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**CITY OF MIDDLESBOROUGH, KENTUCKY
REPORT ON AUDIT OF FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
For the Year Ended June 30, 2011**

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Independent Auditor's Report

To the Mayor and City Council
City of Middlesborough, Kentucky

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Middlesborough, Kentucky, as of and for the year ended June 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Middlesborough, Kentucky's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note I, as of March 1, 2010, the City's sewer and sanitation services are billed by the local water utility. The City has not implemented a methodology to determine the collectability of receivables identified by the local utility and the City has not developed a review process to ascertain all sewer and sanitation services provided are billed. Accounting principles generally accepted in the United States of America require the City to record sewer and sanitation revenues for all services provided, net of an adequate provision for uncollectible receivables. The implementation of these processes could change revenues, assets, and net assets reported in the sewer and sanitation funds. The amounts by which these departures will affect the reported revenues, assets and net assets of the sewer and sanitation funds are not reasonably determined.

In our opinion, except for the effects of not providing a process to ascertain all revenues are billed and not providing an adequate allowance for uncollectible receivables in the sewer and sanitation funds, the financial statements referred to above present fairly, in all material respects, the respective financial position of the sewer and sanitation funds of the City of Middlesborough, Kentucky as of June 30, 2011, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the general fund, the ambulance fund, and the aggregate remaining fund information of the City of Middlesborough, Kentucky as of June 30, 2011, and the respective changes in financial position, and where applicable, cash flows thereof for the year 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 June 30, 2012, on our consideration of the City of Middlesborough, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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, not to provide an opinion on the 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.

Management has omitted the management's discussion and analysis preceding the audited financial statements that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Accounting principles generally accepted in the United States of America require that the budgetary comparison information on page 31 and 32 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.



Raven, Kentucky
June 30, 2012

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF NET ASSETS
June 30, 2011

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
<u>ASSETS</u>			
Current assets:			
Cash.....	\$ 673,351	\$ 1,090,246	\$ 1,763,597
Grants receivable.....	130,000	-	130,000
Receivables, net.....	-	892,272	892,272
Other receivables.....	8,648	-	8,648
Inventories.....	-	5,798	5,798
Total current assets.....	<u>811,999</u>	<u>1,988,316</u>	<u>2,800,315</u>
Noncurrent assets:			
Bond issue and deferred bond costs.....	36,856	-	36,856
Land.....	1,599,747	345,173	1,944,920
Property and equipment, net of accumulated depreciation.....	<u>6,639,834</u>	<u>6,950,745</u>	<u>13,590,579</u>
Total noncurrent assets.....	<u>8,276,437</u>	<u>7,295,918</u>	<u>15,572,355</u>
Total assets.....	<u>9,088,436</u>	<u>9,284,234</u>	<u>18,372,670</u>
<u>LIABILITIES</u>			
Current liabilities:			
Accounts payable.....	52,209	40,500	92,709
Accrued payroll liabilities.....	79,296	5,973	85,269
Due to other governments.....	10,856	-	10,856
Compensated absences.....	215,024	22,997	238,021
Interest and principal due on bonds.....	<u>92,335</u>	<u>-</u>	<u>92,335</u>
Total current liabilities.....	<u>449,720</u>	<u>69,470</u>	<u>519,190</u>
Noncurrent liabilities:			
General obligation bonds payable.....	437,000	-	437,000
Compensated absences.....	<u>148,815</u>	<u>22,061</u>	<u>170,876</u>
Total noncurrent liabilities.....	<u>585,815</u>	<u>22,061</u>	<u>607,876</u>
Total liabilities.....	<u>1,035,535</u>	<u>91,531</u>	<u>1,127,066</u>
<u>NET ASSETS</u>			
Invested in capital, net of related debt.....	8,222,185	7,295,918	15,518,103
Restricted for:			
Capital asset repairs.....	38,760	37,728	76,488
Other special revenue.....	420,341	111	420,452
Unrestricted.....	<u>(628,385)</u>	<u>1,858,946</u>	<u>1,230,561</u>
Total net assets.....	<u>\$ 8,052,901</u>	<u>\$ 9,192,703</u>	<u>\$ 17,245,604</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF ACTIVITIES
Year Ended June 30, 2011

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE) REVENUE AND CHANGES IN NET ASSETS		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business- type Activities	Total
Governmental activities:							
General administration.....	\$ 1,117,701	\$ 26,567	\$ -	\$ 40,880	\$ (1,050,254)	\$ -	\$ (1,050,254)
Public protection - police.....	1,825,582	56,095	228,942	35,239	(1,505,306)	-	(1,505,306)
Public protection - fire.....	1,754,496	-	98,412	13,109	(1,642,975)	-	(1,642,975)
Public street service.....	882,953	24,111	207,035	-	(651,807)	-	(651,807)
Community development.....	136,143	10,614	5,278	-	(120,251)	-	(120,251)
Total governmental activities.....	5,716,875	117,387	539,667	89,228	(4,970,593)	-	(4,970,593)
Business-type activities:							
Ambulance.....	170,038	813,039	-	-	-	643,001	643,001
Sanitation.....	374,465	387,900	-	-	-	13,435	13,435
Sewer.....	1,281,422	1,240,342	-	36,182	-	(4,898)	(4,898)
Total business-type activities.....	1,825,925	2,441,281	-	36,182	-	651,538	651,538
Total all activities.....	\$ 7,542,800	\$ 2,558,668	\$ 539,667	\$ 125,410	\$ (4,970,593)	\$ 651,538	\$ (4,319,055)

GENERAL REVENUES		
Taxes:		
Property taxes levied for general purposes.....	351,962	351,962
Occupational and privilege license tax.....	2,920,361	2,920,361
Tax levied on insurance premiums.....	300,367	300,367
Payments in lieu of taxes.....	67,377	67,377
Franchise fees - electric.....	289,100	289,100
Franchise fees - cable.....	55,768	55,768
	<u>3,984,935</u>	<u>3,984,935</u>
Interest earnings.....	697	10,789
Special item - interest paid on pension obligation bond.....	(27,247)	(27,247)
Special item - gain (loss) on disposition of capital asset.....	(22,126)	(22,126)
Transfers.....	1,093,905	-
Total general revenues, special items and transfe	5,030,164	3,946,351
Change in net assets.....	59,571	(372,704)
Net assets, beginning of year as adjusted.....	7,993,330	17,618,308
Net assets, ending.....	\$ 8,052,901	\$ 17,245,604

See accompanying notes to financial statements

CITY OF MIDDLESBOROUGH, KENTUCKY
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2011

	<u>General Fund</u>	<u>Non-major Governmental Funds</u>	<u>Totals</u>
<u>ASSETS</u>			
Cash.....	\$ 242,154	\$ 431,197	\$ 673,351
Grants receivable.....	130,000	-	130,000
Other receivables.....	8,648	-	8,648
Total assets.....	<u>\$ 380,802</u>	<u>\$ 431,197</u>	<u>\$ 811,999</u>
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable.....	\$ 52,209	\$ -	\$ 52,209
Accrued payroll and taxes.....	79,296	-	79,296
Due to outside agencies.....	-	10,856	10,856
Compensated absences.....	215,024	-	215,024
Total liabilities.....	<u>346,529</u>	<u>10,856</u>	<u>357,385</u>
Fund balances:			
Restricted by grantor or debt covenants.....			
Road maintenance.....		88,317	88,317
Public safety building repairs.....	38,760	-	38,760
Public safety and community development..		98,925	98,925
Economic development.....		233,099	233,099
Unassigned.....	(4,487)	-	(4,487)
Total fund balances.....	<u>34,273</u>	<u>420,341</u>	<u>454,614</u>
Total liabilities and fund balances.....	<u>\$ 380,802</u>	<u>\$ 431,197</u>	<u>\$ 811,999</u>

**CITY OF MIDDLESBOROUGH, KENTUCKY
RECONCILIATION OF BALANCE SHEET TO
THE STATEMENT OF NET ASSETS
GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2011**

Total Fund Balance - Governmental Funds **\$ 454,614**

Capital assets. When capital assets are purchased, the costs of those assets are reported as an expenditure in the fund financial statements. In the government-wide financial statements, the assets are recorded in the statement of net assets and the costs associated with the procurement of the capital assets are depreciated over their estimated useful lives. Likewise, capital assets acquired by the City by other means (donation, etc.) are not recorded in the fund financial statements but are reported as a special item and an increase in assets in the government-wide financials.

Capital assets owned by City	(increase in net assets)	9,274,676
Depreciation allocation	(decrease in net assets)	(1,035,095)

Compensated absences. Vacation and sick leave not currently payable is recorded as a liability in the statement of net assets and an increase of salary costs in the statement of activities. It is not recorded in the funds as it is not a use of current resources.

Non-current compensated absences added to liabilities (decrease in net assets)	(148,815)
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Long-term debt. The principal balance on outstanding debt is not recorded in the fund financial statements because it is not due and payable in the current period. Repayment of principal is recorded as an expenditure of the fund. In the statement of net assets, outstanding debt is recorded as a liability and payment of principal is treated as a reduction of that liability. Bond issue costs, expensed in the funds, are amortized over the life of the bond in the statement of activities. Likewise, interest is accrued between payment dates, while it is recorded as an expense in the funds.

Interest, lease and bond payments due in one year	(decrease in net assets)	(92,335)
Principal balance less amounts due in one year	(decrease in net assets)	(437,000)
Unamortized bond charges included in net assets	(increase in net assets)	36,856

Net Assets - Statement of Net Assets **\$ 8,052,901**

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Year Ended June 30, 2011

	General Fund	Non-major Governmental Funds	Totals
<u>REVENUES</u>			
Property taxes.....	\$ 719,706	\$ -	\$ 719,706
Licenses, permits and fees.....	3,266,704	-	3,266,704
Intergovernmental programs.....	318,507	339,453	657,960
Investment income.....	697	450	1,147
Service charges.....	37,028	-	37,028
Other.....	49,091	-	49,091
Total revenues.....	4,391,733	339,903	4,731,636
<u>EXPENDITURES</u>			
Current:			
General administration.....	2,293,953	-	2,293,953
Public protection - police.....	1,193,089	-	1,193,089
Public protection - fire.....	1,237,465	-	1,237,465
Public street service.....	482,881	180,084	662,965
Community development.....	123,443	-	123,443
Debt service:			
Principal.....	468,000	-	468,000
Interest.....	28,986	-	28,986
Capital outlay.....	73,886	-	73,886
Total expenditures.....	5,901,703	180,084	6,081,787
Excess (deficiency) of revenues over expenditures.....	(1,509,970)	159,819	(1,350,151)
<u>OTHER FINANCING SOURCES (USES)</u>			
Operating transfers in.....	1,269,905	-	1,269,905
Operating transfers out.....	-	(176,000)	(176,000)
Capital grants.....	-	-	-
Interest & principal repayments on			
CDBG and UDAG loans.....	-	9,537	9,537
Total other financing sources.....	1,269,905	(166,463)	1,103,442
Excess(deficiency) of revenues and other sources over expenditures.....	(240,065)	(6,644)	(246,709)
Fund balance, beginning of year	274,338	426,985	701,323
Fund balance, end of year.....	\$ 34,273	\$ 420,341	\$ 454,614

**CITY OF MIDDLESBOROUGH, KENTUCKY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2011**

Net Change in Fund Balance - Governmental Funds **\$ (246,709)**

Capital assets. When capital assets are purchased, the costs of those assets are reported as an expenditure in the fund financial statements. In the government-wide financial statements, the assets are recorded in the statement of net assets and the costs associated with the procurement of the capital assets are depreciated over their estimated useful lives.

Capital outlay removed from expenditures	(increase in net assets)	73,886
Depreciation included in expenses	(decrease in net assets)	(228,075)
Loss on disposition of net assets	(decrease in net assets)	(22,126)

Loans receivable. In past years, the City loaned the proceeds of CDBG and UDAG grants to various businesses. The loans and subsequent repayments of principal and interest are restricted to economic development. As those funds do not represent funds available to finance current City operations, they are recorded in the funds as other financing sources. However, in the statement of net assets, the loans receivable are required to be reported as an asset of the City. Principal payments are recorded as a reduction of the asset, and interest payments are treated as an operating grant to the City's community development function.

Principal repayments removed from other sources	(decrease in net assets)	(9,259)
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Compensated absences. Vacation and sick leave not currently payable is recorded as a liability in the statement of net assets and an increase of salary costs in the statement of activities. It is not recorded in the funds as it is a use of current resources.

Net decrease in non-current compensated absences	(decrease in net assets)	18,905
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Long-term debt. The principal balance on outstanding debt is not recorded in the fund financial statements because it is not due and payable in the current period. Repayment of principal is recorded as an expenditure of the fund. In the statement of net assets, outstanding debt is recorded as a liability and payment of principal is treated as a reduction of that liability. Bond issue costs, expensed in the funds, are amortized over the life of the bond in the statement of activities. Likewise, interest is accrued between payment dates, while it is recorded as an expense in the funds.

Principal repayments removed from expenditures	(increase in net assets)	468,000
Accrued interest removed from expenditures	(increase in net assets)	11,092
Amortized bond costs added to expenditures	(decrease in net assets)	(6,143)

Net Change in Net Assets - Statement of Activities **\$ 59,571**

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2011

	<u>Ambulance Fund</u>	<u>Sanitation Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
<u>ASSETS</u>				
Current assets:				
Cash.....	\$ 559,683	\$ 69,227	\$ 461,336	\$ 1,090,246
Receivables, net.....	384,629	211,837	295,806	892,272
Inventories.....	-	-	5,798	5,798
Total current assets.....	<u>944,312</u>	<u>281,064</u>	<u>762,940</u>	<u>1,988,316</u>
Noncurrent assets:				
Land.....	-	-	345,173	345,173
Property and equipment, net of accumulated depreciation.....	<u>16,388</u>	<u>-</u>	<u>6,934,357</u>	<u>6,950,745</u>
Total noncurrent assets.....	<u>16,388</u>	<u>-</u>	<u>7,279,530</u>	<u>7,295,918</u>
Total assets.....	<u>960,700</u>	<u>281,064</u>	<u>8,042,470</u>	<u>9,284,234</u>
<u>LIABILITIES</u>				
Current liabilities:				
Accounts payable.....	-	31,122	9,378	40,500
Accrued payroll liabilities.....	-	-	5,973	5,973
Compensated absences.....	-	-	22,997	22,997
Total current liabilities.....	<u>-</u>	<u>31,122</u>	<u>38,348</u>	<u>69,470</u>
Noncurrent liabilities:				
Compensated absences.....	-	-	22,061	22,061
Total noncurrent liabilities.....	<u>-</u>	<u>-</u>	<u>22,061</u>	<u>22,061</u>
Total liabilities.....	<u>-</u>	<u>31,122</u>	<u>60,409</u>	<u>91,531</u>
<u>NET ASSETS</u>				
Invested in capital, net of related debt.....	16,388	-	7,279,530	7,295,918
Restricted for:				
Capital asset repairs.....	-	-	37,728	37,728
Other.....	-	-	111	111
Unrestricted.....	<u>944,312</u>	<u>249,942</u>	<u>664,692</u>	<u>1,858,946</u>
Total net assets.....	<u>\$ 960,700</u>	<u>\$ 249,942</u>	<u>\$ 7,982,061</u>	<u>\$ 9,192,703</u>

See accompanying notes to financial statements.

**CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
Year Ended June 30, 2011**

	<u>Ambulance Fund</u>	<u>Sanitation Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
<u>OPERATING REVENUES</u>				
Charges for services.....	\$ 798,087	\$ 387,900	\$ 1,221,020	\$ 2,407,007
Connection fees.....	-	-	1,200	1,200
Miscellaneous income.....	14,952	-	18,122	33,074
Total operating revenues.....	<u>813,039</u>	<u>387,900</u>	<u>1,240,342</u>	<u>2,441,281</u>
<u>OPERATING EXPENSES</u>				
Salaries and benefits.....	9,847	-	454,770	464,617
Contractual services.....	54,291	373,965	35,922	464,178
Utilities.....	-	-	158,922	158,922
Maintenance and repairs.....	14,016	-	85,151	99,167
Other supplies and expenses.....	58,773	-	155,375	214,148
Insurance expense.....	20,000	500	25,000	45,500
Depreciation.....	13,111	-	365,906	379,017
Total operating expenses.....	<u>170,038</u>	<u>374,465</u>	<u>1,281,046</u>	<u>1,825,549</u>
Operating income (loss).....	<u>643,001</u>	<u>13,435</u>	<u>(40,704)</u>	<u>615,732</u>
<u>NON-OPERATING REVENUES (EXPENSES)</u>				
Interest income.....	4,710	2,434	2,948	10,092
Interest expense.....	-	-	(376)	(376)
Total non-operating revenues (expenses).....	<u>4,710</u>	<u>2,434</u>	<u>2,572</u>	<u>9,716</u>
Income (loss) before contributions and transfers...	647,711	15,869	(38,132)	625,448
Capital grants/contributions.....	-	-	36,182	36,182
Transfers in.....	-	-	-	-
Transfers out.....	(535,000)	(331,734)	(227,171)	(1,093,905)
	<u>(535,000)</u>	<u>(331,734)</u>	<u>(190,989)</u>	<u>(1,057,723)</u>
Change in net assets.....	<u>112,711</u>	<u>(315,865)</u>	<u>(229,121)</u>	<u>(432,275)</u>
Net assets, beginning of year	<u>847,989</u>	<u>565,807</u>	<u>8,211,182</u>	<u>9,624,978</u>
Net assets, end of year.....	<u>\$ 960,700</u>	<u>\$ 249,942</u>	<u>\$ 7,982,061</u>	<u>\$ 9,192,703</u>

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
Year Ended June 30, 2011

	<u>Ambulance Fund</u>	<u>Sanitation Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
<u>CASH FLOWS from operating activities:</u>				
Receipts from customers.....	\$ 813,665	\$ 391,255	\$ 1,207,429	\$ 2,412,349
Payments to suppliers.....	(147,080)	(374,465)	(605,687)	(1,127,232)
Payments to employees.....	(9,847)	-	(339,146)	(327,837)
Net cash provided by operating activities.....	<u>656,738</u>	<u>16,790</u>	<u>262,596</u>	<u>936,124</u>
<u>CASH FLOWS from non-capital financing activities:</u>				
Operating transfers to general fund.....	(535,000)	(331,734)	(227,171)	(1,093,905)
Net cash provided by non-capital financing activities..	<u>(535,000)</u>	<u>(331,734)</u>	<u>(227,171)</u>	<u>(1,093,905)</u>
<u>CASH FLOWS from capital and related financing activities:</u>				
Acquisition of capital assets.....	-	-	(62,644)	(62,644)
Proceeds of capital grant.....	-	-	36,182	36,182
Principal and revenue bond maturities.....	-	-	(35,806)	(35,806)
Interest and fees paid on loan and revenue bond maturities....	-	-	(376)	(376)
Net cash (used) by capital and related financing activi	<u>-</u>	<u>-</u>	<u>(62,644)</u>	<u>(98,826)</u>
<u>CASH FLOWS from investing activities:</u>				
Interest income.....	4,710	2,434	2,948	10,092
Net cash provided by investing activities.....	<u>4,710</u>	<u>2,434</u>	<u>2,948</u>	<u>10,092</u>
Net increase (decrease) in cash and cash equivalents...	126,448	(312,510)	(24,271)	(210,333)
Balances, beginning of year.....	433,235	381,737	485,607	1,300,579
Balances, end of year.....	<u>\$ 559,683</u>	<u>\$ 69,227</u>	<u>\$ 461,336</u>	<u>\$ 1,090,246</u>
<u>Reconciliation of operating income (loss) to net cash provided (used) by operating activities:</u>				
Operating income (loss).....	\$ 643,001	\$ 13,435	\$ (40,704)	\$ 615,732
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation.....	13,111	-	365,906	379,017
(Increase) decrease in accounts receivable (net).....	626	3,355	(32,913)	(28,932)
Increase (decrease) in accounts payable.....	-	-	(9,959)	(9,959)
Increase (decrease) in accrued current liabilities.....	-	-	(16,292)	(16,292)
Increase (decrease) in compensated absences.....	-	-	(3,442)	(3,442)
Net cash provided by operating activities.....	<u>\$ 656,738</u>	<u>\$ 16,790</u>	<u>\$ 262,596</u>	<u>\$ 936,124</u>

See accompanying notes to financial statements.

**CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUND
June 30, 2011**

	<u>P&F Pension Fund</u>
<u>ASSETS</u>	
Cash and cash equivalents.....	\$ 2,001,874
Taxes receivable.....	<u>33,657</u>
Total assets.....	<u>2,035,531</u>
 <u>NET ASSETS</u>	
Held in trust for pension benefits.....	<u>\$ 2,035,531</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FIDUCIARY FUND
Year Ended June 30, 2011

	<u>P&F Pension Fund</u>
<u>ADDITIONS</u>	
Employer contributions.....	\$ 207,689
Investment income.....	23,915
	<hr/>
Total additions.....	231,604
	<hr/>
<u>DEDUCTIONS</u>	
Pension benefits paid.....	221,505
Other.....	156
	<hr/>
Total deductions.....	221,661
	<hr/>
Change in net assets.....	9,943
Net assets, beginning of year.....	2,025,588
	<hr/>
Net assets, end of year.....	<u>\$ 2,035,531</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General Statement

The City of Middlesborough, Kentucky operates under a Mayor-Council form of government and provides the following services as authorized by the Commonwealth of Kentucky's 1980 Home Rule Act: public safety (police, fire and ambulance), public works (highways and streets), sanitation, sewage, community development (recreation, parks, preservation) and general administrative services.

The accounting and reporting policies of the City relating to the funds included in the accompanying financial statements conform to the accounting principles generally accepted accounting principles (GAAP). Generally accepted accounting principles for local governments included those principles prescribed by the Government Accounting Standards Board (GASB), the American Institute of Certified Public Accountants in the publication entitled *Audits of State and Local Governmental Units* and by the Financial Accounting Standards Board (when applicable). Pursuant to GASB Statement No. 20, *Accounting for Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Accounting*, the City applies all GASB pronouncements as well as FASB Statements and Interpretations, APB Opinions, and ARBs issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

In 2004, the City implemented the financial reporting requirements of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for States and Local Governments*. GASB 34 requires cities to apply the full accrual accounting method (business approach) to all activities and combine the data into a presentation that records all assets, liabilities, revenues and expenses of the City. Prior to GASB 34, cities reported governmental funds under the modified accrual basis of accounting whereby capital assets owned and long-term debts owed by governmental funds were not reported in the financial statements. GASB 34 emphasizes major funds and specifies the inclusion of a budgetary comparison for governmental funds and an MD&A as required supplementary information. The City customarily presents a Management Discussion and Analysis (MD&A) section that provides an analysis of the City's overall financial position and results of operations; however, for the fiscal year ended June 30, 2011, the City has elected not to present the MD&A.

B. Financial Reporting Entity

The City's basic financial statements include the accounts of all the accounts of the City including any component units. The criteria for including organizations as component units within the City's reporting entity is set forth in Section 2100 of GASB's Codification of Governmental Accounting and Financial Reporting Standards and primarily includes those organizations over which the City exercises significant operational or functional control. The criteria includes whether:

- the organization is legally separate (can sue or be sued in their own name)
- the City holds the corporate powers of organization
- the City appoints a voting majority of the organization's board

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

(Basic financial reporting entity continued)

- the City is able to impose its will on the organization
- the organization has the potential to impose a financial burden on the City
- the organization is fiscally dependent on the City

Based on the criteria listed above, the Middlesborough/Bell County Airport Board, the Municipal Housing Authority, the Library Board, the Tourism Commission, the Bell County Industrial Foundation the Alexander Arthur Museum are not considered component units of the City of Middlesborough because the City's authority generally does not extend beyond making appointments

C. Basis of Presentation

The government-wide financial statements (the statement of net assets and the statement of activities) report information on all the activities of the City. Governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given program or function is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific program and include allocable costs for insurance, employee benefits and depreciation on capital assets clearly utilized by a particular function. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by the program. Program revenues also include operating and capital grants restricted to meeting the operational or capital requirements or a particular program. Taxes and other items not properly allocated to program revenues are reported as general revenues.

Fund Financial Statements/Governmental Funds

The City segregates transactions related to certain functions or activities in separate funds in order to aid financial management and demonstrate legal compliance. Separate statements are presented for governmental and proprietary activities. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

Governmental Funds

Governmental funds are those through which most governmental functions of the City are financed. The measurement focus of governmental funds is on sources, uses and balance of current financial resources. The City uses the following governmental fund types:

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

General Fund

The general fund is the main operating fund of the City. This fund is used to account for all financial resources not accounted for in other funds. All general tax revenues and other receipts that are not restricted by law or contractual agreement to some other fund are accounted for in this fund. Operating expenditures for most of the essential City services such as police and fire protection, community services and general administration are reported in this fund.

Special Revenue Funds

Special revenue funds are used to account for the proceeds of specific revenue sources that are restricted by law to be expended for specific purposes. The City currently maintains three special revenue funds. The municipal road aid fund is funded by taxes collected by the Commonwealth of Kentucky through its highway use tax and is restricted to providing repairs and maintenance to City streets. The local government economic assistance fund is funded through monies received from coal severance taxes and is restricted to public safety, community development and other specified non-administrative funds. The third fund records various prior federal grant escrow accounts with continuing compliance requirements. This fund primarily collects the principle and interest payments for CDBG and UDAG grants received by the City in past years and then loaned to local businesses to stimulate economic development. The use of the funds repaid is restricted to the original purposes of the grants. In addition, the fund includes city and state funds escrowed for a flood control fund controlled by the U.S. Dept. of the Army Corp of Engineers as discussed in Note IX.

Proprietary Funds

Proprietary funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. The accounting objectives are a determination of net income, financial position and changes in cash flow. All assets and liabilities associated with a proprietary fund's activities are included on the statement of net assets. The City utilizes three proprietary funds: sewer, sanitation and ambulance service.

The sewer and sanitation funds report activities which are financed and operated in a manner similar to private business enterprise where the intent of the governing body is that the costs (including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. City employees perform sewer operations. The City has contracted with an outside provider to perform sanitation services. In March 2010, the City and the local water utility agreed to combine utility billing and collection services. The water utility performs billing and collection procedures and, in exchange, city employees accept all walk-in payments at City Hall.

Fees earned from emergency transport finance the ambulance service. The City has contracted with an outside provider to perform the billing function. Employees of the City's fire department provide services. The employment cost associated with this service is recorded and paid by the general fund. No formal determination is made to allocate salaries and benefits to the ambulance fund; however, the City annually budgets and transfers funds from the ambulance fund to offset operational costs in the general fund.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

Fiduciary Funds

Fiduciary funds are used to report assets held in a trustee capacity for others and therefore are not available to support City programs. The reporting focus is on net assets and changes in net assets. These are reported using accounting principles similar to proprietary funds. The City's fiduciary fund is presented in the fiduciary fund financial statements. Since by definition these assets are being held for the benefit of a third party (pension participants) and cannot be used to address activities or obligations of the government, these funds are not incorporated into the government-wide statements.

D. Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to the point at which revenues or expenditures/expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made regardless of the measurement focus.

The government-wide financial statements and the fund statements for the proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. The economic measurement focus means all assets and liabilities (whether current or non-current) are included in the statement of net assets and the operating statements present increases (revenues) and decreases (expenses) in net total assets. Under the accrual basis of accounting, revenues are recognized when earned, including unbilled sewer, sanitation and ambulance services which are reported as receivables. Expenses are recognized at the time the liability is incurred.

The governmental funds financial statements are reported using the current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual: i.e., both measurable and available. "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. The City considers property taxes available if collected within 30 days after year-end. Grants receivable are recorded when the corresponding grant expenditures are recognized. All other revenues are recognized when received. Expenditures are recorded when the related fund liability is incurred. However, debt service expenditures are recorded only when payment is due.

E. Budgetary Control

During June of each year, the City Council prepares the operating budget for the fiscal year beginning July 1 for the general fund and certain special revenue and proprietary funds. Prior to or shortly after June 1, the budget is legally enacted through passage of an ordinance. The budget is adopted on the modified accrual basis in accordance with generally accepted accounting principles. Formal budgetary integration is employed as a management control device; actual revenues and expenses are compared to budget on a monthly basis.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

F. Estimates

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

G. Cash and Investments

Cash of all funds are maintained in interest bearing checking/savings accounts or certificates of deposit.

H. Receivables

"Receivables" in business-type proprietary funds represent revenues earned or accrued for sewer, sanitation or ambulance services provided through June 30, 2011. In the government-wide financial statements, "loans receivable" record amounts outstanding on past government grants awarded to the City for loan to certain local businesses to further economic and community development; details of these agreements are discussed in subsequent notes. In both the fund and government-wide financial statements, "grants receivable" represent amounts due from grantor agencies that are essentially a reimbursement of costs incurred by the City at June 30, 2011.

Generally accepted accounting principles require that receivables are reported net of an allowance for uncollectible accounts. In the ambulance fund, the City considers the following to be uncollectible: 1) all accounts turned over to district court for collection, 2) all private pay accounts over 90 days old, 3) 40% of all claims billed to Medicare, and 4) 90% of all Medicaid claims. As discussed above, the City turned over the billing of sewer and sanitation services to the local water utility on March 1, 2010 and has not reviewed sufficient reliable data to implement a methodology to determine uncollectible accounts.

I. Fund Changes and Transactions between Funds

In the fund financial statements, legally authorized transfers are treated as operating transfers and are included in the results of operations of both governmental and proprietary funds. The transfers from the LGEA and MRA funds are allocated to offset salaries in the police and street departments. Transfers from the ambulance and sewer funds are used to cover administrative costs or to fund general operations.

The City annually budgets insurance costs to both governmental and proprietary funds. Before June 30, the proprietary funds remit the budgeted amount to the general fund. The transaction is recorded as insurance expense in the proprietary funds and an offset of administrative insurance costs in the general fund.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

J. Net Assets and Fund Balance Classifications

Certain resources are set aside in accordance with bond ordinances and other legal, grant, or contractual agreements and are not available to fund routine operations. These are classified as restricted net assets in the statement of net assets and as restricted fund balance in the balance sheet of the governmental funds. The governmental fund financial statements may further designate fund balances as non-spendable, committed or assigned to identify funds that, while not legally restricted, may not be readily available for appropriation. Funds available to fund routine operations are classified as unrestricted in the statement of net assets and unassigned in the governmental fund financial statements.

K. Property, Plant and Equipment

The City reports capital assets, which include property, plant, equipment and infrastructure, net of a provision for depreciation in the government-wide financial statements. The assets are recorded at historical cost or estimated historical cost. Donated fixed assets are recorded at fair market value on the date donated.

The City capitalizes assets over \$5,000; the cost of property, plant and equipment under \$5,000 is reported as an operating expense. Depreciation is calculated on each class of depreciable property using the straight-line method. Estimated useful lives are as follows:

Buildings and Improvements	50 years
Machinery and Equipment	5 years
Infrastructure	25 years

Prior to the implementation of GASB 34 on July 1, 2004, the City reported the net depreciable value of capital assets in the proprietary fund financial statements. Property, plant and equipment purchased by the governmental funds were recorded as a current operating expense. The City maintained an inventory of the assets with a minimum per unit value of \$500 and an estimated useful life of two years. Prior to July 1, 2004, the inventory did not include infrastructure assets such as roads, bridges, curbs and gutters, streets and sidewalks.

GASB 34 did not require the City to estimate the net depreciable value of the non-proprietary capital assets owned by the City prior to July 1, 2004. Accordingly, the government-wide financial statements record property and equipment of the governmental funds as follows: 1) the net depreciable value of capital assets with a per unit cost greater than \$5,000 acquired or placed in service after July 1, 2004 and 2) the historical costs of assets recorded in the City inventory prior to July 1, 2004.

Infrastructure costs associated with the flood control project discussed in Note IX is not included in the City's capital assets.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

L. Compensated Absences

The City's policy allows employees to accumulate a maximum of 288 hours of unused sick leave and 192 hours of vacation leave. Employees are compensated for excess sick leave hours at the regular rate of pay each year in December. All excess vacation hours are lost after December 31.

The estimated current portion of the liability for vacation and sick leave benefits attributed to the general fund is recorded as an expenditure and liability in the general fund. The non-current portion is not recorded in the governmental fund financial statement. However, in the government-wide financial statements and in the fund financial statements of the proprietary funds, the amounts are recorded as current and non-current obligations of the fund.

II. DEPOSITS AND INVESTMENTS

A. Deposit requirements

KRS 66.480 limits the types of instruments and obligations a city may invest in, requires a city to develop a written investment policy and requires all city funds to be federally insured or fully collateralized by securities whose market value equals or exceeds the uninsured fund balances.

The City maintains its funds in interest bearing accounts or certificates of deposits. The City's deposits up to \$250,000 per financial institution are insured by the FDIC. Additional deposits are collateralized by obligations of the United States pledged by the financial institutions in the City's name.

B. Risk disclosures

Custodial credit risk is the risk that in the event of the failure of a bank, the City's deposits may not be returned to it. At June 30, 2011, all of the City's funds, as well as the funds held in trust to pay pension benefits, were adequately insured.

Concentrations of credit risk. All the City's deposits are maintained in one financial institution. Pension trust benefits are held in another financial institution.

III. LOANS RECEIVABLE

In past years, the City has entered into various agreements with developers and local business leaders to loan Community and Urban Development Block Grants to encourage economic growth and enhance the community facilities. The CDBG and UDAG agreements require the City to use the proceeds from interest and principle repayment for further community and economic development as specified in Sec. 5305 Activities eligible for assistance.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

A. Moore Medical Loans

In 1987 and 1988, the City provided CDBG and UDAG funds totaling \$504,381 to assist in the development of a medical complex and senior citizens center. Interest of three percent per year accrued on the loans until repayment began in 1992 and 1996. The City received the annual payment of \$9,537 in interest and principal in the current fiscal year. The loans were paid in full December 2010.

B. Use of CDBG/UDAG Funds

The City remitted \$40,000 in UDAG/CDBG funds to Development Downtown Middlesboro, Inc. (DDM) for assistance in the physical and financial revitalization of the downtown area.

IV. INTERFUND TRANSFERS

Interfund transfers during the year ended June 30, 2011 were as follows:

	<u>Operating Transfers In</u>	<u>Operating Transfers Out</u>
<u>Governmental funds</u>		
General Fund	\$ 1,263,905	\$ -0-
UDAG	-0-	40,000
Municipal Road Aid	-0-	30,000
Coal and Mineral Severance Tax	-0-	100,000
LGEA	-0-	-0-
Total governmental	<u>\$ 1,263,905</u>	<u>\$ 170,000</u>
<u>Business-type activities</u>		
Ambulance	-0-	535,000
Sanitation	-0-	331,734
Sewer	-0-	227,171
Total business-type	<u>-0-</u>	<u>1,093,905</u>
Total transfers	<u>\$ 1,263,905</u>	<u>\$1,263,905</u>

Transfers are primarily used to move funds to the general fund to finance operations in accordance with budgetary authorizations.

V. PROPERTY TAX CALENDAR

Property taxes for fiscal year ended June 30, 2011 were levied September 7, 2010 on the assessed valuation of property located within the City limits as of January 1, 2010, the lien date. The ordinance states the face value of taxes are due January 31, 2011 with a 2% discount if paid by December 31, 2010; an additional 10% penalty and 1% interest per month added as of February 1, 2011.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

VI. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2011, follows:

	Balance 6/30/10	Additions & Adjustments	Retirements & Transfers	Balance 6/30/11
<u>Governmental Activities</u>				
Land	\$1,599,747	\$ -0-	\$ -0-	\$ 1,599,747
Undepreciated assets	<u>1,599,747</u>	<u>-0-</u>	<u>-0-</u>	<u>1,599,747</u>
Infrastructure	90,713	-0-	-0-	90,713
Buildings	4,627,488	33,881	-0-	4,661,369
Equipment	714,272	40,005	22,126	732,151
Vehicles	2,257,427	-0-	66,731	2,190,696
Total depreciable assets	<u>\$7,689,900</u>	<u>\$ 73,886</u>	<u>\$ 88,857</u>	<u>\$7,674,929</u>
Less: Accumulated depreciation	873,751	228,075	\$ 66,731	1,035,095
Net depreciable assets	<u>\$6,816,149</u>			<u>\$6,639,834</u>
<u>Business-type Activities</u>				
Land	\$ 345,173	\$ -0-	\$ -0-	\$ 345,173
Undepreciated assets	<u>345,173</u>	<u>-0-</u>	<u>-0-</u>	<u>345,173</u>
Buildings	101,900	-0-	-0-	101,900
Sewer plant	14,006,037	36,182	-0-	14,042,219
Equipment	1,911,730	26,462	12,400	1,925,792
Vehicles	493,389	-0-	-0-	493,389
Total depreciable assets	<u>16,513,056</u>	<u>62,644</u>	<u>12,400</u>	<u>16,563,300</u>
Less: Accumulated depreciation	9,245,938	379,017	12,400	9,612,555
Net depreciable assets	<u>\$ 7,267,118</u>			<u>\$6,950,745</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

VII. LONG-TERM DEBT

A. Outstanding Debt

Compensated absences

The government-wide statement of net assets and the proprietary fund financial statements record non-current accrued vacation and sick-leave as a long-term liability of the City.

Lease payable

The City acquired street equipment with a fair market value of \$175,410 through two lease-purchase agreements. The dozer and backhoe carry interest rates are 0% and 5.25. Lease balance at June 30, 2011 totals \$17,396 and will be paid in full July 2011.

Bonds payable

At June 30, 2011, revenue bonds payable consisted of the following individual issues:

	<u>Governmental</u>	<u>Proprietary</u>
Middlesborough, Kentucky, Municipal Improvement Corporation Mortgage Revenue Bonds, Series of 1996, payable in annual installments 5%, Final maturity Jan., 2026. <i>Paid Nov. 2010.</i>	\$ -0-	
Kentucky Infrastructure Authority, Fund A, dated December, 1991, payable semi-annually 1.9%, through June, 2014. <i>Paid Nov. 2010.</i>		\$ -0-
Kentucky League of Cities Funding Trust General Obligation Refunding Bonds dated September 1, 2003 payable in annual installments 2.0%-4.5%, <i>Final maturity August 2017</i>	\$ 502,000	
Total bond principal, June 30, 2011 <i>Included in Interest and Principal due on</i> <i>Bonds in the Statement of Net Assets</i>	\$ 502,000	\$ -0-
	65,000	-0-
	<u>\$ 437,000</u>	<u>\$ -0-</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

Revenue Bonds

Municipal Improvement Corporation Mortgage Revenue Bonds, In November 1996, the City issued \$551,000 in mortgage revenue bonds for the purpose of financing the cost of acquisition, construction, and equipping the Police Department/Public Safety Building. The bonds were purchased by the Rural Development / U.S. Department of Agriculture, bear an interest rate of 5%, payable in January and July through the year 2026, and are secured by the lease agreement and a fore-closeable mortgage lien against the City. On November 4, 2010, the City elected to pay the debt in full.

Kentucky Infrastructure Authority. The City entered into an agreement with the Kentucky Infrastructure Authority in December 1991, to borrow \$178,085 at 1.9% interest to provide funding for additional sewer lines. On November 9, 2010, the City elected to pay the loan in full.

General Obligation Bonds/ Debt Refunding

Kentucky League of Cities (KLC) Funding Trust General Obligation Refunding and Taxable Funding Bonds, Series 2003 A and 2003 B. In August, 1988, the City elected to have its employees participate in the Commonwealth of Kentucky's County Employee Retirement System (CERS). In conjunction with this election, the City entered into an agreement with CERS whereby the City would fund the prior service credit of its employees over a thirty-year period at 8% interest. In August 1994, the City issued \$1,115,000 KLC Floating Indebtedness Funding Bonds to refinance the existing debt with CERS.

The re-acquisition price exceeded the net carrying amount of the old debt by \$57,743 and bond issue costs totaled \$28,257. These costs are recorded as a deferred asset in the statement of net assets and are amortized over the life of the bond. Amortization is included in interest as a special item in the statement of activities.

The new refunding bonds were issued at interest rates ranging from 2.0% to 4.5% and mature in August 2017. These bonds are direct obligations issued on a pledge of the general taxing power of the City to repay its debt obligations

Reserves

The bond ordinances require the City establish reserves for future extraordinary repairs and replacement of the Sewer System and Public Safety Building. The reserves are fully funded at June 30, 2011. Both bond issues were paid in full as of June 30, 2011.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

B. Changes in Outstanding Debt

Transactions for the Year ended June 30, 2011 are summarized as follows:

	<u>Balance</u> <u>6/30/10</u>	Issues or Additions	Payments or Expenditures	<u>Balance</u> <u>6/30/11</u>
<u>Governmental Activities</u>				
General obligation bonds	\$ 566,000	\$ -0-	\$ 64,000	\$ 502,000
Revenue bonds	404,000	-0-	404,000	-0-
Lease-purchase	17,396	-0-	-0-	17,396
Compensated absences	167,720	-0-	18,905	148,815
Total	<u>\$1,155,116</u>	<u>\$ -0-</u>	<u>\$ 486,905</u>	<u>\$668,211</u>
<u>Business-type Activities</u>				
Revenue bonds	\$ 35,806	-0-	35,806	\$ -0-
Compensated absences	23,422	-0-	1,361	22,061
Total	<u>\$ 59,228</u>	<u>\$ -0-</u>	<u>\$ 37,167</u>	<u>\$ 22,061</u>
Total all fund types	<u>\$1,214,344</u>	<u>\$ -0-</u>	<u>\$ 524,072</u>	<u>\$ 690,272</u>

C. Annual Requirements to Retire Bond Obligations

<u>Governmental Activities</u>		
<u>Fiscal Year End</u>	<u>Principal</u>	<u>Interest</u>
2012	65,000	19,841
2013	69,000	17,258
2014	67,000	14,505
2015	71,000	11,666
2016	74,000	8,630
2017-2018	156,000	7,174
	<u>\$ 502,000</u>	<u>\$ 79,074</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

VIII. PENSION PLAN

The significant accounting policies adopted by the City in the preparation of the financial statements of the Police and Fireman's Retirement Fund generally conforms to the provisions of the National Council on Governmental Accounting (NCGA) Statement 6.

A. The Police and Fireman's Retirement Fund

The City contributes to a single employer retirement fund for eligible employees of the Police and Fire Department. In August 1988, the City froze admission of new entrants who now join the statewide County Employees Retirement System. Members who had already retired at August 1988 remained in the plan and continue to receive monthly benefits. At June 30, 2011, the fund had nine members or beneficiaries receiving annuities. The pension board may order annual increases in retiree and beneficiary benefits up to the increase in the consumer price index for that year, to a maximum of 5%.

The City annually allocates a portion of property tax collections to the fund. For the year ended June 30, 2011, 39% of all real and personal property taxes collected were remitted to the pension fund. The City elected to suspend allocations of property tax collections to the P&F fund effective July 2011.

B. County Employee's Retirement System

Full-time employees of the City of Middlesborough participate in the statewide County Employee's Retirement System (CERS), a multiple-employer public retirement system. Covered employees are required by statute to contribute 5.0% - 6.0% of their creditable compensation to the plan. Members occupying hazardous positions contribute at a rate of 8% of their creditable compensation. Employer contribution rates are determined by the Board of Trustees of Kentucky Retirement Systems each biennium. The current required rates are (16.93%) and (33.25%) for non-hazardous and hazardous employees, respectively.

The City's payroll for eligible employees for the year ended June 30, 2011 totaled \$3,123,442; payroll for all employees totaled \$3,323,779. The City made required contributions of \$837,402. Employee contributions totaled \$215,377.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess CERS funding status on a going concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and to make comparisons among public employee retirement systems and employers. CERS does not make separate measurements of assets and pension benefit obligations for the individual employer. The pension benefit obligation, net assets available for benefits and historical trend information for the entire system can be found in the Commonwealth of Kentucky's Comprehensive Annual Report for the year ended June 30, 2011.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

IX. COMMITMENTS AND CONTINGENCIES

A. Disaster Recovery

The City received extensive damage due to the flooding of June 19, 2011. In August 2011, the Federal Emergency Management Agency (FEMA) assessed estimated damages of \$588,885 and agreed to provide public assistance grants to reimburse the City a portion of the costs to repair or replace damages associated with twenty-eight FEMA designated projects. Approved FEMA reimbursements total \$418,175. Additionally, the City has filed claims to recover damages to vehicles flooded on June 19th.

In July 2011, the City was approved for a line of credit of \$250,000 with a local financial institution to expedite flood clean-up. The line of credit is due July 21, 2012 and carries an interest rate of 4.35% paid quarterly. The City borrowed \$175,000 of the line of credit.

B. Flood Control Project

In January 1996, the City entered into a cooperative agreement with the Department of the Army Corps of Engineers (Corp) to reduce the threat of flooding in the City. The project essentially consisted of 1) purchasing property adjoining 5.22 miles of Yellow Creek and Little Yellow Creek and widening the channels and 2) flood proofing 17 residential properties and evacuating 2 commercial properties. According to Corp documents, the structural and non-structural phase of the project was completed and released to the City for operation and maintenance in May 2007. Project costs totaled \$34,664,991; with 95% provided by congressionally appropriated federal funds. The Commonwealth of Kentucky provided 95% of the remaining 5%.

\$140,000 in additional funding has been allocated to the development of the associated emergency warning system and a Flood Warning Evacuation Plan required before the project is officially closed. 95% of the funding is provided by the federal government. The final 5% will be paid from interest accrued on escrowed state and local funds.

Project records are maintained by the Corp. and subject to audit by federal authorities. The City does not include the cost of the flood control project in its books and records and has not included it in the government-wide Statement of Net Assets.

C. Lawsuits and Risk Management

The City is exposed to various risk of losses related to theft of, damage to and destruction of its assets, errors and omissions, injuries to employees, and natural disasters. Various claims and lawsuits are pending against the City. The City is adequately insured against such risks. Any potential loss on all claims and lawsuits is not expected to materially affect the City's financial position.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2011

D. Grant Compliance

The City participates in certain federal and state assisted grant programs. These programs are subject to compliance audits by the grantors and their representatives. Any findings of non-compliance that may arise as the result of these audits may require a reimbursement of grant monies to the awarding agency

X. SUBSEQUENT EVENTS

A. Kentucky Labor Cabinet Audit

In December 2011, a Kentucky Labor Cabinet audit determined the City had failed to compensate firefighters for overtime wages due on the state incentive supplement to firefighters. The audit was the result of an August 25, 2011 Supreme Court ruling in another jurisdiction that said cities and counties were not immune from paying retroactive overtime after an overtime calculation was changed by the Kentucky legislature in 2009.

The Kentucky Labor Cabinet audit calculated unpaid overtime from April 2004 through April 2009 and awarded back wages totaling \$196,754 to 27 firefighters. The City financed the repayment of the back wages through a Kentucky Bond Corporation 2012 Series A Revenue Bond. The City will repay \$255,000 in ten annual installments Interest of 2.5% -3.25% is paid semi-annually.

COMBINING FINANCIAL STATEMENTS

NON-MAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Municipal Road Aid Fund

Coal and Mineral Severance Fund

Other Restricted Funds

**CITY OF MIDDLESBOROUGH, KENTUCKY
 COMBINING BALANCE SHEET
 NON-MAJOR GOVERNMENTAL FUNDS
 June 30, 2011**

	<u>Municipal Road Aid</u>	<u>Coal and Mineral Severance</u>	<u>Other Restricted Funds</u>	<u>Total</u>
<u>ASSETS</u>				
Cash.....	\$ 88,317	\$ 98,925	\$ 243,955	\$ 431,197
Grants receivable.....	-	-	-	-
Total assets.....	<u>\$ 88,317</u>	<u>\$ 98,925</u>	<u>\$ 243,955</u>	<u>\$ 431,197</u>
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable.....	\$ -	\$ -	\$ -	\$ -
Due to other governments.....	-	-	10,856	10,856
Total liabilities.....	<u>-</u>	<u>-</u>	<u>10,856</u>	<u>10,856</u>
Fund balances:				
Restricted.....	88,317	98,925	233,099	420,341
Total fund balances.....	<u>88,317</u>	<u>98,925</u>	<u>233,099</u>	<u>420,341</u>
Total liabilities and fund balances.....	<u>\$ 88,317</u>	<u>\$ 98,925</u>	<u>\$ 243,955</u>	<u>\$ 431,197</u>

INDIVIDUAL FUND FINANCIAL STATEMENTS

GOVERNMENTAL ACTIVITIES

General Fund

Includes required budgetary comparisons

**CITY OF MIDDLESBOROUGH, KENTUCKY
 COMBINING STATEMENTS OF REVENUES, EXPENDITURES
 AND CHANGES IN FUND BALANCES
 NON-MAJOR GOVERNMENTAL FUNDS
 Year Ended June 30, 2011**

	Municipal Road Aid	Coal and Mineral Severance	Other Restricted Funds	Total
<u>REVENUES</u>				
Intergovernmental.....	\$ 201,464	\$ 137,989	\$ -	\$ 339,453
Investment income.....	111	93	246	450
Total revenues.....	201,575	138,082	246	339,903
<u>EXPENDITURES</u>				
Current:				
Public protection.....	-	-	-	-
Public works.....	179,644	440	-	180,084
Community development.....	-	-	-	-
Capital outlay.....	-	-	-	-
Total expenditures.....	179,644	440	-	180,084
Excess of revenues over expenditures.....	21,931	137,642	246	159,819
<u>OTHER FINANCING SOURCES (USES)</u>				
Transfers in.....	-	-	-	-
Transfers out.....	(30,000)	(106,000)	(40,000)	(176,000)
Interest & principle repayments on CDBG and UDAG loans.....	-	-	9,537	9,537
Total other sources.....	(30,000)	(106,000)	(30,463)	(166,463)
Excess of revenues over expenditures and sources.....	(8,069)	31,642	(30,217)	(6,644)
Fund balances (deficit) at beginning of year.....	96,386	67,283	263,316	426,985
Fund balances at end of year.....	\$ 88,317	\$ 98,925	\$ 233,099	\$ 420,341

**CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (CASH BASIS)
GENERAL FUND
Year Ended June 30, 2011**

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance Favorable (Unfavorable)</u>
<u>REVENUES</u>				
Property taxes.....	\$ 735,000	\$ 735,000	\$ 719,706	\$ (15,294)
Licenses, permits and fees.....	3,078,500	3,078,500	3,266,704	188,204
Intergovernmental programs.....	254,000	399,000	318,507	(80,493)
Investment income.....	5,000	5,000	697	(4,303)
Service charges.....	40,000	40,000	37,028	(2,972)
Other.....	67,500	67,500	49,091	(18,409)
Total revenues.....	<u>4,180,000</u>	<u>4,325,000</u>	<u>4,391,733</u>	<u>66,733</u>
<u>EXPENDITURES</u>				
General administration.....	2,475,800	2,705,800	2,420,054	285,746
Public protection - police.....	1,406,800	1,771,800	1,637,860	133,940
Public protection - fire.....	1,140,300	1,140,300	1,237,465	(97,165)
Public street service.....	464,000	474,000	482,881	(8,881)
Community development.....	122,500	97,500	123,443	(25,943)
Total expenditures.....	<u>5,609,400</u>	<u>6,189,400</u>	<u>5,901,703</u>	<u>287,697</u>
Excess (deficiency) of revenues over expenditures.....	<u>(1,429,400)</u>	<u>(1,864,400)</u>	<u>(1,509,970)</u>	<u>354,430</u>
<u>OTHER FINANCING SOURCES (USES)</u>				
Operating transfers in.....	795,000	1,270,000	1,269,905	(95)
Operating transfers out.....	-	-	-	-
Total other financing sources.....	<u>795,000</u>	<u>1,270,000</u>	<u>1,269,905</u>	<u>(95)</u>
Excess (deficiency) of revenues and other sources over expenditures.....	(634,400)	(594,400)	(240,065)	354,335
Fund balance, beginning of year.....	<u>650,000</u>	<u>610,000</u>	<u>274,338</u>	<u>(335,662)</u>
Fund balance, end of year.....	<u>\$ 15,600</u>	<u>\$ 15,600</u>	<u>\$ 34,273</u>	<u>\$ 18,673</u>

**CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND
BALANCE - BUDGET AND ACTUAL
GENERAL FUND
For the Year ended June 30, 2011**

I. GENERAL STATEMENT

The budgetary comparison information on the preceding page is not a required part of the basic financial statements but is supplementary information required by the Governmental Standards Accounting Board and is intended to demonstrate the City's compliance in obtaining and using financial resources in accordance with the legally adopted budget.

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF PROGRAM REVENUES BY FUNCTION
GOVERNMENTAL FUNDS
Year Ended June 30, 2011

	<u>General Fund Revenues</u>	<u>Non-Major Governmental Fund Revenues</u>	<u>Adjustments</u>	<u>Activity Revenues</u>
General administration:				
Charges for services				
Permits.....	\$ 1,475	\$ -	\$ -	\$ 1,475
Other.....	25,091	1	-	25,092
Operating grants and contributions				
Local Government Economic Assistance.	40,880			40,880
Total	\$ 67,446	\$ 1	\$ -	\$ 67,447
Public protection - police:				
Charges for services				
Housing Authority security.....	\$ 26,659	\$ -	\$ -	\$ 26,659
Base court revenues, fines, arrest fees.....	29,343	-	-	29,343
Other	-	93	-	93
Operating grants and contributions				
K.I.E.F.P.F. (incentive pay).....	84,293	-	-	84,293
Local Government Economic Assistance.	35,239	137,989	-	173,228
Other.....	6,660	-	-	6,660
Total	\$ 182,194	\$ 138,082	\$ -	\$ 320,276
Public protection - fire:				
Operating grants and contributions				
K.F.P.- 2 (incentive pay).....	\$ 98,412	\$ -	\$ -	\$ 98,412
Local Government Economic Assistance.	13,109	-	-	13,109
Total	\$ 111,521	\$ -	\$ -	\$ 111,521
Public street service:				
Charges for services				
Garbage pick-up.....	\$ 24,000	\$ -	\$ -	\$ 24,000
Other	-	111	-	111
Operating grants and contributions				
Litter Abatement.....	5,571			5,571
Municipal Road Aid.....	-	201,464	-	201,464
Total	\$ 29,571	\$ 201,575	\$ -	\$ 231,146
Community development:				
Charges for services				
Community Center fees.....	\$ 10,369	\$ -	\$ -	\$ 10,369
Other	-	245	-	245
Operating grants and contributions				
Local Government Economic Assistance.	5,000	-	-	5,000
Repayment of CDBG and UDAG loans...	-	9,537	(9,259)	278
Total	\$ 15,369	\$ 9,782	\$ (9,259)	\$ 15,892
Total program revenues by function	\$ 406,101	\$ 349,440	\$ (9,259)	\$ 746,282

Reconciliation.

The revenues recorded by the governmental funds differ from the program revenues recorded in the statement of activities as follows:

Principal repayments. The outstanding balances of loans due the City for CDBG/UDAG grants loaned to local business owners in past years are not included in the fund financial statements as they are not available to pay current City expenditures. Repayments are "other financing source when received. In the government-wide financials, principal payments are treated as a reduction of City receivables.

Principal removed from revenue (decrease in net assets)	(9,259)
	<u>\$ (9,259)</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FUNCTIONAL EXPENSES
GOVERNMENTAL FUNDS
Year Ended June 30, 2011

	<u>General Fund</u> <u>Expenditures</u>	<u>Non-Major</u> <u>Governmental Fund</u> <u>Expenditures</u>	<u>Adjustments</u>	<u>Activity</u> <u>Expenses</u>
General administration:				
Current:				
Salaries.....	\$ 434,112	\$ -	\$ (10,360)	\$ 423,752
Materials and supplies.....	9,012	-		9,012
Other program costs.....	399,265	-		399,265
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	1,134,022	-	(985,087)	148,935
Insurance.....	317,542	-	(241,400)	76,142
Debt service:				
Principal retirement.....	64,000	-	(64,000)	-
Interest expense and bond issue costs.....	22,096	-	(22,096)	-
Capital outlay.....	40,005	-	(40,005)	-
Depreciation.....	-	-	60,595	60,595
Total	\$ 2,420,054	\$ -	\$ (1,302,353)	\$ 1,117,701
Public protection - police:				
Current:				
Salaries.....	\$ 1,030,701	\$ -	\$ (6,287)	\$ 1,024,414
Materials and supplies.....	125,170	-		125,170
Other program costs.....	37,218	-		37,218
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	454,334	454,334
Insurance.....	-	-	107,329	107,329
Debt service:				
Principal retirement.....	404,000	-	(404,000)	-
Interest expense.....	6,890	-	(10,100)	(3,210)
Capital outlay.....	33,881	-	(33,881)	-
Depreciation.....	-	-	80,327	80,327
Total	\$ 1,637,860	\$ -	\$ 187,722	\$ 1,825,582
Public protection - fire:				
Current:				
Salaries.....	\$ 1,134,781	\$ -	\$ 510	\$ 1,135,291
Materials and supplies.....	72,586	-		72,586
Other program costs.....	30,098	-		30,098
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	413,940	413,940
Insurance.....	-	-	87,361	87,361
Debt service:				
Principal retirement.....	-	-		-
Interest expense.....	-	-		-
Capital outlay.....	-	-		-
Depreciation.....	-	-	15,220	15,220
Total	\$ 1,237,465	\$ -	\$ 517,031	\$ 1,754,496

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FUNCTIONAL EXPENSES
GOVERNMENTAL FUNDS
Year Ended June 30, 2011

	<u>General Fund Expenditures</u>	<u>Non-Major Governmental Fund Expenditures</u>	<u>Adjustments</u>	<u>Activity Expenses</u>
Public street service:				
Current:				
Salaries.....	\$ 307,545	\$ -	\$ (2,768)	\$ 304,777
Materials and supplies.....	63,358	179,644		243,002
Other program costs.....	111,978	440		112,418
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	112,964	112,964
Insurance.....	-	-	39,847	39,847
Debt service:				
Principal retirement.....	-	-		-
Interest expense.....	-	-		-
Capital outlay.....	-	-		-
Depreciation.....	-	-	69,945	69,945
Total	\$ 482,881	\$ 180,084	\$ 219,988	\$ 882,953
Community development:				
Current:				
Salaries.....	\$ 50,935	\$ -	\$ -	\$ 50,935
Materials and supplies.....	23,110		-	23,110
Other program costs.....	49,398	-	-	49,398
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	3,849	3,849
Insurance.....	-	-	6,863	6,863
Capital outlay.....	-	-		-
Depreciation.....	-	-	1,988	1,988
Total	\$ 123,443	\$ -	\$ 12,700	\$ 136,143
Total general fund programs.....	\$ 5,901,703	\$ 180,084	\$ (364,912)	\$ 5,716,875

Reconciliation.

The expenditures recorded by the general and non-major governmental funds differ from the functional expenses recorded in the statement of activities as follows:

Indirect costs. Retirement, payroll taxes and insurances are budgeted by the City as a general item and recorded in the funds as expenditures. The statement of activities requires these items to be presented as a cost of the function to which they relate. No effect on total activities.

Compensated absences. Vacation and sick leave that is not likely to be paid within twelve months is not recorded as an expenditure in the funds. However, in the government-wide financial statements, the estimated leave is recorded as a liability in the statement of net assets and is recorded as an increase or decrease in salaries in the statement of activities.

Net change in non-current compensated absences \$ (18,905)

Capital assets. When capital assets are purchased or constructed they are reported as an expenditure in the funds. In the government-wide financial statements, per unit asset costs of \$5,000 or more are allocated over their estimated useful lives.

Capital outlay removed from expenditures (73,886)
Depreciation included in expenses 228,075

Long-term debt. Repayment of principal on debt is recorded as an expenditure in the funds. In the government-wide financial statements, principal is recorded as a reduction of a corresponding liability in the statement of net assets.

Principal payments removed from expenditures (468,000)
Bond issue costs and accrued interest removed from expenditures (10,100)
Interest on pension refunding bond not allocated to a function per GASB 34. (22,096)
Total decrease in expenditures \$ (364,912)

REQUIRED REPORTS

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of Certified Public Accountants

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 Mayor and Council Members
City of Middlesborough
Middlesboro, Kentucky

We have audited the financial statements of the government activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Middlesborough, Kentucky as of and for the year ended June 30, 2011, which collectively comprise the City of Middlesborough, Kentucky's basic financial statements and have issued our report thereon dated June 30, 2012. The report was qualified because the City has not implemented a process to ascertain all sewer and sanitation revenues are billed and does not provide an adequate allowance for bad debts. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses, and other deficiencies we consider to be significant deficiencies.

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 misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency 2010-3 and 2010-4 to be a material weakness.

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider 2011-1 and 2011-2 to be significant deficiencies.

Criteria for findings 2011-1, 2011-2, 2011-3: Those charged with governance and management are responsible for the implementation of a system of internal controls designed to provide reasonable assurance about the reliability of financial reporting, compliance with laws and regulation and the effectiveness and efficiency of operations. A control deficiency 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 misstatements on a timely basis.

2011-1. Inadequate design of internal control over the preparation of the financial statements.

Condition: Auditor drafts the footnotes to the City's financial statements. The governing board and management may not have the in-depth knowledge of the accounting principles and standards concerning local government audits necessary to prevent, detect, and correct a potential misstatement in the financial statements or related notes to the financial statements.

In addition, the City does not submit a Management Discussion and Analysis (MD&A) report with the audited financial statements which the Government Auditing Standards Board has determined is an essential component of financial reporting.

Result: The financial statements and related notes could include misstatements that are undetected by management and the governing board. The financial statements do not contain all required supplementary information.

Recommendation: Management and the governing board could implement a methodology to insure the financial statements and related notes are completely and correctly prepared in conformance with generally accepted accounting principles, including additional training and outsourcing of financial statement preparation.

Management Response: The City has contracted with an external CPA to review the audited financial statements and notes. In the future, he will also prepare the MD&A, assist the City in year-end close out procedures, post the adjusting journal entries and consult on on-going accounting and financial issues related to local government.

Auditor Response: Inclusion of an external CPA in the financial reporting and review process should adequately address the issue.

2011-2. Inadequate internal control over recording payroll data.

Condition: Auditor identified several misstatements in the trial balances of the general fund that were essentially related to payroll reimbursements from other funds.

In addition, the City's payment of wages in lieu of health insurance and the subsequent reimbursement of employer related withholdings were posted to health insurance from July – November and as wages from December through June. The subsequent reimbursements of retirement and payroll taxes from employees to the City were not allocated back to the retirement accounts.

In addition, although the transfers were reimbursed timely they were not currently posted to the general ledger and allocated to the payroll accounts.

Result: The monthly financial statements available for management and council review may not be correct and potential misstatements in payroll data may not be easily found by management in the course of their monthly review.

Recommendation: The City should automate its financial recording processes so that financial data can be recorded efficiently and consistently and available for management review on a timely basis. Another employee should be cross-trained to perform the payroll function and review payroll reports.

In addition, the City should review the regulations for creditable compensation and requirements associated with an “in lieu of health insurance” payroll and ascertain the City’s compliance.

Management Response:

The City has contracted with a software provider and financial recorded keeping will be automated as of July 1, 2011. Another employee is currently being trained to perform some payroll functions.

In addition, the City has contracted with an external CPA to set up the payroll program and review payroll processing and controls. At his suggestion, the City is closing accounts reported in the general fund that are not legally mandated to be held in a separate bank account. This will eliminate the complications resulting from payroll transfers and reimbursements between the general fund and the fire and police incentive accounts.

The health insurance program is currently under review for compliance with recent changes in health insurance legislation. Management maintains that the former City clerk consulted with the Kentucky League of Cities to verify correct procedures before implementation of the health coverage paid as wages and that procedure has been consistently applied since its inception. The City has initiated a legal review of “in lieu of” payroll processes and any changes required will be implemented as soon as practicable after their discovery.

Auditor Response: The City’s response should correct the issue.

2011-3 Inadequate internal control over collection of revenues.

Condition: The City has not implemented a process to ascertain that all sewer and sanitation revenues provided by the City are billed by the local water utility; and the City has not established a process to estimate uncollectible accounts receivable.

In addition, the City has not implemented a methodology to ascertain that all businesses conducting operations within City limits are paying an appropriate business license and correctly remitting occupational tax on employee wages.

In addition, grant reimbursements request are not submitted timely and result in a delay in reimbursement of expenses of more than one year, in some instances.

Result: The City may not collect all revenues or reimbursements due the City for services provided in a timely manner, negatively impacting cash flow

Recommendation: The City should establish a process to estimate anticipated collections based on the number of customers or businesses receiving services. The City should routinely review documentation provided by the local water utility and investigate variances from anticipated collections. The City could construct an automated data base of businesses within the City and track license fees, occupational taxes paid, number of employees for comparability and compliance purposes.

The City should implement a centralized process in which an employee in the clerk's office would be responsible for routinely monitoring pending reimbursements for grants and insurance, etc.

Management Response:

(1) Sewer/Sanitation Revenues: the City's billing agreement with Kentucky Water Service has had positive results to date. Overall revenues have increased and collection of delinquent accounts has increased dramatically. Over time, there have been several procedural adjustments (including an ordinance dealing with payment responsibility for rental properties) and there seems to be a lessening of the problem with sewer customers. There *have* been issues in identifying and updating the customers receiving sanitation service only. Although the water service provides documentation to the City on a monthly basis, there needs to be an adjustment to the format in order to provide more detail regarding these customers. This has been discussed with the water service and they are working on the problem at this time. Also, the City is working with the sanitation contractor to improve both the format and the timeliness of their customer list. After the close of the budget period under examination, a significant number of customers were identified and added to the billing list. The City intends to participate more fully with the sanitation contractor in the January 2013 update and this should correct the remaining problems. At the same time, the City and the contractor will devise a method of ensuring that customers served and customers billed have a much greater level concurrence in future periods. Also, the City's financial consultant is presently establishing procedures for estimating and handling uncollectable revenues. These are expected to be considerably lower than previous years due to the aforementioned billing partnership and new practices that will prevent customers from accumulating large unpaid balances.

(2) Business License/Occupational Tax: In 2011, the Codes Enforcement office was directed by the Mayor to begin a comprehensive review of all business license records and the receipts of license fees and tax revenues associated with each. This process is ongoing. Initial estimates indicate that occupational taxes are being collected properly although some small employers may still be unidentified. There may also be an issue with misinterpretation of the business license ordinance as it applies to certain types of businesses (e.g. professionals and sole proprietorships). All issues are planned to be resolved during 2012-2013 fiscal year and written policies formulated based on the results of the study.

(3) Grant Reimbursements: The problem referred to concerns Single County Coal Severance grants. In addition to its own grants, the City is required to process grants from this fund to certain non-governmental entities (e.g. Main Street Program, Little League, etc). The grants are multi-year programs and it is not uncommon for transactions to roll over from one budget period to the next. Also, the reporting procedures and eligible expenditures have changed several times over recent years. At present there are six programs on extension, two of which are City grants. Delays in reimbursements were largely associated with resubmitting requests and newly required back-up documentation and at this time only one reimbursement payment is outstanding. The City has discussed new procedures with its sub-grantees and future spending and payment requests will be handled differently. The mayor has directed the employee responsible for this program to expedite the closure of prior year programs by the end of 2012 after which all new grants will be handled under the newly established procedures. Among other things, these procedures state that no program expenditure will occur unless sufficient time remains to obtain reimbursement within the same budget year.

Auditor Response: The City has adequately addressed the issue.

Compliance and other matters

As part of obtaining reasonable assurance about whether the City of Middlesborough, Kentucky's financial statements are free of material misstatements, 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 test disclosed an instance of non-compliance or other matter that was required to be reported under *Government Auditing Standards* and which is included above as 2011-2.

This report is intended solely for the information and use of management, the board of directors, and 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.

Jacquie Slone, CPA, PSC

Raven, Kentucky
June 30, 2011