

**CITY OF MIDDLESBOROUGH, KENTUCKY
REPORT ON AUDIT OF FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
For the Year Ended June 30, 2012**

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INDEPENDENT AUDITOR'S REPORT

To the Mayor and City Council
City of Middlesborough, Kentucky

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Middlesborough, Kentucky, as of and for the year ended June 30, 2012, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Middlesborough, Kentucky's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Middlesborough, Kentucky as of June 30, 2012 and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Governmental Auditing Standards*, we have also issued our report dated June 15, 2015 on our consideration of the City of Middlesborough, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance

with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Accounting principles generally accepted in the United States of America require that the budgetary comparison information on page 31 and 32 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operations, 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 inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the basic financial statements of the City of Middlesborough, Kentucky. 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, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements. The schedule of expenditures of federal awards 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 financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

 Jaqueline S. Smith CPA ASE

Raven, Kentucky
June 15, 2015

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF NET ASSETS
June 30, 2012

	Governmental Activities	Business-type Activities	Total
ASSETS			
Current assets:			
Cash.....	\$ 1,043,412	\$ 1,476,977	\$ 2,520,389
Grants receivable.....	42,407	-	42,407
Receivables, net.....	-	494,136	494,136
Other receivables.....	2,987	-	2,987
Prepaid insurance.....	33,831	-	33,831
Inventories.....	-	5,799	5,799
Total current assets.....	1,122,637	1,976,912	3,099,549
Noncurrent assets:			
Bond issue and deferred bond costs.....	30,713	-	30,713
Land.....	1,599,747	345,173	1,944,920
Property and equipment, net of accumulated depreciation.....	6,508,976	6,781,748	13,290,724
Total noncurrent assets.....	8,139,436	7,126,921	15,266,357
Total assets.....	9,262,073	9,103,833	18,365,906
LIABILITIES			
Current liabilities:			
Accounts payable.....	67,293	52,306	119,599
Accrued payroll liabilities.....	202,617	6,946	209,563
Due to other governments.....	9,441	-	9,441
Compensated absences.....	230,677	20,276	250,953
Current portion of bank notes and capital lea	175,000	35,355	210,355
Interest and principal due on bonds.....	96,498	-	96,498
Total current liabilities.....	781,526	114,883	896,409
Noncurrent liabilities:			
Long-term portion of capital leases.....	-	116,744	116,744
General obligation bonds payable.....	368,000	-	368,000
Revenue bonds payable.....	235,000	-	235,000
Compensated absences.....	147,134	18,613	165,747
Total noncurrent liabilities.....	750,134	135,357	885,491
Total liabilities.....	1,531,660	250,240	1,781,900
NET ASSETS			
Invested in capital, net of related debt.....	8,108,723	6,974,822	15,083,545
Restricted for:			
Debt service.....	48,038	-	48,038
Capital asset repairs.....	38,799	37,800	76,599
Other special revenue.....	350,548	111	350,659
Unrestricted.....	(815,695)	1,840,860	1,025,165
Total net assets.....	\$ 7,730,413	\$ 8,853,593	\$ 16,584,006

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF ACTIVITIES
Year Ended June 30, 2012

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE) REVENUE AND CHANGES IN NET ASSETS		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business- type Activities	Total
Governmental activities:							
General administration.....	\$ 1,110,867	\$ 71,485	\$ 8,907	\$ -	\$ (1,030,475)	\$ -	\$ (1,030,475)
Public protection - police.....	1,768,209	79,388	239,274	-	(1,449,547)	-	(1,449,547)
Public protection - fire.....	1,991,636	-	103,649	-	(1,887,987)	-	(1,887,987)
Public street service.....	1,734,153	24,000	896,158	18,500	(795,495)	-	(795,495)
Community development.....	148,944	9,096	-	-	(139,848)	-	(139,848)
Total governmental activities.....	6,753,809	183,969	1,247,988	18,500	(5,303,352)	-	(5,303,352)
Business-type activities:							
Ambulance.....	225,542	835,437	-	-	-	609,895	609,895
Sanitation.....	386,854	427,209	-	-	-	40,355	40,355
Sewer.....	1,375,607	1,531,594	-	-	-	155,987	155,987
Total business-type activities.....	1,988,003	2,794,240	-	-	-	806,237	806,237
Total all activities.....	\$ 8,741,812	\$ 2,978,209	\$ 1,247,988	\$ 18,500	\$ (5,303,352)	\$ 806,237	\$ (4,497,115)

GENERAL REVENUES		
Taxes:		
Property taxes levied for general purposes.....	523,559	523,559
Occupational and privilege license tax.....	2,897,315	2,897,315
Tax levied on insurance premiums.....	332,624	332,624
Payments in lieu of taxes.....	68,047	68,047
Franchise fees - electric.....	280,988	280,988
Franchise fees - cable.....	55,050	55,050
	<u>4,157,583</u>	<u>4,157,583</u>
Interest earnings.....	1,257	6,003
Special item - interest paid on pension obligation bond.....	(23,543)	(23,543)
Special item - gain (loss) on disposition of capital asset.....	(335)	(335)
Transfers.....	<u>845,902</u>	<u>(845,902)</u>
Total general revenues, special items and transfers.....	4,980,864	4,139,708
Change in net assets.....	(322,488)	(357,407)
Net assets, beginning of year as adjusted.....	8,052,901	16,941,413
Net assets, ending.....	\$ 7,730,413	\$ 16,584,006

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2012

	General Fund	Non-major Governmental Funds	Totals
<u>ASSETS</u>			
Cash.....	\$ 683,423	\$ 359,989	\$ 1,043,412
Grants receivable.....	42,407	-	42,407
Other receivables.....	2,987	-	2,987
Prepaid expenses.....	33,831	-	33,831
Total assets.....	\$ 762,648	\$ 359,989	\$ 1,122,637
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable.....	\$ 67,293	\$ -	\$ 67,293
Accrued payroll and taxes.....	150,184	-	150,184
Line of credit	175,000	-	175,000
Due to outside agencies.....	-	9,441	9,441
Compensated absences.....	230,677	-	230,677
Total liabilities.....	623,154	9,441	632,595
Fund balances:			
Nonspendable - prepaid insurance.....	33,831	-	33,831
Restricted by grantor or debt covenants.....			
Road maintenance.....	-	96,545	96,545
Public safety building repairs.....	38,799	-	38,799
Public safety and community development..	-	132,326	132,326
Economic development.....	-	121,677	121,677
Debt service.....	48,038	-	48,038
Unassigned.....	18,826	-	18,826
Total fund balances.....	139,494	350,548	490,042
Total liabilities and fund balances.....	\$ 762,648	\$ 359,989	\$ 1,122,637

**CITY OF MIDDLESBOROUGH, KENTUCKY
RECONCILIATION OF BALANCE SHEET TO
THE STATEMENT OF NET ASSETS
GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2012**

Total Fund Balance - Governmental Funds **\$ 490,042**

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

Capital assets owned by City	(increase in net assets)	9,300,115
Depreciation allocation	(decrease in net assets)	(1,191,392)

Payroll liabilities. The statement of net assets includes all known employer payroll liabilities. The fund statements include payroll liabilities paid within 30 days and employee withholdings on-hand at June 30. Employer retirement due on overtime firefighter wages assessed and paid April 2013 is included in net assets.

Additional employer retirement	(decrease in net assets)	(52,433)
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Compensated absences. Vacation and sick leave not currently payable is recorded as a liability in the statement of net assets and an increase of salary costs in the statement of activities. It is not recorded in the funds as it is not a use of current resources.

Non-current compensated absences added to liabilities (decrease in net assets)	(147,134)
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Long-term debt. The principal balance on outstanding debt is not recorded in the fund financial statements because it is not due and payable in the current period. Repayment of principal is recorded as an expenditure of the fund. In the statement of net assets, outstanding debt is recorded as a liability and payment of principal is treated as a reduction of that liability. Bond issue costs, expensed in the funds, are amortized over the life of the bond in the statement of activities. Likewise, interest is accrued between payment dates, while it is recorded as an expense in the funds.

Interest, lease and bond payments due in one year	(decrease in net assets)	(96,498)
Principal balance less amounts due in one year	(decrease in net assets)	(603,000)
Unamortized bond charges included in net assets	(increase in net assets)	30,713

Net Assets - Statement of Net Assets	<u>\$ 7,730,413</u>
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CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Year Ended June 30, 2012

	General Fund	Non-major Governmental Funds	Totals
<u>REVENUES</u>			
Property taxes.....	\$ 924,230	\$ -	\$ 924,230
Licenses, permits and fees.....	3,233,353	-	3,233,353
Intergovernmental programs.....	863,475	384,513	1,247,988
Investment income.....	822	435	1,257
Service charges.....	92,577	-	92,577
Other.....	91,392	-	91,392
Total revenues.....	5,205,849	384,948	5,590,797
<u>EXPENDITURES</u>			
Current:			
General administration.....	2,307,198	-	2,307,198
Public protection - police.....	1,228,466	-	1,228,466
Public protection - fire.....	1,381,361	-	1,381,361
Public street service.....	1,253,910	190,184	1,444,094
Community development.....	129,293	3,042	132,335
Debt service:			
Principal.....	82,396	-	82,396
Interest.....	26,276	-	26,276
Capital outlay.....	67,645	-	67,645
Total expenditures.....	6,476,545	193,226	6,669,771
Excess (deficiency) of revenues over expenditures.....	(1,270,696)	191,722	(1,078,974)
<u>OTHER FINANCING SOURCES (USES)</u>			
Proceeds of bond issue.....	250,000	-	250,000
Operating transfers in.....	1,107,417	-	1,107,417
Operating transfers out.....	-	(261,515)	(261,515)
Capital grants.....	18,500	-	18,500
Total other financing sources.....	1,375,917	(261,515)	1,114,402
Excess(deficiency) of revenues and other sources over expenditures.....	105,221	(69,793)	35,428
Fund balance, beginning of year	34,273	420,341	454,614
Fund balance, end of year.....	\$ 139,494	\$ 350,548	\$ 490,042

CITY OF MIDDLESBOROUGH, KENTUCKY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2012

Net Change in Fund Balance - Governmental Funds

\$ 35,428

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

Capital outlay removed from expenditures	(increase in net assets)	67,645
Depreciation included in expenses	(decrease in net assets)	(198,168)
Loss on disposition of net assets	(decrease in net assets)	(335)

Payroll liabilities. The statement of net assets includes all known employer payroll liabilities. The fund statements include payroll liabilities paid within 30 days and employee withholdings on-hand at June 30. Employer retirement due on overtime firefighter wages assessed and paid April 2013 is included in net assets.

Additional employer retirement	(decrease in net assets)	(52,433)
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Compensated absences. Vacation and sick leave not currently payable is recorded as a liability in the statement of net assets and an increase of salary costs in the statement of activities. It is not recorded in the funds as it is a use of current resources.

Net decrease in non-current compensated absences	(increase in net assets)	1,681
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Long-term debt. The principal balance on outstanding debt is not recorded in the fund financial statements because it is not due and payable in the current period. Repayment of principal is recorded as an expenditure of the fund. In the statement of net assets, outstanding debt is recorded as a liability and payment of principal is treated as a reduction of that liability. Bond issue costs, expensed in the funds, are amortized over the life of the bond in the statement of activities. Likewise, interest is accrued between payment dates, while it is recorded as an expense in the fund.

Bond proceeds removed from revenues	(decrease in net assets)	(250,000)
Principal repayments removed from expenditures	(increase in net assets)	82,396
Accrued interest removed from expenditures	(increase in net assets)	2,441
Amortized bond costs added to expenditures	(decrease in net assets)	(11,143)

Net Change in Net Assets - Statement of Activities

\$ (322,488)

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2012

	<u>Ambulance Fund</u>	<u>Sanitation Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
<u>ASSETS</u>				
Current assets:				
Cash.....	\$ 586,189	\$ 108,438	\$ 782,350	\$ 1,476,977
Receivables, net.....	323,693	64,446	105,997	494,136
Inventories.....	-	-	5,799	5,799
Total current assets.....	909,882	172,884	894,146	1,976,912
Noncurrent assets:				
Land.....	-	-	345,173	345,173
Property and equipment, net of accumulated depreciation.....	190,643	-	6,591,105	6,781,748
Total noncurrent assets.....	190,643	-	6,936,278	7,126,921
Total assets.....	1,100,525	172,884	7,830,424	9,103,833
<u>LIABILITIES</u>				
Current liabilities:				
Accounts payable.....	398	31,511	20,397	52,306
Accrued payroll liabilities.....	-	-	6,946	6,946
Lease payments due by June 30, 2013.....	35,355	-	-	35,355
Compensated absences.....	-	-	20,276	20,276
Total current liabilities.....	35,753	31,511	47,619	114,883
Noncurrent liabilities:				
Lease payments due after June 30, 2013.....	116,744	-	-	116,744
Compensated absences.....	-	-	18,613	18,613
Total noncurrent liabilities.....	116,744	-	18,613	135,357
Total liabilities.....	152,497	31,511	66,232	250,240
<u>NET ASSETS</u>				
Invested in capital, net of related debt.....	38,544	-	6,936,278	6,974,822
Restricted for:				
Capital asset repairs.....	-	-	37,800	37,800
Other.....	-	-	111	111
Unrestricted.....	909,484	141,373	790,003	1,840,860
Total net assets.....	\$ 948,028	\$ 141,373	\$ 7,764,192	\$ 8,853,593

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
Year Ended June 30, 2012

	Ambulance Fund	Sanitation Fund	Sewer Fund	Total
<u>OPERATING REVENUES</u>				
Charges for services.....	\$ 821,975	\$ 427,209	\$ 1,513,154	\$ 2,762,338
Connection fees.....	-	-	4,006	4,006
Miscellaneous income.....	13,462	-	14,434	27,896
Total operating revenues.....	835,437	427,209	1,531,594	2,794,240
<u>OPERATING EXPENSES</u>				
Salaries and benefits.....	13,197	-	496,692	509,889
Contractual services.....	54,790	386,854	55,606	497,250
Utilities.....	-	-	190,984	190,984
Chemicals and plant supplies.....	-	-	123,106	123,106
Maintenance and repairs.....	17,671	-	96,875	114,546
Other supplies and expenses.....	73,265	-	29,143	102,408
Insurance expense.....	22,457	-	-	22,457
Flood clean-up expense.....	-	-	10,800	10,800
Depreciation.....	37,857	-	372,401	410,258
Total operating expenses.....	219,237	386,854	1,375,607	1,981,698
Operating income (loss).....	616,200	40,355	155,987	812,542
<u>NON-OPERATING REVENUES (EXPENSES)</u>				
Interest income.....	2,433	259	2,054	4,746
Interest expense.....	(6,305)	-	-	(6,305)
Total non-operating revenues (expenses).....	(3,872)	259	2,054	(1,559)
Income (loss) before contributions and transfers....	612,328	40,614	158,041	810,983
Capital grants/contributions.....	-	-	-	-
Transfers in.....	-	-	-	-
Transfers out.....	(625,000)	-	(220,902)	(845,902)
	(625,000)	-	(220,902)	(845,902)
Change in net assets.....	(12,672)	40,614	(62,861)	(34,919)
Net assets, beginning of year	960,700	249,943	7,982,061	9,192,704
Less: overstatement of prior period accounts receivable ...		(149,184)	(155,008)	(304,192)
	960,700	100,759	7,827,053	8,888,512
Net assets, end of year.....	\$ 948,028	\$ 141,373	\$ 7,764,192	\$ 8,853,593

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
Year Ended June 30, 2012

	<u>Ambulance Fund</u>	<u>Sanitation Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
<u>CASH FLOWS from operating activities:</u>				
Receipts from customers.....	\$ 880,130	\$ 425,416	\$ 1,609,450	\$ 2,914,996
Payments to suppliers.....	(167,785)	(386,465)	(552,975)	(1,107,225)
Payments to/for employees.....	(13,197)		(501,915)	
Other refunds and reimbursements.....	16,243	-	14,434	(327,837)
Net cash provided by operating activities.....	<u>715,391</u>	<u>38,951</u>	<u>568,994</u>	<u>1,323,336</u>
<u>CASH FLOWS from non-capital financing activities:</u>				
Operating transfers to general fund.....	(625,000)	-	(220,902)	(845,902)
Net cash provided by non-capital financing activities..	<u>(625,000)</u>	<u>-</u>	<u>(220,902)</u>	<u>(845,902)</u>
<u>CASH FLOWS from capital and related financing activities:</u>				
Acquisition of capital assets.....	(23,550)	-	(29,132)	(52,682)
Proceeds of capital grant.....	-	-	-	
Principal and revenue bond maturities.....	(36,463)	-	-	(36,463)
Interest and fees paid on loan and revenue bond maturities....	(6,305)	-	-	(6,305)
Net cash (used) by capital and related financing activi	<u>(66,318)</u>	<u>-</u>	<u>(29,132)</u>	<u>(95,450)</u>
<u>CASH FLOWS from investing activities:</u>				
Interest income.....	2,433	259	2,054	4,746
Net cash provided by investing activities.....	<u>2,433</u>	<u>259</u>	<u>2,054</u>	<u>4,746</u>
Net increase (decrease) in cash and cash equivalents...	26,506	39,210	321,014	386,730
Balances, beginning of year.....	559,683	69,228	461,336	1,090,247
Balances, end of year.....	<u>\$ 586,189</u>	<u>\$ 108,438</u>	<u>\$ 782,350</u>	<u>\$ 1,476,977</u>
<u>Reconciliation of operating income (loss) to net cash provided (used) by operating activities:</u>				
Operating income (loss).....	\$ 616,200	\$ 40,355	\$ 155,987	\$ 812,542
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation.....	37,857	-	372,401	410,258
(Increase) decrease in accounts receivable (net).....	60,936	(1,793)	34,801	93,944
Increase (decrease) in accounts payable.....	398	389	11,019	11,806
Increase (decrease) in accrued current liabilities.....	-	-	955	955
Increase (decrease) in compensated absences.....	-	-	(6,169)	(6,169)
Net cash provided by operating activities.....	<u>\$ 715,391</u>	<u>\$ 38,951</u>	<u>\$ 568,994</u>	<u>\$ 1,323,336</u>

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUND
June 30, 2012

	<u>P&F Pension Fund</u>
<u>ASSETS</u>	
Cash and cash equivalents.....	\$ 1,796,987
Taxes receivable.....	<u>33,657</u>
Total assets.....	<u>1,830,644</u>
 <u>NET ASSETS</u>	
Held in trust for pension benefits.....	<u>\$ 1,830,644</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FIDUCIARY FUND
Year Ended June 30, 2012

	<u>P&F Pension Fund</u>
<u>ADDITIONS</u>	
Employer contributions.....	\$ 10,015
Investment income.....	<u>17,678</u>
Total additions.....	<u>27,693</u>
<u>DEDUCTIONS</u>	
Pension benefits paid.....	<u>232,580</u>
Total deductions.....	<u>232,580</u>
Change in net assets.....	(204,887)
Net assets, beginning of year.....	<u>2,035,531</u>
Net assets, end of year.....	<u>\$ 1,830,644</u>

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General Statement

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

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

In 2004, the City implemented the financial reporting requirements of GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for States and Local Governments*. GASB 34 requires cities to apply the full accrual accounting method (business approach) to all activities and combine the data into a presentation that records all assets, liabilities, revenues and expenses of the City. Prior to GASB 34, cities reported governmental funds under the modified accrual basis of accounting whereby capital assets owned and long-term debts owed by governmental funds were not reported in the financial statements. GASB 34 emphasizes major funds and specifies the inclusion of a budgetary comparison for governmental funds and an MD&A as required supplementary information. The City customarily presents a Management Discussion and Analysis (MD&A) section that provides an analysis of the City's overall financial position and results of operations; however, for the fiscal year ended June 30, 2012, the City has elected not to present the MD&A.

B. Financial Reporting Entity

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

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

(Basic financial reporting entity continued)

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

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

C. Basis of Presentation

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

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

Fund Financial Statements/Governmental Funds

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

Governmental Funds

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

General Fund

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

Special Revenue Funds

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

Proprietary Funds

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

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

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

Fiduciary Funds

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

D. Measurement Focus/Basis of Accounting

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

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

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

E. Budgetary Control

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

F. Estimates

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

G. Cash and Investments

Cash of all funds are maintained in interest bearing checking/savings accounts or certificates of deposit. For cash flow purposes, cash equivalents include on-hand cash as well as deposited funds.

H. Receivables

"Receivables" in business-type proprietary funds represent revenues earned or accrued for sewer, sanitation or ambulance services provided through June 30, 2012. In both the fund and government-wide financial statements, "grants receivable" represent amounts due from grantor agencies that are essentially a reimbursement of costs incurred by the City at June 30, 2012.

Generally accepted accounting principles require that receivables are reported net of an allowance for uncollectible accounts. In the ambulance fund, the City considers the following to be uncollectible: 1) all accounts turned over to district court for collection, 2) all private pay accounts over 90 days old, 3) 40% of all claims billed to Medicare, and 4) 90% of all Medicaid claims.

As discussed above, the City turned over the billing of sewer and sanitation services to the local water utility on March 1, 2010 and currently utilizes the local water utility's determination of collectible accounts. The local water utility employs various collection procedures including credit agency reporting, and writes the account off as uncollectible after 132 days. The coordination of the City's net receivable reporting with the local water utility resulted in a reduction of collectible accounts receivable at June 30, 2011. Sanitation and sewer accounts receivable at the beginning of the audit period were reduced by \$149,184 and \$155,008, respectively, and are recorded in the statement of revenues, expenses, and changes in net assets as a prior period adjustment.

I. Transactions between Funds

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

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

J. Property, Plant and Equipment

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

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

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

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

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

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

K. Compensated Absences

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

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

L. Net Assets and Fund Balance Classifications

In the statement of net assets, the difference between assets and liabilities is known as net assets. Net assets is further segregated into 1) amounts invested in fixed assets (invested in capital, net of related debt), 2) amounts set aside in accordance with legal or contractual agreements (restricted for debt service, capital asset repairs, or other special revenue sources), and 3) the remaining balance available to finance City operations (unrestricted).

In the governmental funds, the difference between the assets and liabilities is termed fund balance. Fund balance is further separated into the following components: non-spendable (prepaid expenses), restricted (by grant or contract), committed (by action of the commission), assigned (by committee) and unassigned. The City considers expenditures are first applied against the non-spendable fund balance. Next, qualified grant or contractual expenditures are applied against the restricted fund balance. The remaining fund balance is generally designated as unassigned. At June 30, 2012, the City's fund balance was segregated into those funds restricted by bondholder or grantor regulations, non-spendable, and unassigned funds available for general operations.

II. DEPOSITS AND INVESTMENTS

A. Deposit requirements

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

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

B. Risk disclosures

Custodial credit risk is the risk that in the event of the failure of a bank, the City's deposits may not be returned to it. At June 30, 2012, all of the City's deposits, as well as the funds held in trust to pay pension benefits, were adequately insured.

Concentrations of credit risk. The majority of the City's deposits are maintained in one financial institution. Pension trust benefits are held in another local bank. In July 2011, the City established a fund to deposit monies for flood clean-up in a separate bank. In addition, the City maintains escrow accounts at the Bank of New York and Kentucky League of Cities to facilitate the repayment of debt discussed in Note VI.

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

III. INTERFUND TRANSFERS

Interfund transfers during the year ended June 30, 2012 were as follows:

	<u>Operating Transfers In</u>	<u>Operating Transfers Out</u>
<u>Governmental funds</u>		
General Fund	\$ 1,107,417	\$ -0-
UDAG	-0-	111,515
Municipal Road Aid	-0-	30,000
Coal and Mineral Severance Tax	-0-	120,000
LGEA	-0-	-0-
Total governmental	<u>\$ 1,107,417</u>	<u>\$ 261,515</u>
<u>Business-type activities</u>		
Ambulance	-0-	625,000
Sanitation	-0-	-0-
Sewer	-0-	220,902
Total business-type	<u>-0-</u>	<u>845,902</u>
Total transfers	<u>\$ 1,107,417</u>	<u>\$1,107,417</u>

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

IV. PROPERTY TAX CALENDAR

Property taxes for fiscal year ended June 30, 2012 were levied September 18, 2011 on the assessed valuation of property located within the City limits as of January 1, 2011, the lien date. The ordinance states the face value of taxes are due January 31, 2012 with a 2% discount if paid by December 31, 2011; an additional 10% penalty and 1% interest per month added as of February 1, 2012.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

V. CAPITAL ASSETS

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

	Balance 6/30/11	Additions & Adjustments	Retirements & Transfers	Balance 6/30/12
<u>Governmental Activities</u>				
Land	\$1,599,747	\$ -0-	\$ -0-	\$ 1,599,747
Undepreciated assets	<u>1,599,747</u>	<u>-0-</u>	<u>-0-</u>	<u>1,599,747</u>
Infrastructure	90,713	-0-	-0-	90,713
Buildings	4,661,369	14,840	-0-	4,676,209
Equipment	732,151	31,290	-0-	763,441
Vehicles	2,190,696	21,515	42,206	2,170,005
Total depreciable assets	<u>\$7,674,929</u>	<u>\$ 67,645</u>	<u>\$ 42,206</u>	<u>\$7,700,368</u>
Less: Accumulated depreciation	<u>1,035,095</u>	<u>198,168</u>	<u>\$ 41,871</u>	<u>1,191,392</u>
Net depreciable assets	<u>\$6,639,834</u>			<u>\$6,508,976</u>
<u>Business-type Activities</u>				
Land	\$ 345,173	\$ -0-	\$ -0-	\$ 345,173
Undepreciated assets	<u>345,173</u>	<u>-0-</u>	<u>-0-</u>	<u>345,173</u>
Buildings	101,900	9,720	-0-	111,620
Sewer plant	14,042,219	-0-	-0-	14,042,219
Equipment	1,925,792	34,389	15,057	1,945,124
Vehicles	493,389	197,135	113,376	577,148
Total depreciable assets	<u>16,563,300</u>	<u>241,244</u>	<u>128,433</u>	<u>16,676,111</u>
Less: Accumulated depreciation	<u>9,612,539</u>	<u>410,258</u>	<u>128,434</u>	<u>9,894,363</u>
Net depreciable assets	<u>\$ 6,950,761</u>			<u>\$6,781,748</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

VI. LINE OF CREDIT AND LONG-TERM DEBT

A. Line of Credit

In July 2011, the City was approved for a line of credit of \$250,000 with a local financial institution to expedite clean-up of the extensive damage to property due to the June 19, 2011 flooding. The line of credit is due July 21, 2012 and carries an interest rate of 4.35% paid quarterly. The City borrowed \$175,000 of the line of credit and repaid it in full July 2012.

B. Outstanding Long-Term Debt

Compensated absences

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

Lease payable

The City acquired street equipment with a fair market value of \$175,410 through two lease-purchase agreements. The dozer and backhoe carry interest rates are 0% and 5.25 and were paid in full July 2011. On November 8, 2011, the City acquired two ambulances with a fair market value of \$188,562. The lease purchase agreement carry an interest rate of 4.25% and is payable in annual installments over five years

Bonds payable

At June 30, 2012, revenue bonds payable consisted of the following individual issues:

	<u>Governmental</u>	<u>Proprietary</u>
Kentucky Bond Corporation		
Financing Program Revenue Bonds,		
Series A, payable in annual installments		
2.5-3%, Final maturity February 2022.	\$ 255,000	
 Kentucky League of Cities Funding Trust		
General Obligation Refunding Bonds		
dated September 1, 2003		
payable in annual installments		
2.0%-4.5%, Final maturity August 2017	\$ 437,000	
 Total bond principal, June 30, 2012	\$ 692,000	\$ -0-
<i>Included in Interest and Principal due on</i>		
<i>Bonds in the Statement of Net Assets</i>	<u>89,000</u>	<u>-0-</u>
	\$ 603,000	\$ -0-

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

Revenue Bonds

Kentucky Bond Corporation Financing Program Revenue Bonds. In December 2011, a Kentucky Labor Cabinet audit determined that cities across the Commonwealth had failed to compensate firefighters for overtime wages due on the state incentive supplement to firefighters. The City issued \$255,000 in revenue bonds in March 2012 to finance the repayment.

The bonds carry an interest rate of 2.5% - 3.5% and are payable in annual installments of \$20,000 over a ten year period. Interest is paid semi-annually. These bonds are direct obligations issued on a pledge of the general taxing power of the City to repay its debt obligations.

The City makes monthly payments to Kentucky League of Cities, who holds the funds in escrow and remits the funds to the bondholder on the due date. Escrowed payments are recorded as cash in the City's financial statements.

General Obligation Bonds/ Debt Refunding

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

The re-acquisition price exceeded the net carrying amount of the old debt by \$57,743 and bond issue costs totaled \$28,257. For the year ended June 30, 2012, these costs are recorded as a deferred asset in the statement of net assets and are amortized over the life of the bond. Amortization is included in interest as a special item in the statement of activities. Generally accepted accounting policies in place for the year ended June 30, 2013 reclassify bond issue costs as an expense rather than an asset.

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

Reserves

The bond ordinances require the City establish reserves for future extraordinary repairs and replacement of the Sewer System and Public Safety Building. The reserves are fully funded at June 30, 2012. Both bond issues were paid in full as of June 30, 2011.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

C. Changes in Outstanding Long-Term Debt

Transactions for the Year ended June 30, 2012 are summarized as follows:

	Balance 6/30/11	Issues or Additions	Payments or Expenditures	Balance 6/30/12
<u>Governmental Activities</u>				
General obligation bonds	\$ 502,000	\$ -0-	\$ 65,000	\$ 437,000
Revenue bonds	-0-	255,000	-0-	255,000
Lease-purchase	17,396	-0-	17,396	-0-
Compensated absences	148,815	-0 -	1,681	147,134
Total	\$ 668,211	\$ 255,000	\$ 84,077	\$839,134
<u>Business-type Activities</u>				
Lease-purchase	\$ -0-	188,562	36,463	\$ 152,099
Compensated absences	22,061	-0-	3,448	18,613
Total	\$ 22,061	\$188,562	\$ 39,911	\$ 170,712
Total all fund types	\$1,214,344	\$443,562	\$ 123,988	\$1,009,846

D. Annual Requirements to Retire Bond Obligations

<u>Governmental Activities</u>		
Fiscal Year End	<u>Principal</u>	<u>Interest</u>
2013	89,000	23,466
2014	87,000	21,405
2015	96,000	18,066
2016	96,000	17,441
2017	92,000	20,903
2018-2022	232,000	13,425
	\$ 692,000	\$ 114,706

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

VIII. PENSION PLAN

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

A. The Police and Fireman's Retirement Fund

The City contributes to a single employer retirement fund for eligible employees of the Police and Fire Department. In August 1988, the City froze admission of new entrants who now join the statewide County Employees Retirement System. Members who had already retired at August 1988 remained in the plan and continue to receive monthly benefits. At June 30, 2012, the fund had eight members or beneficiaries receiving annuities. The pension board may order annual increases in retiree and beneficiary benefits up to the increase in the consumer price index for that year, to a maximum of 5%.

The City no longer allocates a portion of property tax collections to the fund. The fund has a cash balance of \$1,796,987. The P&F fund receives an estimated annual interest income \$18,000 and pays out approximately \$230,000 in benefits each year.

B. County Employee's Retirement System

Full-time employees of the City of Middlesborough participate in the statewide County Employee's Retirement System (CERS), a multiple-employer public retirement system. Covered employees are required by statute to contribute 5.0% - 6.0% of their creditable compensation to the plan. Members occupying hazardous positions contribute at a rate of 8% of their creditable compensation. Employer contribution rates are determined by the Board of Trustees of Kentucky Retirement Systems each biennium. The current required rates are (18.96%) and (35.76%) for non-hazardous and hazardous employees, respectively.

The City's payroll for eligible employees for the year ended June 30, 2012 totaled \$3,076,449; payroll for all employees totaled \$3,414,950. The City made required contributions of \$884,178. Employee contributions totaled \$211,801.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess CERS funding status on a going concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and to make comparisons among public employee retirement systems and employers. CERS does not make separate measurements of assets and pension benefit obligations for the individual employer. The pension benefit obligation, net assets available for benefits and historical trend information for the entire system can be found in the Commonwealth of Kentucky's Comprehensive Annual Report for the year ended June 30, 2012.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

IX. COMMITMENTS AND CONTINGENCIES

A. Disaster Recovery

The City received extensive damage due to the flooding of June 19, 2011. The Federal Emergency Management Agency (FEMA) assessed damages of \$416,552 and agreed to provide public assistance grants to reimburse the City a portion of the costs to repair or replace damages associated with twenty-eight FEMA designated projects. The Natural Resource Conservation Service (NRCS) identified an additional six projects with an estimated clean-up cost of \$414,700.

Actual flood costs not including labor and equipment provided by the City and employees totaled \$760,372. The City received \$667,951 in FEMA and NRCS funding. The City received \$45,802 in insurance reimbursements for flooded vehicles and related damages. The City estimates it expended \$61,315 in wages and use of City-owned equipment in flood clean-up operations. Additional costs for fuel, supplies, lunches for prisoners aiding in clean-up, additional utilities, and equipment maintenance related to flood clean-up has not been accumulated and is recorded as operating costs in the public street service function.

B. Flood Control Project

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

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

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2012

C. Lawsuits and Risk Management

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

D. Grant Compliance

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

COMBINING FINANCIAL STATEMENTS

NON-MAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Municipal Road Aid Fund

Coal and Mineral Severance Fund

Other Restricted Funds

CITY OF MIDDLESBOROUGH, KENTUCKY
COMBINING BALANCE SHEET
NON-MAJOR GOVERNMENTAL FUNDS
June 30, 2012

	Municipal Road Aid	Coal and Mineral Severance	Other Restricted Funds	Total
<u>ASSETS</u>				
Cash.....	\$ 96,545	\$ 132,326	\$ 131,118	\$ 359,989
Grants receivable.....	-	-	-	-
Total assets.....	<u>\$ 96,545</u>	<u>\$ 132,326</u>	<u>\$ 131,118</u>	<u>\$ 359,989</u>
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable.....	\$ -	\$ -	\$ -	\$ -
Due to other governments.....	-	-	9,441	9,441
Total liabilities.....	-	-	9,441	9,441
Fund balances:				
Restricted.....	96,545	132,326	121,677	350,548
Total fund balances.....	96,545	132,326	121,677	350,548
Total liabilities and fund balances.....	<u>\$ 96,545</u>	<u>\$ 132,326</u>	<u>\$ 131,118</u>	<u>\$ 359,989</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
COMBINING STATEMENTS OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
NON-MAJOR GOVERNMENTAL FUNDS
Year Ended June 30, 2012

	<u>Municipal Road Aid</u>	<u>Coal and Mineral Severance</u>	<u>Other Restricted Funds</u>	<u>Total</u>
<u>REVENUES</u>				
Intergovernmental.....	\$ 228,207	\$ 156,306	\$ -	\$ 384,513
Investment income.....	130	137	168	435
Total revenues.....	228,337	156,443	168	384,948
<u>EXPENDITURES</u>				
Current:				
Public protection.....	-	-	-	-
Public works.....	190,109	-	75	190,184
Community development.....	-	3,042	-	3,042
Capital outlay.....	-	-	-	-
Total expenditures.....	190,109	3,042	75	193,226
Excess of revenues over expenditures.....	38,228	153,401	93	191,722
<u>OTHER FINANCING SOURCES (USES)</u>				
Transfers in.....	-	-	-	-
Transfers out.....	(30,000)	(120,000)	(111,515)	(261,515)
Interest & principle repayments on CDBG and UDAG loans.....	-	-	-	-
Total other sources.....	(30,000)	(120,000)	(111,515)	(261,515)
Excess of revenues over expenditures and sources.....	8,228	33,401	(111,422)	(69,793)
Fund balances (deficit) at beginning of year.....	88,317	98,925	233,099	420,341
Fund balances at end of year.....	\$ 96,545	\$ 132,326	\$ 121,677	\$ 350,548

INDIVIDUAL FUND FINANCIAL STATEMENTS

GOVERNMENTAL ACTIVITIES

General Fund

Includes required budgetary comparisons

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (CASH BASIS)
GENERAL FUND
Year Ended June 30, 2012

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance Favorable (Unfavorable)</u>
<u>REVENUES</u>				
Property taxes.....	\$ 840,000	\$ 840,000	\$ 924,230	\$ 84,230
Licenses, permits and fees.....	3,078,500	3,078,500	3,233,353	154,853
Intergovernmental programs.....	338,000	1,005,750	881,975	(123,775)
Investment income.....	5,000	5,000	822	(4,178)
Service charges.....	72,500	72,500	92,577	20,077
Other.....	67,500	67,500	91,392	23,892
Total revenues.....	<u>4,401,500</u>	<u>5,069,250</u>	<u>5,224,349</u>	<u>155,099</u>
<u>EXPENDITURES</u>				
General administration.....	2,544,600	2,609,600	2,397,538	212,062
Public protection - police.....	1,371,500	1,371,500	1,249,981	121,519
Public protection - fire.....	1,332,500	1,467,500	1,396,201	71,299
Public street service.....	436,050	1,280,500	1,303,532	(23,032)
Community development.....	104,500	104,500	129,293	(24,793)
Total expenditures.....	<u>5,789,150</u>	<u>6,833,600</u>	<u>6,476,545</u>	<u>357,055</u>
Excess (deficiency) of revenues over expenditures.....	<u>(1,387,650)</u>	<u>(1,764,350)</u>	<u>(1,252,196)</u>	<u>512,154</u>
<u>OTHER FINANCING SOURCES (USES)</u>				
Bond proceeds.....	-	262,000	250,000	(12,000)
Operating transfers in.....	1,100,000	1,150,000	1,107,417	(42,583)
Operating transfers out.....	-	-	-	-
Total other financing sources.....	<u>1,100,000</u>	<u>1,412,000</u>	<u>1,357,417</u>	<u>(54,583)</u>
Excess (deficiency) of revenues and other sources over expenditures.....	<u>(287,650)</u>	<u>(352,350)</u>	<u>105,221</u>	<u>457,571</u>
Fund balance, beginning of year.....	<u>447,500</u>	<u>512,200</u>	<u>34,273</u>	<u>(477,927)</u>
Fund balance, end of year.....	<u>\$ 159,850</u>	<u>\$ 159,850</u>	<u>\$ 139,494</u>	<u>\$ (20,356)</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF PROGRAM REVENUES BY FUNCTION
GOVERNMENTAL FUNDS
Year Ended June 30, 2012

	<u>General Fund</u> <u>Revenues</u>	<u>Non-Major</u> <u>Governmental Fund</u> <u>Revenues</u>	<u>Adjustments</u>	<u>Activity</u> <u>Revenues</u>
General administration:				
Charges for services				
Permits.....	\$ 4,093	\$ -	\$ -	\$ 4,093
Other.....	67,392	-	-	67,392
Operating grants and contributions				
Local Government Economic Assistance.	8,907	-	-	8,907
Total	\$ 80,392	\$ -	\$ -	\$ 80,392
Public protection - police:				
Charges for services				
Housing Authority security.....	\$ 41,093	\$ -	\$ -	\$ 41,093
Base court revenues, fines, arrest fees.....	38,295	-	-	38,295
Other	-	-	-	-
Operating grants and contributions				
K.L.E.F.P.F. (incentive pay).....	82,968	-	-	82,968
Local Government Economic Assistance.	-	156,306	-	156,306
Total	\$ 162,356	\$ 156,306	\$ -	\$ 318,662
Public protection - fire:				
Operating grants and contributions				
K.F.P.- 2 (incentive pay).....	\$ 103,649	\$ -	\$ -	\$ 103,649
Total	\$ 103,649	\$ -	\$ -	\$ 103,649
Public street service:				
Charges for services				
Garbage pick-up.....	\$ 24,000	\$ -	\$ -	\$ 24,000
Other	-	-	-	-
Operating grants and contributions				
Municipal Road Aid.....	-	228,207	-	228,207
FEMA and NRCS flood grants.....	667,951	-	-	667,951
Capital grants and contributions				
Local Government Economic Assistance.	18,500	-	-	18,500
Total	\$ 710,451	\$ 228,207	\$ -	\$ 938,658
Community development:				
Charges for services				
Community Center fees.....	\$ 9,096	\$ -	\$ -	\$ 9,096
Other	-	-	-	-
Total	\$ 9,096	\$ -	\$ -	\$ 9,096
Total program revenues by function	\$ 1,065,944	\$ 384,513	\$ -	\$ 1,450,457

Reconciliation.

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

-no variance in program revenues FY 6/30/2012

\$ -

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FUNCTIONAL EXPENSES
GOVERNMENTAL FUNDS
Year Ended June 30, 2012

	General Fund Expenditures	Non-Major Governmental Fund Expenditures	Adjustments	Activity Expenses
General administration:				
Current:				
Salaries.....	\$ 320,577	\$ -	\$ 2,863	\$ 323,440
Materials and supplies.....	14,405	-	-	14,405
Other program costs.....	440,851	-	-	440,851
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	1,166,896	-	(992,836)	174,060
Insurance.....	364,469	-	(270,280)	94,189
Debt service:				
Principal retirement.....	65,000	-	(65,000)	-
Interest expense and bond issue costs.....	25,340	-	(19,841)	5,499
Capital outlay.....	-	-	-	-
Depreciation.....	-	-	58,423	58,423
Total	\$ 2,397,538	\$ -	\$ (1,286,671)	\$ 1,110,867
Public protection - police:				
Current:				
Salaries.....	\$ 1,066,844	\$ -	\$ (3,634)	\$ 1,063,210
Materials and supplies.....	130,344	-	-	130,344
Other program costs.....	31,278	-	-	31,278
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	361,136	361,136
Insurance.....	-	-	110,346	110,346
Debt service:				
Principal retirement.....	-	-	-	-
Interest expense.....	-	-	-	-
Capital outlay	21,515	-	(21,515)	-
Depreciation.....	-	-	71,895	71,895
Total	\$ 1,249,981	\$ -	\$ 518,228	\$ 1,768,209
Public protection - fire:				
Current:				
Salaries.....	\$ 1,298,964	\$ -	\$ (2,505)	\$ 1,296,459
Materials and supplies.....	67,679	-	-	67,679
Other program costs.....	14,718	-	-	14,718
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	496,401	496,401
Insurance.....	-	-	96,159	96,159
Debt service:				
Principal retirement.....	-	-	-	-
Interest expense.....	-	-	5,000	5,000
Capital outlay.....	14,840	-	(14,840)	-
Depreciation.....	-	-	15,220	15,220
Total	\$ 1,396,201	\$ -	\$ 595,435	\$ 1,991,636

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FUNCTIONAL EXPENSES
GOVERNMENTAL FUNDS
Year Ended June 30, 2012

	<u>General Fund</u> <u>Expenditures</u>	<u>Non-Major</u> <u>Governmental Fund</u> <u>Expenditures</u>	<u>Adjustments</u>	<u>Activity</u> <u>Expenses</u>
Public street service:				
Current:				
Salaries.....	\$ 317,028	\$ -	\$ 1,595	\$ 318,623
Materials and supplies.....	133,360	190,109	-	323,469
Flood clean-up costs.....	762,390	-	-	762,390
Other program costs.....	41,132	75	-	41,207
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	180,263	180,263
Insurance.....	-	-	56,623	56,623
Debt service:				
Principal retirement.....	17,396	-	(17,396)	-
Interest expense.....	936	-	-	936
Capital outlay.....	31,290	-	(31,290)	-
Depreciation.....	-	-	50,642	50,642
Total	\$ 1,303,532	\$ 190,184	\$ 240,437	\$ 1,734,153
Community development:				
Current:				
Salaries.....	\$ 49,708	\$ -	\$ -	\$ 49,708
Materials and supplies.....	17,867	-	-	17,867
Other program costs.....	61,718	3,042	-	64,760
Indirect cost allocation:				
Health insurance, retirement & payroll taxes	-	-	7,469	7,469
Insurance.....	-	-	7,152	7,152
Capital outlay.....	-	-	-	-
Depreciation.....	-	-	1,988	1,988
Total	\$ 129,293	\$ 3,042	\$ 16,609	\$ 148,944
Total general fund programs.....	\$ 6,476,545	\$ 193,226	\$ 84,038	\$ 6,753,809

Reconciliation.

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

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

Payroll liabilities. The fund financials record only payroll liabilities paid within 30 days and employee withholdings on hand June 30. ER retirement calculated April 2013 on firefighter OT wages paid Feb. 2012 is included in the statement of net assets.

Net change in payroll accruals \$ 52,433

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

Net change in non-current compensated absences (1,681)

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

Capital outlay removed from expenditures (67,645)

Depreciation included in expenses 198,168

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

Principal payments removed from expenditures (82,396)

Bond issue costs incurred to finance firefighter's overtime pay 5,000

Interest on pension refunding bond not allocated to a function per GASB 34. (19,841)

Total decrease in expenditures \$ 84,038

REQUIRED REPORTS

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

To the Mayor and Council Members
City of Middlesborough
Middlesboro, Kentucky

We have audited the financial statements of the government activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Middlesborough, Kentucky as of and for the year ended June 30, 2012, which collectively comprise the City of Middlesborough, Kentucky's basic financial statements and have issued our report thereon dated June 15, 2015. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency 2012-3 to be a material weakness.

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider 2012-1 and 2012-2 to be significant deficiencies.

Compliance and other matters

As part of obtaining reasonable assurance about whether the City of Middlesborough, Kentucky's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our test disclosed an instance of non-compliance or other matter that was required to be reported under *Government Auditing Standards* and which is recorded in the Statement of Findings and Questioned Costs as 2012-4.

This report is intended solely for the information and use of management, the board of directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Jacquie Slone, CPA, PSC

Raven, Kentucky
June 15, 2015

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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

To the Mayor and City Council
City of Middlesborough, Kentucky

Compliance

We have audited the compliance of the City of Middlesborough, Kentucky with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2012. City of Middlesborough, Kentucky's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Middlesborough, Kentucky's management. Our responsibility is to express an opinion on the City of Middlesborough, Kentucky's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB 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 of Middlesborough, Kentucky'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. Our audit does not provide a legal determination of the City of Middlesborough, Kentucky's compliance with those requirements.

In our opinion, the City of Middlesborough, Kentucky complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2012.

Internal Control over Compliance

The management of the City of Middlesborough, Kentucky is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of Middlesborough, Kentucky's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance, 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 of Middlesborough, Kentucky'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, such that there is a reasonable possibility that a material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the use of management, the board of directors, and federal award agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Jacquie Slone CPA PSC

Raven, Kentucky
June 15, 2015

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2012

<u>Federal Grantor</u>	<u>CFDA</u>	<u>FEDERAL EXPENDITURES</u>
U. S. Department of Agriculture		
Emergency Watershed Protection Program	10.923	\$ 373,230
U. S. Department of Homeland Security		
Federal Emergency Management Agency Disaster Grants – Public Assistance Presidentially Declared Disaster FEMA-4008-DR-KY	97.036	<u>254,070</u>
Totals		<u>\$ 627,300</u>

NOTE A. BASIS OF PRESENTATION

The schedule of expenditures of federal awards includes the federal grant activity of the City of Middlesborough. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of the City of Middlesborough, Kentucky, it is not intended to and does not present the financial position, changes in net assets, or cash flows, where applicable, of the City of Middlesborough, Kentucky.

NOTE B. SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87 *Cost Principles for State, Local, and Indian Tribal Governments* wherein certain types of expenditures are not allowable or are limited as to reimbursement.

**CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended December 31, 2012**

I. SUMMARY OF AUDITOR RESULTS

- A. The auditor's report expresses an unqualified opinion on the financial statements of the City of Middlesborough, Kentucky.
- B. The auditor's report expresses an unqualified opinion on the supplemental data in the financial statements of the City of Middlesborough, Kentucky.
- C. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed three significant deficiencies in internal control material to the financial statements.
- D. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed three material weaknesses in internal controls.
- E. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed one instance of non-compliance material to the financial statements.
- F. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed no significant deficiencies in internal controls over federal award programs.
- G. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed no material weaknesses in internal controls over federal award programs.
- H. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed no findings related to federal award programs required to be reported.
- I. The auditor's report on compliance for the major federal award programs of the City of Middlesborough, Kentucky expresses an unqualified opinion on all major programs.
 - 1. Major program:
 - U.S. Department of Agriculture
 - Emergency Watershed Protection Program
 - CFDA: 10.923
 - 2. Dollar threshold between Type A and Type B programs - \$300,000
 - 3. Does not qualify as a low-risk auditee.

II. FINANCIAL STATEMENT FINDINGS

2012-1. *Inadequate design of internal control over the preparation of the financial statements.*
Repeat of 2011-1. See statement of prior year findings and responses - page 45.

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

**CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended December 31, 2012**

(2012-1 continued)

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

2012-2. Inadequate internal control over recording payroll data.

Repeat of 2011-2. See statement of prior year findings and responses - page 45-46.

Management Response: Beginning July 1, 2015, the City will compensate any employee that elects to opt out of the health insurance benefit – 60% of the current premium. Employees who opt out will continue to be required to provide proof of coverage of health insurance that complies with the Affordable Care Act. This process should eliminate the complex reimbursement issues.

The personnel committee is currently researching the cost benefit to the City of not paying wages in lieu of health insurance in future periods.

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

2012-3. Inadequate internal control over deposits.

Condition: Several checks for sewer services totaling \$229,050 were received and held in the City vault for 30-60 days.

Effect: City funds were not available for use, or appropriately protected or insured by the FDIC. In addition, sewer accounts receivable could not be readily reconciled to billings and collections.

Cause: City has not developed a policy defining the expected time period for deposits.

Criteria: Kentucky Revised Statutes require local governments to timely deposit all funds in an institution that protects deposits via the Federal Deposit Insurance Corporation and with additional pledged securities as needed.

Recommendation: The City should deposit all funds no later than weekly.

Management Response: The City has instituted a policy to deposit all funds weekly with any deposit over \$10,000 made daily. In addition, the City Clerk will verify all funds are timely deposited.

Auditor Response: The City has adequately addressed the issue.

2012-4. Compliance with audit requirements.

Condition: City audit for year ended June 30, 2012 was not completed by February 2, 2013.

Effect: City audits for years ended June 30, 2012, 2013 and 2014 are delinquent.

Cause: The City has been unable to generate an adequate trial balance to submit for audit due to difficulties with the installation of a new financial system.

**CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended December 31, 2012**

(2012-4 continued)

Criteria: Kentucky Revised Statutes require local governments to submit audited financial statements no later than February 2 of the subsequent year.

Recommendation: The City should file audits timely.

Management Response:

The City's delinquency is a result of several factors. The City installed a completely new financial system as recommended in a prior audit. The City engaged the services of an independent CPA to assist in the installation of the beginning balances, perform year-end adjustments, and complete the year-end financial reports, as also recommended in a prior audit.

The City received extensive damage in the June 19, 2011 flooding—at the time the new system was installed and personnel training in process. A major disaster declaration was declared July 25, 2011 and the City's primary focus for the next six months was remediating the effects of the flooding and completing the projects designated by the Federal Emergency Management Service and the Natural Resources Conservation Service. These projects were time sensitive and required the City to reassign personnel from their financial duties to grant management. As a result, input of data into the system was not consistent or timely nor performed by the same person. A variety of mistakes resulted in the inability to compile an accurate trial balance. Finally, the clerks re-recorded the data manually, as had been done in the past. It was a time consuming process to manually record the data for several years past while learning the computer system and keeping up the current year work-load.

The computer system is functioning well now. City personnel are trained, data input is prepared by specific clerks, and the City Clerk reviews and reconciles the financial data on a monthly basis. The City has engaged an outside CPA familiar with the City's records to review data periodically, as well as prepare the year-end adjustments and financial statements for the remaining delinquent periods. Once the audited balances as of July 1, 2012 are entered as beginning balances into the computer system, the City expects to generate an adequate trial balance available for audit quickly.

Auditor Response: The City has adequately addressed the issue.

III. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS – NONE

**CITY OF MIDDLESBOROUGH, KENTUCKY
PRIOR YEAR FINDINGS AND RESPONSES
Prior year ended June 30, 2011**

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

Auditor follow-up response: The City did engage an independent CPA to review the audited financial statements for the year ended June 30, 2011 and engaged the CPA to perform the compilation for the following year. In addition, the CPA assisted with the set-up of the new financial system, adjusted beginning balances, compiled various schedules and financial statements for the year ended June 30, 2012. Unfortunately, the CPA was unable to complete the compilation procedures in a timely manner – due primarily to issues surrounding the installation of the new financial system. Condition not corrected FY June 30, 2012.

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

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

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

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

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

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

Auditor follow-up response: The City has automated all payrolls and has cross-trained another employee to perform payroll functions. The payroll reimbursement system has been streamlined somewhat and fewer transfer mistakes occurred in the current year. However, payroll reimbursement issues, particularly surrounding the process of paying wages in lieu of health insurance, still exists.

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

**CITY OF MIDDLESBOROUGH, KENTUCKY
PRIOR YEAR FINDINGS AND RESPONSES
Prior year ended June 30, 2011**

(Prior year conditions continued)

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

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

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

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

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

Management Response:

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

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

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

CITY OF MIDDLESBOROUGH, KENTUCKY
PRIOR YEAR FINDINGS AND RESPONSES
Prior year ended June 30, 2011

2011-3. Inadequate internal control over collection of revenues.

Auditor follow-up response: CORRECTED.

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

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

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

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

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

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

Management Response:

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

CITY OF MIDDLESBOROUGH, KENTUCKY
REVIEW OF PRIOR YEAR FINDINGS AND RESPONSES
Prior year ended June 30, 2011

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

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