.08 |
| Noncurrent Liabilities including LTD | \$59,168,947 | \$40,512,290 | \$18,656,657 | 46.05 |
| Net Assets: | | | | |
| Invested in Capital Assets, Net of Related Debt | \$37,457,686 | \$34,841,538 | \$2,616,148 | 7.51 |
| Restricted Net Assets | \$10,832,320 | \$17,186,249 | \$-6,353,929 | -36.97 |
| Unrestricted Net Assets | \$12,607,839 | \$5,957,892 | \$6,649,947 | 111.62 |
| Total Liabilities & Net Assets | \$123,898,334 | \$101,536,849 | \$22,361,485 | 22.02 |

- **Statement of Revenues, Expenses and Changes in Net Assets**

Condensed Statement of Revenues, Expenses and Changes in Net Assets

| | 2012 | 2011 | Difference | Percent |
|---|--------------|--------------|-------------|---------|
| Operating Revenues | | | | |
| Water | \$4,843,271 | \$4,233,483 | \$609,788 | 14.40 |
| Wastewater | \$6,226,897 | \$5,196,310 | \$1,030,587 | 19.83 |
| Solid waste | \$2,925,001 | \$2,553,652 | \$371,349 | 14.54 |
| Other Income | \$0 | \$0 | \$ | |
| Total Operating Revenues | \$13,995,169 | \$11,983,445 | \$2,011,724 | 16.79 |
| Operating Expenses including Depreciation | \$11,620,270 | 10,841,985 | \$778,285 | 7.18 |
| Operating Income | \$2,374,899 | \$1,141,460 | \$1,233,439 | 108.06 |

| | | | | |
|----------------------------------|---------------|--------------|-------------|--------|
| Non-Operating Income | \$392,847 | \$369,477 | \$23,370 | 6.33 |
| Interest/Amortization Expense | \$(1,186,501) | \$(749,905) | \$(436,596) | 58.22 |
| Net Income to Retained Earnings | \$1,581,245 | \$761,032 | \$820,213 | 107.78 |
| Capital Grants and Contributions | \$1,330,921 | \$1,183,234 | \$147,687 | 12.48 |
| Changes in Net Assets | \$2,912,166 | \$1,944,266 | \$967,900 | 49.78 |
| Net Assets, Beginning of Year | \$57,985,679 | \$56,041,413 | \$1,944,266 | 3.47 |
| Net Assets, End of Year | \$60,897,845 | \$57,985,679 | \$2,912,166 | 5.02 |

- **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 \$12,759,500. Of these planned expenditures, \$11,846,500 will be invested in infrastructure renewal and administrative support with the remaining \$913,000 allocated for one-time, and intermittent investments. Additionally \$275,000 is reserved for emergency and / or unexpected expenditures.

- **Debt Administration**

As of July 1, 2012, WMU maintained the following debt:

- Series 2011 Bonds \$8,676,667
- Series 2012 Bonds \$7,400,000
- KIA loan Strodes Creek \$17,817,272
- KIA loan Vaught \$263,529
- KIA loan Tank \$319,231
- KIA LHC (loan of 36.6 mil) \$27,471,733 drawn

The Debt Service coverage factor for Bonds of 4.45 in FY 2011/2012 is favorable to the required 1.2 coverage limit. The Debt Service coverage factor for KIA debt of 2.24 in FY 2011/2012 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 2002 Bonds were refinanced with the Series 2012 Bonds to take advantage of the lower interest rates. The balance of the existing debt will retire in 2029 thru 2032.

- **FY 2012/2013 Budget Assumptions**

Total combined revenues for FY 2012/2013 are projected to increase from FY 2011/2012 actual revenues by 13.37%. No annual adjustment to rates based upon the CPI index is expected this year, however, a rate increase is budgeted in January 2013 based upon the approved rate ordinance passed by the City in 2010. Operating expenses excluding depreciation for FY 2012/2013 are projected to increase over budgeted FY 2011/2012 operating expenses by approximately 6.00%. Operating expenses will be impacted by increased power,

employee benefits, chemical, insurance costs and professional fees related to the CMOM requirements & solid waste study.

The debt service coverage ratio is required to be 1.20 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 4.59 for Bond debt and 2.72 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
JUNE 30, 2012 AND 2011**

| ASSETS | <u>2012</u> | <u>2011</u> |
|--|-------------------------------------|-------------------------------------|
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | \$ 5,386,377 | \$ 3,693,753 |
| Cash and Cash Equivalents, Restricted | 404,038 | 557,280 |
| Investments, Restricted | 4,741,588 | 4,843,206 |
| Accrued Interest, Restricted | 19,977 | 27,789 |
| Accounts Receivable, Customers (Net of Allowance for Doubtful Accounts, 2012 and 2011, \$20,361 and \$14,689) | 1,693,797 | 1,394,757 |
| SDC Assessments Receivable | 943,036 | 945,155 |
| Other Accounts Receivable | 50,470 | 15,502 |
| Other Receivable | 0 | 3,474 |
| Materials and Supplies | 315,675 | 306,656 |
| Prepaid Expenses | <u>616,292</u> | <u>604,388</u> |
| Total Current Assets | <u>14,171,250</u> | <u>12,391,960</u> |
| NONCURRENT ASSETS: | | |
| Cash and Cash Equivalents, Restricted | 10,605,127 | 10,513,223 |
| Investments, Restricted | 413,765 | 1,446,872 |
| Property, Plant & Equipment: | | |
| Utility Systems, Net of Depreciation | 64,717,555 | 63,136,883 |
| Land | 1,051,011 | 1,051,011 |
| Construction in Progress | 32,771,273 | 12,856,597 |
| Other Assets: | | |
| Bond Issue Costs | <u>168,353</u> | <u>140,303</u> |
| Total Noncurrent Assets | <u>109,727,084</u> | <u>89,144,889</u> |
| TOTAL ASSETS | <u><u>\$ 123,898,334</u></u> | <u><u>\$ 101,536,849</u></u> |

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF NET ASSETS (CONTINUED)
JUNE 30, 2012 AND 2011**

| LIABILITIES AND NET ASSETS | <u>2012</u> | <u>2011</u> |
|---|------------------------------|------------------------------|
| CURRENT LIABILITIES: | | |
| Accounts Payable | \$ 636,053 | \$ 222,285 |
| Other Accrued Liabilities | 361,080 | 384,855 |
| Compensated Absences | 401,302 | 398,425 |
| Current Portion of Capital Lease Payable | 6,975 | - |
| Payable from Restricted Assets: | | |
| Accounts Payable - Construction | 287,090 | 97,188 |
| Accounts Payable - Retainage | 75,126 | - |
| Customer Deposits | 157,685 | 157,096 |
| Accrued Interest Payable | 90,116 | 88,368 |
| Current Portion of Long-Term Debt | <u>1,816,115</u> | <u>1,690,663</u> |
| Total Current Liabilities | <u>3,831,542</u> | <u>3,038,880</u> |
| NONCURRENT LIABILITIES: | | |
| Noncurrent Portion of Long-Term Debt | 59,161,973 | 40,512,290 |
| Noncurrent Portion of Capital Lease Payable | <u>6,974</u> | <u>-</u> |
| Total Noncurrent Liabilities | <u>59,168,947</u> | <u>40,512,290</u> |
| TOTAL LIABILITIES | <u>63,000,489</u> | <u>43,551,170</u> |
| NET ASSETS: | | |
| Invested in Capital Assets, Net of Related Debt | 37,457,686 | 34,841,538 |
| Restricted for: | | |
| Restricted for Capital Projects (Expendable) | 9,991,337 | 16,280,685 |
| Restricted for Debt Service (Expendable) | 840,983 | 905,564 |
| Unrestricted | <u>12,607,839</u> | <u>5,957,892</u> |
| TOTAL NET ASSETS | <u>60,897,845</u> | <u>57,985,679</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 123,898,334</u> | <u>\$ 101,536,849</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, 2012 AND 2011

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| OPERATING REVENUES: | | |
| Water | \$ 4,843,271 | \$ 4,233,483 |
| Wastewater | 6,226,897 | 5,196,310 |
| Solid Waste | 2,868,726 | 2,500,490 |
| Transfer Station | <u>56,275</u> | <u>53,162</u> |
| | | |
| Total Operating Revenues | <u>13,995,169</u> | <u>11,983,445</u> |
| | | |
| OPERATING EXPENSES: | | |
| Administrative | 1,896,651 | 1,766,620 |
| Solid Waste | 1,676,815 | 1,581,153 |
| Water | 3,061,054 | 2,825,955 |
| Wastewater | 4,848,891 | 4,543,138 |
| Vehicle Maintenance | <u>136,859</u> | <u>125,119</u> |
| | | |
| Total Operating Expenses | <u>11,620,270</u> | <u>10,841,985</u> |
| | | |
| OPERATING INCOME (LOSS) | 2,374,899 | 1,141,460 |
| | | |
| NONOPERATING REVENUES (EXPENSES): | | |
| Interest Income | 223,376 | 183,425 |
| Interest Expense | (1,014,251) | (738,948) |
| Other Income | 202,791 | 169,773 |
| Investment Income | (72,484) | (11,705) |
| Gain on Sale of Capital Assets | 39,164 | 27,984 |
| Amortization Expense of Bond Issue costs & Bond Discount | (172,250) | (10,957) |
| Federal and State Grants | <u>1,124,188</u> | <u>860,771</u> |
| | | |
| Total Nonoperating Revenues (Expenses) | <u>330,534</u> | <u>480,343</u> |
| | | |
| NET INCOME (LOSS) BEFORE CONTRIBUTIONS | 2,705,433 | 1,621,803 |
| | | |
| CAPITAL CONTRIBUTIONS | <u>206,733</u> | <u>322,463</u> |
| | | |
| CHANGE IN NET ASSETS | <u>2,912,166</u> | <u>1,944,266</u> |
| | | |
| NET ASSETS, BEGINNING OF YEAR | <u>57,985,679</u> | <u>56,041,413</u> |
| | | |
| NET ASSETS, END OF YEAR | <u>\$ 60,897,845</u> | <u>\$ 57,985,679</u> |

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

| | 2012 | 2011 |
|--|----------------------|----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Receipts from Customers | \$ 13,698,837 | \$ 11,859,457 |
| Payments to Suppliers | (5,017,062) | (5,475,479) |
| Payments to Employees | (2,498,862) | (2,331,302) |
| Other Operating Receipts (Payments) | (31,493) | 336,235 |
| Net Cash Provided (Used) by Operating Activities | 6,151,420 | 4,388,911 |
| CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES: | | |
| Proceeds from Sale of Equipment | 49,858 | 29,011 |
| Proceeds from Long-Term Debt | 27,823,103 | 15,967,881 |
| Bond Issue Costs/Discount on Long-Term Debt | (146,835) | - |
| Principal Payments | (9,087,484) | (6,246,664) |
| Interest Payments | (1,292,551) | (798,232) |
| Purchase of Property, Plant and Equipment | (24,639,267) | (8,316,590) |
| Proceeds from Federal and State Grants - Capital items | 1,124,188 | 999,801 |
| Contributed Capital Received | 149,890 | 85,720 |
| Cash from Other Income | 202,791 | 169,773 |
| Net Cash Provided (Used) by Capital and Related Financing Activities | (5,816,307) | 1,890,700 |
| CASH PROVIDED (USED) BY INVESTING ACTIVITIES: | | |
| Proceeds from Sales and Maturities of Investments | 3,329,581 | 4,221,243 |
| Purchase of Investments | (2,174,995) | (8,764,709) |
| Cash from Interest in Investments | 141,587 | 183,425 |
| Net Cash Provided (Used) by Investing Activities | 1,296,173 | (4,360,041) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 1,631,286 | 1,919,570 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 14,764,256 | 12,844,686 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | \$ 16,395,542 | \$ 14,764,256 |
| Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets: | | |
| Cash and Cash Equivalents - unrestricted | \$ 5,386,377 | \$ 3,693,753 |
| Cash and Cash Equivalents - restricted current | 404,038 | 557,280 |
| Cash and Cash Equivalents - restricted noncurrent | 10,605,127 | 10,513,223 |
| Cash and Cash Equivalents, End of Year | \$ 16,395,542 | \$ 14,764,256 |

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES: | | |
| Operating Income (Loss) | \$ 2,374,899 | \$ 1,141,460 |
| Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities: | | |
| Depreciation/Amortization | 3,467,372 | 3,285,394 |
| (Increase) Decrease in Current Assets: | | |
| Accounts Receivable, Customers | (299,040) | (120,081) |
| SDC Receivables | 2,119 | 2,854 |
| Other Accounts Receivable | (34,968) | 31,918 |
| Other Receivable | 3,474 | 306,241 |
| Material and Supplies | (9,019) | 17,422 |
| Prepaid Expenses | (11,904) | (69,181) |
| Increase (Decrease) in Current Liabilities: | | |
| Accounts Payable | 413,768 | (26,874) |
| Accounts Payable - Construction | 189,902 | (128,852) |
| Accounts Payable - Retainage | 75,126 | (114,495) |
| Accrued Liabilities | (23,775) | (1,117) |
| Accrued Vacation | 2,877 | 70,974 |
| Customer Deposits | 589 | (6,752) |
| Net Cash Provided (Used) by Operating Activities | <u>\$ 6,151,420</u> | <u>\$ 4,388,911</u> |
| NONCASH TRANSACTIONS AFFECTING FINANCIAL POSITION | | |
| Capital assets were acquired through Contributions from Developers | \$ 56,843 | \$ 236,473 |
| | <u>\$ 56,843</u> | <u>\$ 236,473</u> |

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

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. Revenues are recognized when earned and expenses are recognized when incurred.

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

All investments are stated at fair value. Investment fair values are based on quoted market prices. All 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. As of June 30, 2012 and 2011, \$53,973 and \$60,390 were written off as uncollectible, respectively.

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.

Materials and Supplies

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Prepaid Expenses

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

Restricted Assets

The use of certain assets of enterprise funds is restricted by specific provisions of bond resolutions and agreements with various parties. Assets so designated are identified as restricted assets on the statement of net assets. 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. Restricted assets are classified as noncurrent if they are for acquisition or construction of capital assets, for liquidation of long-term debt, or are for other current operations.

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.

Bond Amortization Costs

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, 2012 and 2011 was \$59,709 and \$2,630, respectively. Amortization expense for bond discount as of June 30, 2012 and 2011 was \$112,536 and \$8,327, respectively.

Interest

Interest is charged to expense as incurred except, WMU follows the policy of capitalizing interest as a component of construction in progress. For the years ended June 30, 2012 and 2011, total interest incurred was \$1,294,299 and \$870,092, respectively, of which \$280,048 and \$131,144 was capitalized and \$1,014,251 and \$738,948 was expensed, respectively.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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”.

Operating and Nonoperating 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.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 \$64,782 and \$70,555 for the years ended 2012 and 2011, respectively. CCGIS had accounts payables to WMU of \$18,892 and \$0 for they years ended 2012 and 2011, respectively, for reimbursements of payroll and other expenses. CCGIS had accounts receivable from WMU of \$8,105 and \$9,282 for they years ended 2012 and 2011, 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

WMU's investment policy conforms to state statutes. WMU deposits its funds in banks insured by FDIC. Investments include short term cash securities and United States backed securities. Collateral is required for all deposits in excess of FDIC at 100% of the carrying amount at the bank. Collateral consists of obligations of the United States and Kentucky municipal bonds.

Interest rate Risk

This is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. WMU does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. Information about the exposure of WMU's deposits and investments to this risk, using the segmented time distribution model is as follows:

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)

| 06/30/12 | | Maturities (in Years) | | | | |
|----------------------------|----------------------|-----------------------|-------------------|-------------|-------------|-------------|
| Type | Fair Value | < Than 1 | 1 - 5 | 6 - 10 | > Than 10 | |
| Cash and Cash Equivalents | \$ 16,395,542 | \$ 16,395,542 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| U.S. Treasury Obligations | 3,761,653 | 3,761,653 | 0 | 0 | 0 | 0 |
| Federal Home Loan Mtg Corp | 492,688 | 299,528 | 193,160 | 0 | 0 | 0 |
| Federal National Mtg Assn | 680,407 | 680,407 | 0 | 0 | 0 | 0 |
| Federal Home Loan Bank | 220,605 | 0 | 220,605 | 0 | 0 | 0 |
| Total | <u>\$ 21,550,895</u> | <u>\$ 21,137,130</u> | <u>\$ 413,765</u> | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 0</u> |

| 06/30/11 | | Maturities (in Years) | | | | |
|----------------------------|----------------------|-----------------------|---------------------|-------------|-------------|-------------|
| Type | Fair Value | < Than 1 | 1 - 5 | 6 - 10 | > Than 10 | |
| Cash and Cash Equivalents | \$ 14,764,256 | \$ 14,764,256 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| U.S. Treasury Obligations | 4,626,136 | 4,626,136 | 0 | 0 | 0 | 0 |
| Federal Home Loan Mtg Corp | 620,405 | 108,149 | 512,256 | 0 | 0 | 0 |
| Federal National Mtg Assn | 815,649 | 108,921 | 706,728 | 0 | 0 | 0 |
| Federal Home Loan Bank | 227,888 | 0 | 227,888 | 0 | 0 | 0 |
| Total | <u>\$ 21,054,334</u> | <u>\$ 19,607,462</u> | <u>\$ 1,446,872</u> | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 0</u> |

Credit Risk

This risk is the risk that an issuer of a debt type investment will not fulfill its obligation to the holder of the investment. This is measured by assignment of a rating by a nationally recognized rating organization. U.S. Government securities or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk exposure. WMU has no formal policy on managing credit risk; however, 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. Presented below is the minimum rating required for each type of deposit and investment:

| 06/30/12 | | Ratings | | | | |
|----------------------------|----------------------|---------------------|-------------|-------------|----------------------|--|
| Type | Fair Value | AAA | AA | A | Unrated | |
| Cash and Cash Equivalents | \$ 16,395,542 | \$ 0 | \$ 0 | \$ 0 | \$ 16,395,542 | |
| U.S. Treasury Obligations | 3,761,653 | 3,761,653 | 0 | 0 | 0 | |
| Federal Home Loan Mtg Corp | 492,688 | 492,688 | 0 | 0 | 0 | |
| Federal National Mtg Assn | 680,407 | 680,407 | 0 | 0 | 0 | |
| Federal Home Loan Bank | 220,605 | 220,605 | 0 | 0 | 0 | |
| Total | <u>\$ 21,550,895</u> | <u>\$ 5,155,353</u> | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 16,395,542</u> | |

| 06/30/11 | | Ratings | | | | |
|----------------------------|----------------------|---------------------|-------------|-------------|----------------------|--|
| Type | Fair Value | AAA | AA | A | Unrated | |
| Cash and Cash Equivalents | \$ 14,764,256 | \$ 0 | \$ 0 | \$ 0 | \$ 14,764,256 | |
| U.S. Treasuries | 4,626,136 | 4,626,136 | 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>\$ 21,054,334</u> | <u>\$ 6,290,078</u> | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 14,764,256</u> | |

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)

Custodial Credit Risk

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 and investments that are in possession of an outside party. WMU has no formal policy for custodial credit risk; however, as of June 30, 2012 and 2011 all deposits and investments were either fully collateralized by federal depository insurance or by the pledging institution in WMU's name or were held in a bank's trust department in the City of Winchester's name, the primary government of the component unit, WMU.

NOTE 3 – CREATION OF ACCOUNTS AND RESTRICTED ASSETS

The Bond Ordinances require the creation of various separate deposit accounts designated for a specific purpose in accordance with the ordinance. A brief description of each required account is as follows:

Revenue Account

All income to WMU is deposited to the Revenue Account and then transferred to the other ordinance accounts as listed below.

Bond Redemption Account

The Bond Redemption Account was established to provide a source of funds for the payment of the bond principal and interest due within the current year. By the 20th day of each month funds equal to the total of one-sixth of the semiannual interest payment plus one-twelfth of the next annual bond principal payment are to be transferred to the account.

Reserve Account

The Reserve Account was established to provide funds for the payment of debt based on the least of three provisions: 1) maximum annual principal and interest, 2) 125% of the average annual principal and interest or 3) 10% of bond proceeds.

Depreciation Account

The Depreciation Account was established to provide funds for extraordinary repairs, improvements and expansion. WMU is required to fund 12% of the annual gross revenues or \$42,000 whichever is greater annually into the account.

Operation and Maintenance Account

The Operation and Maintenance Account was established to pay the reasonable necessary costs of operating, maintaining and repairing of the systems.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 3 – RESTRICTED ASSETS (CONTINUED)

The restricted assets in the accompanying financial statements are restricted as to use by bond ordinance or by external parties at June 30, 2012 and 2011 follows:

| <u>06/30/12</u> | <u>Cash</u> | <u>Investments</u> | <u>Accrued Interest</u> | <u>Total</u> |
|---------------------------------|----------------------|---------------------|-------------------------|----------------------|
| Restricted by Ordinance: | | | | |
| Bond Redemption Account | \$ 309,500 | \$ 0 | \$ 0 | \$ 309,500 |
| Reserve Accounts | 524,392 | 0 | 0 | 524,392 |
| Depreciation Account | 5,358,163 | 0 | 0 | 5,358,163 |
| Subtotal | <u>6,192,055</u> | <u>0</u> | <u>0</u> | <u>6,192,055</u> |
| Other Restricted | | | | |
| Accounts: | | | | |
| SDC Water Fund | 2,559,083 | 0 | 0 | 2,559,083 |
| SDC Wastewater Fund | 1,794,265 | 0 | 0 | 1,794,265 |
| Customer Deposits | 176,845 | 0 | 0 | 176,845 |
| KIA Reserve | 7,091 | 0 | 0 | 7,091 |
| 2011 Bond Funds | 0 | 5,155,353 | 19,860 | 5,175,213 |
| 2008 BAN | 94,537 | 0 | 0 | 94,537 |
| Capital Accum-Water | 147,128 | 0 | 93 | 147,221 |
| Capital Accum-Wastewater | 38,161 | 0 | 24 | 38,185 |
| Total | <u>\$ 11,009,165</u> | <u>\$ 5,155,353</u> | <u>\$ 19,977</u> | <u>\$ 16,184,495</u> |

| <u>06/30/11</u> | <u>Cash</u> | <u>Investments</u> | <u>Accrued Interest</u> | <u>Total</u> |
|---------------------------------|----------------------|---------------------|-------------------------|----------------------|
| Restricted by Ordinance: | | | | |
| Bond Redemption Account | \$ 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> |
| Other Restricted | | | | |
| Accounts: | | | | |
| 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 | 27,265 | 6,317,343 |
| 2008 BAN | 261,564 | 0 | 362 | 261,926 |
| Capital Accum-Water | 510,483 | 0 | 161 | 510,644 |
| Capital Accum-Wastewater | 227,202 | 0 | 0 | 227,202 |
| Total | <u>\$ 11,070,504</u> | <u>\$ 6,290,078</u> | <u>\$ 27,790</u> | <u>\$ 17,388,370</u> |

WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

NOTE 4 – PROPERTY, PLANT AND EQUIPMENT

WMU's property, plant and equipment as of June 30, 2012 and 2011 is as follows:

| <u>06/30/12</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 | 12,856,597 | 26,940,271 | (7,025,595) | 32,771,273 |
| Total Non-depreciable Assets | <u>\$ 13,907,608</u> | <u>\$ 296,940,271</u> | <u>\$ (7,025,595)</u> | <u>\$ 33,822,284</u> |
| Depreciable Assets: | | | | |
| Administrative | \$ 3,030,966 | \$ 72,349 | \$ (19,520) | \$ 3,083,795 |
| Water System | 37,499,778 | 1,931,060 | (37,123) | 39,393,715 |
| Wastewater System | 63,167,584 | 2,546,890 | (24,263) | 65,690,211 |
| Solid Waste | 5,814,764 | 476,552 | (173,405) | 6,117,911 |
| Vehicle Maintenance | 428,994 | 13,708 | (1,722) | 440,980 |
| Equipment Capital Lease | 62,004 | 20,923 | 0 | 82,927 |
| Subtotal | <u>110,004,090,</u> | <u>5,061,482</u> | <u>(256,033)</u> | <u>114,809,539</u> |
| Accumulated Depreciation: | | | | |
| Administrative | (1,199,279) | (173,371) | 18,230 | (1,354,420) |
| Water System | (9,619,472) | (875,516) | 26,696 | (10,468,292) |
| Wastewater System | (15,147,785) | (2,137,591) | 22,542 | (17,262,834) |
| Solid Waste | (1,389,023) | (259,010) | 173,405 | (1,474,628) |
| Vehicle Maintenance | (280,892) | (21,884) | 1,722 | (301,054) |
| Prior Years Accumulated | (19,230,756) | 0 | 0 | (19,230,756) |
| Subtotal | <u>(46,867,207)</u> | <u>(3,467,372)</u> | <u>242,595</u> | <u>(50,091,984)</u> |
| Total Net Property, Plant and Equipment | <u>\$ 63,136,883</u> | <u>\$ 1,594,110</u> | <u>\$ (13,438)</u> | <u>\$ 64,717,555</u> |
| | | | | |
| <u>06/30/11</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 |
| Total Non-depreciable Assets | <u>\$ 11,193,659</u> | <u>\$ 10,534,767</u> | <u>\$ (7,820,818)</u> | <u>\$ 13,907,608</u> |
| Depreciable Assets: | | | | |
| Administrative | \$ 2,814,707 | \$ 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 |
| Subtotal | <u>104,476,220</u> | <u>5,839,115</u> | <u>(311,242)</u> | <u>110,004,090</u> |
| Accumulated Depreciation: | | | | |
| Administrative | (1,107,178) | (126,828) | 34,727 | (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) |
| Subtotal | <u>(43,862,456)</u> | <u>(3,286,133)</u> | <u>281,381</u> | <u>(46,867,207)</u> |
| Total Net Property, Plant and Equipment | <u>\$ 60,613,764</u> | <u>\$ 2,552,982</u> | <u>\$ (29,860)</u> | <u>\$ 63,136,883</u> |

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

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 by function follows:

| <u>Function</u> | | <u>2012</u> | | <u>2011</u> |
|----------------------------|----|------------------|----|------------------|
| Administrative | \$ | 173,371 | \$ | 126,829 |
| Water System | | 875,516 | | 928,755 |
| Wastewater System | | 2,137,591 | | 2,026,173 |
| Solid Waste | | 259,010 | | 184,943 |
| Vehicle Maintenance | | 21,884 | | 19,433 |
| Total Depreciation Expense | \$ | <u>3,467,372</u> | \$ | <u>3,286,133</u> |

NOTE 5 – LONG-TERM DEBT

WMU issues revenue bonds to finance improvements and extensions to the water and sewer systems. The Winchester Municipal Utilities bonded indebtedness and other long-term notes at June 30, 2012 and 2011, are summarized as follows:

| <u>Description</u> | <u>Rate</u> | <u>Maturity</u> | <u>Original Issue</u> | <u>2012 Total</u> | <u>2011 Total</u> |
|------------------------------|-------------|----------------------|-----------------------|-------------------|-------------------|
| 2002 Issue | 4.50-5.13% | 07/01/32 | \$ 9,025,000 | \$ 0 | \$ 7,500,000 |
| 2011 Issue | 5.27% | 01/01/31 | 9,010,000 | 8,676,667 | 8,965,555 |
| 2012 Issue | 2.00-3.75% | 07/01/32 | 7,495,000 | 7,400,000 | 0 |
| Less: Unamortized Discount | | | | (205,266) | (258,729) |
| Total Bonds | | | | <u>15,871,401</u> | <u>16,206,826</u> |
| KIA Loan | 1.00% | 12/01/28 Estimate | 21,000,000 | 17,817,272 | 18,987,705 |
| KIA-Lower Howards Creek | 2.00% | 01/01/31 | 36,600,000 | 26,706,654 | 6,399,475 |
| KIA-Industrial Storage Tanks | 2.00% | 12/01/30 | 340,326 | 319,231 | 333,364 |
| KIA-Vaught Court | 2.00% | 06/01/31 | 287,400 | 263,529 | 275,583 |
| Total KIA Loans | | | | <u>45,106,686</u> | <u>25,996,127</u> |
| Less: Current Maturities | | | | (1,816,115) | (1,690,663) |
| Total | | | | <u>59,161,973</u> | <u>40,512,290</u> |

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 5 - LONG-TERM DEBT (CONTINUED)

The annual bond and long-term debt service requirements, as of June 30, 2012, are as follows:

| <u>Fiscal Year</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|--------------------|----------------------|---------------------|----------------------|
| 2013 | \$ 1,796,928 | \$ 788,013 | \$ 2,584,941 |
| 2014 | 1,630,485 | 760,706 | 2,391,191 |
| 2015 | 1,658,899 | 734,333 | 2,393,233 |
| 2016 | 1,693,283 | 707,387 | 2,400,669 |
| 2017 | 1,719,881 | 679,741 | 2,399,621 |
| 2018-2022 | 9,122,944 | 2,911,673 | 12,034,617 |
| 2023-2027 | 10,222,203 | 1,873,355 | 12,095,558 |
| 2028-2032 | 6,426,810 | 572,562 | 6,999,374 |
| | <u>\$ 34,271,433</u> | <u>\$ 9,027,770</u> | <u>\$ 43,299,204</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.

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. The bonds were paid in full during the 2011-2012 fiscal year by a refunding, Series 2012 Bonds issuance (See Refunding, Series 2012 Bonds below).

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.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

2008 Bond Anticipation Note

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.

Series 2011 Bonds

On April 14, 2011, the City issued \$9,010,000 of utilities revenue bonds for WMU secured by a first and prior security interest in any and all right, title and interest of WMU in the portions of the Project (extensions and improvements of the System) that constitute personal property and in all additions, attachments, accessions, and substitutions thereto, and any proceeds therefrom. 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.

Refunding, Series 2012 Bonds

On April 19, 2012, the City issued \$7,495,000 of utilities refunding revenue bonds for WMU to pay off the Series 2002 Bonds (See Series 2002 Bonds above). The bonds were 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 2.0% to 3.75% and mature on July 1, 2021. The interest payments are to be made on July 1 and January 1 and the principal payments are to be made on July 1.

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
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

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.

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, \$741,450 with a principal forgiveness of \$401,124 and a loan amount of \$340,326. 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, \$401,124 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.

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
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

KIA – Lower Howards Creek

The Kentucky Infrastructure Authority has made these loans 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 Océ 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. On September 30, 2011, the Utility entered into a new capital lease agreement with Océ Financial Services, Inc. for two new copiers in the amount of \$20,923. Payments are for \$648 for 36 months at an interest rate of 7.20%. The assets held under capital leases are included in equipment and total \$20,923 less accumulated amortization of \$2,790 as of June 30, 2012 and \$18,169 less accumulated amortization of \$7,274 as of June 30, 2011.

The following presents future minimum lease payments at June 30, 2012 as follows:

| | | | |
|---|-----------------|-----------------|--------------|
| | <u>06/30/13</u> | <u>06/30/14</u> | <u>Total</u> |
| | \$7,776 | \$7,776 | \$15,552 |
| Less: Interest | | | 1,602 |
| Present value of Minimum Lease Payments | | | \$13,950 |

Amortization of leased equipment under capital leases is included with depreciation expense.

Long-Term Debt consists of bonds and other indebtedness for which the changes in the years ended June 30, 2012 and 2011 are as follows:

| <u>Description</u> | <u>Beginning</u> | <u>Borrowings Additions</u> | <u>Repayments Reductions</u> | <u>2012 Ending</u> | <u>Current</u> |
|----------------------|------------------|---------------------------------|----------------------------------|------------------------|----------------|
| Compensated Absences | \$ 398,425 | \$ 36,715 | \$ 33,838 | \$ 401,302 | \$ 52,399 |
| Bonds | 16,206,826 | 7,435,931 | 7,771,356 | 15,871,401 | 589,980 |
| KIA Loan | 18,987,705 | 0 | 1,170,433 | 17,817,272 | 1,180,235 |
| Capital Lease | 0 | 20,923 | 6,973 | 13,950 | 6,974 |
| KIA-Lower Howards | 6,399,475 | 20,307,179 | 0 | 26,706,654 | 0 |
| KIA-Storage Tank | 333,364 | 0 | 14,133 | 319,231 | 14,417 |
| KIA-Vaught Court | 275,583 | 0 | 12,054 | 263,529 | 12,296 |
| Total Long-Term Debt | \$ 42,601,378 | \$ 27,800,748 | \$ 9,008,787 | \$ 61,393,339 | \$ 1,856,301 |

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

| <u>Description</u> | <u>Beginning</u> | <u>Borrowings Additions</u> | <u>Repayments Reductions</u> | <u>2011 Ending</u> | <u>Current</u> |
|----------------------|----------------------|---------------------------------|----------------------------------|------------------------|---------------------|
| Compensated Absences | \$ 327,451 | \$ 78,961 | \$ (7,987) | \$ 398,425 | \$ 33,838 |
| 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 | 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>1,724,501</u> |

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, 2012 and required a balance of \$507,944. The first factor was applicable for June 30, 2011 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.

Interest Coverage Ratio – Bonds and KIA Loan

As of June 30, 2011, Winchester Municipal Utilities was required to maintain an interest coverage ratio of 1.4 times – annual debt service requirements for bonds and 1.0 times – annual debt service requirements for bonds and KIA loans. On April 3, 2012, a new general bond ordinance was adopted and Winchester Municipal Utilities is now required to maintain an interest coverage ratio of 1.2 times – annual debt service requirements for bonds and 1.0 times – annual debt service requirements for bonds and KIA loans. Other changes in coverage ratio are noted below in calculation of ratios as shown. The City of Winchester is required by bond ordinance to adjust rates as necessary to maintain such minimum coverage. Computed as follows:

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 6 – COMPLIANCE WITH COVENANTS (CONTINUED)

| Bonds: | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Income Available for Debt Service | \$ 2,801,066 | \$ 1,510,937 |
| Add: Depreciation | 3,467,372 | 3,285,394 |
| Subtract: Interest & Principal Payments on Bonds | <u>0</u> | <u>(1,047,607)</u> |
| Cash Available for Bond Debt Service | \$ <u>6,268,438</u> | \$ <u>3,748,724</u> |
| Maximum Debt Service on Bonds | 0 | 596,631 |
| Annual Debt Service on Bonds | <u>1,407,396</u> | <u>0</u> |
| Coverage Ratio | <u>4.45</u> | <u>6.28</u> |
| | | |
| KIA: | <u>2012</u> | <u>2011</u> |
| Income Available for Debt Service | \$ 2,801,066 | \$ 1,510,937 |
| Add: Depreciation | 3,467,372 | 3,285,394 |
| Cash Available for Debt Service | <u>\$ 6,268,438</u> | <u>\$ 4,796,331</u> |
| Annual Debt Service on all Debt | <u>2,803,022</u> | <u>1,753,297</u> |
| Coverage Ratio | <u>2.24</u> | <u>2.74</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, 2012 and 2011.

NOTE 7 – 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 Utility Improvements | \$ 60,600,000 |
| Wastewater Utility Improvements | <u>57,821,000</u> |
| Total projected financing requirement | <u>\$ 118,421,000</u> |

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 7 – FIVE YEAR CAPITAL CONSTRUCTION PLAN (CONTINUED)

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 | 8,000 |
| Replace Microcomputers | 8,000 |
| Engineering Software Upgrades | 2,500 |
| Field Operation Vehicles | 385,000 |
| Solid Waste Collection: | |
| Cubit Replacement | 40,000 |
| Container Replacement | 10,000 |
| Replace Compactor Ejector Box | 10,000 |
| Solid Waste Recycling | 15,000 |
| Water Treatment Plant Equipment Improvements | 150,000 |
| Water System Improvements | 770,000 |
| Water Distribution: | |
| Main Replacement | 200,000 |
| Fire Hydrant Replacement | 10,000 |
| Gate Value Box Adjustment – New Paving | 5,000 |
| Gate Value Replacement | 10,000 |
| Elevated Storage Tank Rehabilitation | 210,000 |
| Meter Change-Out/AMR Equipment | 125,000 |
| New Meter Services | 40,000 |
| Wastewater Collection: | |
| Manhole Grade Adjustment | 200,000 |
| Manhole Grade Adjustment – New Paving | 10,000 |
| I&I Rehabilitation | 25,000 |
| Rehabilitation of Private Sewers | 20,000 |
| Flow Meters | 5,000 |
| Infrastructure Rehabilitation Program | 25,000 |
| System Capacity Assurance Program | 18,000 |
| Continuous Sewer System Assessment Program | 7,000 |
| Routine Hydraulic Cleaning | 60,000 |
| Wastewater Treatment Plant: | |
| Replacement of Laboratory Equipment | 2,000 |
| WWTP Equipment Improvements | 45,000 |
| Solids Processing Improvements | 200,000 |
| Total Annual Allocations for Infrastructure Investment | <u>\$ 2,668,100</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, 2012 AND 2011**

NOTE 8 – 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 2012 and 2011, and the Retirement Systems' Board of Trustees sets the employer contribution rates, currently 18.96% and 16.93% for fiscal year ending 2012 and 2011, 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, 2012, 2011 and 2010, under the current plan amounted to \$505,126, \$432,605 and \$407,933, 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, 2012 and 2011, 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, 2012 AND 2011**

NOTE 8 – 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, 2012 and 2011 were \$47,650 and \$17,427, respectively. WMU does not contribute to these plans.

NOTE 9 – ECONOMIC DEPENDENCY

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

| <u>Name</u> | <u>2012</u> | <u>2011</u> |
|----------------------|---------------------|---------------------|
| Sekisui | \$ 727,684 | \$ 541,362 |
| Alltech | 556,451 | 257,745 |
| The Kroger Company | 492,413 | 452,019 |
| East Clark County WD | 270,307 | 304,656 |
| | <u>\$ 2,046,855</u> | <u>\$ 1,555,782</u> |

NOTE 10 – 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 11 – 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.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

NOTE 11 – LANDFILL POST-CLOSURE COSTS (CONTINUED)

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 12 – UTILITY REVENUES PLEDGED

WMU has pledged future revenues from water, wastewater and solid waste to repay the 2002 and 2012 bonds 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.

NOTE 13 – CONSTRUCTION COMMITMENTS

As of June 30, 2012, WMU had several uncompleted construction contracts. The remaining commitment on these construction contracts was approximately \$10,005,918 financed with KIA loans.

SUPPLEMENTAL INFORMATION

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE 1 - DEPARTMENT EXPENSES
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

| | <u>2012</u> | <u>2011</u> |
|---------------------------|------------------|------------------|
| ADMINISTRATIVE | | |
| Salaries | \$ 844,430 | \$ 828,373 |
| Employee Benefits | 426,289 | 387,202 |
| Repairs and Maintenance | 76,157 | 67,681 |
| Supplies | 34,521 | 32,832 |
| Small Tools | 3,507 | 4,065 |
| Utilities and Telephone | 33,815 | 36,273 |
| Property Insurance | 43,760 | 40,195 |
| Other | 41,300 | 32,728 |
| Postage and Freight | 65,014 | 62,245 |
| Bad Debts | 49,650 | 15,000 |
| Professional Fees | 104,837 | 133,197 |
| Depreciation/Amortization | 173,371 | 126,829 |
| | <u>1,896,651</u> | <u>1,766,620</u> |
| SOLID WASTE | | |
| Salaries | 435,245 | 434,147 |
| Employee Benefits | 291,292 | 281,028 |
| Repairs and Maintenance | 360,826 | 298,498 |
| Supplies | 20,458 | 17,483 |
| Small Tools | 8,125 | 5,733 |
| Utilities and Telephone | 16,518 | 17,650 |
| Property Insurance | 49,105 | 44,896 |
| Other | 24,350 | 32,612 |
| Depreciation | 259,010 | 184,203 |
| Landfill Charges | 211,886 | 264,903 |
| | <u>1,676,815</u> | <u>1,581,153</u> |
| WATER | | |
| Salaries | 564,781 | 573,555 |
| Employee Benefits | 301,960 | 286,165 |
| Repairs and Maintenance | 255,625 | 126,807 |
| Supplies | 488,223 | 364,780 |
| Small Tools | 15,377 | 12,050 |
| Utilities and Telephone | 446,552 | 436,599 |
| Property Insurance | 63,770 | 62,421 |
| Other | 42,135 | 26,182 |
| Postage | 32 | 58 |
| Depreciation/Amortization | 875,516 | 928,755 |
| New Services | 7,083 | 8,583 |
| | <u>3,061,054</u> | <u>2,825,955</u> |
| | \$ | \$ |

WINCHESTER MUNICIPAL UTILITIES
SCHEDULE 1 - DEPARTMENT EXPENSES (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

| | <u>2012</u> | <u>2011</u> |
|-------------------------------------|--------------------------|--------------------------|
| WASTEWATER | | |
| Salaries | \$ 658,704 | \$ 564,150 |
| Employee Benefits | 357,133 | 330,873 |
| Repairs and Maintenance | 342,335 | 243,970 |
| Supplies | 304,546 | 391,406 |
| Small Tools | 22,802 | 13,840 |
| Utilities and Telephone | 681,375 | 718,557 |
| Property Insurance | 89,844 | 73,853 |
| Other | 21,389 | 22,858 |
| Postage | 287 | 665 |
| Professional Fees | 232,885 | 156,450 |
| Depreciation/Amortization | 2,137,591 | 2,026,174 |
| New Services | - | 342 |
| | <u>4,848,891</u> | <u>4,543,138</u> |
| VEHICLE MAINTENANCE | | |
| Salaries | 20,512 | 23,985 |
| Employee Benefits | 56,746 | 39,408 |
| Repairs and Maintenance | 3,131 | 5,642 |
| Supplies | 3,439 | 3,079 |
| Small Tools | 2,552 | 6,414 |
| Utilities and Telephone | 17,121 | 18,523 |
| Property Insurance | 10,144 | 7,261 |
| Other | 1,330 | 1,374 |
| Depreciation/Amortization | 21,884 | 19,433 |
| | <u>136,859</u> | <u>125,119</u> |
| TOTAL OPERATING EXPENSES | <u>\$ 11,620,270</u> | <u>\$ 10,841,985</u> |

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE II - REVENUE BOND DEBT SERVICES
FOR THE YEAR ENDED JUNE 30, 2012**

| Maturity Date | 2012 Issue | | 2011 Issue | | Total | |
|---------------|---------------------|---------------------|---------------------|---------------------|----------------------|---------------------|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2012-2013 | \$ 285,000 | \$ 220,844 | \$ 324,167 | \$ 380,419 | \$ 609,167 | \$ 601,263 |
| 2013-2014 | 290,000 | 215,144 | 334,167 | 370,694 | 624,167 | 585,838 |
| 2014-2015 | 295,000 | 209,344 | 346,250 | 360,669 | 641,250 | 570,013 |
| 2015-2016 | 305,000 | 203,444 | 359,166 | 350,281 | 664,166 | 553,725 |
| 2016-2017 | 310,000 | 197,344 | 369,167 | 339,506 | 679,167 | 536,850 |
| 2017-2018 | 320,000 | 191,144 | 381,250 | 328,431 | 701,250 | 519,575 |
| 2018-2019 | 325,000 | 184,744 | 396,250 | 315,369 | 721,250 | 500,113 |
| 2019-2020 | 330,000 | 174,994 | 411,250 | 299,519 | 741,250 | 474,513 |
| 2020-2021 | 345,000 | 165,094 | 428,333 | 283,069 | 773,333 | 448,163 |
| 2021-2022 | 355,000 | 154,744 | 448,333 | 265,706 | 803,333 | 420,450 |
| 2022-2023 | 365,000 | 144,094 | 468,333 | 246,733 | 833,333 | 390,827 |
| 2023-2024 | 375,000 | 133,144 | 490,417 | 226,994 | 865,417 | 360,138 |
| 2024-2025 | 390,000 | 121,894 | 515,417 | 203,399 | 905,417 | 325,293 |
| 2025-2026 | 400,000 | 109,705 | 540,417 | 178,365 | 940,417 | 288,070 |
| 2026-2027 | 415,000 | 96,705 | 567,500 | 151,344 | 982,500 | 248,049 |
| 2027-2028 | 430,000 | 82,700 | 597,500 | 122,664 | 1,027,500 | 205,364 |
| 2028-2029 | 445,000 | 67,650 | 629,583 | 91,722 | 1,074,583 | 159,372 |
| 2029-2030 | 460,000 | 52,074 | 666,667 | 58,330 | 1,126,667 | 110,404 |
| 2030-2031 | 480,000 | 35,400 | 402,500 | 22,138 | 882,500 | 57,538 |
| 2031-2032 | 480,000 | 18,000 | 0 | 0 | 480,000 | 18,000 |
| | <u>\$ 7,400,000</u> | <u>\$ 2,778,206</u> | <u>\$ 8,676,667</u> | <u>\$ 4,595,352</u> | <u>\$ 16,076,667</u> | <u>\$ 7,373,558</u> |

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012**

| Federal Grantor/Pass Through Grantor/Program Title | Federal CFDA Number | Pass-Through Entity Identifying Number | Federal Expenditures |
|--|------------------------------------|---|-----------------------------------|
| <u>U.S. Environmental Protection Agency</u> | | | |
| Passed through Kentucky Infrastructure Authority: Federal Assisted Wastewater revolving funds | 66.458 | A 10-03 | 3,227,241 |
| Passed through City of Winchester: Community Development Block Grants/State's program and Non-Entitlement Grants | 14.228 | 09-066 | 555,714 |
| Total Federal Awards | | | \$ <u><u>3,782,955</u></u> |

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

MEMBERS:

AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

KENTUCKY SOCIETY
OF CERTIFIED PUBLIC ACCOUNTANTS

PRIVATE COMPANIES
PRACTICE SECTION OF THE AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

STUART K. MCCRARY, JR., CPA
THOMAS S. SPARKS, CPA
JAMES R. WHITTEN, CPA

SUSAN A. LACY, CPA
DEBORAH L. MAYNARD, CPA
RYAN R. LASKI, CPA

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, 2012 and have issued our report thereon dated November 15, 2012. 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 previously.

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*.

We noted certain matters that we reported to management of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, in a separate letter dated November 15, 2012.

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 15, 2012

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

MEMBERS:

AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

KENTUCKY SOCIETY
OF CERTIFIED PUBLIC ACCOUNTANTS

PRIVATE COMPANIES
PRACTICE SECTION OF THE AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

STUART K. McCRARY, JR., CPA
THOMAS S. SPARKS, CPA
JAMES R. WHITTEN, CPA

SUSAN A. LACY, CPA
DEBORAH L. MAYNARD, CPA
RYAN R. LASKI, CPA

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, 2012. 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, 2012.

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 15, 2012

WINCHESTER MUNICIPAL UTILITIES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2012

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 Community Development Block Grants/State's program and Non-Entitlement Grants – CFDA #14.228.
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