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# **CITY OF COVINGTON, KENTUCKY**

Basic Financial Statements

Fiscal Year Ended June 30, 2013

With Independent Auditors' Report

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## **INDEPENDENT AUDITORS' REPORT**

To the Mayor and City Commissioners  
City of Covington, Kentucky:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Covington, Kentucky (the "City") as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City's 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.

### ***Auditors' Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Devou Properties, Inc., which is a component unit of the City. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Devou Properties, Inc., is based on solely on the report of the other auditors. 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 from 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 auditors' 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.

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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, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Covington, Kentucky, as of June 30, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### **Effect of Adopting New Accounting Standards**

As discussed in Note 12, the City adopted the provisions of Governmental Accounting Standards Board Statement No. 61, *The Financial Reporting Entity: Omnibus-an Amendment of GASB Statements No. 14 and No. 34*, Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Our opinions were not modified with respect to this matter.

### ***Other Matters***

#### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and other required supplementary information, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### *Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133 and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates 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 statement themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated January 31, 2014 on our consideration of the City of Covington's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 the City of Covington's internal control over financial reporting and compliance.

*Clark, Schaefer, Hackett & Co.*

Cincinnati, Ohio  
January 31, 2014

City of Covington, Kentucky  
Management's Discussion and Analysis  
For the Fiscal Year Ended June 30, 2013  
(*unaudited*)

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The management discussion and analysis (MD&A) of the City of Covington, Kentucky's (the City's) financial statements provides readers a narrative overview and analysis of the City's financial position and activities for the fiscal year ended June 30, 2013. The information presented here should be read in conjunction with the City's basic financial statements which immediately follow this overview and analysis.

### Financial Highlights

Some of the City's financial highlights for the fiscal year ended June 30, 2013 include:

- The assets and deferred outflows of resources exceeded its liabilities at the close of the most recent fiscal year by \$31,350,567 (*net position*).
- The City's total net position decreased during the fiscal year by \$1,315,561, or 4%.
- The City's total expenses were \$61,697,776, a decrease of \$3,723,816.
- Program revenues of \$19,761,224 reduced the net cost of the City's functions to be financed from the City's general revenue to \$41,936,552.
- At the close of the current fiscal year, the City's governmental funds reported combined fund balances of \$17,668,298, an increase of \$14,375,434 in comparison with the prior year. Approximately 4% of this amount (\$738,275) is available for spending at the City's discretion (*unassigned fund balance*).
- At the end of the fiscal year end, unrestricted fund balance (the total of the *committed* and *unassigned* components of *fund balance*) for the general fund was \$738,275, or approximately 2% of total general fund expenditures.
- The City's total outstanding long-term debt increased by \$12,529,835 during the fiscal year because of the inception of a \$16.04 million capital lease.

### Overview of the Financial Statements

The discussion and analysis provided here is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements consist of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report also includes supplementary information intended to furnish additional detail to support the basic financial statements themselves.

**Government-wide Financial Statements.** The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net position* presents financial information on all of the City's assets/deferred outflows of resources and liabilities, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the City's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods.

The government-wide financial statements include functions of the City, including police, fire, street maintenance, parks and recreation, and general administration services, that are principally supported by licenses, fees, taxes and intergovernmental revenues (*governmental activities*).

The government-wide financial statements include not only the City itself (known as the *primary government*), but also Devou Properties, Inc., a legally separate non-profit organization. Financial information for this component unit is reported separately from the financial information presented for the primary government itself. The Municipal Properties Corporation, although also legally separate, functions for all practical purposes as a department of the City, and therefore has been included as an integral part of the primary government.

**Fund Financial Statements.** A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

**Governmental Funds.** Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in assessing a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains several individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Housing Voucher Program Fund, Neighborhood Stabilization Program Fund, and the Capital Improvement Fund, which are considered to be major funds. Data from the other governmental funds are combined into a single aggregated presentation.

The City adopts an annual appropriation budget for its governmental funds. Budgetary comparison schedules have been provided for its general and special revenue major funds in required supplementary information to demonstrate compliance with its budgets.

**Proprietary Funds.** Proprietary funds can be classified into two subcategories; enterprise funds and internal service funds. The City does not have any enterprise funds. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for the management of its retained risks and for self-insured for medical and dental coverage for its employees. Internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Because both of these services benefit governmental functions, they have been included within *governmental activities* in the government-wide financial statements.

**Fiduciary Funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside the City. Fiduciary funds are *not* reported in the government-wide financial statements because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The City is trustee, or fiduciary, for two retirement funds. The Police and Firemen's Pension Fund and Employee's Retirement Fund are closed pension funds held solely for trust beneficiaries.

**Notes to the Financial Statements.** The notes provide additional information that is necessary to acquire a full understanding of the data provided in the government-wide and fund financial statements.

### Government-wide Overall Financial Analysis

As noted earlier, net position over time, may serve as a useful indicator of a government's financial position. In the case of the City, assets and deferred outflows of resources exceeded liabilities by \$31,350,567, at the close of the most recent fiscal year.

### City's Net Position

	<u>Governmental Activities</u>		
		<i>Restated</i>	
	2013	2012	Change
Current and other assets	\$ 29,775,101	18,957,202	10,817,899
Capital assets	54,489,483	56,255,259	(1,765,776)
Total assets	<u>84,264,584</u>	<u>75,212,461</u>	<u>9,052,123</u>
Deferred outflows of resources	<u>711,805</u>	<u>1,174,521</u>	<u>(462,716)</u>
Long-term liabilities	47,816,091	35,323,350	12,492,741
Other liabilities	<u>5,809,731</u>	<u>8,397,504</u>	<u>(2,587,773)</u>
	<u>53,625,822</u>	<u>43,720,854</u>	<u>9,904,968</u>
Net position:			
Net investment in capital assets	33,666,204	34,173,497	(507,293)
Restricted	4,561,466	3,972,563	588,903
Unrestricted (deficit)	<u>(6,877,103)</u>	<u>(5,479,932)</u>	<u>(1,397,171)</u>
Total net position	\$ <u>31,350,567</u>	<u>32,666,128</u>	<u>(1,315,561)</u>

By far, the largest portion of the City's net position (\$33,666,204) reflects its investment in capital assets (e.g., land and improvements, buildings and improvements, machinery and equipment, vehicles, and infrastructure), less any related outstanding debt that was used to acquire those assets. The City uses these capital assets to provide a variety of services to its citizens. Accordingly, these assets are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources used to repay this debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City's net position (\$4,561,466) represents resources that are subject to external restrictions on how they may be used. Any remaining balance is unrestricted and may be used to meet the City's ongoing obligations to its citizens and creditors.

At the end of the current fiscal year, the City's overall net position decreased from the prior fiscal year. The reasons for this overall decrease are discussed in the following section.



## City's Changes in Net Position

	<b>Governmental Activities</b>		
	2013	Restated 2012	Change
Program revenues:			
Charges for services	\$ 6,538,387	6,669,237	(130,850)
Operating grants and contributions	11,932,368	12,518,909	(586,541)
Capital grants and contributions	1,290,469	1,647,156	(356,687)
Total program revenues	<u>19,761,224</u>	<u>20,835,302</u>	<u>(1,074,078)</u>
General revenues:			
Taxes	40,049,286	40,538,696	(489,410)
Investment earnings	96,889	23,084	73,805
Miscellaneous	577,261	2,286,030	(1,708,769)
Total general revenues	<u>40,723,436</u>	<u>42,847,810</u>	<u>(2,124,374)</u>
Total revenues	<u>60,484,660</u>	<u>63,683,112</u>	<u>(3,198,452)</u>
Expenses:			
General government	4,028,857	4,250,735	(221,878)
Police	15,464,519	16,455,964	(991,445)
Fire	13,727,885	15,180,999	(1,453,114)
Public improvements	10,916,212	11,349,786	(433,574)
Recreation	683,742	711,584	(27,842)
Community development	13,912,337	15,379,018	(1,466,681)
Parking garage	783,059	768,661	14,398
Interest on long-term debt	2,181,165	1,324,845	856,320
Total expenses	<u>61,697,776</u>	<u>65,421,592</u>	<u>(3,723,816)</u>
Special item	(102,445)	-	(102,445)
Change in net position	(1,315,561)	(1,738,480)	422,919
Net position beginning of year	<u>32,666,128</u>	<u>34,404,608</u>	<u>(1,738,480)</u>
Net position end of year	<u>\$ 31,350,567</u>	<u>32,666,128</u>	<u>(1,315,561)</u>

During the current fiscal year, net position for governmental activities decreased \$1,315,561 from the prior fiscal year for an ending balance of \$31,350,567. Total revenues decreased by \$3,198,452, or 5%. The City experienced decreases in funding from federal and state resources due to the winding down of stimulus funding in the prior year and budget constraints at both the federal and state levels. Additionally, the City moved its 911 dispatch operations over to Kenton County, reducing its dispatch revenues (and related expenses). However, the City was able to reduce its expenses by \$3,723,816, or 6%. Factors leading to the decrease include moving the City's 911 dispatch operations, decreases in personnel, health care plan design savings realized from recently negotiated collective bargaining agreements, and declines in grant program expenses associated with the decreases in federal and state funding.

The special item of \$102,445 represents amounts identified as alleged embezzlement transactions incurred during the fiscal year by the former finance director. The City has filed lawsuits to recover these funds and is currently involved in litigation.

## Financial Analysis of Governmental Funds

At June 30, 2013, the City's governmental funds reported combined fund balances of \$17,668,298, an increase of \$14,375,434 in comparison with the prior year. Approximately 4% of this amount (\$738,275) constitutes unassigned fund balance, which is available for spending at the City's discretion. The remainder of the fund balance is either nonspendable, restricted, or committed to indicate that it is 1) not in spendable form (\$291,593), 2) restricted for particular purposes (\$16,339,191), or 3) committed for particular purposes (\$299,239).

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, unassigned fund balance of the General Fund was \$738,275, or 2% of total General Fund expenditures. The following schedules present a summary of the General Fund revenues and expenditures for the current fiscal year.

### General Fund Revenues for the Fiscal Year Ended June 30,

	2013	Percent of Total	<i>Restated*</i> 2012	Percent Change
Taxes	\$ 13,725,616	28.92%	\$ 13,657,232	0.50%
Licenses and permits	25,979,427	54.75%	26,175,310	-0.75%
Intergovernmental	839,800	1.77%	884,604	-5.06%
Fines and forfeitures	367,591	0.77%	439,189	-16.30%
Charges for services	6,063,670	12.78%	6,063,323	0.01%
Investment earnings	95,694	0.20%	21,856	337.84%
Miscellaneous	382,851	0.81%	380,677	0.57%
Total Revenue	<u>\$ 47,454,649</u>	<u>100.00%</u>	<u>\$ 47,622,191</u>	<u>-0.35%</u>

\* 2012 was restated for the reclassification of the Capital Improvement Fund – see Note 14.

Revenue remained fairly consistent during the fiscal year, with total General Fund revenue only decreasing by \$167,542, or less than 1%.

### General Fund Expenditures for the Fiscal Year Ended June 30,

	2013	Percent of Total	<i>Restated*</i> 2012	Percent Change
General government	\$ 3,526,196	8.21%	\$ 3,207,768	9.93%
Public safety	26,197,607	60.99%	27,743,547	-5.57%
Public improvements	5,994,547	13.95%	5,891,702	1.75%
Recreation	437,483	1.02%	475,601	-8.01%
Community development	4,146,502	9.65%	3,947,945	5.03%
Parking garage	776,758	1.81%	743,506	4.47%
Debt service	1,877,930	4.37%	2,054,440	-8.59%
Capital outlay	-	0.00%	3,250	-100.00%
Total Expenditures	<u>\$ 42,957,023</u>	<u>100.00%</u>	<u>\$ 44,067,759</u>	<u>-2.52%</u>

\* 2012 was restated for the reclassification of the Capital Improvement Fund – see Note 14.

Total General Fund expenditures decreased by \$1,110,736 or 2.52%. Factors leading to the decrease include the aforementioned transferring of the City's 911 dispatch operations over to Kenton County, decreases in personnel, and health care plan design savings realized from recently negotiated collective bargaining agreements.

The Housing Vouchers Program Fund, a major governmental fund, is used to account for the HUD funded housing assistance program. The fund balance decreased \$377,744 to \$1,067,728. Reimbursement of units rented is based on how well the City utilizes its unit capacity. Administration is reimbursed on a per unit basis as well.

The Neighborhood Stabilization Program is a cost reimbursement HUD-funded program. There is no fund balance, and therefore, no change in fund balance to report.

The Capital Improvement Fund, the City's remaining major governmental fund, is used to account for the City's acquisition and construction of public improvements and equipment. The fund balance increased \$14,499,257 to \$14,875,127. The City entered into a lease agreement in December 2012 in the amount of \$16.04 million to finance various public improvements. At the end of the fiscal year, the City had \$14,213,318 remaining to fund its planned capital improvements.

### General Fund Budgetary Highlights

Over the course of the fiscal year, the City Commission approved revisions to the General Fund budget. The final amended budget resulted in a new \$2.2 million increase in appropriations and transfers.

The revenue budget was increased due to, among other things, better than anticipated collections from net profit taxes and payroll license fees. This provided additional resources for the City to invest in more community and economic development activities.

### Capital Assets and Debt Administration

**Capital assets.** The City's investment in capital assets for its governmental activities as of June 30, 2013 amounts to \$54,489,483 (net of accumulated depreciation), a decrease of \$1,765,776 from the prior year. This investment in capital assets includes land and improvements, buildings and improvements, machinery and equipment, vehicles, infrastructure and construction in progress. The total decrease in capital assets for the current fiscal year was approximately 3%, as capital activity was slower than prior years up until the City obtained \$16.04 million in capital lease financing used during the second half of the fiscal year.

#### Capital Assets at June 30, (Net of Depreciation)

	Governmental Activities	
	2013	2012
Land	\$ 14,339,320	14,569,320
Land improvements	1,717,703	1,551,092
Buildings	14,299,467	14,060,062
Building improvements	2,924,807	2,749,406
Machinery and equipment	1,521,925	1,667,377
Vehicles	2,033,469	1,209,427
Infrastructure	17,617,964	19,795,256
Construction in progress	34,828	653,319
Totals	\$ <u>54,489,483</u>	<u>56,255,259</u>

Additional information on the City's capital assets can be found in Note 4.

**Long-term debt.** At the end of the current fiscal year, the City had outstanding notes, bonds and capital leases of \$46,571,597, which is backed by the full faith and credit of the City.

**Outstanding Long-term Debt Obligations at June 30,**

	Governmental Activities	
	2013	2012
Mortgage bonds and notes	\$ 16,863,621	18,960,628
Capital Leases	29,707,976	15,081,134
Total	\$ 46,571,597	34,041,762

The City issues and incurs debt in order to fund capital improvement projects, purchase capital equipment and facilities, and respond to other economic development needs. The City’s outstanding debt increased by \$12,529,835 (37%) from the prior year. The reason for the increase was the inception of a \$16.04 million capital lease in December 2012.

The Kentucky Constitution states the total principal amount of indebtedness, which excludes self-supporting obligations, revenue bonds, special assessment debt, and non-tax supported debt, cannot exceed 10% of the value of taxable property in the City.

Additional information on the City’s long-term debt can be found in Note 7.

**Economic Factors and Next Year’s Budget**

The Northern Kentucky and City of Covington, Kentucky economy is continuing to show improvement and recovery over the past year, as well as the Cincinnati Metropolitan Statistical Area, which saw an unemployment level of 6.2 percent as of the end of December 2013.

The recovery in jobs and wages has been reflected in the City Occupational License Fee collections for fiscal year (FY) 2013, with an increase of nearly a half a million dollars, or 2.1 percent, representing 55 percent of the General Fund receipts. This increase was achieved even though the City Commission lowered the Occupational License Fee from 2.50 percent to 2.45 percent during the year (the City’s occupational license fee only applies to the FICA cap on wages). This reduction in the Occupational License Fee rate was done as a part of the overall economic development plan for the City. Job growth and job retention is the focus of the newly reorganized Economic Development Department and the reduction in the rate makes the City more competitive with surrounding cities.

While overall City revenue was down for the year, expenses were reduced even more. The expense reductions are expected to be ongoing, in that the two major savings were created by change in the City’s health care programs (negotiated concessions in all three labor contracts) and transfer of Emergency Dispatch Service to Kenton County (for which they also accepted responsibility for funding, as part of consolidation of Emergency Dispatch throughout the county. The reduction in revenues was primarily due to elimination of 911 fees and reduction in grant receipts and program income in FY2013.

With an eye on economic growth, the City Commission approved a \$72 million Five Year Community Investment Plan reconstructing streets and sidewalks; removing blighted housing from neighborhoods; developing the City’s river front area and assisting new business to relocate in the City core areas and more efficient fleet and equipment. This investment is intended to grow General Fund receipts through new jobs and increased property values.

The City of Covington expects the growth in the economy to continue into FY2014, and general operating funds are forecast with modest growth the City will continue its major capital improvements through the judicious use of debt funding.

**Requests for Information**

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Finance Department, 20 West Pike Street, Covington, KY 41011.

**CITY OF COVINGTON, KENTUCKY**

Statement of Net Position

June 30, 2013

	Primary Government	Component Unit
	<u>Governmental Activities</u>	<u>Devou Properties, Inc.</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 4,073,126	1,955,480
Cash with fiscal agent	14,213,318	-
Cash held in escrow	401,000	
Receivables (net of allowance for doubtful accounts)		
Taxes	4,813,989	-
Intergovernmental	305,354	-
Notes	2,715,192	-
Accounts	1,190,197	114,444
Due from fiduciary activities	316,343	-
Prepaid items	340,090	31,868
Deferred charges, net	226,377	-
Net pension obligation asset	1,180,115	-
Nondepreciable capital assets	16,091,851	-
Depreciable capital assets, net	<u>38,397,632</u>	<u>41,900</u>
Total assets	<u>84,264,584</u>	<u>2,143,692</u>
<b>Deferred Outflows of Resources</b>		
Deferred outflows - hedges	<u>711,805</u>	<u>-</u>
<b>Liabilities</b>		
Accounts payable	1,046,156	29,148
Accrued liabilities	1,475,128	264,600
Claims payable	1,802,724	-
Accrued interest payable	160,278	-
Unearned revenue	613,640	-
Derivative instruments - interest rate swap	711,805	
Noncurrent liabilities:		
Due within one year	3,986,815	-
Due in more than one year	<u>43,829,276</u>	<u>-</u>
Total liabilities	<u>53,625,822</u>	<u>293,748</u>
<b>Net Position</b>		
Net investment in capital assets	33,666,204	41,900
Restricted for:		
Capital improvements	580,454	-
Debt service	401,000	
HUD programs	3,565,125	-
Other purposes	14,887	-
Unrestricted (deficit)	<u>(6,877,103)</u>	<u>1,808,044</u>
Total net position	<u>\$ 31,350,567</u>	<u>1,849,944</u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**

Statement of Activities  
Year Ended June 30, 2013

	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Position</u>	
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Primary Government</u>	<u>Component Unit</u>
					<u>Governmental Activities</u>	<u>Devou Properties, Inc.</u>
<u>Functions/Programs</u>						
<u>Primary Government</u>						
Governmental activities:						
General government	\$ 4,028,857	1,214,447	505,762	95,072	(2,213,576)	-
Police	15,464,519	133,915	923,421	447,026	(13,960,157)	-
Fire	13,727,885	1,238,042	-	-	(12,489,843)	-
Public improvements	10,916,212	2,506,617	645,239	748,371	(7,015,985)	-
Recreation	683,742	11,739	-	-	(672,003)	-
Community development	13,912,337	79,873	9,857,946	-	(3,974,518)	-
Parking garage	783,059	1,353,754	-	-	570,695	-
Interest on long-term debt	<u>2,181,165</u>	-	-	-	<u>(2,181,165)</u>	-
Total governmental activities	<u>61,697,776</u>	<u>6,538,387</u>	<u>11,932,368</u>	<u>1,290,469</u>	<u>(41,936,552)</u>	-
<u>Component Unit</u>						
Devou Properties, Inc.	<u>1,198,147</u>	<u>993,641</u>	-	-	-	<u>(204,506)</u>
Total	\$ <u>62,895,923</u>	<u>7,532,028</u>	<u>11,932,368</u>	<u>1,290,469</u>	<u>(41,936,552)</u>	<u>(204,506)</u>
General Revenues:						
Taxes:						
Real property taxes					\$ 6,043,907	-
Personal property taxes					655,275	-
Public service taxes					2,018,535	-
Taxes, levied for bank deposits					62,729	-
Insurance premium taxes					5,279,824	-
Payroll taxes					22,974,835	-
Net profit taxes					2,710,237	-
Other taxes					303,944	-
Investment earnings					96,889	1,208
Miscellaneous					577,261	-
Special item					<u>(102,445)</u>	-
Total general revenues and special item					<u>40,620,991</u>	<u>1,208</u>
Change in net position					(1,315,561)	(203,298)
Net position beginning of year, <i>restated</i>					<u>32,666,128</u>	<u>2,053,242</u>
Net position end of year					\$ <u>31,350,567</u>	<u>1,849,944</u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**

Balance Sheet  
 Governmental Funds  
 June 30, 2013

	General	Housing Voucher Program	Neighborhood Stabilization Program	Capital Improvement	Nonmajor Governmental Funds
<b>Assets</b>					
Cash and cash equivalents	\$ 1,723,528	1,181,450	-	-	843,329
Cash with fiscal agent	-	-	-	14,213,318	-
Cash held in escrow	-	-	-	401,000	-
Receivables (net of allowance for doubtful accounts):					
Taxes	4,813,989	-	-	-	-
Intergovernmental	-	-	160,254	-	145,100
Notes	531,956	-	2,183,236	-	-
Accounts	1,028,505	30,827	-	-	130,865
Due from other funds	368,816	-	-	154,219	767,044
Due from fiduciary funds	316,343	-	-	-	-
Prepaid items	41,593	-	-	250,000	-
Total assets	<u>8,824,730</u>	<u>1,212,277</u>	<u>2,343,490</u>	<u>15,018,537</u>	<u>1,886,338</u>
<b>Liabilities:</b>					
Accounts payable	576,597	755	68,640	96,660	291,948
Accrued liabilities	1,460,878	14,250	-	-	-
Due to other funds	3,096,650	4,613	91,614	46,750	327,252
Deferred revenue	2,910,737	124,931	2,183,236	-	321,563
Total liabilities	<u>8,044,862</u>	<u>144,549</u>	<u>2,343,490</u>	<u>143,410</u>	<u>940,763</u>
<b>Fund balances:</b>					
Nonspendable	41,593	-	-	250,000	-
Restricted	-	1,067,728	-	14,625,127	646,336
Committed	-	-	-	-	299,239
Unassigned	738,275	-	-	-	-
Total fund balances	<u>779,868</u>	<u>1,067,728</u>	<u>-</u>	<u>14,875,127</u>	<u>945,575</u>
Total liabilities and fund balances	\$ <u>8,824,730</u>	<u>1,212,277</u>	<u>2,343,490</u>	<u>15,018,537</u>	<u>1,886,338</u>

See accompanying notes to the basic financial statements.





**CITY OF COVINGTON, KENTUCKY**

Statement of Revenues, Expenditures and Changes  
in Fund Balances  
Governmental Funds  
Year Ended June 30, 2013

	General	Housing Voucher Program	Neighborhood Stabilization Program	Capital Improvement	Nonmajor Governmental Funds
<b>Revenues:</b>					
Taxes	\$ 13,725,616	-	-	-	303,944
Licenses and permits	25,979,427	-	-	-	-
Intergovernmental	839,800	6,515,513	1,581,191	748,371	3,212,623
Charges for services	6,063,670	-	-	-	-
Fines and forfeitures	367,591	-	-	-	-
Investment earnings	95,694	838	-	71	286
Miscellaneous	382,851	199	-	468,407	994,199
Total revenues	<u>47,454,649</u>	<u>6,516,550</u>	<u>1,581,191</u>	<u>1,216,849</u>	<u>4,511,052</u>
<b>Expenditures:</b>					
Current:					
General government	3,526,196	-	-	-	456,356
Police	13,465,973	-	-	-	741,032
Fire	12,731,634	-	-	1,710	470,497
Public improvements	5,994,547	-	-	-	-
Recreation	437,483	-	-	-	-
Community development	4,146,502	6,894,294	768,414	-	1,242,693
Parking garage	776,758	-	-	3,258	-
Debt service:					
Principal	1,312,011	-	-	603,154	1,595,000
Interest	565,919	-	-	1,123,460	584,068
Capital outlay	-	-	812,777	4,187,625	485,007
Total expenditures	<u>42,957,023</u>	<u>6,894,294</u>	<u>1,581,191</u>	<u>5,919,207</u>	<u>5,574,653</u>
Excess (deficiency) of revenues over (under) expenditures	<u>4,497,626</u>	<u>(377,744)</u>	<u>-</u>	<u>(4,702,358)</u>	<u>(1,063,601)</u>
<b>Other financing sources (uses):</b>					
Transfers in	731,942	-	-	3,051,615	2,226,200
Transfers out	(5,334,951)	-	-	-	(731,942)
Sale of assets	31,092	-	-	110,000	-
Inception of capital lease	-	-	-	16,040,000	-
Total other financing sources (uses)	<u>(4,571,917)</u>	<u>-</u>	<u>-</u>	<u>19,201,615</u>	<u>1,494,258</u>
Special item	<u>(102,445)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances	(176,736)	(377,744)	-	14,499,257	430,657
Fund balance, beginning of year, <i>restated</i>	956,604	1,445,472	-	375,870	514,918
Fund balance, end of year	\$ <u>779,868</u>	<u>1,067,728</u>	<u>-</u>	<u>14,875,127</u>	<u>945,575</u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**  
 Reconciliation of the Statement of Revenues, Expenditures  
 and Changes in Fund Balances of Governmental Funds  
 to the Statement of Activities  
 Year Ended June 30, 2013

Total Governmental Funds	
14,029,560 25,979,427 12,897,498 6,063,670 367,591 96,889 1,845,656 61,280,291	<b>Net change in fund balances - total governmental funds</b> <span style="float: right;">\$ 14,375,434</span>
	<i>Amounts reported for governmental activities in the statement of activities are different because:</i>
	Governmental funds report capital outlays as expenditures. However, in the statement of activities, the costs of those assets are allocated over their estimated useful lives as depreciation expense:
	Capital outlay 5,207,397 Depreciation expense (6,594,463)
	In the statement of activities, loss on disposal of capital assets is reported, whereas only proceeds from sales are reported in the governmental funds.
3,982,552	(378,710)
	Revenue in the statement of activities that do not provide current financial resources are reported as deferred revenue in the governmental funds.
14,207,005 13,203,841 5,994,547 437,483 13,051,903 780,016	(558,012)
	Internal service funds are used by management to charge the cost of certain activities, such as liability and medical insurance, to individual funds. The net revenue (expense) of internal service funds is reported with governmental activities.
3,510,165 2,273,447 5,485,409 62,926,368	572,125
	Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds:
	Compensated absences 37,093 Interest on long-term debt 115,484 Amortization of issue costs (23,202)
(1,646,077)	
	Repayment of bonds, notes and lease principal is an expenditure in the governmental funds, whereas the payments reduce long-term liabilities in the statement of net position
6,009,757 (6,066,893) 141,092 16,040,000 16,123,956	3,510,165
	The statement of activities report annual pension cost, which includes the actuarially required contribution along with an interest factor and adjustment of the net pension obligation asset.
(102,445)	(1,538,872)
	The inception of a capital lease is recorded as an other financing source in the governmental funds, but as an asset and liability on the statement of net position.
14,375,434 3,292,864 17,668,298	(16,040,000)
17,668,298	<b>Change in net position of governmental activities</b> <span style="float: right;">\$ (1,315,561)</span>

**CITY OF COVINGTON, KENTUCKY**

Statement of Net Position

Proprietary Funds

June 30, 2013

	<u>Governmental Activities</u>
	<u>Internal Service Funds</u>
<b>Assets</b>	
Cash and cash equivalents	\$ 324,819
Due from other funds	2,276,800
Prepaid items	<u>48,497</u>
Total assets	<u>2,650,116</u>
<b>Liabilities</b>	
Accounts payable	11,556
Claims payable	<u>1,802,724</u>
Total liabilities	<u>1,814,280</u>
<b>Net Position</b>	
Unrestricted	<u>835,836</u>
Total net position	\$ <u><u>835,836</u></u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**  
Statement of Revenues, Expenses  
and Changes in Net Position  
Proprietary Funds  
Year Ended June 30, 2013

	Governmental Activities <u>Internal Service Funds</u>
<b><i>Operating revenues:</i></b>	
Insurance premiums	\$ 4,833,023
Other	<u>3,990</u>
Total operating revenues	<u>4,837,013</u>
<b><i>Operating expenses:</i></b>	
Contractual services	735,969
Claims and judgments	<u>3,586,251</u>
Total operating expenses	<u>4,322,220</u>
Operating income	514,793
<b><i>Non-operating revenues (expenses):</i></b>	
Investment income	<u>196</u>
Income before transfers	514,989
Transfers in	<u>57,136</u>
Change in net position	572,125
Net position, beginning of year	<u>263,711</u>
Net position, end of year	\$ <u><u>835,836</u></u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2013

	<u>Governmental Activities</u> <u>Internal Service Funds</u>
<b><i>Cash flows from operating activities:</i></b>	
Cash received from other funds	\$ 3,704,662
Cash received from other income	3,990
Cash payments for other activities	(48,497)
Cash payments for claims	<u>(4,461,161)</u>
Net cash used by operating activities	<u>(801,006)</u>
<b><i>Cash flows from noncapital financing activities:</i></b>	
Transfers	<u>57,136</u>
<b><i>Cash flows from investing activities:</i></b>	
Interest income	<u>196</u>
Net change	(743,674)
Cash and cash equivalents, beginning of year	<u>1,068,493</u>
Cash and cash equivalents, end of year	\$ <u><u>324,819</u></u>
Reconciliation of operating income to net cash used by operating activities:	
Operating income	\$ 514,793
Adjustments to reconcile operating income to net cash used by operating activities:	
Changes in assets and liabilities:	
Prepaid items	(48,497)
Due from/to other funds	(1,128,361)
Accounts payable	(155,874)
Claims payable	<u>16,933</u>
Net cash used by operating activities	\$ <u><u>(801,006)</u></u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**  
Statement of Net Position  
Fiduciary Funds  
June 30, 2013

	<u>Employees'</u> <u>Retirement</u>	<u>Police and</u> <u>Firemen's</u> <u>Retirement</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 11,263	186,199
Investments	<u>3,283,118</u>	<u>7,622,330</u>
Total assets	<u><u>3,294,381</u></u>	<u><u>7,808,529</u></u>
<b>Liabilities</b>		
Due to the primary government	<u>204,917</u>	<u>111,426</u>
<b>Net Position</b>		
Net position held in trust for pension benefits	\$ <u><u>3,089,464</u></u>	<u><u>7,697,103</u></u>

See accompanying notes to the basic financial statements.

**CITY OF COVINGTON, KENTUCKY**  
Statement of Changes in Net Position  
Fiduciary Funds  
Year Ended June 30, 2013

	<u>Employees'</u> <u>Retirement</u>	<u>Police and</u> <u>Firemen's</u> <u>Retirement</u>
<b>Additions</b>		
Contributions:		
Impounding lot	\$ -	62,687
Total revenue	<u>-</u>	<u>62,687</u>
Investment return:		
Interest and dividends	137,398	319,643
Net appreciation in fair value of investments	<u>320,131</u>	<u>779,989</u>
Total net investment return	<u>457,529</u>	<u>1,099,632</u>
Total additions	<u>457,529</u>	<u>1,162,319</u>
<b>Deductions</b>		
Benefit payments	815,719	1,497,002
Administration	<u>12,428</u>	<u>30,460</u>
Total deductions	<u>828,147</u>	<u>1,527,462</u>
Change in net position	(370,618)	(365,143)
Net position, beginning of year	<u>3,460,082</u>	<u>8,062,246</u>
Net position, end of year	\$ <u><u>3,089,464</u></u>	<u><u>7,697,103</u></u>

See accompanying notes to the basic financial statements.



City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 1 - Summary of Significant Accounting Policies**

***Basis of Presentation***

The basic financial statements of the City of Covington, Kentucky, have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting policies of the City are described below.

**Financial Reporting Entity**

The City of Covington is a municipality that operates under a City Manager form of government. Legislative authority is vested in the elected Mayor and four City Commissioners. As required by U.S. generally accepted accounting principles, these financial statements present the government and its component units, entities for which the government is considered to be financially accountable.

**Blended** component units, although legally separate entities are, in substance, part of the government's operations and so data from these units are combined with data of the primary government. Each blended component unit of the City has a June 30 year end. The component units discussed below is included in the City's reporting entity as part of the primary government because of the significance of its operational and/or financial relationship with the City.

**Blended Component Unit Included Within the Reporting Entity**

***City of Covington Municipal Properties Corporations***

The City of Covington Municipal Properties Corporation was formed to act as an agent and to be instrumental in the financing of public improvements and projects of a capital nature for the City and for the particular purpose of acquiring real estate located within the City and constructing, acquiring and equipping thereon capital improvements, facilities, buildings, structures and related appurtenances. The Corporation finances these projects by the issuance of debt. These debt issues are secured by (1) first mortgage liens on the projects, (2) lease and option agreements between the Corporation and the City, the construction agreements and pledged receipts. The lease and option agreements require the City to pay rental, on a yearly basis with the option to renew each year, equal to the amount of bonds and interest coupons coming due in that year. If the City renews the leases from year-to-year, and pays the rentals for each year as stipulated, and when the Corporation has fully paid and retired all of the bonds, the Corporation agrees it will convey the properties to the City free and clear.

**Discretely Presented Component Units Included Within the Reporting Entity**

Devou Properties, Inc. (a non-profit organization) is included in the City's financial statements as a discretely presented component unit. Although a legally separate entity, Devon Properties, Inc. is included in these financial statements because of its financial accountability to the City. Devou Properties, Inc. was formed to maintain and operate the Drees Pavilion at Devou Memorial Overlook for the City of Covington, for the benefit of Devou Park. Devou Properties, Inc. is responsible for renting out the facilities for events, including weddings, receptions and corporate events. Directors of Devou Properties, Inc. are appointed by the City's Board of Commissioners, upon the recommendation of the Mayor. Any excess funds from operations of the facility are to be set aside to be used on Devou Park projects. As a discretely presented component unit, the financial statements of Devou Properties, Inc. are only included on the City's government-wide financial statements in a column that makes it clearly separate from the primary government. Devou Properties, Inc. operates on a calendar year-end basis; therefore, the financial statements for the year ended December 31, 2012, are included in the City's current financial statements. Audited financial statements of Devou Properties Inc. are available and may be obtained by contacting the City Manager.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 1 - Summary of Significant Accounting Policies - continued**

**Basis of Presentation Government-Wide Financial Statements**

The government-wide financial statements (i.e., the statement of net position and the statement of activities) report information on all of the non-fiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements; however, interfund services provided and used are not eliminated. Governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which direct expenses of a given function or segments are offset by program revenues. Direct expenses are those clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Amounts paid to acquire capital assets are capitalized as assets in the government-wide financial statements, rather than reported as an expenditure. Proceeds of long-term debt are recorded as a liability in the government-wide financial statements, rather than as other financing source. Amounts paid to reduce long-term indebtedness of the reporting government are reported as a reduction of the related liability, rather than as an expenditure.

**Measurement Focus, Basis of Accounting and Financial Statement Presentation**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period.

For this purpose, the government considers revenues to be available if they are collected within sixty days of the end of the current fiscal period. Material revenues susceptible to accrual are payroll license fees, insurance fees and grant revenues. The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 1 - Summary of Significant Accounting Policies - continued**

The City reports the following major governmental funds:

- The General Fund is the government's primary operating fund. It accounts for all financial resources of the general government that are not accounted for in the other funds.
- The Housing Voucher Fund accounts for funds provided to the City by the U.S. Department of Housing and Urban Development Section 8 rent subsidy program. Resources are used for the payment of rent subsidies to landlords on behalf of qualified tenants.
- The Neighborhood Stabilization Program Fund accounts for U.S. Department of Housing and Urban Development funds, passed through from the State, to develop low income rental units and owner occupied homes purchased out of foreclosure.
- The Capital Improvement Fund accounts for funds provided to the City by the Federal and State governments and public financing for the acquisition and/or construction of capital improvements and equipment.

The City reports the following proprietary funds:

- The City has two internal service funds. One fund is for self-insurance for the City's health and dental insurance program for City employees. The second fund is for the self-insurance of the City's liability claims. Proprietary funds distinguish operating revenues and expenses from non-operating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Additionally, the City reports two fiduciary funds. The two pension trust funds account for the activities of the Employees' Retirement Fund and the Police and Firemen's Pension Fund. These funds are for the accumulation of resources for pension benefit payments to qualified retired employees.

**Assets, Deferred Outflows, Liabilities and Net Position/Fund Balance**

***Cash and Cash Equivalents***

Cash and cash equivalents include amounts in demand deposits as well as short-term investments with an initial maturity date within three months of the date acquired by the City.

The City is authorized by state statute to invest in:

- Obligations of the United States and of its Agencies and Instrumentalities
- Certificates of Deposits
- Bankers Acceptances
- Commercial Paper
- Bonds of Other State or Local Governments
- Mutual Funds

Cash with fiscal agent represents the balance available to be drawn from the inception of a capital lease for public improvements. Cash held in escrow represents the portion of the capital lease proceeds used to fund a debt service reserve account to satisfy debt service requirements in the final year of maturity.

***Property Tax Receivable***

Property taxes are levied as of January 1 on property values assessed as of the same date. The taxes are billed on approximately August 15 and are due and payable on September 30. On October 1, the bill becomes delinquent and penalties and interest may be assessed by the City. A lien may be placed on the property on October 1.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 1 - Summary of Significant Accounting Policies - continued**

**Notes Receivable**

Notes receivable are comprised of housing development and small business loans financed by a combination of resourced appropriated by the City and allocations from the U.S. Department of Housing and Urban Development (HUD). As of June 30, 2013, the City had housing development and small business loans outstanding of \$15,154,476 and \$1,295,250, respectively. The City has recorded an allowance of \$12,971,240 on housing development and \$763,294 on small business loans. Although some loans are repaid, repayment may be limited to net proceeds after payment of the first mortgage and seller closing costs and; therefore most repayments are minimal. Additionally, many loans have favorable repayments terms to encourage home ownership that include deferral and/or forgiveness if homeowners remain in the home for a specified period of time.

**Short-Term Interfund Receivables/Payables**

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from/to other funds" on the balance sheet. Short-term interfund loans are classified as "interfund receivables/payables."

**Prepaid Items**

Payments made to vendors for services that will benefit periods beyond June 30, 2013, are recorded as prepaid items in both the government-wide and fund statements. The consumption method is used in the fund statements.

**Capital Assets**

General capital assets are those assets not specifically related to activities reported in a propriety fund. These assets are reported in the governmental activities column of the government-wide statement of net position.

The accounting and reporting treatment applied to capital assets associated with a fund are determined by its measurement focus. General capital assets are long-lived assets of the City as a whole. When purchased, such assets are recorded as expenditures in the governmental funds and capitalized. Infrastructure, such as streets, traffic signals and signs are capitalized. The valuation basis for general capital assets are historical costs, or where historical cost is not available, estimated historical cost based on replacement cost. Donated capital assets are recorded at their fair value on the date donated. Repairs and maintenance are recorded as expenses. Renewals and betterments are capitalized. The City maintains a capitalization threshold of one thousand dollars with the exception of infrastructure for which the threshold is twenty-five thousand dollars.

Capital assets used in operations are depreciated over their estimated useful lives using the straight-line method in the government-wide financial statements. Depreciation is charged as an expense against operations and accumulated depreciation is reported on the statement of net position. The range of lives used for depreciation purposes for each capital asset class is as follows:

<u>Description</u>	<b>Governmental Activities</b> <u>Estimated Lives</u>
Buildings	30 years
Buildings and improvements	10 – 20 years
Public domain infrastructure	25 – 35 years
Vehicles	5 – 10 years
Office equipment	3 – 10 years

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 1 - Summary of Significant Accounting Policies - continued**

***Deferred Outflows of Resources***

In addition to assets, the statement of net position reports a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The City's interest rate swap was deemed to be an effective hedge and was offset by a deferred outflow of resources in accordance with GASB No. 53.

***Compensated Absences***

The City's policy permits employees to accumulate earned but unused vacation benefits, which are eligible for payment upon separation. Vested or accumulated vacation leave that has matured and is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability of the governmental fund that will pay it. Accumulated sick leave lapses when employees leave employment of the City and, upon separation from service, no monetary obligation exists.

***Long-Term Obligations***

The accounting treatment of long-term debt depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the governmental activities, statement of net position. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds.

Long-term debt for governmental funds is not reported as a liability in the fund financial statements. The debt proceeds are reported as an other financing source and payment of principal and interest reported as expenditures. The accounting for the proprietary fund is the same in the fund statements as it is in the government-wide statements.

***Unearned/Deferred Revenue***

In the government-wide financial statements, unearned revenue represents the amount for which revenue recognition criteria have not been met. In subsequent periods, when the incurrence of qualifying expenditures has been made, the liability for the unearned revenue is removed and the revenue is recognized. In the governmental fund financial statements, revenues are deferred for amounts that are unearned or unavailable.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 1 - Summary of Significant Accounting Policies - continued**

***Fund Equity***

Net position is the difference between assets and deferred outflows of resources and liabilities and deferred inflows of resources. Net investment in capital assets is capital assets less accumulated depreciation and any outstanding debt related to the acquisition, construction or improvement of those assets.

In the governmental fund financial statements, fund balances are classified as follows:

- Nonspendable- Amounts that cannot be spent either because they are in a non-spendable form or because they are legally or contractually required to be maintained intact.
- Restricted - Amounts that can be spent only for specific purposes because of the City Charter, the City Code, state or federal laws, or externally imposed conditions by grantors or creditors.
- Committed - Amounts that can be used only for specific purposes determined by a formal action by City Commission ordinance or resolution.
- Assigned - Amounts that are designated by the Mayor for a particular purpose but are not spendable until a budget ordinance is passed or there is a majority vote approval (for capital projects or debt service) by City Commission.
- Unassigned- All amounts not included in other spendable classifications.

When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the City's policy is to first apply the expense toward restricted resources and then toward unrestricted resources. In governmental funds, when both restricted and unrestricted resources are available for use, it is the City's policy to use externally restricted resources first, then unrestricted resources - committed, assigned and unassigned - in order as needed.

**Revenues, Expenditures and Expenses**

***Operating Revenues and Expenses***

Operating revenues and expenses generally result from providing services and producing and delivering services in connection with a proprietary fund's principal ongoing operations. Operating revenues and expenses for the proprietary funds are those that result from internal insurance premiums.

***Interfund Transactions***

Interfund services provided/used are accounted for as revenues, expenditures or expenses. Transactions that constitute reimbursements to a fund for expenditures/expenses initially made from it that are properly applicable to another fund, are recorded as expenditures/expenses in the reimbursing fund and as reductions of expenditures/expenses in the fund that is reimbursed.

***Use of Estimates***

The process of preparing financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and designated fund balances, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

***Budgetary Information***

Annual budgets are adopted on a basis consistent with U.S. generally accepted accounting principles for all governmental funds and for proprietary funds.

***Special Item***

Subsequent to the fiscal year ended June 30, 2013, the City uncovered embezzlement that had been perpetrated by the former Finance Director. The City reported the amount embezzled during the fiscal year as a special item. See Note 11 for additional information.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 2 - Stewardship, Compliance and Accountability**

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

- In accordance with City ordinance, prior to June 1, the City Manager submits to the Board of Commissioners, a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means of financing them for the upcoming year.
- A public meeting is conducted to obtain taxpayer comment.
- Prior to June 30, the budget is legally enacted through passage of an ordinance.
- The City Manager is required by Kentucky revised statutes to present a quarterly report to the Mayor and Board of Commissioners explaining any variance from the approved budget.
- Appropriations continue in effect until a new budget is adopted.

The Board of Commissioners may authorize supplemental appropriations during the year.

Expenditures may not legally exceed budgeted appropriations at the fund level. Any amendments to the budget that would change fund level totals must be approved by the Board of Commissioners. Encumbrance accounting is not employed by the City. During the year, the Board of Commissioners adopted two supplementary appropriation ordinances. Appropriations lapse at year end unless a new budget has not been adopted.

***Excess of Expenditures over Appropriations***

The following funds had expenditures in excess of legally adopted appropriations for the year ended June 30, 2013:

	<u>Budget</u>	<u>Actual</u>
Housing Vouchers Program	\$6,629,573	\$6,904,591
HOME Consortium	210,517	258,833
Newport Steel UDAG	300,000	602,172
Investor Program	200,000	515,840

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 3 - Deposits**

***Cash and Cash Equivalents***

*Custodial Credit Risk.* For deposits, this is the risk that in the event of a bank failure, the City's deposits will not be returned. The City maintains deposits with financial institutions insured by the Federal Deposit Insurance Corporation (FDIC). As allowed by law, the depository bank should pledge securities along with FDIC insurance at least equal to the amount on deposit at all times.

As of June 30, 2013, \$411,269 of the City's deposits are insured by the FDIC, and \$7,566,847 of the City's deposits are collateralized with securities held by the pledging institution's trust department but not in the City's name. As of June 30, 2013, the City did not have any deposits in excess of insured and/or collateralized amounts.

During fiscal year 2013, the City entered into a capital lease agreement for \$16.04 million to fund specific public improvements. As of June 30, 2013, the City had \$14,213,318 available to be drawn. Additionally, the City had \$401,000 in a debt reserve account to be used to satisfy the debt service requirements in the final year of maturity on the 2012 capital lease.

As of December 31, 2012, Devou Properties, Inc. (a component unit of the City) had \$1,706,084 in cash in excess of insured limits.

***Investments***

*Custodial Credit Risk.* For investments, this is the risk, that in the event of the failure of the counterparty, the City will not be able to recover the value of its investments that are in the possession of an outside party. Investments are made by the City as an agent for the City Employee's Retirement Fund and the Police and Firemen's Pension Fund. The City maintains investment accounts with brokerage institutions which hold the investments registered in the City's name. As of June 30, 2013, all of the City's investments were covered by SIPC coverage or excess SIPC coverage provided by the institution, and are therefore not subject to custodial credit risk.



City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 4 - Capital Assets and Depreciation**

Capital asset activity for the fiscal year ended June 30, 2013, was as follows:

	<b>Balance Beginning of Year</b>	<b>Additions</b>	<b>Retirements</b>	<b>Balance End of Year</b>
<b>Governmental Activities</b>				
Capital assets not being depreciated				
Land	\$ 14,569,320	\$ 20,000	\$ 250,000	\$ 14,339,320
Land improvements	1,551,092	166,611	-	1,717,703
Construction in progress	<u>653,319</u>	<u>34,828</u>	<u>653,319</u>	<u>34,828</u>
Total capital assets not being depreciated	<u>16,773,731</u>	<u>221,439</u>	<u>903,319</u>	<u>16,091,851</u>
Depreciable capital assets				
Buildings	24,067,895	859,768	24,002	24,903,661
Building improvements	11,477,906	574,881	-	12,052,787
Infrastructure	111,303,574	2,156,912	-	113,460,486
Machinery and equipment	6,093,862	648,760	2,041,638	4,700,984
Vehicles	<u>11,296,540</u>	<u>1,398,956</u>	<u>289,900</u>	<u>12,405,596</u>
Total depreciable capital assets	<u>164,239,777</u>	<u>5,639,277</u>	<u>2,355,540</u>	<u>167,523,514</u>
Less accumulated depreciation				
Buildings	10,007,833	618,096	21,735	10,604,194
Building improvements	8,728,500	399,480	-	9,127,980
Infrastructure	91,508,318	4,334,204	-	95,842,522
Machinery and equipment	4,426,485	701,269	1,948,695	3,179,059
Vehicles	<u>10,087,113</u>	<u>541,414</u>	<u>256,400</u>	<u>10,372,127</u>
Total accumulated depreciation	<u>124,758,249</u>	<u>6,594,463</u>	<u>2,226,830</u>	<u>129,125,882</u>
Total depreciable capital assets, net	<u>39,481,528</u>	<u>(955,186)</u>	<u>128,710</u>	<u>38,397,632</u>
Governmental Activities capital assets, net	<u>\$ 56,255,259</u>	<u>\$ (733,747)</u>	<u>\$ 1,032,029</u>	<u>\$ 54,489,483</u>
<b>Component Unit</b>				
Devou Properties, Inc.				
Depreciable capital assets				
Property and equipment	\$ 82,388	\$ 7,736	\$ -	\$ 90,124
Less accumulated depreciation	<u>33,518</u>	<u>14,706</u>	<u>-</u>	<u>48,224</u>
Component Unit property and equipment, net	<u>\$ 48,870</u>	<u>\$ (6,970)</u>	<u>\$ -</u>	<u>\$ 41,900</u>

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 4 - Capital Assets and Depreciation - continued**

Depreciation expense was charged to functions as follows:

Governmental Activities		
General government	\$	421,688
Police		458,923
Fire		611,653
Public improvements		4,861,286
Recreation		<u>240,913</u>
Total Governmental Activities depreciation expense		<u>\$ 6,594,463</u>

**Note 5 - Interfund Activity**

Interfund transactions at June 30, 2013 consisted of the following due to/from other funds and transfers in/out:

	Interfund		Transfers	
	Receivable	Payable	In	Out
General Fund	\$ 368,816	3,096,650	731,942	5,334,951
Housing Vouchers Fund	-	4,613	-	-
Neighborhood Stabilization Program	-	91,614	-	-
Capital Improvement Fund	154,219	46,750	3,051,615	-
Nonmajor Governmental Funds	767,044	327,252	2,226,200	731,942
Internal Service Funds	<u>2,276,800</u>	<u>-</u>	<u>57,136</u>	<u>-</u>
	<u>\$ 3,566,879</u>	<u>3,566,879</u>	<u>6,066,893</u>	<u>6,066,893</u>

Due To/From Other Funds

Interfund receivables/payables represent short-term loans from one fund to another to cover cash overdrafts. Much of the City's revenue is received in the general fund, and then transferred to various other funds in order to fund immediate expenditures.

Interfund Transfers

Transfers are typically used to move unrestricted revenues collected in one fund to finance various programs accounted for in another fund in accordance with budgetary authorizations and to fund debt service payment when they become due. Much of the City's revenue is received in the General Fund and transferred to various other funds in order to fund immediate expenditures.

**Note 6 - Short-Term Debt**

On July 2, 2012, the City issued a Tax and Revenue Anticipation Note (TRAN) in the amount of \$3,500,000 for the purpose of providing working capital in advance of tax and revenue cash flows. This note carried a fixed rate of 1.004% and matured on June 30, 2013, at which time it was repaid out of the General Fund.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 7 - General Long-Term Debt**

Capital Lease Obligations

Capital lease obligations in the government-wide financial statements are reported as liabilities at lease inception. The related assets along with depreciation are reported at that time. Lease payments are reported as a reduction of the liability. For capital lease obligations in governmental funds, "Other Financing Sources –Inception of capital lease" was recorded at lease inception. Lease payments are recorded as expenditures. On December 20, 2012, the City entered into a lease agreement with the Kentucky Bond Corporation for \$16.04 million to finance acquisition and construction of various public improvements. The lease terminates on February 1, 2039.

The following capital lease obligations payable are payable from governmental fund revenues. The City has entered into various lease agreements as lessee for financing the acquisition of capital assets. These lease agreements qualify as capital leases for accounting purposes and therefore, have been recorded at the present value of the future minimum lease payments as of the date of their inception.

The following is an analysis of the capital assets acquired through capital leases as of June 30, 2013:

		Capital Assets
Buildings	\$	9,105,682
Building improvements		534,589
Equipment		903,819
Land		6,992,070
Infrastructure		989,002
Vehicles		2,208,054
Total cost		20,733,216
Accumulated depreciation		(4,896,210)
Net Book Value	\$	15,837,006

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 7 - General Long-Term Debt – continued**

The following is a schedule of the future minimum lease payments under these capital leases, and the present value of the net minimum lease payments at June 30, 2013:

Fiscal Year Ending June 30,		
2014	\$	2,607,031
2015		2,615,549
2016		2,516,722
2017		2,534,164
2018		2,272,839
2019-2023		10,983,590
2024-2028		5,967,931
2029-2033		4,610,420
2034-2038		4,319,543
2039		232,317
Total minimum lease payments		38,660,106
Less amounts representing interest		8,952,130
Present value of minimum lease payments	\$	29,707,976

The following schedule summarizes outstanding long-term mortgage bonds and notes payable at June 30, 2013:

	Purpose	Interest Rate	Mature Date June 30,	Issued	Outstanding
<b>Mortgage Bonds</b>					
2003 Series	Refunding	2.00-4.50%	2018	4,996,000	2,062,000
2004 Series	Pension funding	Variable	2030	14,410,000	11,535,000
KY Infrastructure Auth.	Rainwater project	2.00%	2030	1,197,390	513,704
KY Bond Corp. 2010 Series A	Refinancing	2.00%	2030	315,000	102,917
Recovery Zone Economic Dev	River Center	4.90-7.00%	2030	2,650,000	2,650,000

Interest on the variable rate 2004 Series Pension Obligation Bonds is paid at the rate of interest determined by the Remarketing Agent, determined on a weekly basis. The rate was 0.38% at June 30, 2013.

The bonds may be called prior to maturity at rates and redemption premiums specified in each issue.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 7 - General Long-Term Debt – continued**

Assuming no issues are called prior to maturity, the minimum obligations of the City at June 30, 2013 are as follows:

Fiscal Year Ending June 30,	Principal	Interest	Total
2014	\$ 1,037,785	764,927	1,802,712
2015	1,047,200	720,592	1,767,792
2016	1,050,791	674,911	1,725,702
2017	1,095,310	627,457	1,722,767
2018	1,142,838	577,541	1,720,379
2019-2023	3,982,504	2,325,813	6,308,317
2024-2028	4,977,413	1,278,335	6,255,748
2029-2030	2,529,780	165,984	2,695,764
	<u>\$ 16,863,621</u>	<u>7,135,560</u>	<u>23,999,181</u>

Interest Rate Swap

*Objective of the Interest Rate Swap.* As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in May 2005, the City entered into an interest rate swap in connection with its \$14.4 million 2004 Series variable-rate general obligation bonds. The intention of the swap was to effectively change the City's variable interest rate on the bonds to a synthetic fixed rate of 4.56 percent. The interest rate swap is considered a hedging derivative instrument.

*Terms.* The bonds mature on December 1, 2029, and the related swap agreement matures on December 1, 2014. The swap's initial notional amount of \$14.4 million matched the \$14.4 million variable-rate bonds on an amortizing schedule. The swap was entered at the same time the bonds were issued (December 2004). Starting in fiscal year 2006, the notional value of the swap and the principal amount of the associated debt decline. Under the swap, the City pays the counterparty a fixed payment of 4.56 percent and receives a variable payment based on the London Interbank Offered Rate (LIBOR). Conversely, the bond's variable-rate coupons are based on a rate determined by the remarketing agent in accordance with the indenture.

*Fair Value.* The swap had a fair value of (\$711,805) as of June 30, 2013. The swap's fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating a lower synthetic interest rate. Because the coupons on the City's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase or decrease.

*Credit Risk.* As of June 30, 2013, the City was exposed to credit risk in the amount of the swap's fair value. The swap counterparty was rated AA by Standard & Poor's and Aa2 by Moody's Investors Service as of June 30, 2013.

*Swap Payments and Associated Debt.* For the year ended June 30, 2013, the City did not receive any payments from the agreement. Using rates as of June 30, 2013, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 7 - General Long-Term Debt – continued**

Fiscal Year Ending June 30,	Principal	Interest	Swap, Net	Total
2014	\$ 445,000	42,142	496,118	983,260
2015	470,000	40,356	242,257	752,613
2016	490,000	468,950	-	958,950
2017	515,000	446,237	-	961,237
2018	540,000	422,394	-	962,394
2019-2023	3,150,000	1,708,560	-	4,858,560
2024-2028	4,020,000	902,870	-	4,922,870
2029-2030	1,905,000	87,123	-	1,992,123
	<u>\$ 11,535,000</u>	<u>4,118,632</u>	<u>738,375</u>	<u>16,392,007</u>

Conduit Debt Obligations

The City has issued Industrial Revenue Bonds to provide financial assistance to private-sector entities for the acquisition and construction of industrial and commercial facilities deemed to be in the public interest. The bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities transfers to the private-sector entity served by the bond issuance. Neither the City, state, nor any political subdivision thereof, is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the accompanying financial statements. As of June 30, 2013, there were four series of Industrial Revenue Bonds outstanding, with an aggregate principal amount payable of \$9.8 million.

During the year ended June 30, 2013, the following changes occurred in long-term liabilities:

Debt Issue	Beginning Balance	Issued	Redeemed	Ending Balance	Amounts Due Within One Year
Mortgage bonds and notes:					
2003 Refunding	\$ 2,427,000	-	(365,000)	2,062,000	383,000
KY Infrastructure Auth.	50,628	-	(50,628)	-	-
2005 Refunding Bonds	1,170,000	-	(1,170,000)	-	-
2004 Series	11,960,000	-	(425,000)	11,535,000	445,000
KIA Rainwater Harvest	538,000	-	(24,296)	513,704	24,785
KY Bond Corp 2010					
Series A	165,000	-	(62,083)	102,917	65,000
Recovery Zone Bonds	2,650,000	-	-	2,650,000	120,000
Total mortgage bonds and notes	18,960,628	-	(2,097,007)	16,863,621	1,037,785
Capital lease obligations:					
Infrastructure/equipment	15,081,134	16,040,000	(1,413,158)	29,707,976	1,704,536
Compensated absences	1,281,588	(1,318,682)	1,281,588	1,244,494	1,244,494
Total Long-Term Liabilities	<u>\$ 35,323,350</u>	<u>14,721,318</u>	<u>(2,228,577)</u>	<u>47,816,091</u>	<u>3,986,815</u>

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 7 - General Long-Term Debt – continued**

Compensated absences will be liquidated by the City's general fund. Compensated absences are required to be used within one year, therefore the balance is classified as due within one year.

**Note 8 - Risk Management**

The City is exposed to various risks to loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The City has established a Liability Self Insurance Fund (an internal service fund) to account for and finance its uninsured risks of loss. Under this program, the Liability Self Insurance Fund provides coverage for all losses. The City purchases commercial insurance for fire and extended coverage losses.

All funds of the City participate in the program and make payments to the Liability Self Insurance Fund; however, the payments are not based on actuarial estimates of the amounts needed to pay prior and current-year claims but are intended to establish a reserve for catastrophic losses. That reserve was \$714,000 at June 30, 2013. Changes in the Liability Self Insurance Fund's claims liability amount during the fiscal year ended June 30, 2013 were as follows:

	<b>2013</b>	<b>2012</b>
Claims liability at July 1	\$ 792,500	-
Change in claims and estimates	514,364	1,199,357
Claims payments	(592,864)	(406,857)
Claims liability at June 30	\$ 714,000	792,500

Additionally, the City accrued a liability of approximately \$193,000 during fiscal year 2013 in the General Fund for a settlement of pension payments.

The City has also established a Medical Self Insurance Fund. Employees may elect to participate in this program or certain other medical insurance programs offered by the City. Under this program the first \$125,000 of a participants' medical claims are payable by the Medical Self Insurance Fund. The City purchases insurance for claims in excess of coverage provided by the fund. All funds of the City participate in the program and make payments to the Medical Self Insurance Fund based on historical estimates of the amounts needed to pay prior and current year claims. The claims liability reported at June 30, 2013 is \$1,088,724. Changes in the Medical Self Insurance Fund's claims liability amount during the fiscal year ended June 30, 2013 were as follows:

	<b>2013</b>	<b>2012</b>
Claims liability at July 1	\$ 993,291	837,960
Change in claims and estimates	3,963,730	5,277,809
Claims payments	(3,868,297)	(5,122,478)
Claims liability at June 30	\$ 1,088,724	993,291

There have been no significant reductions in insurance coverage from the prior year.

There have been no settlements in excess of insurance coverage in the past three years.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 9 - Employee Retirement Plans**

The City of Covington maintains two single employer, defined benefit pension plans: Employees' Pension Plan and Police and Firemen's Pension Plan. A separate, audited post-employment benefit plan report prepared in accordance with U.S. generally accepted accounting principles is not available for these plans.

Summary of Significant Accounting Policies

*Basis of Accounting.* The plan's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

*Method Used to Value Investments.* Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Investments that do not have all established market are reported at estimated fair value. The plans issued separate financial statements which may be obtained by request from the City of Covington.

**Plan Descriptions and Contribution Information**

Membership of each plan consisted of the following at the date of the latest actuarial valuation:

Group	Employees' Pension Plan July 1, 2013	Police and Firemen's Pension Plan July 1, 2013
Retirees and beneficiaries currently receiving benefits	46	77

**Employees' Pension Plan**

*Plan Description.* The Employees' Pension Plan is a single employer defined benefit pension plan that covers substantially all non-public safety employees hired prior to April 1, 1977. The plan provides retirement, disability and death benefits to plan members and their beneficiaries. Cost-of-living adjustments (COLA) are provided at the discretion of the Board of Trustees. Benefits are provided and may be amended by City ordinance.

*Contributions.* As of June 30, 2013, all plan members were retired. The City is required to contribute at an actuarially determined rate. Contribution requirements of the City are established and may be amended by City ordinance. Administrative costs are financed through investment earnings.



City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 9 - Employee Retirement Plans - continued**

Police and Firemen's Pension Plan

*Plan Description.* The Police and Firemen's Pension Plan is a single employer defined benefit pension plan that covers all retired police and firemen who were receiving benefits prior to August 1, 1989. The plan provides retirement, disability, and death benefits to plan members and their beneficiaries. Cost-of living adjustments are provided at the discretion of the Board of Trustees. Benefits are provided under Kentucky Revised Statutes (KRS) 95.852 to 95.991.

*Contributions.* There are no active employees contributing to the plan. The City is required to contribute at an actuarially determined rate. Contribution requirements of the City are established under KRS 95.868. Administrative costs are financed through investment earnings.

**Employer Contributions**

Years Ended June 30,	Employees' Pension Plan			Police and Firemen's Pension Plan		
	Annual Required Contribution	Contributions Made	Percentage Contributed	Annual Required Contribution	Contributions Made	Percentage Contributed
2013	\$ 228,313	\$ -	0%	\$ 468,920	\$ -	0%
2012	304,163	-	0%	796,500	-	0%
2011	304,163	-	0%	342,169	-	0%

During the year ended June 30, 2005, the City issued Pension Obligation Bonds for the purpose of funding both Pension Plans. As a result, the City has a net pension obligation asset on the government-wide statement of net position. As of June 30, 2013, the Plan liabilities in both the Police and Firemen's Pension Plan and the Employees' Pension Plan exceeded the assets. Therefore, the City did have an unfunded actuarial accrued liability in the Police and Firemen's Pension Plan or the Employees' Pension Plan. The City is required by state statute to contribute impounding lot income and required contributions into the Police and Firemen's Pension Plan each year.

**Funded Status and Funding Progress**

Actuarial Valuation Date July 1,	Actuarial Value of Assets (a)	Actuarial Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
<b>Employees' Pension Plan</b>						
2013	\$ 3,294,381	\$ 4,861,543	\$ 1,567,162	68%	N/A	N/A
2011	4,002,169	5,363,292	1,361,123	75%	\$ 105,615	1289%
2009	3,867,919	5,955,714	2,087,795	65%	105,381	1981%
<b>Police and Firemen's Pension Plan</b>						
2013	\$ 7,808,529	\$ 11,027,235	\$ 3,218,706	71%	N/A	N/A
2012	8,062,246	11,315,285	3,253,039	71%	N/A	N/A
2011	9,573,902	11,003,692	1,429,790	87%	N/A	N/A

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 9 - Employee Retirement Plans - continued**

An actuarial valuation report was not prepared as of July 1, 2010 or July 1, 2012, for the Employees' Pension Plan.

**Annual Pension Cost and Net Pension Obligation**

The City's annual pension cost and net pension obligation to each plan for the fiscal year ended June 30, 2013 were as follows:

	<u>Employees' Pension Plan</u>	<u>Police and Firemen's Pension Plan</u>
Annual Required Contribution (ARC)	\$ 228,313	468,920
Interest on Net Pension Obligation	(58,013)	(145,912)
Adjustment to ARC	<u>297,443</u>	<u>748,121</u>
Annual Pension Cost	467,743	1,071,129
Actual Contribution Made	<u>-</u>	<u>-</u>
Increase in Net Pension Obligation	467,743	1,071,129
Net Pension Asset - beginning of year	<u>(773,500)</u>	<u>(1,945,487)</u>
Net Pension Asset - end of year	\$ <u>(305,757)</u>	<u>(874,358)</u>

**Three-Year Trend Information**

<u>Fiscal Years Ended</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Changes in Net Pension Obligation</u>	<u>Balance of Net Pension Asset</u>
<b>Employees' Pension Plan</b>				
June 30, 2013	\$ 467,743	0%	\$ 467,743	\$ (305,757)
June 30, 2012	528,284	0%	528,284	(773,500)
June 30, 2011	638,151	0%	638,151	(1,301,784)
<b>Police and Firemen's Pension Plan</b>				
June 30, 2013	\$ 1,071,129	0%	\$ 1,071,129	\$ (874,358)
June 30, 2012	1,366,751	0%	1,366,751	(1,945,487)
June 30, 2011	1,102,176	0%	1,102,176	(4,414,414)

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 9 - Employee Retirement Plans - continued**

The information presented in this note was determined as part of the actuarial valuations at the dates indicated. The entry age or the projected unit credit actuarial cost method is used in the valuations. Additional information as of the latest actuarial valuation follows

	<b><u>Employees' Pension Plan</u></b>	<b><u>Police and Firemen's Pension Plan</u></b>
Valuation date	July 1, 2013	July 1, 2013
Actuarial cost method	Entry Age	Unit Credit
Amortization method	Level Percent Closed	Level Percent Closed
Remaining amortization period	Ten Years	Ten Years
Asset valuation method	Market	Market
Actuarial assumptions		
Investment rate of return	7.5%	7.5%
Projected salary increases	n/a	n/a
Cost-of- living adjustments	2.0%	2.0%

**County Employees Retirement System (CERS)**

City employees hired subsequent to April 1, 1977, who work at least 100 hours per month, participate in the County Employees Retirement System (CERS). Under the provisions of Kentucky Revised Statute 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS.

The plan issues separate financial statements which may be obtained by request from Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, Kentucky 40601.

*Plan Description* - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments are provided at the discretion of the state legislature.

*Non-Hazardous Contributions* - For the year ended June 30, 2013, all plan members were required to contribute 5% of their annual creditable compensation. Any plan members that entered the retirement plan on or after September 1, 2008 are required to contribute an additional 1% of their annual creditable compensation for health insurance. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the year ended June 30, 2013, participating employers contributed 19.55% of creditable compensation. Administrative costs of CERS are financed through employer contributions and investment earnings.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 9 - Employee Retirement Plans - continued**

*Hazardous Contributions* - For the year ended June 30, 2013, plan members were required to contribute 8% of their annual creditable compensation. Any plan members that entered the retirement plan on or after September 1, 2008 are required to contribute an additional 1% of their annual creditable compensation for health insurance. The City was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding July 1 of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the year ended June 30, 2013, participating employers contributed 37.60% of each employee's creditable compensation. Administrative costs of CERS are financed through employer contributions and investment earnings.

The City's contributions to CERS for the fiscal years ended June 30, 2013, 2012, and 2011 were \$6,561,961, \$6,423,348, and \$6,129,008, respectively, which equaled the required contributions each fiscal year.

*Medical Insurance Plan* - The CERS provides post-retirement healthcare benefits to eligible members and dependents, under a cost-sharing multiple employer defined benefit plan. Medical benefits are offered to members who have retired from service or disability. The post-retirement healthcare is financed through member contributions and state appropriations.

**Note 10 - Fund Balances**

Fund balance is classified as nonspendable, restricted, committed, and/or unassigned based primarily on the extent to which the City is bound to observe constraints imposed upon the use of the resources in the governmental funds. The constraints placed on fund balance for the major funds and all other governmental funds are presented below:

Fund Balances	General	Housing Voucher Program	Capital Improvement	Nonmajor Governmental Funds	Total Governmental Funds
<b><i>Nonspendable</i></b>					
Prepaid expenses	\$ 41,593	-	250,000	-	291,593
<b><i>Restricted for</i></b>					
Capital projects	-	-	14,224,127	-	14,224,127
Debt service	-	-	401,000	-	401,000
HUD programs	-	1,067,728	-	311,804	1,379,532
Devou Park maintenance	-	-	-	319,645	319,645
Other grant programs	-	-	-	14,887	14,887
<b><i>Total Restricted</i></b>	<b>-</b>	<b>1,067,728</b>	<b>14,625,127</b>	<b>646,336</b>	<b>16,339,191</b>
<b><i>Committed to</i></b>					
Police	-	-	-	299,239	299,239
<b><i>Unassigned</i></b>	<b>738,275</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>738,275</b>
<b><i>Total Fund Balance</i></b>	<b>\$ 779,868</b>	<b>1,067,728</b>	<b>14,875,127</b>	<b>945,575</b>	<b>17,668,298</b>

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 11 - Contingencies**

The City is a defendant in a number of lawsuits pertaining to matters that are incidental to performing routine governmental and other funds. Management anticipates that any potential claims against the City would be covered by the self-insurance reserve and would not materially affect the City's financial position.

Subsequent to fiscal year-end, the City's former finance director was arraigned on charges of theft of City funds. The alleged theft was believed to be approximately \$700,000 since 2002 and the former finance director is awaiting trial. The City has identified transactions during the year ended June 30, 2013 which it believes to be fraudulent in the amount of \$102,445 and reported those as a special item in the financial statements. The Kentucky State Auditor's office initiated an examination of the City's finances, which is ongoing.

Amounts grantor agencies pay to the City are subject to audit and adjustments by the grantor, principally the federal government. The grantor may require refunding by the City for any disallowed costs. Management cannot determine amounts grantors may disallow in future periods. However, based on prior experience, management believes any refunds would be immaterial to its financial statement as of June 30, 2013.

**Note 12 - Subsequent Events**

On July 1, 2013, the City issued \$3.5 million in tax and revenue anticipation notes, bearing interest at 1.75% and maturing on June 30, 2014.

**Note 13 - Change in Accounting Principles**

The City adopted Governmental Accounting Standards Board (GASB) Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This statement establishes accounting and financial reporting requirements for service concession arrangements.

The City adopted GASB Statement No. 61, *The Financial Reporting Entity: Omnibus-an Amendment of GASB Statements No. 14 and No. 34*. This Statement amends certain reporting entity issues related to component units and equity interests in joint ventures.

The City adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance, included in certain FASB and AICPA pronouncements issued prior to November 30, 1989, which does not conflict with or contradict GASB pronouncements.

The City adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This Statement provides financial reporting guidance for deferred outflows and deferred inflows of resources, and identifies net position as the residual of all other elements presented in a statement of financial position.

City of Covington, Kentucky  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2013

**Note 14 - Restatement/Reclassification**

The City's net position as of June 30, 2012 has been adjusted to record allowance reserves against outstanding notes receivable balances. The recording of allowances had the following effect on beginning net position:

		<u>Governmental Activities</u>
Net position, June 30, 2012	\$	46,206,205
Reserve for notes receivable		<u>(13,540,077)</u>
Net position, June 30, 2012	\$	<u>32,666,128</u>

In accordance with GASB No. 54, the City reclassified the Capital Improvement fund from the General Fund to a capital projects fund. The reclassification had the following effect on governmental fund balances:

		<u>General Fund</u>	<u>Capital Improvement Fund</u>
Fund balance, June 30, 2012	\$	1,332,474	-
Reclassification		<u>(375,870)</u>	<u>375,870</u>
Fund balance, June 30, 2012	\$	<u>956,604</u>	<u>375,870</u>

**CITY OF COVINGTON, KENTUCKY**

Schedule of Revenues, Expenditures, and Changes in

Fund Balance - Budget and Actual -

General Fund

Year Ended June 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual</u> <u>Amounts</u>	<u>Variance with</u> <u>Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b>Revenues:</b>				
Taxes:				
Real property	\$ 6,544,896	6,544,896	6,427,257	(117,639)
Franchise	2,057,235	2,107,235	2,018,535	(88,700)
Insurance premium	4,900,000	5,000,000	5,279,824	279,824
Licenses and permits:				
Payroll license fees	21,525,000	22,718,097	22,974,835	256,738
Net profits license fees	2,400,000	2,800,000	2,710,237	(89,763)
Liquor and beer licenses	262,500	262,500	132,503	(129,997)
Other licenses and permits	3,000	3,000	161,852	158,852
Intergovernmental	600,000	900,000	839,800	(60,200)
Fines and forfeitures	595,000	645,000	367,591	(277,409)
Charges for services:				
Waste fees	2,273,137	2,273,137	2,474,433	201,296
Parking	1,325,000	1,325,000	1,353,754	28,754
Rental property	555,000	585,000	125,088	(459,912)
Other	2,350,000	2,425,000	2,110,395	(314,605)
Interest	168,000	168,000	95,694	(72,306)
Miscellaneous	503,800	503,800	382,851	(120,949)
Total revenues	<u>46,062,568</u>	<u>48,260,665</u>	<u>47,454,649</u>	<u>(806,016)</u>
<b>Expenditures:</b>				
Current:				
General government:				
Administration department:				
Payroll	976,926	906,825	848,442	58,383
Contractual services	377,755	445,781	1,213,936	(768,155)
Materials and supplies	20,000	29,823	29,823	-
Miscellaneous	24,000	26,252	26,252	-
Total administrative	<u>1,398,681</u>	<u>1,408,681</u>	<u>2,118,453</u>	<u>(709,772)</u>

**CITY OF COVINGTON, KY**

Schedule of Revenues, Expenditures, and Changes in

Fund Balance - Budget and Actual -

General Fund - *continued*

Year Ended June 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b><i>Expenditures - continued</i></b>				
Current - <i>continued</i> :				
General government - <i>continued</i> :				
Legal department:				
Payroll	373,556	369,968	319,729	50,239
Contractual services	41,650	57,784	57,784	-
Materials and supplies	2,000	2,983	2,983	-
Miscellaneous	8,600	5,071	5,071	-
Total legal	<u>425,806</u>	<u>435,806</u>	<u>385,567</u>	<u>50,239</u>
Finance department:				
Payroll	752,928	724,450	708,943	15,507
Contractual services	349,300	299,021	299,021	-
Materials and supplies	8,000	11,469	11,469	-
Miscellaneous	4,900	105,188	2,743	102,445
Total finance	<u>1,115,128</u>	<u>1,140,128</u>	<u>1,022,176</u>	<u>117,952</u>
Total general government	<u>2,939,615</u>	<u>2,984,615</u>	<u>3,526,196</u>	<u>(541,581)</u>
Police:				
Payroll	11,208,355	12,478,933	12,359,520	119,413
Contractual services	354,325	669,186	635,039	34,147
Materials and supplies	452,250	458,610	458,610	-
Miscellaneous	6,500	12,804	12,804	-
Total police	<u>12,021,430</u>	<u>13,619,533</u>	<u>13,465,973</u>	<u>153,560</u>
Fire:				
Payroll	11,927,973	11,945,070	12,156,613	(211,543)
Contractual services	510,910	298,710	314,307	(15,597)
Materials and supplies	337,630	334,630	257,068	77,562
Miscellaneous	4,000	4,000	3,646	354
Total fire	<u>12,780,513</u>	<u>12,582,410</u>	<u>12,731,634</u>	<u>(149,224)</u>



**CITY OF COVINGTON, KY**

Schedule of Revenues, Expenditures, and Changes in

Fund Balance - Budget and Actual -

General Fund - *continued*

Year Ended June 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b><i>Expenditures - continued</i></b>				
Current - <i>continued</i> :				
Public improvement:				
Payroll	3,821,298	4,049,578	3,888,054	161,524
Contractual services	1,129,350	1,249,815	1,243,840	5,975
Materials and supplies	834,800	861,448	861,448	-
Miscellaneous	3,300	1,205	1,205	-
Total public improvement	<u>5,788,748</u>	<u>6,162,046</u>	<u>5,994,547</u>	<u>167,499</u>
Recreation				
Payroll	308,058	289,047	289,047	-
Contractual services	167,600	109,902	109,902	-
Materials and supplies	44,500	37,495	37,495	-
Miscellaneous	1,500	1,039	1,039	-
Total recreation	<u>521,658</u>	<u>437,483</u>	<u>437,483</u>	<u>-</u>
Community development:				
Code enforcement:				
Payroll	383,824	630,571	630,571	-
Contractual services	2,379,304	2,477,408	2,477,408	-
Materials and supplies	14,700	14,678	14,678	-
Miscellaneous	1,000	575	575	-
Total code enforcement	<u>2,778,828</u>	<u>3,123,232</u>	<u>3,123,232</u>	<u>-</u>
Economic development:				
Payroll	370,929	464,789	464,789	-
Contractual services	89,940	128,366	141,397	(13,031)
Materials and supplies	9,400	6,512	6,512	-
Miscellaneous	502,400	502,572	410,572	92,000
Total economic development	<u>972,669</u>	<u>1,102,239</u>	<u>1,023,270</u>	<u>78,969</u>
Total community development	<u>3,751,497</u>	<u>4,225,471</u>	<u>4,146,502</u>	<u>78,969</u>

**CITY OF COVINGTON, KY**

Schedule of Revenues, Expenditures, and Changes in

Fund Balance - Budget and Actual -

General Fund - *concluded*

Year Ended June 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b><i>Expenditures - concluded</i></b>				
Current - <i>continued</i> :				
Parking garages:				
Contractual services	829,590	829,590	776,758	52,832
Materials and supplies	<u>5,300</u>	<u>5,300</u>	-	<u>5,300</u>
Total parking garages	<u>834,890</u>	<u>834,890</u>	<u>776,758</u>	<u>58,132</u>
Debt service:				
Principal	570,460	570,460	1,312,011	(741,551)
Interest	<u>162,665</u>	<u>162,665</u>	<u>565,919</u>	<u>(403,254)</u>
Total debt service	<u>733,125</u>	<u>733,125</u>	<u>1,877,930</u>	<u>(1,144,805)</u>
Total expenditures	<u>39,371,476</u>	<u>41,579,573</u>	<u>42,957,023</u>	<u>(1,377,450)</u>
Excess (deficiency) of revenues over (under) expenditures	6,691,092	6,681,092	4,497,626	(2,183,466)
<b><i>Other Financing Sources (Uses)</i></b>				
Transfers in	719,400	719,400	731,942	12,542
Proceeds on sale of assets	-	-	31,092	31,092
Transfers out	<u>(7,079,727)</u>	<u>(7,079,727)</u>	<u>(5,334,951)</u>	<u>(1,744,776)</u>
Total other financing sources (uses)	<u>(6,360,327)</u>	<u>(6,360,327)</u>	<u>(4,571,917)</u>	<u>(1,701,142)</u>
Special item	-	-	(102,445)	102,445
Net change in fund balance	330,765	320,765	(176,736)	(3,884,608)
Fund balance, beginning of year, <i>restated</i>	-	-	956,604	
Fund balance, end of year	<u>\$ 330,765</u>	<u>320,765</u>	<u>779,868</u>	

**CITY OF COVINGTON, KENTUCKY**

Schedule of Revenues, Expenditures, and Changes in

Fund Balance - Budget and Actual -

Housing Voucher Program

Year Ended June 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b>Revenues:</b>				
Intergovernmental	\$ 6,619,573	6,619,573	6,515,513	(104,060)
Investment earnings	10,000	10,000	838	(9,162)
Miscellaneous	-	-	199	199
Total revenues	<u>6,629,573</u>	<u>6,629,573</u>	<u>6,516,550</u>	<u>(113,023)</u>
<b>Expenditures:</b>				
Current:				
Community development	<u>6,629,573</u>	<u>6,629,573</u>	<u>6,894,294</u>	<u>(264,721)</u>
Net change in fund balance	-	-	(377,744)	(377,744)
Fund balance, beginning of year	<u>-</u>	<u>-</u>	<u>1,445,472</u>	
Fund balance, end of year	<u>\$ -</u>	<u>-</u>	<u>1,067,728</u>	

**CITY OF COVINGTON, KENTUCKY**

Schedule of Revenues, Expenditures, and Changes in

Fund Balance - Budget and Actual -

Neighborhood Stabilization Program

Year Ended June 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b>Revenues:</b>				
Intergovernmental	\$ 1,500,000	1,700,000	1,581,191	(118,809)
Total revenues	<u>1,500,000</u>	<u>1,700,000</u>	<u>1,581,191</u>	<u>(118,809)</u>
<b>Expenditures:</b>				
Current:				
Community development	1,000,000	1,000,000	768,414	231,586
Capital outlay	<u>500,000</u>	<u>700,000</u>	<u>812,777</u>	<u>(112,777)</u>
Total expenditures	<u>1,500,000</u>	<u>1,700,000</u>	<u>1,581,191</u>	<u>118,809</u>
Net change in fund balance	-	-	-	-
Fund balance, beginning of year	<u>-</u>	<u>-</u>	<u>-</u>	
Fund balance, end of year	\$ <u><u>-</u></u>	<u><u>-</u></u>	<u><u>-</u></u>	

**CITY OF COVINGTON, KENTUCKY**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2013**

Federal Grantor / Pass- Through Grantor / Program Title	Federal CFDA Number	Pass-Through Grantor's Number	Fund Balance at June 30, 2012	Revenues	Expenditures	Fund Balance at June 30, 2013
<u>U.S. Department of Housing and Urban Development</u>						
Section 8 Housing Choice Vouchers	14.871	(M) KY-133-VO-0054-0F04	\$ 792,245	\$ 5,681,361 (F)	\$ 5,786,912 (F)	\$ 686,694
			653,228	845,427 (NF)	1,117,679 (NF)	380,976
Community Development Block Grants/ Entitlement Grants	14.218	B-11-MC-21-0001	-	1,125,211 (F)	1,125,211 (F)	-
			-	230,325 (NF)	230,325 (NF)	-
<i>Pass Through From Kentucky Department of Local Government</i>						
Community Development Block Grants/ State's Program (NSP1)	14.228	N09-017	-	1,581,191 (F)	1,581,191 (F)	-
HOME Investment Partnership Programs	14.239	M-10-MC-21-0200	129,422	445,770 (F)	455,382 (F)	119,881
			-	77,005 (NF)	76,934 (NF)	71
Community Challenge Planning Grants	14.704	CC-PKY-0009-10	-	13,082 (F)	13,082 (F)	-
<u>U.S. Department of Justice</u>						
<i>Pass Through From Kenton County</i>						
Justice Assistance Grant Program	16.738	N/A	-	72,415 (F)	72,415 (F)	-
<u>U.S. Department of Transportation</u>						
<i>Pass Through From Kentucky Transportation Cabinet</i>						
State and Community Highway Safety	20.600	2008-DJ-BX-463	-	44,564 (F)	44,564 (F)	-
<u>U.S. Environmental Protection Agency</u>						
Brownfield Assessments and Cleanup - Stewart Ironworks Cleanup	66.818	BF-95482411	-	17,225 (F)	17,225 (F)	-
Total Assistance			\$ 1,574,895	\$ 10,133,576	\$ 10,520,920	\$ 1,187,551
Total Federal Financial Assistance			\$ 921,667	\$ 8,980,819 (F)	\$ 9,095,982 (F)	\$ 806,575
Total Non-Federal Financial Assistance			653,228	1,152,757 (NF)	1,424,938 (NF)	380,976
Total Assistance			\$ 1,574,895	\$ 10,133,576	\$ 10,520,920	\$ 1,187,551

F - Federal Funds; NF - Non-Federal Funds; M - Major Program

**CITY OF COVINGTON, KENTUCKY**  
**Notes to the Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2013**

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**Note 1 - Basis of Presentation**

The accompanying Schedule of Expenditures of Federal Awards includes Federal grant activity of the City and is presented on the modified accrual basis of accounting. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, therefore, some amounts presented in this Schedule may differ from amounts presented in or used in the preparation of the basic financial statements.

**Note 2 - Summary by Federal Agency**

Federal expenditures summarized by Federal grantor/agency are as follows:

<u>Federal Grantor/Agency</u>	<u>Amount</u>
U.S. Department of Housing and Urban Development	\$ 8,961,778
U.S. Department of Justice	72,415
U.S. Department of Transportation	44,564
U.S. Environmental Protection Agency	<u>17,225</u>
	<u>\$ 9,095,982</u>

**Note 3 - Outstanding Notes**

The community development loans outstanding at June 30, 2013 totaled \$5,677,126 under CFDA 14.218 and \$7,017,891 under CFDA 14.239.

**Note 4- Subrecipients**

Of the Federal expenditures presented in the Schedule, the City provided Federal awards to subrecipients as follows:

<u>Subrecipients</u>	<u>Amount</u>
CFDA 14.228 - Community Development Block Grants/State's Program (NSP1):	
Center for Great Neighborhoods	\$ 419,365
Housing Opportunities of Northern Kentucky	23,322
Housing Authority of Covington	616,404
CFDA 14.239 - HOME Investment Partnerships Program:	
Entryway, Inc.	90,000

## **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***

### **INDEPENDENT AUDITORS' REPORT**

To the Mayor and City Commissioners  
City of Covington, Kentucky:

We have audited, in accordance with the 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, the financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Covington, Kentucky ("City") as of and for the year ended June 30, 2013 and the related notes to the financial statements, which collectively comprise the City's basic financial statements and have issued our report thereon dated January 31, 2014, wherein we noted the City implemented Governmental Accounting Standards Board Statements No. 61, 62, and 63 and the financial statements of Devou Properties, Inc. were audited by other auditors.

#### **Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the City's 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 the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider finding 2013-001 and 2013-002 described in the schedule of findings and questioned costs to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies in findings 2013-003, 2013-004, 2013-005 and 2013-006 described in the accompanying schedule of findings and questioned costs to be significant deficiencies.

### **Compliance and Other Matters**

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

### **City's Responses to Findings**

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on them.

### **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 result 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.

*Clark, Schaefer, Hackett & Co.*

Cincinnati, Ohio  
January 31, 2014



## **REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE**

### **INDEPENDENT AUDITORS' REPORT**

To the Mayor and City Commissioners  
City of Covington, Kentucky:

#### **Report on Compliance for Each Major Federal Program**

We have audited the City of Covington, Kentucky's (the "City") 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 the City's major federal programs for the year ended June 30, 2013. The City's major federal programs are identified in the summary of auditors' 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.

#### ***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance for each of the City's 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 the City's 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 the City's compliance.

#### ***Opinion on Each Major Federal Program***

In our opinion, the City 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 the City 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 of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each 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 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 the City's 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 by 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. 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.

*Clark, Schaefer, Hackett & Co.*

Cincinnati, Ohio  
January 31, 2014

**CITY OF COVINGTON, KENTUCKY**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2013**

**Section I – Summary of Auditors’ Results**

**Financial Statements**

Type of auditors’ report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	Yes
• Significant deficiency(ies) identified not considered to be material weaknesses?	Yes
Noncompliance material to the financial statements noted?	None

**Federal Awards**

Internal control over major programs:	
• Material weakness(es) identified?	None
• Significant deficiency(ies) identified not considered to be material weaknesses?	None
Type of auditors’ report issued on compliance for major programs:	Unmodified
Any audit findings that are required to be reported in accordance with 510(a) of Circular A-133?	None
Identification of major programs:	
• CFDA 14.871 – Section 8 Housing Choice Vouchers	
Dollar threshold to distinguish between Type A and Type B Programs:	\$300,000
Auditee qualified as low-risk auditee?	No

**Section II – Financial Statement Findings**

**Finding 2013-001 – Material Weakness – Audit Adjustments**

During the course of our audit, we identified misstatements in the financial statements for the year under audit that were not initially identified by the City’s internal control over financial reporting. The following transactions required reclassification adjustments and a restatement and are reflected in the accompanying financial statements:

- The City has \$16,449,726 outstanding on housing development and small business commercial loans receivable as of June 30, 2013. Historically, the City presented these receivables as fully collectible but also reported a deferred revenue liability in an equal amount in the governmental fund financial statements which resulted in no impact on fund balance. However, when reporting these receivables on the full accrual basis in the government-wide financial statements, this accounting treatment resulted in the inclusion of these receivables in the City’s governmental activities’ net position. The City has utilized a deferred revenue liability to offset potentially uncollectible receivables rather than evaluating the receivables for an allowance for doubtful accounts. Since many of

these loans have deferred payments, have forgivable terms or are no longer being paid in accordance with terms, audit adjustments were necessary to establish an allowance for doubtful accounts for these loan balances. A restatement of \$13,540,077 was made to beginning net position to correct the previous reporting due to the lack of the establishment of a proper allowance for doubtful accounts.

- The City initially recorded \$6,514,054 of Housing Voucher Program revenues directly to the fund balance equity account instead of to the federal income revenue account. An audit adjustment was necessary to properly record these items as revenue.
- During the year, the City entered into a lease agreement for \$16.04 million to finance various public improvements and equipment purchases. The proceeds of the lease were placed in an account for the City to draw down as needed. As of June 30, 2013, the City had spent and only reported \$786,753 as being drawn. However, under generally accepted accounting principles, the City is required to present this liability on its government-wide financial statements and the proceeds should have been recognized as an other financing source in its governmental fund financial statements. An audit adjustment of \$15,253,247 was made to record the proceeds from the inception of the lease and the related cash balances associated with the undrawn funds.

We recommend the City enhance its internal controls over financial reporting by utilizing techniques such as management analysis of the financial statements and completion of financial reporting checklists to ensure financial reporting accurately reflects the operations and transactions of the City. This should include an ongoing analysis of an allowance for doubtful accounts receivable.

***Management's Response:*** *We agree with the auditors' comments, and the following actions have been taken or will be taken to improve the situation. To implement the recommendation, it will be necessary to enhance the current accounting internal control systems. As soon as the necessary modifications have been made, management will perform monthly reconciliations of all related accounts.*

### **Finding 2013-002 – Material Weakness – Purchasing and Accounts Payable Processes**

During our review of the City's purchasing and accounts payable processes, we noted the following:

- The Accounts Payable Clerk is responsible for processing payments and maintaining the vendor master database which represents a lack of segregation of duties. Without proper segregation of duties, the risk increases that errors or fraud could occur and not be detected within a timely basis. Therefore, we recommend vendor setup in the vendor database be performed by an individual independent of the accounts payable disbursement process.
- Checks printed with electronic signatures are not subject to independent review before being mailed. Additionally, during the audit period, multiple employees had access to print checks. In September 2013, the City reduced access to two individuals. We recommend an independent review of the checks and check register prior to mailing.
- Passwords within the system were not required to be changed periodically and the systems administrator (former finance director) had access to user names and their passwords. In September 2013, the City changed its system setting to require password changes every ninety days. We recommend additional training of City staff on the importance of changing passwords and maintaining the integrity of their own passwords.

- In determining accounts payable at year-end, it is the City's policy to include contemplated purchases that were encumbered as of June 30 and paid in July. A payable is only created after goods or services have been delivered rather than at the time of encumbrance and thus, this policy could potentially include expenditures that apply to the subsequent fiscal year. Additionally, while deemed immaterial, we noted instances of fiscal year 2013 invoices for goods and services paid in the subsequent fiscal year not captured as accounts payable as of June 30, 2013. The lack of effective cut-off procedures increases the possibility that expenditures and corresponding liabilities are not recognized in the appropriate accounting period and financial reporting does not accurately reflect the operations of the City. We recommend the City implement additional procedures related to proper cut-off of payables at both month end and year end.

**Management's Response:** *We agree with the auditors' comments, and the following actions have been taken or will be taken to improve the situation. We will have an independent individual of the accounts payable department setup vendors. We now have independent review of checks and check registers prior to mailing. We will educate staff better regarding the importance of changing passwords and maintaining the integrity of their own passwords and apply the 90-day rule for changing passwords already implemented. The City will implement additional procedures related to proper cut off at both month end and year end.*

#### **Finding 2013-003 – Significant Deficiency – Accounting Procedures**

During our review of the City accounting and financial reporting processes, we noted the City does not have a comprehensive accounting procedures manual. With the recent turnover, it was difficult to gain an understanding of the City's accounting procedures, as many of the accounting processes funneled through the former finance director. A manual of written procedures, instructions, and assignments of duties will prevent or reduce misunderstandings, errors, inefficient or wasted effort, duplicated or omitted procedures, and other situations that can result in inaccurate or untimely accounting records. A well-devised accounting manual can also help to ensure that all similar transactions are treated consistently, that accounting principles used are proper, and that records are produced in the form designed by management. A good accounting manual would aid in the training of new employees.

**Management's Response:** *We agree with the auditors' comments, and the City is currently working on a good accounting manual that will include clear instructions and assignment of duties. The City staff will be advised of all revisions.*

#### **Finding 2013-004 – Significant Deficiency – Notes Receivable**

During our review of notes receivable, we noted the City lacked processes to assess the collectability of its outstanding notes, and thus accurately report receivables in its financial statements. We recommend management prepare an analysis of its outstanding loans periodically to determine the collectability of each loan and the amount of allowance for doubtful accounts needed. This analysis should consider prior write-off experience, experience with the borrowers, as well as other information management may have about the account, such as indicators of financial difficulty.

We also noted the individuals responsible for maintaining the databases used to track the loans, are also responsible for ensuring the database reconciles with the general ledger and processing the releases of mortgages associated with the loans which represents a lack of segregation of duties. Without proper segregation of duties, the risk increases that errors or fraud could occur and not be detected within a timely basis. We recommend the City find ways to segregate these duties or develop additional monitoring controls to mitigate risk.

**Management's Response:** *We agree with the auditors' comments, and the following actions have been taken or will be taken to improve the situation. We will prepare an analysis of outstanding loans periodically and determine collectability of each loan and the amount of allowance for doubtful accounts as needed. With improved internal control procedures, we will work for better segregation of duties as it relates to maintaining the database for outstanding loans and general ledger maintenance and processing of the release of mortgages associated with the loans. The City staff will be advised of all revisions.*

#### **Finding 2013-005 – Significant Deficiency – Tax Collection Processes**

During our review of property and other taxes and license fees, we observed the following:

- The Revenue/Collections Manager has the access and ability to initiate and authorize transactions, record and process transactions, reconcile and report on the transactions, and authorize refunds which represents a lack of segregation of duties. Without proper segregation of duties, the risk increases that errors or fraud could occur and not be detected within a timely basis. We recommend the City find ways to segregate these duties or develop additional monitoring controls to mitigate risk.
- Due to a recent reorganization, staff has been assigned new responsibilities. However, we noted a lack of formal training resources and manuals, such as a formalized manual of written procedures, instructions, and assignments of duties and checklists for processes and auditing that could assist with the training and reduce misunderstandings, errors, duplicated or wasted efforts and other situations that can result in inaccurate or untimely accounting records. We recommend additional training for staff and the development of formalized procedures and policies.
- Currently, the City only has one employee with the full knowledge of the property tax billing and collections processes. This employee is also eligible to retire. We recommend the City implement succession planning for this position as well as the development of a back-up employee with the knowledge of the billing and collection process.

**Management's Response:** *We agree with the auditors' comments, and the following actions have been taken or will be taken to improve the situation. We will find ways to segregate the duties relating to the tax collection process. The City is currently seeking new staff to help improve this process and implement the needed segregation. The City is also currently seeking a replacement for the individual currently responsible for property tax billing. Once in place, staff will be trained and procedures formalized to improve the billing and collection process. Succession plans are underway and the development of a backup employee with knowledge of the billing and collection process has been planned for. The staff will be advised of all revisions.*

#### **Finding 2013-006 – Significant Deficiency – Cash Receipts Processes and Reconciliation**

During our review of the cash collection processes, we observed the following:

- The individual responsible for making many of the adjustments to the general ledger is also responsible for performing the monthly bank reconciliations. Ideally, these duties should be segregated. We recommend an individual without access to the general ledger prepare the monthly bank reconciliations.

- During our review of the bank reconciliation, we noted certain reconciling items which were unsupported by documentation. Unreconciled differences that appear immaterial can obscure significant but offsetting items such as bank errors or improperly recorded transactions that would warrant further review. Also, if small differences are not reconciled on a monthly basis, the differences become more difficult to reconcile after the passage of time. We recommend the City fully reconcile all of its bank accounts on a monthly basis to the City's books.

**Management's Response:** *We agree with the auditors' comments, and the following actions have been or will be taken to improve the situation. A separate individual will be made responsible for making adjustments to the general ledger and performing monthly bank reconciliations. All differences will be investigated and resolved timely. The City will reconcile bank accounts on a monthly basis to the City's books.*

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

None Noted.

### **Section IV – Schedule of Prior Year Findings and Questioned Costs**

#### **Finding 2012-01 – Material Weakness – Internal Control – Classification of Net Asset Balances**

Although in aggregate, net assets as of June 30, 2011 were correct, the various components of net assets required adjustment for proper presentation by net asset classification.

**Status:** Audit adjustments were identified in the current year audit; this finding was repeated as Finding 2013-001.