

**WINCHESTER MUNICIPAL UTILITIES
WINCHESTER, KENTUCKY**

AUDITED FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2013 and 2012

**WINCHESTER MUNICIPAL UTILITIES
WINCHESTER, KENTUCKY
JUNE 30, 2013 and 2012**

CONTENTS

	<u>Page</u>
Independent Auditor's Report	1-3
Management's Discussion & Analysis	4-20
Statements of Net Position	21-22
Statements of Revenue, Expenses and Changes in Fund Net Position	23
Statements of Cash Flows	24-25
Notes to the Financial Statements	26-44
Supplemental Information:	
Schedule I - Department Expenses	45-46
Schedule II - Revenue Bond Debt Service	47
Schedule of Expenditures of Federal Awards	48
Notes to the Schedule of Expenditures of Federal Awards	49
Independent Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with <i>Government Auditing Standards</i>	50-51
Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by with OMB Circular A-133	52-54
Schedule of Findings and Questioned Costs	55

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

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INDEPENDENT AUDITOR'S REPORT

To the Commissioners
Winchester Municipal Utilities
Winchester, KY

We have audited the accompanying financial statements of the business-type activities of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Utilities' basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of June 30, 2013 and 2012, and the respective changes in financial position and, where applicable cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 20 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 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, basic financial statements. The Department Expenses, Revenue Bond Debt Schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements.

The Department Expenses, Revenue Bond Debt Schedules and the Schedule of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance

with auditing standards generally accepted in the United States of America. In our opinion, the Department Expenses, Revenue Bond Debt Schedules and Schedule of Expenditures of Federal Awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2013, on our consideration of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control over financial reporting and compliance.

Summers, McCrary & Sparks, PSC

Summers, McCrary & Sparks, PSC
Winchester, Kentucky
October 21, 2013

**MANAGEMENT'S DISCUSSION AND ANALYSIS
WINCHESTER MUNICIPAL UTILITIES
JUNE 30, 2013**

UTILITY PROFILE

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

WMU has 11,765 water customers, 11,483 wastewater customers, and 8,913 solid waste customers.

Fiscal Year 2013/2014 budget reflects annual revenue of \$16,853,400 and annual debt service of \$4,671,360.

• **Water System**

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

The water treatment plant under special provision is rated to produce 6.0 million gallons per day (MGD). Clearwell storage is 1,000,000 gallons; elevated storage totals 3,500,000 gallons. WMU maintains approximately 166.43 miles of water line in the distribution system.

Average day water production for FY 2012/2013 was 3.96 MGD. Peak day water production for FY 2012/2013 was 4.90 MGD. In addition to the provision of service to its retail customers, WMU provides water for resale to the East Clark County Water District (ECCWD) and the Kentucky American Water Company (KAWC).

- **Wastewater System**

WMU maintains approximately 153.6 miles of gravity and force main sanitary sewers, eight (8) sewage-pumping stations (excluding the landfill pump stations), and two (2) wastewater treatment plants (WWTP). The Strodes Creek WWTP is rated at 7.2 MGD and the Lower Howards Creek WWTP is rated at 2.0 MGD. The Strodes Creek WWTP is designed to handle a biological load approximately four times greater than typical domestic sewage. The Lower Howards Creek WWTP is designed to handle typical domestic sewage. In addition, WMU operates solids processing facilities at both locations with the Strodes Creek WWTP producing and distributing for beneficial reuse Class A biosolids in compliance with 40 Code of Federal Regulations (CFR) §503.

Average day wastewater treatment for FY 2012/2013 at Strodes Creek was 4.11 MGD with a peak day wastewater treatment for FY 2012/2013 at 17.45. Average day wastewater treatment for FY 2012/2013 at Lower Howards Creek was 0.80 MGD with a peak day wastewater treatment for FY 2012/2013 at 2.40. Average day production of Class A biosolids at Strodes Creek for FY 2012/2013 was 5.0 dry tons.

- **Solid Waste System**

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

Average day solid waste collection and disposal for FY 2012/2013 was 53.00 tons and average day yard waste collection for FY 2012/2013 was 5.63 tons.

SIGNIFICANT ISSUES

- **Consent Decree**

The Consent Decree remains one of the most significant issues facing the utility at this time. However, much progress has been made since April of 2007 to comply with the requirements of this enforcement action. The Consent Decree is the settlement agreement between the United States Environmental Agency (EPA), the Kentucky Energy and Environment Cabinet (EEC, formerly known as the Environmental and Public Protection Cabinet), City and WMU detailing actions to be taken by City and WMU for violations of the Clean Water Act , 33 U.S.C. § 1319. The basic tenants of the Consent Decree call for the City and WMU to:

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

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

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

Project	Project Area	Proposed Date for Removal from Service
Lower Howards Creek Sanitary Sewer Improvements	Snowfall Stoneybrook	January 31, 2013
Bel-Air Sanitary Sewer Improvements	Bel-Air Westside	July 31, 2013
Madison, Flanagan, & East Washington Street	Madison, Flanagan, & East Washington Street	January 31, 2021
Other locations identified in Exhibit A of the Consent Decree	WMU Collection System	January 31, 2025

The Lower Howards Creek Project involved a facilities plan update, construction of sanitary sewer interceptors, force main and construction of a new wastewater treatment plant. The Lower Howards Creek Project is approximately 99% complete and is expected to receive final acceptance November 2013. The Bel-Air Sanitary Sewer Improvements project involved construction of an interstate road bore and new interceptor sewer that eliminated two (2) sewage pumping stations. Construction of BelAir is complete. Construction of the Madison, Flanagan, and East Washington Street project includes the rehabilitation of the East Interceptor Sewer coupled with construction of larger diameter sewers in the downtown area of Winchester to replace aging infrastructure. This project along with any other locations identified in Exhibit A of the Consent Decree will be designed upon completion of the necessary flow monitoring and updates to the Sewer Hydraulic Model as required.

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

- Sewer Overflow Response Plan (SORP)
- Inter Jurisdictional Agreement Program
- Public Education Program
- Spill Impact Water Quality Monitoring Program
- Corrosion Control Program
- Routine Hydraulic Cleaning Program
- Root Control Program
- Capacity Assurance Program (CAP)
- Acquisition Consideration Program
- Infrastructure Rehabilitation Program (IRP)
- Sewer System Assessment Program (CSSAP)
- Sewer System Inventory Program
- Fats, Oils, and Grease Control Program (FOG)
- Financial and Cost Analysis Program

Additional requirements of the Consent Decree included a Supplemental Environmental Project (SEP). As a result, it was determined to be environmentally beneficial to the public to implement a SEP which would commission a study of the streams in the Lower Howards Creek Watershed (LHCW) and develop a Lower Howards Creek Watershed Management Plan (LHCWMP). The SEP Completion Report was submitted to the EPA and KDOW on November 20, 2012. On January 8, 2013 WMU received written confirmation that the SEP Completion Report in accordance with General Provision 4 of Exhibit D of the Consent Decree was approved by the EPA.

- **Water Supply, Treatment and Distribution**

Addressing the water supply, treatment, and distribution needs of the community will move to the forefront of priorities with completion of the Lower Howards Creek Sanitary Sewer Improvements project. Normal growth pattern projections have indicated the need for additional potable water capacity now. The timeframe for that need may or may not be accelerated or become critical based upon the needs of the industrial community and projected growth rates being met. While plans to increase water demand 1,000,000 million gallons per day at Sekisui S-LEC America have been delayed for a period of time, Alltech has initiated production activities at 555 Rolling Hills Lane (previously Martek Biosciences) and will continue to play a significant role in water needs along with Winchester Farms Dairy, Sekisui, and other large water users. Currently, several lots within the Industrial Park, Phase VI development have been constructed, housing Amazon and the Rocky Mountain ATV facilities. Determination of the water requirements for the remaining lots will factor into defining the ultimate water needs.

As previously stated WMU's current permitted capacity is 6.0 million gallons per day (MGD) with current average day demand of 3.96 MGD and peak day

demand of 4.90 MGD. Projections of WMU's 20-year demand are 12.0 MGD based upon normal growth patterns which can be skewed with the addition or loss of any significant industrial or other large user. WMU's average and peak day water production is down from previous years. Contributing factors are most likely weather related (wet weather) and an increased awareness from customers related to water conservation. All these factors must be considered with sizing of a new water treatment plant (WTP) and associated infrastructure.

Discussions in 2008 between the WMU and City Commissions led to a decision to construct a new water treatment plant. Construction was proposed to be phased with the initial capacity being 6.0 MGD to operate in concert with the existing water treatment plant yielding an effective capacity of 8.0 – 9.0 MGD. The final effective capacity will be determined by the Division of Water (DOW). In addition, raw and finished water transmission improvements will be designed to insure the delivery of the additional capacity. Over time, the existing water treatment plant was proposed to be phased out of service and the planned water treatment plant expanded to 12.0 MGD. A final determination on maintaining the existing water treatment plant or removing it from service has not been finalized. The total estimated cost (preliminary engineering costs) of the initial phase of improvements ranges from \$40 - \$50 million dollars. The timetable for construction of the improvements ranges from 2013 through 2018. Preliminary grade work and siting of the facilities was constructed as part of the Lower Howards Creek Wastewater Treatment Plant project at a cost of \$2,189,500.

WMU received Proposals for engineering services relating to planning, design, bidding and construction administration of a new raw and finished water transmission main in April of 2013. Design of the facilities is expected to begin in October 2013. The finished water main is projected to begin at the future site of the proposed WTP located at 7055 Boonesboro Road, interconnect with the existing WTP facilities at 365 Water Works Road, and end with connection to the existing 12-inch water main near 550 Bypass Road. The raw water main is projected to begin at the Kentucky River Raw Water Intake facilities at 1045 Ford Road and extend to the proposed WTP at 7055 Boonesboro Road. As part of the services WMU requested a proposal for additional engineering services relating to planning, design, bidding, and construction administration for two (2) additional raw water vertical turbine pumps at WMU's Kentucky River Pump Station (1001 Ford Road).

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

Construction of the Kentucky River Lock and Dam No. 10 were completed in 1905. The lock and dam were owned and operated by the United States Army Corps of Engineers (COE) until 1996 at which time ownership and the responsibility for maintenance and replacement of the lock and dam were transferred to the Commonwealth of Kentucky. The General Assembly created by statute the Kentucky River Authority (KRA) to oversee the operation,

maintenance and replacement of the 14 locks and dams on the Kentucky River. Implicit in that charge of authority is the maintenance of the 14 pools of water for water supply. The Kentucky River supplies water to approximately 22% of Kentucky's population. WMU, like all other water utilities that withdraw water from the Kentucky River, pays a withdrawal fee for each gallon of water withdrawn from the Kentucky River and the reservoir and passes that cost to its customers. The withdrawal fees are used by KRA for repair and replacement of the 14 locks and dams. The withdrawal fees were recently increased (July 2013) to help facilitate the repair and replacement of the aging infrastructure.

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

Pool No. 10 is the longest pool on the Kentucky River stretching nearly 25 miles along the 260 miles of the Kentucky River. The East Kentucky Power (EKP) Dale Generating Plant withdraws cooling water for the power generating plant from this pool. EKP has plans to decommission the facility located at this location. Approximately 95% of that cooling water from the facility is returned to the river. The EKP withdrawal and the WMU withdrawal are the only permitted withdrawals from Pool No. 10. The City of Richmond Utilities has constructed a new wastewater treatment plant (WWTP) which discharges to Otter Creek in Madison County upstream from WMU's water intake in Pool 10. The permitted WWTP discharge meets the Kentucky, five-mile separation rule between a WWTP discharge and a WTP intake.

The Kentucky River is subject to wide variations in flow from 0 flows to 1 billion gallons per day. The wide variations in flow and resulting stress on the dam and scour below the dam make Dam No. 10 vulnerable to overturning. KRA has ranked replacement of Dam No. 10 as a top priority and has allocated funding in its budget to design and construct replacement facilities. The Board of the Kentucky River Authority has approved a six-year capital plan that includes approximately \$2.5 million in the 2012-14 bienniums for design and \$46 million in the 2014-16 bienniums for construction of a new dam. KRA's capital plan which included this funding was approved by the Kentucky Legislature during the 2012 General Assembly. A failed dam would leave Winchester without its primary water supply and KRA has indicated their emergency action plan to repair a failed dam would place the burden on the water withdrawer for a minimum of 7-14 days until equipment could be mobilized. WMU's reservoir would yield, without mandatory conservation measures, approximately a 30-45 day supply of water under normal weather patterns.

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

- **Carroll Ecton Reservoir**

The Carroll Ecton Reservoir currently serves as a secondary source of water supply for the City of Winchester and Clark County. As previously mentioned the Reservoir impounds approximately 500,000,000 gallons of water on an unnamed tributary in Lower Howards Creek. Excess raw water flow from the Kentucky River can be pumped to the Reservoir during normal operation. Over the years significant leakage has developed out of the hillside (rock face) just below the dam and an unknown amount of silt has accumulated within the body of water both of which effect storage volumes. With construction of a new Water Treatment Plant and phasing the existing Water Treatment Plant out of service as proposed, maintaining the Reservoir as a water source will require significant rehabilitation. Previously allocated capital budget dollars have been removed from the most recent budget plans that were intended to address these issues.

- **Solid Waste Study**

The WMU Commission authorized a comprehensive solid waste study of the solid waste operations for WMU on May 31, 2012. The scope of services was comprised of four (4) phases of work that included 1) Compilation and review of existing information, 2) Cost and rate analysis, 3) Review of alternatives (optional), and 4) Reporting. The final report delivered in March of 2013 provided a comprehensive review of the operational and financial performance of WMU's solid waste services, including collection, recycling, and operation of the transfer station. The final report also included state and national benchmarking of municipal and solid waste management systems to gauge the "state of the industry" and to identify best practices for consideration by WMU. Key findings from the study included elimination of the mandatory commercial customer charge, establishment of a multi-family customer class, validation and implementation of several operational alternatives including integration of elderly/disabled collection into regular refuse routes; conversion of the second weekly refuse collection service to curbside recycling collection; consideration of a Pay As You Throw (PAYT) structure; and establishment of commercial collection for corrugated cardboard recycling. The final report developed rate structures for "full cost" and "revenue sufficiency". Future budgets will be impacted by any changes that are made as a result of the findings of the study.

- **Affordability**

Affordability of services continues to be a major concern of the City Commission, the Utility Commission and to management. The WMU service area population

is approximately 27,000 of which 51% fall in the low to moderate income (LMI) level. While the economy continues to slowly recover a continued depressed world-wide economy further impacts the affordability of WMU's services.

The primary costs in WMU's budget are capital costs including renewals and replacements. The cost of compliance with the Consent Decree (approximately 67 million to-date), cost for upgrading and expanding WMU's water system capacity, and additional capital needs are expected to exceed \$100 million. Renewals and replacements exceed \$2,000,000 each year. The driving factors in WMU's operations and maintenance budget are power, fuel, chemical, and personnel costs.

The City and WMU Commissions, in concert with management, have continuously worked to reduce the financial burden of rate increases. Cost-effective decisions must be considered and made with respect to capital needs. Management is focused on cost-effective operations while taking into consideration the high level of service demanded by WMU's customers. One of the cost effective measures included in the budgeting process for Fiscal Years 2012/2013 and 2013/2014 included setting aside \$770,000 in 2012/2013 and \$710,000 in 2013/2014 of the Depreciation budget to fund new water system improvements. Total accumulated funds are expected to be approximately \$4.3 million within five (5) years.

The City and WMU Commissions passed rate increases that became effective in February 2010. Rates continue to be adjusted annually with the last increase to be effective January 2015. These rate increases were necessary despite a depressed economy, high unemployment, and a declining stock market. Implementation of the rate increases will allow WMU to comply with the Consent Decree, upgrade and improve WMU's water system, and replace WMU's aging water and wastewater infrastructure to ensure service to existing customers and to position the community to be able to attract and retain residential, commercial, and industrial development while balancing the affordability of providing a prescribed level of service.

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

The City and WMU Commissions, in concert with the Fiscal Court, have adopted legislation (Privilege Fee) that will ensure that the costs of growth for WMU's sanitary sewer system are apportioned to all benefitted properties versus being solely supported by the existing customer base. The privilege fee approach is favored for its equity and for the benefit to the community by insuring that

sanitary sewers are sized on a watershed basis versus the historical “first in, one size fits all approach”. The Privilege Fee Ordinance and Policies have been approved by the respective legislative bodies and WMU’s first Privilege Fee Agreement, located in the Strodes Creek, Basin B has received preliminary application approval.

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

BUSINESS FACTORS

• Facilities Planning

WMU is required by federal and state regulation to maintain a Facilities Plan that outlines the long-term plan for growth of the sanitary sewer system and treatment works. A Facilities Plan Update was completed and approved by the Energy and Environmental Cabinet (EEC) for the upgrade of the Strodes Creek Wastewater Treatment Plant. The last Facilities Plan with respect to the collection system was completed in 1973. The plan should be updated on a minimum 20-year cycle. The WMU Commission authorized a Facilities Plan Update for the sanitary sewer collection system in August 2008. The Facilities Plan Update was necessary to determine the recommended end-of-pipe sewage management plan for the Lower Howards Creek Sanitary Sewer Improvements which was a requirement of the Consent Decree. The Facilities Plan Update was completed at a cost of \$189,000, approved by the Kentucky Division of Water on August 11, 2010 and identifies and addresses sanitary sewer collection recommendations for WMU’s 14 sub-watersheds listed below:

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

Conversely, there is no such mandate for the drinking water system with respect to planning. However, in November 2009 Hazen & Sawyer prepared a Water System Planning Study outlining recommendations for significant improvements needed to meet current and future needs for the utility. Recommendations included conceptual cost estimates for a new water treatment plant, raw water pump station upgrades, raw water transmission main upgrades, finished water transmission upgrades, and reservoir improvements. The conceptual cost summary totaled \$58,700,000 of improvements excluding any reservoir improvements. Management expects to utilize recommendations contained in the planning study as a guide for future decision-making. As previously mentioned engineering services have been secured to design raw and finished water improvements in the WMU distribution system as well as upgrading the raw water pumping capacities. Design of the facilities is expected to begin in 2013 with initiation of construction to begin in 2014. Funds to pay for the engineering services were acquired in the 2011 Bond issue.

In response to initiatives identified in the Clark County Community (CCC) Action Plan, the Winchester Recycling Task Force (RTF) was established in 2009. In the same year, the RTF developed and coordinated a county-wide Recycling Survey mailed to approximately 12,000 customers of WMU, Rumpke, and S&G Sanitation within the December 2009 and January 2010 billing cycle. A total of 2,167 survey responses were received representing a response rate of 22 percent. Of the 2,167 respondents, 1,447 (67%) were WMU customers. Based on the survey results and research efforts of the RTF, the Winchester City Commission and WMU Commission implemented Phase I of single stream curb side recycling for WMU customers the week of August 1, 2011. Data tracking of specific deliverables has provided valuable information to incorporate into the long-term plan for the proposed full implementation of single stream, curb-side recycling throughout the WMU solid waste customer service area. Results of Phase I and budgetary restrictions will dictate decision-making moving forward for expanding the recycling program. Currently, the Commission is reviewing several alternatives for moving the recycling effort forward that include the following 1) Mirroring the Yard Waste Program, 2) Piloting another area, 3) Developing a Phased Approach, 4) Implementing a Pay As You Throw (PAYT) Program and 5) Abandoning the Recycling Program. Once a direction has been established budgetary numbers can be developed for funding of the desired program.

- **Rate Studies**

The WMU Commission authorized rate studies of WMU's three utility functions. The rate studies proposed revenue sufficient rates to support WMU's operations, including the expanded operations as required by CMOM, the operations of the Strodes Creek WWTP and the planned WTP, the capital needs as required by the Consent Decree and the planned water system improvements. Results of

the rate study are reflective of the rates recommended, approved, and implemented February 2010.

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

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

- **Work Force**

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

WMU has 83 budgeted staff positions of which 75 are filled. The average age for WMU employees is 39 years. The number of eligible retirements at WMU over the next five years, due to age, years of service, or both, is three or 5% of the workforce. Since 2002, there have been 43 retirements which equates to a loss of 52% of the WMU workforce. Large scale retirement numbers often enable entities to renew and refresh operations, systems, and business philosophies. Transition planning has been successful for most key positions, however, such changeover carries the burden of losing institutional and industry knowledge, and challenges management to find, attract, train, and retain replacements particularly for supervisory positions. As WMU moves forward with construction of additional facilities for both water and wastewater, staffing of those facilities will be of concern. In an effort to screen and find quality employees WMU has acquired the help of a local temporary staffing service agency.

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

service delivered by WMU and for compliance with enforcement and regulatory activities.

- **Infrastructure Renewal**

A structured approach for infrastructure renewal spreads costs over the long-term and can increase the service life of assets. WMU continues to be a leader in Kentucky in the area of asset management and infrastructure renewal. WMU's infrastructure renewal program includes a prioritization methodology to maximize capital investment, and annual allocations for defined asset categories. WMU annually allocates an average of \$2,970,100 of its capital investment for this effort. Program elements include:

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

While WMU's program of infrastructure renewal is a model for other utilities and public works agencies in Kentucky, the program is limited in its scope by funding, especially with large water system improvements looming on the horizon. Infrastructure renewal funding should be based upon a mathematical model that addresses asset category inventory and asset category service life. WMU's program is based upon funds available. As an example and simply stated, for the waterline asset category, funding for waterline replacement should be based upon the cost for replacing the number of miles of waterline divided by the service life of the pipe. In this example, if WMU owns and maintains 166.43 miles of waterline with the waterlines having a service life of 60 years, the allocation for waterline replacement should be the average cost of replacing 2.77 miles of waterline per year. At \$60 per foot for replacement of a waterline this calculates to an annual allocation of \$877,536. WMU typically allocates \$200,000 but only allocated \$125,000 for FY 2013/2014. Likewise, if WMU owns and maintains 153.6 miles of sanitary sewer lines having a service life of 60 years, the allocation for sewer line replacement should be the average cost of replacing 2.56 miles of sewer line per year. At \$70 per foot for replacement of a sewer line, the annual allocation calculates to be \$946,176. WMU typically allocates \$200,000 but only allocated \$125,000 for FY 2013/2014. Without

adequate funding for infrastructure renewal WMU is susceptible to interruption of service to its customers and a reduced level of service provided to its customers.

- **Regulations**

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

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

State regulations typically result as mandates on state regulatory agencies from federal legislation. Kentucky is a primacy state meaning that the state is responsible for implementing and enforcing federal regulation. Staff works to ensure that state regulations, when promulgated, are reasonable and practicable.

Recently, two (2) regulations were enacted at the State level that will have a financial impact on WMU. The first being the Kentucky wastewater laboratory certification program for wastewater treatment plants (401KAR 5:320) and the other being HB 1 which requires a special purpose governmental entity to register, pay fees, and submit financial disclosure statements each fiscal year to the Kentucky State Auditor.

- **Vulnerability**

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

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

continues to explore opportunities to reduce vulnerabilities of the utility through upgrades to its systems and allocating budget dollars to make its facilities as safe and secure as possible. Funds were allocated in the FY 2013/2014 budget process for security upgrades at the Water Treatment Plant and WMU Administration building.

- **Growth**

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

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

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

UTILITY HIGHLIGHTS

- **Renewals and Replacements**

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

• Waterline Replacements	41,049 feet
• Sanitary Sewer Replacements	83,920 feet
• Fire Hydrant Replacements	74
• Gate Valve Replacements	177
• Manhole Replacements	301
• Elevated Storage Tank Rehabilitations	4

UTILITY HIGHLIGHTS: FINANCIAL

Total Assets increased from \$123,898,334, June 30, 2012, to \$135,072,706 June 30, 2013, a net increase of \$11,174,372 or 9.02%. The construction of the Lower Howards Creek wastewater plant, outfall sewer and force main is the main contributing factor to the increase of total assets. The Forest Park sanitary sewer improvement project and the BelAir pump station elimination was completed in this fiscal year. All of these are consent decree required projects. The site work for the new planned water treatment plant was ongoing in coordination with the new wastewater treatment plant. The donated capital of ownership and perpetual maintenance of system water and sewer lines and related appurtenances by developers also increased.

Operating Revenues increased from \$13,995,169, June 30, 2012, to \$15,403,126, June 30, 2013, a net increase of \$1,407,957 or 10.06%. The increase in revenues was attributable to a rate increase effective in January. This increase is part of a phased process that will have an increase every January until 2015.

Operating Expenses decreased from \$11,620,270, June 30, 2012, to \$11,583,515, June 30, 2013, a net decrease of \$36,755 or 0.32%. The decrease is due to salaries and related benefit costs and is offset by increases in property insurance, professional fees, electricity and chemical costs. Many open positions from retirements were filled by new entry level employees. The ongoing replacement of older equipment and new construction resulted in increased insurance costs. The ongoing CMOM related responsibilities resulted in increased professional fee expenses. The utility experienced an increase in chemical cost and electricity due to the demand of an additional wastewater and solids treatment plant.

Net Income to Retained Earnings changed from \$1,581,245, June 30, 2012, to \$3,363,513, June 30, 2013, a net change of \$1,782,268 or 112.71%. This change in Net Income to Retained Earnings is due to the cost of service rate increase that was effective in January. The continued phased rate increases are expected to result in positive net incomes in the future years and to pay for the increased debt that is expected with the long term capital needs.

• Statement of Net Position

Condensed Statement of Net Position - Assets

	2013	2012	Difference	Percent
Current Assets	\$16,488,568	\$14,171,250	\$2,317,318	16.35
Non-Current Assets	\$8,136,845	\$11,018,892	\$-2,882,047	-26.16
Property, Plant & Equip	\$110,287,568	\$98,539,839	\$11,747,729	11.92
Other Assets	\$159,725	\$168,353	\$-8,628	-5.12
Total Assets	\$135,072,706	\$123,898,334	\$11,174,372	9.02

Condensed Statement of Net Position – Liabilities and Net Position

	2013	2012	Difference	Percent
Current Liabilities	\$4,523,084	\$3,831,542	\$691,542	18.05
Noncurrent Liabilities including LTD	\$65,377,038	\$59,168,947	\$6,208,091	10.49
Net Position:				
Invested in Capital Assets, Net of Related Debt	\$41,621,273	\$37,457,686	\$4,163,587	11.12
Restricted Net Position	\$13,049,244	\$16,007,650	\$-2,958,406	-18.48
Unrestricted Net Position	\$10,502,067	\$7,432,509	\$3,069,558	41.30
Total Liabilities & Net Position	\$135,072,706	\$123,898,334	\$11,174,372	9.02

• Statement of Revenues, Expenses and Changes in Net Position

Condensed Statement of Revenues, Expenses and Changes in Net Position

	2013	2012	Difference	Percent
Operating Revenues				
Water	\$5,269,419	\$4,843,271	\$426,148	8.80
Wastewater	\$6,826,218	\$6,226,897	\$599,321	9.62
Solid waste	\$3,307,489	\$2,925,001	\$382,488	13.08
Other Income	\$0	\$0	\$0	
Total Operating Revenues	\$15,403,126	\$13,995,169	\$1,407,957	10.06
Operating Expenses including Depreciation	\$11,583,515	\$11,620,270	\$-36,755	-0.32
Operating Income	\$3,819,611	\$2,374,899	\$1,444,712	60.83
Non-Operating Income	\$376,287	\$392,847	\$-16,560	-4.22
Interest Expense	\$(832,385)	\$(1,186,501)	\$354,116	-29.85
Net Income to Retained Earnings	\$3,363,513	\$1,581,245	\$1,782,268	112.71
Capital Grants and Contributions	\$911,226	\$1,330,921	\$-419,695	-31.53
Changes in Net Position	\$4,274,739	\$2,912,166	\$1,362,573	46.79
Net Position, Beginning of Year	\$60,897,845	\$57,985,679	\$2,912,166	5.02
Net Position, End of Year	\$65,172,584	\$60,897,845	\$4,274,739	7.02

• Five-Year Capital Plan

The WMU Commission maintains and annually updates a five-year capital plan that identifies and prioritizes the capital requirements of WMU necessary for customer service, regulatory compliance, and to accommodate growth. The five-year investment totals in excess of \$12,102,500. Of these planned expenditures, \$11,642,500 will be invested in infrastructure renewal and administrative support with the remaining \$460,000 allocated for one-time, and intermittent investments. Additionally \$275,000 is reserved for emergency and / or unexpected expenditures.

• Debt Administration

As of July 1, 2013, WMU maintained the following debt:

- Series 2011 Bonds \$8,352,500
- Series 2012 Bonds \$7,115,000

- KIA loan Strodes Creek \$16,637,037
- KIA loan Vaught \$251,233
- KIA loan Tank \$304,815
- KIA LHC (loan of 36.6 mil) \$35,600,004 drawn
- KIA BelAir \$478,140 drawn

The Debt Service coverage factor for Bonds of 6.25 in FY 2012/2013 is favorable to the required 1.2 coverage limit. The Debt Service coverage factor for KIA debt of 2.91 in FY 2012/2013 is favorable to the required 1.0 coverage limit. Debt Service coverage is based upon the revenue of the combined utility functions – Water, Sewer, and Solid Waste.

• **FY 2013/2014 Budget Assumptions**

Total combined revenues for FY 2013/2014 are projected to increase from FY 2012/2013 revenues by 5.43%. No annual adjustment to rates based upon the CPI index is expected this year, however, a rate increase is budgeted in January 2014 based upon the approved rate ordinance passed by the City in 2010. Operating expenses excluding depreciation for FY 2013/2014 are projected to increase over budgeted FY 2012/2013 operating expenses by approximately 5.32%. Operating expenses will be impacted by increased power, employee benefits, insurance costs, purchased labor related to the cleaning of the East and West Interceptor Sewer Lines and temporary labor costs in all departments.

The debt service coverage ratio is required to be 1.40 for bonds and 1.00 for KIA. Both formulas calculate by adding depreciation, a non cash expense back to income available for debt service. The budgeted debt service coverage ratio is 3.26 for Bond debt and 1.59 for KIA debt.

CONTACTING THE COMPANY’S FINANCIAL MANAGEMENT

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

Michael H. Flynn
 General Manager
 or
 Jennifer Sparks
 Director of Finance and Accounting

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

WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF NET POSITION
JUNE 30, 2013 AND 2012

ASSETS	<u>2013</u>	<u>2012</u>
CURRENT ASSETS:		
Cash and Cash Equivalents	\$ 7,658,841	\$ 5,386,377
Cash and Cash Equivalents, Restricted	351,373	404,038
Investments, Restricted	4,729,869	4,741,588
Accrued Interest, Restricted	6,738	19,977
Accounts Receivable, Customers (Net of Allowance for Doubtful Accounts, 2013 and 2012, \$46,831 and \$20,361)	1,718,516	1,693,797
SDC Assessments Receivable	940,509	943,036
Other Accounts Receivable	10,496	50,470
Other Receivable	233	-
Materials and Supplies	351,665	315,675
Prepaid Expenses	<u>720,328</u>	<u>616,292</u>
Total Current Assets	<u>16,488,568</u>	<u>14,171,250</u>
NONCURRENT ASSETS:		
Cash and Cash Equivalents, Restricted	8,136,845	10,605,127
Investments, Restricted	-	413,765
Property, Plant & Equipment:		
Utility Systems, Net of Depreciation	66,152,427	64,717,555
Land	1,051,011	1,051,011
Construction in Progress	43,084,130	32,771,273
Other Assets:		
Bond Issue Costs	<u>159,725</u>	<u>168,353</u>
Total Noncurrent Assets	<u>118,584,138</u>	<u>109,727,084</u>
TOTAL ASSETS	<u>\$ 135,072,706</u>	<u>\$ 123,898,334</u>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF NET POSITION (CONTINUED)
JUNE 30, 2013 AND 2012**

LIABILITIES AND NET POSITION	<u>2013</u>	<u>2012</u>
CURRENT LIABILITIES:		
Accounts Payable	\$ 370,010	\$ 636,053
Other Accrued Liabilities	287,977	361,080
Compensated Absences	-	52,399
Current Portion of Capital Lease Payable	6,974	6,975
Payable from Restricted Assets:		
Accounts Payable - Construction	25,275	287,090
Accounts Payable - Retainage	-	75,126
Customer Deposits	155,489	157,685
Accrued Interest Payable	106,671	90,116
Current Portion of Long-Term Debt	<u>3,175,612</u>	<u>1,816,115</u>
Total Current Liabilities	<u>4,128,008</u>	<u>3,482,639</u>
NONCURRENT LIABILITIES:		
Compensated Absences	395,076	348,903
Noncurrent Portion of Long-Term Debt	65,377,038	59,161,973
Noncurrent Portion of Capital Lease Payable	<u>-</u>	<u>6,974</u>
Total Noncurrent Liabilities	<u>65,772,114</u>	<u>59,517,850</u>
TOTAL LIABILITIES	<u>69,900,122</u>	<u>63,000,489</u>
NET POSITION:		
Invested in Capital Assets, Net of Related Debt	41,621,273	37,457,686
Restricted for:		
Restricted for Capital Projects (Expendable)	12,158,802	15,166,667
Restricted for Debt Service (Expendable)	890,442	840,983
Unrestricted	<u>10,502,067</u>	<u>7,432,509</u>
TOTAL NET POSITION	<u>65,172,584</u>	<u>60,897,845</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 135,072,706</u>	<u>\$ 123,898,334</u>

See Auditor's Report and Accompanying Notes

WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
OPERATING REVENUES:		
Water	\$ 5,269,419	\$ 4,843,271
Wastewater	6,826,218	6,226,897
Solid Waste	3,260,013	2,868,726
Transfer Station	<u>47,476</u>	<u>56,275</u>
Total Operating Revenues	<u>15,403,126</u>	<u>13,995,169</u>
OPERATING EXPENSES:		
Administrative	1,985,151	1,896,651
Solid Waste	1,755,845	1,676,815
Water	2,990,591	3,061,054
Wastewater	4,701,673	4,848,891
Vehicle Maintenance	<u>150,255</u>	<u>136,859</u>
Total Operating Expenses	<u>11,583,515</u>	<u>11,620,270</u>
OPERATING INCOME (LOSS)	3,819,611	2,374,899
NONOPERATING REVENUES (EXPENSES):		
Interest Income	136,511	223,376
Interest Expense	(804,569)	(1,014,251)
Other Income	222,464	202,791
Investment Income (Loss)	(36,477)	(72,484)
Gain on Sale of Capital Assets	53,789	39,164
Amortization Expense of Bond Issue Costs & Bond Discount	(27,816)	(172,250)
Federal and State Grants	<u>83,506</u>	<u>1,124,188</u>
Total Nonoperating Revenues (Expenses)	<u>(372,592)</u>	<u>330,534</u>
NET INCOME (LOSS) BEFORE CONTRIBUTIONS	3,447,019	2,705,433
CAPITAL CONTRIBUTIONS	<u>827,720</u>	<u>206,733</u>
CHANGE IN NET POSITION	<u>4,274,739</u>	<u>2,912,166</u>
NET POSITION, BEGINNING OF YEAR	<u>60,897,845</u>	<u>57,985,679</u>
NET POSITION, END OF YEAR	<u>\$ 65,172,584</u>	<u>\$ 60,897,845</u>

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Customers	\$ 15,378,738	\$ 13,698,837
Payments to Suppliers	(6,480,467)	(5,017,062)
Payments to Employees	(2,538,627)	(2,498,862)
Other Operating Receipts (Payments)	39,740	(31,493)
Net Cash Provided (Used) by Operating Activities	6,399,384	6,151,420
CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from Sale of Equipment	53,789	49,858
Proceeds from Long-Term Debt	9,371,490	27,823,103
Bond Issue Costs/Discount on Long-Term Debt	-	(146,835)
Principal Payments	(1,823,089)	(9,087,484)
Interest Payments	(1,432,763)	(1,292,551)
Purchase of Property, Plant and Equipment	(14,528,751)	(24,639,267)
Proceeds from Federal and State Grants - Capital items	83,506	1,124,188
Contributed Capital Received	827,720	149,890
Cash from Other Income	222,464	202,791
Net Cash Provided (Used) by Capital and Related Financing Activities	(7,225,634)	(5,816,307)
CASH PROVIDED (USED) BY INVESTING ACTIVITIES:		
Proceeds from Sales and Maturities of Investments	1,401,256	3,329,581
Purchase of Investments	(960,000)	(2,174,995)
Cash from Interest in Investments	136,511	141,587
Net Cash Provided (Used) by Investing Activities	577,767	1,296,173
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(248,483)	1,631,286
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	16,395,542	14,764,256
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 16,147,059	\$ 16,395,542
Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets:		
Cash and Cash Equivalents - unrestricted	\$ 7,658,841	\$ 5,386,377
Cash and Cash Equivalents - restricted current	351,373	404,038
Cash and Cash Equivalents - restricted noncurrent	8,136,845	10,605,127
Cash and Cash Equivalents, End of Year	\$ 16,147,059	\$ 16,395,542

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

	2013	2012
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating Income (Loss)	\$ 3,819,611	\$ 2,374,899
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:		
Depreciation/Amortization	3,386,759	3,467,372
(Increase) Decrease in Assets:		
Accounts Receivable, Customers	(24,719)	(299,040)
SDC Receivables	2,527	2,119
Other Accounts Receivable	39,974	(34,968)
Other Receivable	(233)	3,474
Material and Supplies	(35,990)	(9,019)
Prepaid Expenses	(104,036)	(11,904)
Increase (Decrease) in Liabilities:		
Accounts Payable	(266,043)	413,768
Accounts Payable - Construction	(261,815)	189,902
Accounts Payable - Retainage	(75,126)	75,126
Accrued Liabilities	(73,103)	(23,775)
Accrued Vacation	(6,226)	2,877
Customer Deposits	(2,196)	589
Net Cash Provided (Used) by Operating Activities	\$ 6,399,384	\$ 6,151,420
 NONCASH TRANSACTIONS AFFECTING FINANCIAL POSITION		
Capital assets were acquired through Contributions from Developers	\$ 300	\$ 56,843
	\$ 300	\$ 56,843

See Auditor's Report and Accompanying Notes

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Introduction

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

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

Cash and Cash Equivalents

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

Investments

All investments are stated at fair value. Investment fair values are based on quoted market prices. All investments are restricted as to use.

Accounts Receivable

Accounts receivable - Customers, are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense. An adjustment to an allowance for doubtful accounts is based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. As of June 30, 2013 and 2012, \$34,730 and \$53,973 were written off as uncollectible, respectively.

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

Materials and Supplies

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Prepaid Expenses

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

Restricted Assets

The use of certain assets of enterprise funds is restricted by specific provisions of bond resolutions and agreements with various parties. Assets so designated are identified as restricted assets on the statement of net position. When both restricted and unrestricted resources are available for use, it is WMU's policy to use restricted resources first, and then unrestricted resources as they are needed. Restricted assets are classified as noncurrent if they are for acquisition or construction of capital assets, for liquidation of long-term debt, or are for other current operations.

Property, Plant and Equipment

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

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

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized

Assets under capitalized lease obligations are recorded at the discounted present value of the future minimum lease payments at the inception of the respective leases. The amounts capitalized are being amortized by the straight-line method over the lesser of the term of the lease or the estimated life of the asset. Amortization of these assets is included in depreciation expense.

Accrued Compensated Absences

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

Bond Amortization Costs

Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Amortization expense for bond issue costs as of June 30, 2013 and 2012 was \$8,628 and \$59,709, respectively. Amortization expense for bond discount as of June 30, 2013 and 2012 was \$19,187 and \$112,536, respectively.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interest

Interest is charged to expense as incurred except, WMU follows the policy of capitalizing interest as a component of construction in progress. For the years ended June 30, 2013 and 2012, total interest incurred was \$1,449,319 and \$1,294,299, respectively, of which \$644,750 and \$280,048 was capitalized and \$804,569 and \$1,014,251 was expensed, respectively.

Net Position

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

Operating and Nonoperating Revenues and Expenses

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

Nonmonetary Transaction

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

Capital and Operating Grants and Subsidies

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

Tap Fees

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

System Development Charges

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

Basis of Estimates

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

Joint Venture

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

Clark County Geographic Information System Consortium (CCGIS), is a governmental agency created by an inter-local agreement between the Clark County PVA, City of Winchester and WMU. CCGIS was created to provide a geographic system to serve the needs of Winchester and Clark County. The operations are funded by the City, WMU and the Clark County Fiscal Court. WMU provides management services for CCGIS. WMU contributed \$76,958 and \$64,782 for the years ended 2013 and 2012, respectively. CCGIS had accounts payables to WMU of \$0 and \$18,892 for the years ended 2013 and 2012, respectively, for reimbursements of payroll and other expenses. CCGIS had accounts receivable from WMU of \$0 and \$8,105 for the years ended 2013 and 2012, respectively, for excess reimbursements of payroll and other expenses. Complete financial statements for CCGIS can be obtained from WMU's Director of Finance.

New Accounting Pronouncements

GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989, FASB and AICPA Pronouncements, effective for periods beginning after December 15, 2011, incorporates into GASB's authoritative literature certain accounting and financial reporting guidance included in Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants (AICPA) Committee on Accounting Procedure, which do not conflict with or contradict GASB pronouncements. The District implemented the new requirements for the fiscal year 2013 financial statements.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 2 – DEPOSITS AND INVESTMENTS

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

Interest rate Risk

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

06/30/13		Maturities (in Years)			
Type	Fair Value	< Than 1	1 - 5	6 - 10	> Than 10
Cash and Cash Equivalents	\$ 16,147,059	\$ 16,147,059	\$ 0	\$ 0	\$ 0
U.S. Treasury Obligations	4,332,646	4,332,646	0	0	0
Federal Home Loan Mtg Corp	185,316	185,316	0	0	0
Federal Home Loan Bank	211,907	211,907	0	0	0
Total	<u>\$ 20,876,928</u>	<u>\$ 20,876,928</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

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

Credit Risk

This risk is the risk that an issuer of a debt type investment will not fulfill its obligation to the holder of the investment. This is measured by assignment of a rating by a nationally recognized rating organization. U.S. Government securities or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk exposure. WMU has no formal policy on managing credit risk; however, Kentucky Revised Statutes authorize municipalities to invest in obligations of the United States and its agencies, obligations of the Commonwealth of Kentucky and its agencies and shares in savings and loan associations insured by federal agencies. Larger amounts can be deposited in savings and loan associations and banks provided such institutions pledge obligations of the United States government or its agencies as security. Presented below is the minimum rating required for each type of deposit and investment:

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)

06/30/13		Ratings			
Type	Fair Value	AAA	AA	A	Unrated
Cash and Cash Equivalents	\$ 16,147,059	\$ 0	\$ 0	\$ 0	\$ 16,147,059
U.S. Treasury Obligations	4,332,646	4,332,646	0	0	0
Federal Home Loan Mtg Corp	185,316	185,316	0	0	0
Federal Home Loan Bank	211,907	211,907	0	0	0
Total	<u>\$ 20,876,928</u>	<u>\$ 4,729,869</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 16,147,059</u>

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

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty, WMU will not be able to recover the value of its deposits and investments that are in possession of an outside party. WMU has no formal policy for custodial credit risk; however, as of June 30, 2013 and 2012 all deposits and investments were either fully collateralized by federal depository insurance or by the pledging institution in WMU's name or were held in a bank's trust department in the City of Winchester's name, the primary government of the component unit, WMU.

NOTE 3 – CREATION OF ACCOUNTS AND RESTRICTED ASSETS

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

Revenue Account

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

Bond Redemption Account

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

Reserve Account

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 3 – CREATION OF ACCOUNTS AND RESTRICTED ASSETS (CONTINUED)

Depreciation Account

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

Operation and Maintenance Account

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

The restricted assets in the accompanying financial statements are restricted as to use by bond ordinance or by external parties at June 30, 2013 and 2012 follows:

<u>06/30/13</u>	<u>Cash</u>	<u>Investments</u>	<u>Accrued Interest</u>	<u>Total</u>
Restricted by Ordinance:				
Bond Redemption Account	\$ 351,373	\$ 0	\$ 0	\$ 351,373
Reserve Accounts	528,400	0	0	528,400
Depreciation Account	2,326,421	0	0	2,326,421
Subtotal	<u>3,206,194</u>	<u>0</u>	<u>0</u>	<u>3,206,194</u>
Other Restricted Accounts:				
SDC Water Fund	2,623,222	0	0	2,623,222
SDC Wastewater Fund	1,376,260	0	0	1,376,260
Customer Deposits	175,581	0	0	175,581
KIA Reserve	10,669	0	0	10,669
Water Improvements	772,333	0	0	772,333
2011 Bond Funds	0	4,729,869	6,595	4,736,464
Capital Accum-Water	231,409	0	102	231,511
Capital Accum-Wastewater	92,550	0	41	92,591
Total	<u>\$ 8,488,218</u>	<u>\$ 4,729,869</u>	<u>\$ 6,738</u>	<u>\$ 13,224,825</u>

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 4 – PROPERTY, PLANT AND EQUIPMENT

WMU's property, plant and equipment as of June 30, 2013 and 2012 is as follows:

<u>06/30/13</u>	<u>Beginning</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending</u>
Non-depreciable Assets:				
Land	\$ 1,051,011	\$ 0	\$ 0	\$ 1,051,011
Construction in Progress	32,771,273	20,707,549	(10,394,692)	43,084,130
Total Non-depreciable Assets	\$ 33,822,284	\$ 20,707,549	\$ (10,394,692)	\$ 44,135,141
Depreciable Assets:				
Administrative	\$ 3,083,795	\$ 197,828	\$ (20,807)	\$ 3,260,817
Water System	39,393,715	1,170,413	(35,713)	40,528,415
Wastewater System	65,690,211	3,387,040	(419,965)	68,657,286
Solid Waste	6,117,911	370,524	(199,801)	6,288,634
Vehicle Maintenance	440,980	2,288	0	443,268
Equipment Capital Lease	82,927	0	0	82,927
Subtotal	<u>114,809,539</u>	<u>5,128,093</u>	<u>(676,286)</u>	<u>119,261,346</u>
Accumulated Depreciation:				
Administrative	(1,354,420)	(167,189)	17,819	(1,503,790)
Water System	(10,468,292)	(931,153)	0	(11,399,445)
Wastewater System	(17,262,834)	(1,983,188)	154,717	(19,091,305)
Solid Waste	(1,474,628)	(281,432)	197,288	(1,558,772)
Vehicle Maintenance	(301,054)	(23,797)	0	(324,851)
Prior Years Accumulated	(19,230,756)	0	0	(19,230,756)
Subtotal	<u>(50,091,984)</u>	<u>(3,386,759)</u>	<u>369,824</u>	<u>(53,108,919)</u>
Total Net Property, Plant and Equipment	\$ 64,717,555	\$ 1,741,334	\$ (306,462)	\$ 66,152,427
<u>06/30/12</u>	<u>Beginning</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending</u>
Non-depreciable Assets:				
Land	\$ 1,051,011	\$ 0	\$ 0	\$ 1,051,011
Construction in Progress	12,856,597	26,940,271	(7,025,595)	32,771,273
Total Non-depreciable Assets	\$ 13,907,608	\$ 26,940,271	\$ (7,025,595)	\$ 33,822,284
Depreciable Assets:				
Administrative	\$ 3,030,966	\$ 72,349	\$ (19,520)	\$ 3,083,795
Water System	37,499,778	1,931,060	(37,123)	39,393,715
Wastewater System	63,167,584	2,546,890	(24,263)	65,690,211
Solid Waste	5,814,764	476,552	(173,405)	6,117,911
Vehicle Maintenance	428,994	13,708	(1,722)	440,980
Equipment Capital Lease	62,004	20,923	0	82,927
Subtotal	<u>110,004,090</u>	<u>5,061,482</u>	<u>(256,033)</u>	<u>114,809,539</u>
Accumulated Depreciation:				
Administrative	(1,199,279)	(173,371)	18,230	(1,354,420)
Water System	(9,619,472)	(875,516)	26,696	(10,468,292)
Wastewater System	(15,147,785)	(2,137,591)	22,542	(17,262,834)
Solid Waste	(1,389,023)	(259,010)	173,405	(1,474,628)
Vehicle Maintenance	(280,892)	(21,884)	1,722	(301,054)
Prior Years Accumulated	(19,230,756)	0	0	(19,230,756)
Subtotal	<u>(46,867,207)</u>	<u>(3,467,372)</u>	<u>242,595</u>	<u>(50,091,984)</u>
Total Net Property, Plant and Equipment	\$ 63,136,883	\$ 1,594,110	\$ (13,438)	\$ 64,717,555

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 4 – PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

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

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

Depreciation expense in total and by function follows:

<u>Function</u>	<u>2013</u>	<u>2012</u>
Administrative	\$ 167,189	\$ 173,371
Water System	931,153	875,516
Wastewater System	1,983,188	2,137,591
Solid Waste	281,432	259,010
Vehicle Maintenance	23,797	21,884
Total Depreciation Expense	<u>\$ 3,386,759</u>	<u>\$ 3,467,372</u>

The total invested in capital assets, net of related debt, at June 30, 2013 and 2012 is composed of the following elements:

	<u>2013</u>	<u>2012</u>
Capital Assets	\$ 110,287,568	\$ 98,539,839
Total Debt, gross	<u>(68,666,295)</u>	<u>(61,082,153)</u>
Invested in Capital Assets, Net of Related Debt	<u>\$ 41,621,273</u>	<u>\$ 37,457,686</u>

NOTE 5 – LONG-TERM DEBT

WMU issues revenue bonds to finance improvements and extensions to the water and sewer systems. The Winchester Municipal Utilities bonded indebtedness and other long-term notes at June 30, 2013 and 2012, are summarized as follows:

<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Original Issue</u>	<u>2013 Total</u>	<u>2012 Total</u>
2011 Issue	5.27%	01/01/31	9,010,000	\$ 8,352,500	\$ 8,676,667
2012 Issue	2.00-3.75%	07/01/32	7,495,000	7,115,000	7,400,000
Less: Unamortized Discount				<u>(186,077)</u>	<u>(205,266)</u>
Total Bonds				<u>15,281,423</u>	<u>15,871,401</u>
KIA Loan	1.00%	12/01/28 Estimate	21,000,000	16,637,036	17,817,272
KIA-Lower Howards Creek	2.00%	01/01/31 Estimate	36,600,000	35,600,004	26,706,654
KIA-Bel-Air	2.00%	01/01/31	1,000,000	478,140	0
KIA-Industrial Storage Tanks	2.00%	12/01/30	340,326	304,814	319,231
KIA-Vaught Court	2.00%	06/01/31	287,400	251,233	263,529
Total KIA Loans				<u>53,271,227</u>	<u>45,106,686</u>
Less: Current Maturities				<u>(3,175,612)</u>	<u>(1,816,115)</u>
Total				<u>\$ 65,377,038</u>	<u>\$ 59,161,973</u>

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 5 - LONG-TERM DEBT (CONTINUED)

The annual bond and long-term debt service requirements, as of June 30, 2013, are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 3,177,855	\$ 1,514,000	\$ 4,691,855
2015	3,237,304	1,455,176	4,692,480
2016	3,303,259	1,396,657	4,699,916
2017	3,362,062	1,336,807	4,698,869
2018	3,428,729	1,275,799	4,704,528
2019-2023	18,207,264	5,016,606	23,223,870
2024-2028	18,413,458	3,271,214	21,684,672
2029-2033	15,422,719	991,955	16,414,674
	<u>\$ 68,552,650</u>	<u>\$ 16,258,214</u>	<u>\$ 84,810,864</u>

The above schedule includes estimated future payments towards the KIA-Lower Howards Creek and KIA-Bel-Air financing. At year end, the related projects were not completed, but are expected to be completed in the subsequent period, and KIA has provided WMU with estimated payment amounts.

Series 2002 Bonds

On March 1, 2002, the City issued \$9,025,000 of utilities revenue bonds for WMU secured by a first pledge of a fixed portion of the gross revenues to be derived from the operation of the system, which fixed portion shall be sufficient to pay the principal and interest of the bonds. The 2002 bond issue financed the acquisition, construction and installation of major new municipal sanitary sewer (wastewater) facilities and paying and discharging the outstanding Utilities Revenue Bond Anticipation Note, Series 1997. The bonds carry interest rates of 4.5% to 5.125% and mature on July 1, 2032. The interest payments are to be made on July 1 and January 1 and the principal payments are to be made on July 1. The bonds were paid in full during the 2011-2012 fiscal year by a refunding, Series 2012 Bonds issuance (See Refunding, Series 2012 Bonds below).

Series 2011 Bonds

On April 14, 2011, the City issued \$9,010,000 of utilities revenue bonds for WMU secured by a first and prior security interest in any and all right, title and interest of WMU in the portions of the Project (extensions and improvements of the System) that constitute personal property and in all additions, attachments, accessions, and substitutions thereto, and any proceeds therefrom. The 2011 bond issues financed the extensions and improvements to the combined and consolidated municipal waterworks, sanitary sewer and solid waste disposal system. The bonds carry an interest rate of 5.2656174% and mature on January 1, 2031. The interest and principal payments are to be made monthly.

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

Refunding, Series 2012 Bonds

On April 19, 2012, the City issued \$7,495,000 of utilities refunding revenue bonds for WMU to pay off the Series 2002 Bonds (See Series 2002 Bonds above). The bonds were secured by a first pledge of a fixed portion of the gross revenues to be derived from the operation of the system, which fixed portion shall be sufficient to pay the principal and interest of the bonds. The 2002 bond issue financed the acquisition, construction and installation of major new municipal sanitary sewer (wastewater) facilities and paying and discharging the outstanding Utilities Revenue Bond Anticipation Note, Series 1997. The bonds carry interest rates of 2.0% to 3.75% and mature on July 1, 2021. The interest payments are to be made on July 1 and January 1 and the principal payments are to be made on July 1.

KIA Loan

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

KIA – Vaught Court Loan

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

KIA – Industrial Elevated Storage Tank

On December 1, 2009, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for construction of an Elevated Storage Tank Rehabilitation, \$741,450 with a principal forgiveness of \$401,124 and a loan amount of \$340,326. This agreement calls for interest payments to commence within six months from the first draw of funds estimated to be June 1, 2010 with full principal and interest payments to commence within one year of initiation of operation estimated to be June 1, 2011. During the year ended June 30, 2010, \$401,124 of principal was forgiven. During the year ended June 30, 2011, \$340,326 was drawn down, and the project was completed. The loan carries a 2.00% interest rate, with principal and interest payments due on December 1 and June 1 every year until maturity on December 1, 2030. The loan is required to establish a replacement reserve account where \$2,000 is to be added to the account each December 1 until the balance reaches \$20,000 and is to be maintained for the life of the loan.

KIA – Lower Howards Creek

On February 5, 2010, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for the Lower Howards Creek Sewershed project, \$36,600,000. This agreement calls for interest payments to commence within six months from the first draw of funds with full principal and interest payments to commence within one year of initiation of operation, which was on February 12, 2013. During the current year, \$8,893,350 of the loan was drawn down. Upon completion of the project, the loan will carry a 2.00% interest rate and mature in twenty years. The loan is required to establish a replacement reserve account where \$91,500 is to be added to the account each December 1 until the balance reaches \$915,000 and is to be maintained for the life of the loan.

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

KIA – Bel-Air Sanitary

On October 1, 2012, Winchester Municipal Utilities entered into an “Assistance Agreement” with the Kentucky Infrastructure Authority (KIA), to provide funds for the Bel-Air and Westside pump station projects, \$1,000,000. This agreement calls for interest payments to commence within six months from the first draw of funds with full principal and interest payments to commence within one year of initiation of operation estimated to be December 1, 2013. During the current year, \$478,140 of the loan was drawn down. Upon completion of the project, the loan will carry a 2.00% interest rate and mature in twenty years. The loan is required to establish a replacement reserve account where \$2,500 is to be added to the account each December 1 until the balance reaches \$25,000 and is to be maintained for the life of the loan.

Capital Lease

On September 30, 2011, the Utility entered into a new capital lease agreement with Océ Financial Services, Inc. for two new copiers in the amount of \$20,923. Payments are for \$648 for 36 months at an interest rate of 7.20%. The assets held under capital leases are included in equipment and total \$20,923 less accumulated depreciation of \$6,974 and \$2,790, as of June 30, 2013 and 2012, respectively.

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

06/30/14	\$	7,272
Less: Interest		<u>(298)</u>
Present Value of Minimum Lease Payments	\$	<u>6,974</u>

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

Long-Term Debt consists of bonds and other indebtedness for which the changes in the years ended June 30, 2013 and 2012 are as follows:

<u>Description</u>	<u>Beginning</u>	<u>Borrowings Additions</u>	<u>Repayments Reductions</u>	<u>2013 Ending</u>	<u>Current</u>
Compensated Absences	\$ 401,302	\$ 46,173	\$ 52,399	\$ 395,076	\$ 0
Bonds	15,871,401	0	589,978	15,281,423	605,751
KIA Loan	17,817,272	0	1,180,235	16,637,037	997,483
Capital Lease	13,950	0	6,976	6,974	6,974
KIA-Lower Howards	26,706,654	8,893,350	0	35,600,004	1,504,837
KIA-Bel-Air	0	478,140	0	478,140	40,290
KIA-Storage Tank	319,231	0	14,416	304,815	14,707
KIA-Vaught Court	263,529	0	12,296	251,233	12,544
Total Long-Term Debt	<u>\$ 61,393,339</u>	<u>\$ 9,417,663</u>	<u>\$ 1,856,300</u>	<u>\$ 68,954,700</u>	<u>\$ 3,182,586</u>

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 5 – LONG-TERM DEBT (CONTINUED)

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

NOTE 6 – COMPLIANCE WITH COVENANTS

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

Bond Debt Service - Bonds

Monthly deposits equal to one-sixth of the next interest payment and one-twelfth of the next principal payment shall be set aside monthly so as to accumulate in the Bond Fund in order to pay interest and principal on the bonds. In addition, the Bond Ordinance requires that a specific amount be maintained in the Debt Service Reserve Account defined as the "Reserve Amount." The account is to be reviewed each year and funded based on the least of three factors: 1) maximum annual principal and interest requirement, 2) 125% of the average annual principal and interest requirement or 3) 10% of the outstanding loan proceeds. The first factor was applicable for June 30, 2013 and 2012, and required a balance of \$507,944.

Depreciation Reserve – Bonds and KIA Loan

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

Interest Coverage Ratio – Bonds and KIA Loan

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 6 – COMPLIANCE WITH COVENANTS (CONTINUED)

Bonds:	<u>2013</u>	<u>2012</u>
Income Available for Debt Service	\$ 4,178,586	\$ 2,801,066
Add: Depreciation	3,386,759	3,467,372
Cash Available for Bond Debt Service	<u>\$ 7,565,345</u>	<u>\$ 6,268,438</u>
Annual Debt Service on Bonds	<u>1,210,429</u>	<u>1,407,396</u>
Coverage Ratio	<u>6.25</u>	<u>4.45</u>
KIA:	<u>2013</u>	<u>2012</u>
Income Available for Debt Service	\$ 4,178,586	\$ 2,801,066
Add: Depreciation	3,386,759	3,467,372
Cash Available for Debt Service	<u>\$ 7,565,345</u>	<u>\$ 6,268,438</u>
Annual Debt Service on all Debt	<u>2,604,128</u>	<u>2,803,022</u>
Coverage Ratio	<u>2.91</u>	<u>2.24</u>

Winchester Municipal Utilities is in compliance with all of the covenants of the bond ordinance and KIA loan agreement as of June 30, 2013 and 2012.

NOTE 7 – FIVE YEAR CAPITAL CONSTRUCTION PLAN

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

Water Utility Improvements	\$ 60,672,000
Wastewater Utility Improvements	22,616,000
Total projected financing requirement	<u>\$ 83,288,000</u>

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 7 – FIVE YEAR CAPITAL CONSTRUCTION PLAN (CONTINUED)

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

Finance and Administration:	
Copiers	\$ 8,000
Upgrade/Renew Network Virus Protection	1,600
Upgrade Local Area Network	8,000
Replace Microcomputers	8,000
Engineering Software Upgrades	2,500
Field Operation Vehicles	385,000
Solid Waste Collection:	
Cubit Replacement	30,000
Container Replacement	35,000
Replace Compactor Ejector Box	10,000
Solid Waste Recycling	100,000
Water Treatment Plant Equipment Improvements	233,000
Water System Improvements	710,000
Water Distribution:	
Main Replacement	125,000
Fire Hydrant Replacement	10,000
Gate Value Box Adjustment – New Paving	5,000
Gate Value Replacement	10,000
Elevated Storage Tank Rehabilitation	400,000
Meter Change-Out/AMR Equipment	125,000
New Meter Services	40,000
Wastewater Collection:	
Main Replacement Program	125,000
Manhole Grade Adjustment – New Paving	10,000
I&I Rehabilitation	25,000
Rehabilitation of Private Sewers	20,000
Flow Meters	35,000
Infrastructure Rehabilitation Program	25,000
System Capacity Assurance Program	18,000
Routine Hydraulic Cleaning	60,000
Wastewater Treatment Plant:	
Replacement of Laboratory Equipment	2,000
WWTP Equipment Improvements	100,000
Solids Processing Improvements	304,000
Total Annual Allocations for Infrastructure Investment	<u>\$ 2,970,100</u>

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 8 – PENSION FUND

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

Retirement benefits are provided for through legislative action of the Kentucky General Assembly and are funded by employee contributions which are deducted from employees' wages and by employer paid contributions. The General Assembly sets the employee contribution rates, currently 5% for fiscal year ending 2013 and 2012, and the Retirement Systems' Board of Trustees sets the employer contribution rates, currently 19.55% and 18.96% for fiscal year ending 2013 and 2012, respectively. Each employer is notified prior to each fiscal year of any change in the contribution rates. The Retirement System's administrative expenses are subject to approval by the Kentucky General Assembly and are paid from the State's Retirement Allowance Account.

Employer contributions for the years ended June 30, 2013, 2012 and 2011, under the current plan amounted to \$500,979, \$505,126 and \$432,605, respectively, which represents 100% of the required contributions.

In a prior year, the WMU Commission agreed to pay \$381,296 in prior service costs. This cost will be expensed equally over 19 years, based upon the average remaining service lives of all involved employees. Prior service costs expensed amounted to \$21,934 and \$21,934 for the years ended June 30, 2013 and 2012, respectively.

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

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 8 – PENSION FUND (CONTINUED)

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

Employee contributions made to the 401k and 457 plans as of June 30, 2013 and 2012 were \$44,771 and \$47,650, respectively. WMU does not contribute to these plans.

NOTE 9 – ECONOMIC DEPENDENCY

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

<u>Name</u>	<u>2013</u>	<u>2012</u>
Sekisui	\$ 744,656	\$ 727,684
Alltech	504,423	556,451
The Kroger Company	559,965	492,413
East Clark County WD	318,513	270,307
	<u>\$ 2,127,557</u>	<u>\$ 2,046,855</u>

NOTE 10 – RISK OF LOSS

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

NOTE 11 – LANDFILL POST-CLOSURE COSTS

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

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

NOTE 11 – LANDFILL POST-CLOSURE COSTS (CONTINUED)

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

The Division of Waste Management has finished construction of a new wetlands treatment system for treating the landfill leachate at the WMU and Clark County Landfills. With construction of this treatment facility a new Kentucky Pollution Discharge Elimination System (KPDES) Permit was required. Laboratory testing/Monitoring required as part of the conditions of this permit were unexpectedly more stringent than the previous permit resulting in a higher monthly cost for operation.

NOTE 12 – UTILITY REVENUES PLEDGED

WMU has pledged future revenues from water, wastewater and solid waste to repay the 2011 and 2012 bonds and KIA outstanding debt referenced in Note 5. Proceeds from these debt obligations provided financing of the water and wastewater infrastructure, including a new wastewater treatment plant. The debt obligations will be repaid from the previously mentioned utility revenues through the year 2032.

NOTE 13 – CONSTRUCTION COMMITMENTS

As of June 30, 2013, WMU had several uncompleted construction contracts. The remaining commitment on these construction contracts was approximately \$2,418,023 financed with KIA loans.

NOTE 14 – RESTATEMENT

We have restated Unrestricted Net Position and Restricted for Capital Project Net Position, as of June 30, 2012, by reclassifying \$5,175,330 from Unrestricted to Restricted for Capital Project Net Position. This restatement did not have an effect on the Change in Net Position for the year ending June 30, 2012.

SUPPLEMENTAL INFORMATION

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE I - DEPARTMENT EXPENSES
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
ADMINISTRATIVE		
Salaries	\$ 881,012	\$ 844,430
Employee Benefits	422,446	426,289
Repairs and Maintenance	79,804	76,157
Supplies	35,525	34,521
Small Tools	3,039	3,507
Utilities and Telephone	36,414	33,815
Property Insurance	53,653	43,760
Other	40,803	41,300
Postage and Freight	67,443	65,014
Bad Debts	61,200	49,650
Professional Fees	136,623	104,837
Depreciation/Amortization	167,189	173,371
	<u>1,985,151</u>	<u>1,896,651</u>
SOLID WASTE		
Salaries	468,064	435,245
Employee Benefits	305,425	291,292
Repairs and Maintenance	330,014	360,826
Supplies	22,421	20,458
Small Tools	3,733	8,125
Utilities and Telephone	16,635	16,518
Property Insurance	46,382	49,105
Other	55,736	24,350
Depreciation	281,432	259,010
Landfill Charges	226,003	211,886
	<u>1,755,845</u>	<u>1,676,815</u>
WATER		
Salaries	540,019	564,781
Employee Benefits	282,721	301,960
Repairs and Maintenance	148,823	255,625
Supplies	492,186	488,223
Small Tools	11,445	15,377
Utilities and Telephone	469,412	446,552
Property Insurance	75,310	63,770
Other	37,832	42,135
Postage	212	32
Depreciation/Amortization	931,153	875,516
New Services	1,478	7,083
	<u>2,990,591</u>	<u>3,061,054</u>
	\$	\$

WINCHESTER MUNICIPAL UTILITIES
SCHEDULE I - DEPARTMENT EXPENSES (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
WASTEWATER		
Salaries	\$ 637,824	\$ 658,704
Employee Benefits	352,668	357,133
Repairs and Maintenance	286,733	342,335
Supplies	334,470	304,546
Small Tools	19,838	22,802
Utilities and Telephone	767,107	681,375
Property Insurance	87,757	89,844
Other	22,522	21,389
Postage	424	287
Professional Fees	208,562	232,885
Depreciation/Amortization	1,983,188	2,137,591
New Services	580	-
	<u>4,701,673</u>	<u>4,848,891</u>
 VEHICLE MAINTENANCE		
Salaries	27,416	20,512
Employee Benefits	62,116	56,746
Repairs and Maintenance	4,233	3,131
Supplies	3,049	3,439
Small Tools	2,355	2,552
Utilities and Telephone	17,671	17,121
Property Insurance	8,725	10,144
Other	893	1,330
Depreciation/Amortization	23,797	21,884
	<u>150,255</u>	<u>136,859</u>
 TOTAL OPERATING EXPENSES	 <u>\$ 11,583,515</u>	 <u>\$ 11,620,270</u>

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE II - REVENUE BOND DEBT SERVICES
FOR THE YEAR ENDED JUNE 30, 2013**

Maturity Date	2012 Issue		2011 Issue		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2013-2014	\$ 290,000	\$ 215,144	\$ 334,167	370,694	\$ 624,167	585,838
2014-2015	295,000	209,344	346,250	360,669	641,250	570,013
2015-2016	305,000	203,444	359,166	350,281	664,166	553,725
2016-2017	310,000	197,344	369,167	339,506	679,167	536,850
2017-2018	320,000	191,144	381,250	328,431	701,250	519,575
2018-2019	325,000	184,744	396,250	315,369	721,250	500,113
2019-2020	330,000	174,994	411,250	299,519	741,250	474,513
2020-2021	345,000	165,094	428,333	283,069	773,333	448,163
2021-2022	355,000	154,744	448,333	265,706	803,333	420,450
2022-2023	365,000	144,094	468,333	246,733	833,333	390,827
2023-2024	375,000	133,144	490,417	226,994	865,417	360,138
2024-2025	390,000	121,894	515,417	203,399	905,417	325,293
2025-2026	400,000	109,705	540,417	178,365	940,417	288,070
2026-2027	415,000	96,705	567,500	151,344	982,500	248,049
2027-2028	430,000	82,700	597,500	122,664	1,027,500	205,364
2028-2029	445,000	67,650	629,583	91,722	1,074,583	159,372
2029-2030	460,000	52,074	666,667	58,330	1,126,667	110,404
2030-2031	480,000	35,400	402,500	22,138	882,500	57,538
2031-2032	480,000	18,000	0	0	480,000	18,000
	<u>\$ 7,115,000</u>	<u>\$ 2,557,362</u>	<u>\$ 8,352,500</u>	<u>\$ 4,214,933</u>	<u>\$ 15,467,500</u>	<u>\$ 6,772,295</u>

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2013**

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. Environmental Protection Agency			
Passed through Kentucky Infrastructure Authority:			
Capitalization Grant for Clean Water Revolving Funds	66.458	A 10-03	7,044,958
Capitalization Grant for Clean Water Revolving Funds	66.458	A 12-05	135,768
Total Federal Awards			\$ <u>7,180,726</u>

**WINCHESTER MUNICIPAL UTILITIES
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2013**

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the WMU under the programs of the federal government for the year ended June 30, 2013. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Because the schedule presents only a selected portion of operations of WMU, it is not intended to and does not present the financial position, changes in net assets or cash flows of WMU.

NOTE 2- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB A-87, Cost Principles for State and Local Governments, wherein certain types of expenditures are not allowable or are limited as to reimbursements. Pass-through entity identifying numbers are presented where available.

MEMBERS:

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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Commissioners
Winchester Municipal Utilities
Winchester, KY

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Audit Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Utilities' basic financial statements, and have issued our report thereon dated October 21, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control. Accordingly, we do not express an opinion on the effectiveness of the Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Summers, McCrary & Sparks, PSC

Summers, McCrary & Sparks, PSC
Winchester, Kentucky
October 21, 2013

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

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY
OMB CIRCULAR A-133**

To the Commissioners
Winchester Municipal Utilities
Winchester, Kentucky

Report on Compliance for Each Major Federal Program

We have audited Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, major federal programs for the year ended June 30, 2013. Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Winchester Municipal Utilities', component unit of the

City of Winchester, Kentucky, compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Winchester Municipal Utilities', component unit of the City of Winchester, Kentucky, compliance.

Opinion on Each Major Federal Program

In our opinion, Winchester Municipal Utilities, component unit of the City of Winchester, Kentucky, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

Report on Internal Control Over Compliance

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

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention y those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Summers, McCrary & Sparks, PSC

Summers, McCrary & Sparks, PSC
Winchester, Kentucky
October 21, 2013

**WINCHESTER MUNICIPAL UTILITIES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2013**

Section 1 - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued – unqualified

Internal control over financial reporting:

Material weakness(es) identified? yes X no

Significant deficiencies identified
that are not considered to be material
weakness? yes X none reported

Noncompliance material to financial
statements noted? yes X no

Federal Awards

Internal control over majority programs:

Material weakness(es) identified? yes X no

Significant deficiencies identified
that are not considered to be material
weakness(es)? yes X none reported

Type of auditor's report issued on compliance for the major programs unqualified:

Any audit findings disclosed that are
required to be report in accordance
with section 510(a) of Circular A-133? yes X no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
66.458	EPA Capitalization Grant for Clean Water Revolving Funds

Dollar threshold used to distinguish
between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? X yes no

Section II – Financial Statement Findings

No Findings

Section III – Federal Award Findings and Questioned Costs

No Findings