

**Mount Sterling Water and
Sewer Commission**

**Independent Auditor's Report
and Basic Financial Statements
June 30, 2012 and 2011**

Mount Sterling Water and Sewer Commission
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June 30, 2012 and 2011

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INDEPENDENT AUDITOR'S REPORT

Mount Sterling Water and
Sewer Commission and
the City Council
Mount Sterling, Kentucky 40353

We have audited the accompanying financial statements of the Mount Sterling Water and Sewer Commission of the City of Mount Sterling, 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 Mount Sterling Water and Sewer Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1, the financial statements present only the Mount Sterling Water and Sewer Commission and are not intended to, and do not, present fairly the financial position of the City of Mount Sterling, Kentucky, as of June 30, 2012 and 2011, and the changes in financial position, or its cash flows for the year then ended in conformity with accounting 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 Mount Sterling Water and Sewer Commission of the City of Mount Sterling, Kentucky as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows 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 October 8, 2012, on our consideration of the Mount Sterling Water and Sewer Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

Mount Sterling Water and
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Accounting principles generally accepted in the United States of America require that the budgetary comparison information on page 15 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 audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Mount Sterling Water and Sewer Commission's financial statements as a whole. The accompanying financial information listed as supplemental information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. The financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The budgetary comparison information have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Mount Sterling Water and Sewer Commission has not presented Management's Discussion & Analysis that accounting principles generally accepted in the United States have determined is necessary to supplement, although not required to be part of, the basic financial statements.

Faulkner, King & Wenz, PSC

October 8, 2012

Mount Sterling Water and Sewer Commission
Statements of Net Assets
June 30, 2012 and 2011

| Assets | 2012 | 2011 |
|---|---------------|---------------|
| Current assets: | | |
| Cash and investments | \$ 2,961,981 | \$ 2,731,194 |
| Accounts receivable, net | 649,022 | 704,102 |
| Interest receivable | 347 | 486 |
| Other receivables | 27,936 | 36,024 |
| Inventory | 172,944 | 197,538 |
| Prepaid expenses | 163,971 | 11,909 |
| Total current assets | 3,976,201 | 3,681,253 |
| Non-current assets: | | |
| Restricted cash and cash equivalents | 1,280,103 | 1,241,678 |
| Capital Assets: | | |
| Land and building | 1,259,126 | 1,252,564 |
| Water and sewer system | 57,014,942 | 56,802,787 |
| Equipment | 826,467 | 752,612 |
| Vehicles | 308,283 | 291,756 |
| Construction in progress | 1,005 | 0 |
| Less accumulated depreciation | (24,700,630) | (23,221,019) |
| Bond issue costs/discounts | 61,196 | 72,156 |
| Total non-current assets | 36,050,492 | 37,192,534 |
| Total assets | 40,026,693 | 40,873,787 |
| Liabilities | | |
| Current liabilities: | | |
| Accounts payable | 78,089 | 62,037 |
| Other accrued liabilities | 259,880 | 252,403 |
| Accrued interest on bonds | 11,764 | 13,376 |
| Customer deposits | 479,487 | 456,111 |
| Notes payable | 1,187,865 | 1,171,493 |
| Total current liabilities | 2,017,085 | 1,955,420 |
| Non-current liabilities: | | |
| Notes payable | 9,262,781 | 10,450,644 |
| Total non-current liabilities | 9,262,781 | 10,450,644 |
| Total liabilities | 11,279,866 | 12,406,064 |
| Net Assets | | |
| Invested in capital assets, net of related debt | 24,258,547 | 24,256,563 |
| Restricted for debt service | 800,616 | 785,567 |
| Unrestricted | 3,687,664 | 3,425,593 |
| Total net assets | \$ 28,746,827 | \$ 28,467,723 |

Mount Sterling Water and Sewer Commission
Statements of Revenues, Expenses And Changes in Net Assets
For the Years Ended June 30, 2012 and 2011

| Operating revenues | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| Water sales | \$ 2,614,383 | \$ 2,545,285 |
| Sewer sales | 2,229,462 | 2,121,760 |
| Other income | 161,623 | 164,492 |
| Total operating revenues | <u>5,005,468</u> | <u>4,831,537</u> |
| | | |
| Operating expenses | | |
| Water | 2,177,330 | 2,130,723 |
| Sewer | 1,460,224 | 1,483,096 |
| General and administrative costs: | | |
| Water | 729,216 | 681,662 |
| Sewer | 367,283 | 352,239 |
| Total operating expenses | <u>4,734,053</u> | <u>4,647,720</u> |
| Operating income | <u>271,415</u> | <u>183,817</u> |
| | | |
| Nonoperating revenues (expenses) | | |
| Interest income | 22,956 | 37,461 |
| Grants | 3,940 | 0 |
| Loss on sale of fixed assets | (7,711) | (1,731) |
| Remaining unamortized cost on debt retired | 0 | (174,497) |
| Other expense | (38,578) | (46,028) |
| Interest expense | (156,586) | (204,626) |
| Total net nonoperating revenues (expenses) | <u>(175,979)</u> | <u>(389,421)</u> |
| Income (Loss) before contributions | 95,436 | (205,604) |
| Capital contributions | <u>183,668</u> | <u>0</u> |
| Change in net assets | <u>279,104</u> | <u>(205,604)</u> |
| Total net assets, beginning of year | <u>28,467,723</u> | <u>28,673,327</u> |
| Total net assets, end of year | <u>\$ 28,746,827</u> | <u>\$ 28,467,723</u> |

Mount Sterling Water and Sewer Commission
Statements of Cash Flows
For the Years Ended June 30, 2012 and 2011

| Cash Flows from Operating Activities | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Cash received from customers | \$ 4,907,013 | \$ 4,605,753 |
| Other cash receipts | 161,623 | 164,492 |
| Cash payments to vendors for water services and supplies | (622,160) | (597,682) |
| Cash payments to vendors for sewer services and supplies | (322,801) | (363,308) |
| Cash payments to employees for services | (1,245,136) | (1,179,187) |
| Cash payments for water administrative costs | (598,327) | (501,634) |
| Cash payments for sewer administrative costs | (302,126) | (232,781) |
| Net cash provided by operating activities | <u>1,978,087</u> | <u>1,895,654</u> |
| | | |
| Cash Flows from Capital and Related Financing Activities | | |
| Acquisition and construction of capital assets | (410,670) | (237,001) |
| Proceeds from sale of assets | 19,651 | 0 |
| Interest paid on revenue bonds | (158,198) | (203,687) |
| Principal paid on debt | (1,171,491) | (4,385,203) |
| Acquisition of debt | 0 | 2,760,000 |
| Bond issue costs | 0 | (78,550) |
| Increase in customer deposits | 23,376 | 25,019 |
| Other expense | (38,578) | (46,028) |
| Grant contributions | 3,940 | 0 |
| Net cash used in capital and related financing activities | <u>(1,731,970)</u> | <u>(2,165,450)</u> |
| | | |
| Cash Flows from Investing Activities | | |
| Interest income from investments | <u>23,095</u> | <u>37,435</u> |
| Net cash provided by investing activities | <u>23,095</u> | <u>37,435</u> |
| | | |
| Net change in cash and cash equivalents | 269,212 | (232,361) |
| | | |
| Cash and cash equivalents, beginning of year | <u>3,972,872</u> | <u>4,205,233</u> |
| | | |
| Total cash and cash equivalents, end of year | <u>\$ 4,242,084</u> | <u>\$ 3,972,872</u> |
| | | |
| Restricted cash and cash equivalents | \$ 1,280,103 | \$ 1,241,678 |
| | | |
| Unrestricted cash and cash equivalents | <u>2,961,981</u> | <u>2,731,194</u> |
| | | |
| Total cash and cash equivalents, end of year | <u>\$ 4,242,084</u> | <u>\$ 3,972,872</u> |

Mount Sterling Water and Sewer Commission
Statements of Cash Flows (continued)
For the Years Ended June 30, 2012 and 2011

| Reconciliation of operating income to net cash provided by operating activities: | <u>2012</u> | <u>2011</u> |
|---|----------------------------|----------------------------|
| Operating income | <u>\$ 271,415</u> | <u>\$ 183,817</u> |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 1,736,483 | 1,749,291 |
| Amortization | 10,960 | 10,030 |
| Change in assets and liabilities: | | |
| (Increase) decrease in accounts receivable | 63,168 | (61,291) |
| (Increase) decrease in inventories | 24,594 | (45,930) |
| (Increase) decrease in prepaids | (152,062) | 542 |
| Increase in accounts payable and accrued expenses | <u>23,529</u> | <u>59,195</u> |
| Total adjustments | <u>1,706,672</u> | <u>1,711,837</u> |
| Net cash provided by operating activities | <u><u>\$ 1,978,087</u></u> | <u><u>\$ 1,895,654</u></u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 1. Summary of Significant Accounting Policies

The accounting policies of the Mount Sterling Water and Sewer Commission (the Commission) conform to accounting principles generally accepted in the United States of America (GAAP). The Commission applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict Governmental Accounting Standards Board (GASB) pronouncements, in which case, GASB prevails. The following is a summary of the more significant policies:

Basis of accounting

The Commission is an individual fund of the City of Mount Sterling, Kentucky and is accounted for as a governmental enterprise fund. 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. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred or prepaid amounts have been utilized.

Investments

Investments are carried at cost. Some of the investments are restricted as to use (Note 2). Funds of the Commission are required to be invested in accordance with the investment policy adopted by the Commission. The investment policy allows the Commission to invest in those instruments authorized by KRS 66.480. Bank deposits were substantially secured by FDIC insurance and collateral or invested in direct obligations of the United States at June 30, 2012 and 2011.

Custodial credit risks – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2012 \$2,643,265 of the Commission's bank balance of \$4,296,017 was exposed to custodial credit risk, detailed as follows:

| | |
|---|---------------------|
| Insured | \$ 1,652,752 |
| Collateral held by pledging bank's trust department in the Commission's name | <u>2,643,265</u> |
| Total bank deposits | <u>\$ 4,296,017</u> |

Accounts receivable

Customer receivables are recorded as receivables and revenues at their original invoice amount. Management regularly reviews the customer receivable accounts and determines the allowance for doubtful accounts. A receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 60 days. For the years ended June 30, 2012 and 2011, accounts receivable is stated less an allowance for doubtful accounts of \$105,331 and \$90,255, respectively. A schedule of allowance for doubtful accounts at June 30, 2012, follows:

| | | | |
|-------------|-------------------|--------------------|-------------|
| <u>2011</u> | <u>Provisions</u> | <u>Charge-offs</u> | <u>2012</u> |
| \$90,255 | \$15,076 | \$0 | \$105,331 |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 1. Summary of Significant Accounting Policies (Continued)

Inventories

Inventories are stated at the lower of cost or market on the basis of "first-in, first-out" (FIFO) inventory method.

Budgets

In June of 2011, the Commission adopted the annual management budget in the amount of \$4,862,219 for the fiscal year ended June 30, 2012, detailed as follows:

| | |
|-----------------------------------|--------------------|
| Water | \$1,995,440 |
| Sewer | 1,817,066 |
| General and administrative costs: | |
| Water | 684,661 |
| Sewer | 365,052 |
| Total operating expenses | <u>\$4,862,219</u> |

Property, plant and equipment

Property, plant and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method. The range of useful lives used in computing depreciation is:

| <u>Classification</u> | <u>Range of lives</u> |
|-----------------------|-----------------------|
| Buildings | 20-40 years |
| Water plant | 25-40 years |
| Water systems | 10-30 years |
| Sewer system | 10-40 years |
| Office equipment | 7-10 years |
| Other equipment | 7 years |
| Vehicles | 5 years |

Total depreciation expense was \$1,736,483 and \$1,749,291 for the years ended June 30, 2012 and 2011, respectively.

Unamortized debt discount and expense

These costs are being amortized as non-operating expenses over the life of the debt issue using the straight line method. Amortization expense was \$10,960 and \$10,030 for the years ended June 30, 2012 and 2011, respectively.

Cash and cash equivalents

All cash, unrestricted and restricted, is considered cash for the purposes of the statement of cash flows.

Estimates

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

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 1. Summary of Significant Accounting Policies (Continued)

Capital and operating grants

Grants that are restricted to the purchase of property, plant and equipment are recorded as other income, per GASB 33. The Commission received \$3,940 and \$0 in grants of this type for the years ended June 30, 2012 and 2011.

Infrastructure assets constructed by outside entities then taken over by the Commission are also recorded as other income per GASB 33. The total amount of the assets taken over were \$183,668 and \$0 for the years ended June 30, 2012 and 2011, respectively. These amounts constitute noncash transactions.

Capitalized interest

The Commission follows the policy of capitalizing interest as a component of construction cost. For the year ended June 30, 2012, total interest cost incurred was \$156,586 of which \$0 was capitalized. For the year ended June 30, 2011, total interest cost incurred was \$204,626 of which \$0 was capitalized.

Note 2. Restricted Assets

The restricted assets in the accompanying financial statements are restricted as to use by ordinance (Note 5), external parties, or by board designation. A schedule of restricted assets at June 30, 2012, follows:

| <u>Description</u> | <u>Cash</u> | <u>Investments at Cost</u> | <u>Total</u> |
|--|--------------------|--------------------------------|--------------------|
| Assets restricted by grant agreement or bond ordinance: | | | |
| Customer deposits | \$ 479,487 | \$ -0- | \$ 479,487 |
| Reserve accounts | 550,616 | -0- | 550,616 |
| Depreciation accounts | <u>250,000</u> | <u>-0-</u> | <u>250,000</u> |
| | <u>\$1,280,103</u> | <u>\$ -0-</u> | <u>\$1,280,103</u> |

A schedule of restricted assets at June 30, 2011, follows:

| <u>Description</u> | <u>Cash</u> | <u>Investments at Cost</u> | <u>Total</u> |
|--|--------------------|--------------------------------|--------------------|
| Assets restricted by grant agreement or bond ordinance: | | | |
| Customer deposits | \$ 456,111 | \$ -0- | \$ 456,111 |
| Reserve accounts | 535,567 | -0- | 535,567 |
| Depreciation accounts | <u>250,000</u> | <u>-0-</u> | <u>250,000</u> |
| | <u>\$1,241,678</u> | <u>\$ -0-</u> | <u>\$1,241,678</u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 3. Long-Term Debt

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2012 and 2011, are summarized as follows:

| | <u>Rate</u> | <u>Original Issue</u> | <u>2012</u> | <u>2011</u> |
|--|-------------|---------------------------|---------------------|----------------------|
| Kentucky Bond Corporation 2010 Series C | 2.70% | \$ 2,760,000 | \$ 1,884,167 | \$ 2,288,333 |
| KIA Fund A | 1.20% | 1,055,969 | 288,131 | 343,717 |
| KIA Fund B | 1.50% | 2,448,213 | 818,942 | 948,434 |
| KIA Fund A Loan | 1.00% | <u>13,202,540</u> * | <u>7,459,406</u> | <u>8,041,653</u> |
| | | <u>\$19,466,722</u> | 10,450,646 | 11,622,137 |
| Less current maturities | | | <u>(1,187,865)</u> | <u>(1,171,493)</u> |
| Total long term debt | | | <u>\$ 9,262,781</u> | <u>\$ 10,450,644</u> |

- The original issue of the KIA Fund A Loan is \$13,202,540. As of June 30, 2012, the Commission had borrowed \$11,936,783 of this amount.

The Mount Sterling Water and Sewer Commission's bonded indebtedness and other long-term notes at June 30, 2012 and 2011, are detailed as follows:

| | Balance June 30 2010 | | | Balance June 30 2011 | | | Balance June 30 2012 |
|---------------------------|----------------------------|--------------------|----------------------|----------------------------|------------|----------------------|----------------------------|
| | Advances | Repayments | 2010 | Advances | Repayments | 2011 | 2012 |
| 1998-B Bonds | \$ 1,730,000 | \$0 | \$(1,730,000) | \$0 | \$0 | \$0 | \$0 |
| KMLPL Financing Program | 1,424,571 | 0 | (1,424,571) | 0 | 0 | 0 | 0 |
| Kentucky Bond Corporation | | | | | | | |
| 2010 Series C | 0 | 2,760,000 | (471,667) | 2,288,333 | 0 | (404,166) | 1,884,167 |
| KIA Fund A | 398,643 | 0 | (54,926) | 343,717 | 0 | (55,586) | 288,131 |
| KIA Fund B | 1,076,006 | 0 | (127,572) | 948,434 | 0 | (129,492) | 818,942 |
| KIA Fund A Loan | 8,618,120 | 0 | (576,467) | 8,041,653 | 0 | (582,247) | 7,459,406 |
| Total | <u>\$13,247,340</u> | <u>\$2,760,000</u> | <u>\$(4,385,203)</u> | <u>\$11,622,137</u> | <u>\$0</u> | <u>\$(1,171,491)</u> | <u>\$10,450,646</u> |

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 3. Long-Term Debt (Continued)

| | Balance | |
|---------------------------|--------------------|---------------------|
| | June 30, 2012 | |
| | <u>Current</u> | <u>Long-Term</u> |
| Kentucky Bond Corporation | | |
| 2010 Series C | \$ 412,083 | \$ 1,472,084 |
| KIA Fund A | 56,256 | 231,875 |
| KIA Fund B | 131,443 | 687,499 |
| KIA Fund A Loan | <u>588,083</u> | <u>6,871,323</u> |
| | | |
| Total | <u>\$1,187,865</u> | <u>\$ 9,262,781</u> |

The long-term debt service requirements are as follows:

| <u>Fiscal Year</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|--------------------|---------------------|-------------------|---------------------|
| 2012-2013 | \$ 1,187,865 | \$ 138,192 | \$ 1,326,057 |
| 2013-2014 | 1,205,583 | 121,400 | 1,326,983 |
| 2014-2015 | 1,229,232 | 102,534 | 1,331,766 |
| 2015-2016 | 1,134,228 | 80,701 | 1,214,929 |
| 2016-2017 | 987,656 | 61,881 | 1,049,537 |
| 2017-2022 | 3,400,027 | 157,416 | 3,557,443 |
| 2022-2024 | <u>1,306,055</u> | <u>16,365</u> | <u>1,322,420</u> |
| | <u>\$10,450,646</u> | <u>\$ 678,489</u> | <u>\$11,129,135</u> |

KIA Fund A and KIA Fund B

As of June 30, 2012 and 2011, the Commission had drawn on a KIA loan which was made to finance the construction of the water treatment plant sludge facilities. The loan is secured by a pledge of revenues, and has been drawn up to \$1,055,969. The loan bears an interest rate of 1.2% and has a life of 20 years and matures in 2017.

As of June 30, 2012 and 2011, the Commission had also drawn on a KIA loan which was made to finance the construction of ground storage tanks and a water strengthening main. The loan is secured by a pledge of revenues, and has been drawn up to \$2,448,213. The loan bears an interest rate of 1.5% and has a life of 20 years and matures in 2018.

Kentucky Infrastructure Authority - A02-01

The Commission had drawn \$11,936,783 as of June 30, 2012 and 2011, from the Kentucky Infrastructure Authority. The loan was made for the construction of a new trunk sewer and wastewater treatment plant. The loan is secured by a pledge of revenues and can be drawn up to \$13,202,540. The loan bears an interest rate of 1% and has a life of 20 years.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 3. Long-Term Debt (Continued)

Kentucky Bond Corporation 2010 Series C Bonds

On November 4, 2010, the Commission borrowed the aggregate principal amount of \$2,760,000 with the Kentucky Bond Corporation 2010 Series C Bonds. The purpose of the issue was for the refunding in advance of the obligations of the City of Danville, Kentucky designated as its Multi-City Lease Revenue Bonds (City of Mount Sterling, Kentucky Water and Sewer System Revenue Refunding & Improvement Project) Series 1998-B and the Kentucky Municipal League Pooled Lease Financing Program. The bonds are secured by a pledge of revenues. The bonds are subject to optional and mandatory redemption prior to maturity.

Note 4. Net Assets

GASB Statement No. 34 requires the delineation of Net Assets as Invested in Property, Plant and Equipment (capital investments), Restricted and Unrestricted.

The balance of capital investments represents funds that have been used to acquire pump stations, storage facilities, meter stations, etc., constructed and operated by the Mount Sterling Water and Sewer Commission, net of outstanding debt. The balance was \$24,258,547 and \$24,256,563 at June 30, 2012 and 2011, respectively.

The Commission has the following restricted net assets that are reserved in accordance with the Commission's various bond ordinances (Note 5) or Board designations:

| | | |
|---------------------------|------------------|-------------------|
| | <u>2012</u> | <u>2011</u> |
| Operation and Maintenance | \$270,000 | \$ 270,000 |
| Replacement | 278,214 | 244,225 |
| Depreciation | 250,000 | 250,000 |
| Other | <u>2,402</u> | <u>21,342</u> |
| Total Restricted | <u>\$800,616</u> | <u>\$ 785,567</u> |

The Commission has a balance of \$3,687,664 and \$3,425,593 for unrestricted net assets at June 30, 2012 and 2011, respectively.

Note 5. Compliance with Bond Ordinance

The Kentucky Bond Corporation 2010 Series C bond ordinance requires the Commission to maintain certain reserves and restricted assets as follows:

Operation and Maintenance Fund - This reserve is required to maintain a balance equal to three month's cost of operating, maintaining, and insuring the system. The balance of this reserve at June 30, 2012 was \$270,000.

Depreciation Fund - This reserve is required for major repairs and replacements. Funds may be withdrawn only to pay the cost of making unusual or extraordinary maintenance, repairs, renewals, and/or replacements to the system not included in the annual budget of current expenses, or for the purpose of paying the cost of construction improvements. The balance of this reserve at June 30, 2012 was \$250,000.

The Kentucky Infrastructure Authority requires the Commission to maintain certain reserves and restricted assets as follows:

Replacement Reserve - This reserve requires the Commission to deposit \$32,790 each December 1 into a separate account until the balance reaches \$327,900 and be maintained for the life of the loan. The balance of this reserve at June 30, 2012 and 2011, was \$278,214 and \$244,225, respectively.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 6. Property, Plant and Equipment

A summary of changes in property, plant and equipment is as follows:

| | Balance | | | Balance | | | Balance |
|---|------------------|---------------|-----------|------------------|---------------|------------|------------------|
| | June 30, 2010 | Additions | Disposals | June 30, 2011 | Additions | Disposals | June 30, 2012 |
| Land and building | \$1,252,564 | \$0 | \$0 | \$1,252,564 | \$6,562 | \$0 | \$1,259,126 |
| Water and sewer system | 56,616,468 | 186,319 | 0 | 56,802,787 | 424,187 | (212,032) | 57,014,942 |
| Equipment | 780,195 | 27,182 | (54,765) | 752,612 | 122,853 | (48,998) | 826,467 |
| Construction in progress | 0 | 0 | 0 | 0 | 1,005 | 0 | 1,005 |
| Vehicles | 268,256 | 23,500 | 0 | 291,756 | 39,731 | (23,204) | 308,283 |
| | 58,917,483 | 237,001 | (54,765) | 59,099,719 | 594,338 | (284,234) | 59,409,823 |
| Accumulated depreciation | (21,524,762) | (1,749,291) | 53,034 | (23,221,019) | (1,736,483) | 256,872 | (24,700,630) |
| Total net property, plant and equipment | \$37,392,721 | (\$1,512,290) | (\$1,731) | \$35,878,700 | (\$1,142,145) | (\$27,362) | \$34,709,193 |

Note 7. Pension Plan

The Mount Sterling Water and Sewer Commission is a participating employer of the County Employees' Retirement System (CERS) which is a multi-employer defined benefit plan that covers substantially all regular full-time employees of county, school board, municipal and other local agencies electing to participate. Upon election to participate in the CERS, each employee has the option to participate. However, all subsequent employees must participate and the employer is required to continue participation.

The Mount Sterling Water and Sewer Commission had a total of 32 employees at June 30, 2012 and 2011, covered by the CERS who contributed 5.00%. The employer contributed 18.96% in 2012 and 16.93% in 2011. The Commission's contribution was \$225,319 and \$191,103, and the employees contributed \$59,387 and \$56,501 for the years ended June 30, 2012 and 2011, respectively.

The amount shown below as "actuarial accrued liability" 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 the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems (PERS). The measure is independent of the actuarial funding method used to determine contributions to the System.

Vesting in a retirement benefit begins immediately upon entry into the System. The participant has a fully vested interest after the completion of sixty months of service, twelve of which are current service. At a minimum, terminated employees are refunded their contributions with credited interest at 3% compounded annually through June 30, 1981, 6% thereafter through June 30, 1986 and 4% thereafter. All required contributions were paid at year end or within thirty (30) days thereafter. The percentage of the Commission's contribution to total employers' contribution in the CERS for the year is not known.

The CERS total actuarial accrued liability was \$11,777,126,000 and net assets available for benefits were \$7,409,157,000 as of June 30, 2011, which is the latest information available.

Mount Sterling Water and Sewer Commission
Notes to the Financial Statements
June 30, 2012 and 2011

Note 8. Risk Management

The Mount Sterling Water and Sewer Commission 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. In addition to its general liability insurance, the Commission also carries commercial insurance for all other risks of loss such as workers' compensation and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The following is a schedule of insurance in force as of June 30, 2012:

| <u>Coverage</u> | <u>Amount of Coverage</u> | <u>Premium</u> | <u>Policy Term</u> |
|---------------------------------|---------------------------|----------------|--------------------|
| Buildings & property | \$ 28,426,025 | * | 7/1/11 - 7/1/12 |
| General liability | 3,000,000 | * | 7/1/11 - 7/1/12 |
| Public officials liability | 3,000,000 | * | 7/1/11 - 7/1/12 |
| Automobile liability | 3,000,000 | * | 7/1/11 - 7/1/12 |
| Automobile physical | Actual Value | * | 7/1/11 - 7/1/12 |
| Crime: | | | |
| Forgery or alteration | 100,000 | * | 7/1/11 - 7/1/12 |
| Theft-inside premises | 100,000 | * | 7/1/11 - 7/1/12 |
| Theft-outside premises | 100,000 | * | 7/1/11 - 7/1/12 |
| Public dishonesty | 250,000 | * | 7/1/11 - 7/1/12 |
| Counterfeit paper | 100,000 | * | 7/1/11 - 7/1/12 |
| Workers compensation insurance: | | | |
| Waterworks | 606,617 | * | 7/1/11 - 7/1/12 |
| Sewage | 235,106 | * | 7/1/11 - 7/1/12 |
| Clerical | 266,485 | * | 7/1/11 - 7/1/12 |
| Health & life insurance | Various | \$ 167,610 | Monthly |

*Blanket coverage; total premium \$148,558.

Note 9. Subsequent Events

Subsequent events for Mount Sterling Water and Sewer Commission have been evaluated through October 8, 2012, which is the date the financial statements were available to be issued.

**Mount Sterling Water and Sewer Commission
Schedule of Revenues, Expenses And Changes
in Net Assets Budget and Actual
For the Year Ended June 30, 2012**

| | <u>Enacted Budget</u> | <u>Actual</u> | <u>Favorable (Unfavorable)</u> |
|--|---------------------------|----------------------|------------------------------------|
| Operating revenues | | | |
| Water sales | \$ 2,893,163 | \$ 2,614,383 | \$ (278,780) |
| Sewer sales | 2,753,149 | 2,229,462 | (523,687) |
| Other income | 75,871 | 161,623 | 85,752 |
| Total operating revenues | <u>5,722,183</u> | <u>5,005,468</u> | <u>(716,715)</u> |
| Operating expenses | | | |
| Water | 1,995,440 | 2,177,330 | (181,890) |
| Sewer | 1,817,066 | 1,460,224 | 356,842 |
| General and administrative costs: | | | |
| Water | 684,661 | 729,216 | (44,555) |
| Sewer | 365,052 | 367,283 | (2,231) |
| Total operating expenses | <u>4,862,219</u> | <u>4,734,053</u> | <u>128,166</u> |
| Operating income | <u>859,964</u> | <u>271,415</u> | <u>(588,549)</u> |
| Nonoperating revenues (expenses) | | | |
| Interest income | 33,854 | 22,956 | (10,898) |
| Grants | 0 | 3,940 | 3,940 |
| Loss on sale of fixed assets | 0 | (7,711) | (7,711) |
| Remaining unamortized cost on debt retired | 0 | 0 | 0 |
| Other expense | 0 | (38,578) | (38,578) |
| Interest expense | (3,473) | (156,586) | (153,113) |
| Total net nonoperating revenues (expenses) | <u>30,381</u> | <u>(175,979)</u> | <u>(206,360)</u> |
| Income before contributions | 890,345 | 95,436 | (794,909) |
| Capital contributions | <u>0</u> | <u>183,668</u> | <u>183,668</u> |
| Change in net assets | 890,345 | 279,104 | (611,241) |
| Total net assets, beginning of year | <u>28,467,723</u> | <u>28,467,723</u> | <u>0</u> |
| Total net assets, end of year | <u>\$ 29,358,068</u> | <u>\$ 28,746,827</u> | <u>\$ (611,241)</u> |

**Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority Fund A
June 30, 2012**

| Fiscal Year Ending June 30 | Principal Due Dec. 1 & June 1 | Interest December 1 | Interest June 1 | Total Debt Requirements | Principal Outstanding at End of Year |
|---------------------------------------|--|--------------------------------|----------------------------|------------------------------------|---|
| 2013 | \$ 56,256 | \$ 1,729 | \$ 1,560 | \$ 59,545 | \$ 231,875 |
| 2014 | 56,933 | 1,391 | 1,221 | 59,545 | 174,942 |
| 2015 | 57,618 | 1,050 | 877 | 59,545 | 117,324 |
| 2016 | 58,311 | 704 | 530 | 59,545 | 59,013 |
| 2017 | 59,013 | 354 | 178 | 59,545 | 0 |
| | <u>\$ 288,131</u> | <u>\$ 5,228</u> | <u>\$ 4,366</u> | <u>\$ 297,725</u> | |

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority Fund B
June 30, 2012

| <u>Fiscal Year Ending June 30</u> | <u>Principal Due Dec. 1 & June 1</u> | <u>Interest</u> | | <u>Total Debt Requirements</u> | <u>Principal Outstanding at End of Year</u> |
|---------------------------------------|--|-------------------|------------------|------------------------------------|---|
| | | <u>December 1</u> | <u>June 1</u> | | |
| 2013 | \$ 131,443 | \$ 6,142 | \$ 5,650 | \$ 143,235 | \$ 687,499 |
| 2014 | 133,421 | 5,156 | 4,658 | 143,235 | 554,078 |
| 2015 | 135,430 | 4,155 | 3,650 | 143,235 | 418,648 |
| 2016 | 137,469 | 3,140 | 2,626 | 143,235 | 281,179 |
| 2017 | 139,537 | 2,109 | 1,589 | 143,235 | 141,642 |
| 2018 | 141,642 | 1,062 | 534 | 143,238 | 0 |
| | <u>\$ 818,942</u> | <u>\$ 21,764</u> | <u>\$ 18,707</u> | <u>\$ 859,413</u> | |

**Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Infrastructure Authority A02-01
June 30, 2012**

| Fiscal Year Ending June 30 | Principal Due Dec. 1 & June 1 | Interest Due Dec. 1 & June 1 | Admin. Fees | Total Debt Requirements | Principal Outstanding at End of Year |
|---------------------------------------|--|---|------------------------|------------------------------------|---|
| 2013 | \$ 588,083 | \$ 73,128 | \$ 14,626 | \$ 675,837 | \$ 6,871,323 |
| 2014 | 593,979 | 67,232 | 13,446 | 674,657 | 6,277,344 |
| 2015 | 599,934 | 61,277 | 12,255 | 673,466 | 5,677,410 |
| 2016 | 605,948 | 55,263 | 11,053 | 672,264 | 5,071,462 |
| 2017 | 612,022 | 49,188 | 9,838 | 671,048 | 4,459,440 |
| 2018 | 618,158 | 43,053 | 8,610 | 669,821 | 3,841,282 |
| 2019 | 624,355 | 36,856 | 7,372 | 668,583 | 3,216,927 |
| 2020 | 630,614 | 30,597 | 6,119 | 667,330 | 2,586,313 |
| 2021 | 636,936 | 24,275 | 4,855 | 666,066 | 1,949,377 |
| 2022 | 643,321 | 17,889 | 3,578 | 664,788 | 1,306,056 |
| 2023 | 649,771 | 11,440 | 2,288 | 663,499 | 656,285 |
| 2024 | 656,285 | 4,925 | 985 | 662,195 | 0 |
| | <u>\$ 7,459,406</u> | <u>\$ 475,123</u> | <u>\$ 95,025</u> | <u>\$ 8,029,554</u> | |

Mount Sterling Water and Sewer Commission
Schedule of Debt Service Requirements
Kentucky Bond Corporation Financing Program Revenue Bonds 2010 First Series C
June 30, 2012

| <u>Fiscal Year Ending June 30</u> | <u>Principal Payments</u> | <u>Interest</u> | <u>Admin. Fees</u> | <u>Total Debt Requirements</u> | <u>Principal Outstanding at End of Year</u> |
|---------------------------------------|-------------------------------|-------------------|------------------------|------------------------------------|---|
| 2013 | \$ 412,083 | \$ 49,983 | \$ 5,161 | \$ 467,227 | \$ 1,472,084 |
| 2014 | 421,250 | 41,742 | 4,130 | 467,122 | 1,050,834 |
| 2015 | 436,250 | 31,525 | 3,077 | 470,852 | 614,584 |
| 2016 | 332,500 | 18,438 | 1,986 | 352,924 | 282,084 |
| 2017 | 177,084 | 8,463 | 1,155 | 186,702 | 105,000 |
| 2018 | 105,000 | 3,150 | 525 | 108,675 | 0 |
| | <u>\$ 1,884,167</u> | <u>\$ 153,301</u> | <u>\$ 16,034</u> | <u>\$ 2,053,502</u> | |

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October 8, 2012

Mount Sterling Water and
Sewer Commission and
the City Council
Mount Sterling, Kentucky 40353

We have audited the financial statements of Mount Sterling Water and Sewer Commission for the year ended June 30, 2012, and have issued our report thereon dated October 8, 2012. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated June 23, 2012, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control structure of Mount Sterling Water and Sewer Commission. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Mount Sterling Water and Sewer Commission are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2012. We noted no transactions entered into by the Commission during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Commission's financial reporting process (that is, cause future financial statements to be materially misstated). As required by generally accepted auditing standards, a schedule of our audit adjustments is attached.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principal to the Commission's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Commission's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 8, 2012.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing and completing our audit.

This information is intended solely for the use of the Commission and City Council and management of Mount Sterling Water and Sewer Commission and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Faulkner, King & Wenz, PSC

Client: **Mount Sterling Water and Sewer Commission**
 Engagement: **2012 Audit**
 Workpaper: **Attached adjustments sheet for SAS 114 letter**

| Account | Description | W/P Ref | Debit | Credit |
|---|---------------------------------------|----------------|---------------------|---------------------|
| Adjusting Journal Entries JE # 1 | | 4600.50 | | |
| To record trade-in allowance on backhoe and current year disposals. | | | | |
| 00156-0000-000 | Equipment | | 13,500.00 | |
| 00161-0000-000 | Accumulated Depreciation | | 256,711.00 | |
| 00405-0010-000 | Other Income | | 6,310.00 | |
| 00942-0000-000 | Gain/loss On Sale Of Assets | | 7,711.00 | |
| 00141-0000-000 | Water Tower | | | 212,030.00 |
| 00155-0000-000 | Vehicles | | | 23,204.00 |
| 00156-0000-000 | Equipment | | | 48,998.00 |
| Total | | | 284,232.00 | 284,232.00 |
| Adjusting Journal Entries JE # 2 | | 4600.15 | | |
| To record current year depreciation. | | | | |
| 00511-0016-000 | Depreciaton | | 402,152.00 | |
| 00511-0026-000 | Depreication | | 410,331.00 | |
| 00161-0000-000 | Accumulated Depreciation | | | 812,483.00 |
| Total | | | 812,483.00 | 812,483.00 |
| Reclassifying Journal Entries JE # 3 | | | | |
| to adjust s/t and l/t notes payable | | | | |
| 00202-0000-000 | Note Payable - Kia | | 56,256.00 | |
| 00203-0000-000 | Note Payable - Kia Fund B | | 131,443.00 | |
| 00205-0000-000 | N/p Kia (wwtp) | | 588,083.00 | |
| 00207-0000-000 | Series C Bonds Payable | | 412,083.00 | |
| 00202 | Notes Payable - KIA FUND A Short Term | | | 56,256.00 |
| 00203 | Notes Payable - KIA FUND B Short Term | | | 131,443.00 |
| 00205 | N/P KIA (WWTP) Short Term | | | 588,083.00 |
| 00207 | Series C Bonds Payable - Short Term | | | 412,083.00 |
| Total | | | 1,187,865.00 | 1,187,865.00 |
| Reclassifying Journal Entries JE # 4 | | | | |
| to reclass | | | | |
| 00318-0000-000 | Retained Earnings | | 33,989.00 | |
| 00302-0000-000 | Replacement Reserve | | | 33,989.00 |
| Total | | | 33,989.00 | 33,989.00 |
| Adjusting Journal Entries JE # 5 | | | | |
| to adjust for contributed water/sewer lines | | | | |
| 00143-0000-000 | Sewer Expansion | | 27,723.00 | |
| 00150-0000-000 | Water Expansion | | 155,945.00 | |
| 00405-0010-000 | Other Income | | | 155,945.00 |
| 00405-0020-000 | Other Income | | | 27,723.00 |
| Total | | | 183,668.00 | 183,668.00 |
| Reclassifying Journal Entries JE # 6 | | | | |
| to adjust reserves to actual | | | | |
| 00303-0000-000 | Other Reserve | | 18,940.00 | |
| 00318-0000-000 | Retained Earnings | | | 18,940.00 |
| Total | | | 18,940.00 | 18,940.00 |

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**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**

Mount Sterling Water and Sewer Commission
Mount Sterling, Kentucky

We have audited the financial statements of the Mount Sterling Water and Sewer Commission (the Commission) of the City of Mount Sterling, Kentucky, as of and for the year ended June 30, 2012, and have issued our report thereon dated October 8, 2012 which includes an explanatory paragraph regarding the omission of Management Discussion and Analysis. 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 Mount Sterling Water and Sewer Commission is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Commission's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Finding: 2012-1

- Condition: While management is knowledgeable in regard to the numbers reported in the financial statements, identifying and applying new authoritative guidance in regard to information reported in the notes to those statements is outside the scope of management's training and experience.
- Management Response and Corrective Action Plan: It does not appear that it would be economically feasible for our organization to enlarge its staff or contract an individual with appropriate skill and knowledge in applying new authoritative guidance. Thus, it is important that our Board provide oversight and independent review functions.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's 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*.

The Commission's response to the findings identified in our audit is described in the paragraphs above. We did not audit the Commission's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Directors, others within the Commission, and the Council of the City of Mount Sterling, Kentucky and is not intended to be and should not be used by anyone other than these specified parties.

Faulkner, King & Wenz, PSC

October 8, 2012