

CITY OF JACKSON, KENTUCKY

**FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2010**

TOGETHER WITH INDEPENDENT AUDITOR'S REPORTS



Kelley,
Galloway &
Company, PSC

CERTIFIED PUBLIC ACCOUNTANTS

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Kelley,
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Company, PSC

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

The Honorable Mayor
and Members of City Council
City of Jackson
Jackson, Kentucky

We were engaged to audit the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the City of Jackson, Kentucky as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the City of Jackson's management. Our responsibility is to express opinions on these financial statements based on our audit.

As further explained in the audit findings found in the accompanying Schedule of Findings and Questioned Costs, management of the City had material weaknesses in the design and operation of its internal control procedures and accounting functions. Because policies and procedures were often not followed or possibly did not exist, questionable transactions, many of which included management override, occurred resulting in a high level of audit risk. In addition, we were unable to test for appropriate compliance with statutory, contractual, and administrative regulations. The City's financial records do not permit the application of other auditing procedures to Disaster Grants - Public Assistance (FEMA) received. The City of Jackson, Kentucky, has expended certain federal grant funds in a manner that may have violated certain of the restrictive provisions of the related grants. The possible outcome of these matters, which have been reported to appropriate federal officials, is uncertain at this time. Accordingly, no provision for any liability has been made in the financial statements for possible federal claims for refunds of those grant monies. The significance of these issues, in the aggregate, prevents us from placing any reliance on the financial activities contained in the financial statements of the City.

Because we were not able to apply other audit procedures to reduce audit risk to an appropriate level, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 24, 2011 on our consideration of the City of Jackson's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on 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.

The City of Jackson has not presented a Management's Discussion and Analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Jackson, Kentucky's basic financial statements. The schedule of expenditures of federal awards contained on page 27 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 not a required part of the basic financial statements of City of Jackson, Kentucky. Because of the scope limitations discussed in detail in paragraph two above, the scope of our work is not sufficient to enable us to express, and we do not express, an opinion on the schedule of federal awards.

Kelley, Galloway & Company, PSC

January 24, 2011

CITY OF JACKSON, KENTUCKY
STATEMENT OF NET ASSETS
JUNE 30, 2010

	Governmental Activities	Business-Type Activities	Total
ASSETS			
Cash and cash equivalents	\$ 72,975	\$ 161,932	\$ 234,907
Accounts receivable	30,563	246,549	277,112
Taxes receivable	6,781	-	6,781
Grants receivable	-	-	-
Due from (to) other funds	672,252	(672,252)	-
Restricted assets -			
Cash and cash equivalents	429	81,855	82,284
Investments-debt reserve - KADD	358,703	-	358,703
Nondepreciable capital assets	329,000	806,587	1,135,587
Depreciable capital assets	7,425,180	22,023,536	29,448,716
Accumulated depreciation	(3,447,961)	(8,013,287)	(11,461,248)
 Total assets	 <u>5,447,922</u>	 <u>14,634,920</u>	 <u>20,082,842</u>
 LIABILITIES			
Accounts payable	120,849	50,139	170,988
Other accrued liabilities	79,538	60,948	140,486
Current portion of long-term debt	305,054	927,633	1,232,687
Accrued interest payable	-	117,622	117,622
Customer deposits	-	125,755	125,755
Long-term debt, net of current portion	4,953,628	4,590,607	9,544,235
 Total liabilities	 <u>5,459,069</u>	 <u>5,872,704</u>	 <u>11,331,773</u>
 NET ASSETS			
Invested in capital assets, net of related debt	(593,760)	9,298,596	8,704,836
Restricted	429	81,855	82,284
Unrestricted	582,184	(618,235)	(36,051)
 Total net assets	 <u>\$ (11,147)</u>	 <u>\$ 8,762,216</u>	 <u>\$ 8,751,069</u>

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
STATEMENT OF ACTIVITIES
JUNE 30, 2010

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 government	\$ 914,740	\$ -	\$ 280,868	\$ -	\$ (633,872)	\$ -	\$ (633,872)
Police	461,808	9,981	-	-	(451,827)	-	(451,827)
Fire	297,274	-	-	-	(297,274)	-	(297,274)
Streets	417,947	-	140,598	-	(277,349)	-	(277,349)
Sanitation	273,236	341,811	-	-	68,575	-	68,575
Parks	557,352	38,936	-	-	(518,416)	-	(518,416)
Social service	14,400	-	-	-	(14,400)	-	(14,400)
Infrastructure depreciation	11,041	-	-	-	(11,041)	-	(11,041)
Debt service	69,280	-	-	-	(69,280)	-	(69,280)
Total governmental activities	<u>3,017,078</u>	<u>390,728</u>	<u>421,466</u>	<u>-</u>	<u>(2,204,884)</u>	<u>-</u>	<u>(2,204,884)</u>
Business-Type Activities							
Water	1,412,360	1,095,337	-	124,312	-	(192,711)	(192,711)
Sewer	872,946	657,733	-	82,465	-	(132,748)	(132,748)
Total business-type activities	<u>2,285,306</u>	<u>1,753,070</u>	<u>-</u>	<u>206,777</u>	<u>-</u>	<u>(325,459)</u>	<u>(325,459)</u>
Total primary government	<u>\$ 5,302,384</u>	<u>\$ 2,143,798</u>	<u>\$ 421,466</u>	<u>\$ 206,777</u>	<u>\$ (2,204,884)</u>	<u>\$ (325,459)</u>	<u>\$ (2,530,343)</u>
General Revenues:							
Property and other local taxes					\$ 299,723	\$ -	\$ 299,723
Occupational license fees					837,295	-	837,295
Insurance premiums					328,393	-	328,393
Tourism tax					308,039	-	308,039
Coal/mineral severance & LGEA					50,714	-	50,714
Interest income					446	1,700	2,146
Other income					172,769	-	172,769
Total general revenues					<u>1,997,379</u>	<u>1,700</u>	<u>1,999,079</u>
Change in net assets					<u>(207,505)</u>	<u>(323,759)</u>	<u>(531,264)</u>
Net assets, June 30, 2009					<u>196,358</u>	<u>9,085,975</u>	<u>9,282,333</u>
Net assets, June 30, 2010					<u>\$ (11,147)</u>	<u>\$ 8,762,216</u>	<u>\$ 8,751,069</u>

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2010

	General	Total Governmental Funds
Assets		
Cash	\$ 72,975	\$ 72,975
Fee receivable	30,563	30,563
Taxes receivable	6,781	6,781
Grants receivable	-	0
Restricted assets-cash	429	429
Investments-debt service - KADD	358,703	358,703
Due from other funds	672,252	672,252
Total assets	<u>\$ 1,141,703</u>	<u>\$ 1,141,703</u>
Liabilities and Fund Balances		
Liabilities:		
Accounts payable	\$ 120,849	\$ 120,849
Accrued expenses	79,538	79,538
Total liabilities	<u>200,387</u>	<u>200,387</u>
Fund Balances:		
Reserved for construction	429	429
Reserved for debt service	358,703	358,703
Unreserved	582,184	582,184
Total fund balances	<u>941,316</u>	<u>941,316</u>
Total liabilities and fund balances	<u>\$ 1,141,703</u>	<u>\$ 1,141,703</u>

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUNDS TO THE STATEMENT OF
NET ASSETS
JUNE 30, 2010

Total fund balance - total governmental funds	\$ 941,316
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Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets of \$7,754,180, net of accumulated depreciation of \$3,447,961 used in governmental activities are not financial resources and therefore are not reported in the governmental funds.	4,306,219
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Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds.	<u>(5,258,682)</u>
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Net assets - Governmental Activities	<u><u>\$ (11,147)</u></u>
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The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2010

	General	Total Governmental Funds
Revenues		
Property taxes	\$ 204,904	\$ 204,904
Delinquent property taxes	23,647	23,647
Franchise taxes	71,172	71,172
Occupational license fees	837,295	837,295
Arrest fees, fines and forfeitures	9,981	9,981
Garbage collections	341,811	341,811
Tourism tax	308,039	308,039
Insurance premiums	328,393	328,393
Parks and recreation	38,936	38,936
FEMA grant income	280,868	280,868
Coal/mineral severance & LGEA	50,714	50,714
Municipal road aid	140,598	140,598
Interest income	446	446
Other income	172,769	172,769
Total revenues	<u>2,809,573</u>	<u>2,809,573</u>
Expenditures		
General government	886,112	886,112
Police	454,927	454,927
Fire	184,575	184,575
Streets	411,736	411,736
Sanitation	231,879	231,879
Parks	399,706	399,706
Social service	14,400	14,400
Capital outlay-Sanitation	143,620	143,620
Debt service	1,296,711	1,296,711
Total expenditures	<u>4,023,666</u>	<u>4,023,666</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,214,093)</u>	<u>(1,214,093)</u>
Other financing sources (uses):		
Proceeds from debt	1,058,620	1,058,620
Total other financing sources (uses)	<u>1,058,620</u>	<u>1,058,620</u>
Net change in fund balances	(155,473)	(155,473)
Fund balance, beginning of year	<u>1,096,789</u>	<u>1,096,789</u>
Fund balance, end of year	<u>\$ 941,316</u>	<u>\$ 941,316</u>

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010

Net change in fund balances - total governmental funds \$ (155,473)

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of these assets are allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation expense in the current period. (220,843)

The issuance of long-term debt provides current financial resources to governmental funds, while repayment of the principal and interest consumes current financial resources of governmental funds. This amount is the net effect of these differences in the treatment of long-term debt and related items. 168,811

Change in net assets of governmental activities \$ (207,505)

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2010

	Business-Type Activities		
	Water Fund	Sewer Fund	Total
ASSETS			
Current Assets:			
Cash and cash equivalents	\$ 148,567	\$ 13,365	\$ 161,932
Accounts receivable - utilities	154,613	91,936	246,549
Due from other funds	-	-	-
Total current assets	303,180	105,301	408,481
Restricted Assets:			
Cash and cash equivalents	74,810	7,045	81,855
Total restricted assets	74,810	7,045	81,855
Capital Assets:			
Property, plant and equipment	14,955,766	7,874,357	22,830,123
Less: Accumulated depreciation	(4,748,705)	(3,264,582)	(8,013,287)
Total capital assets - net	10,207,061	4,609,775	14,816,836
Total assets	\$ 10,585,051	\$ 4,722,121	\$ 15,307,172
LIABILITIES			
Current liabilities (payable from current assets):			
Accounts payable	\$ 28,468	\$ 21,671	\$ 50,139
Due to other funds	425,332	246,920	672,252
Accrued liabilities	44,346	16,602	60,948
Accrued interest payable	73,139	44,483	117,622
Current portion of debt	221,518	706,115	927,633
Total current liabilities (payable from current assets)	792,803	1,035,791	1,828,594
Current liabilities (payable from restricted assets):			
Customer deposits	125,755	-	125,755
Total current liabilities (payable from restricted assets)	125,755	-	125,755
Long-term debt, net of current portion	3,745,932	844,675	4,590,607
Total liabilities	4,664,490	1,880,466	6,544,956
NET ASSETS			
Invested in capital assets, net of related debt	6,239,611	3,058,985	9,298,596
Restricted	74,810	7,045	81,855
Unrestricted	(393,860)	(224,375)	(618,235)
Total net assets	\$ 5,920,561	\$ 2,841,655	\$ 8,762,216

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2010

	Business-Type Activities		
	Water	Sewer	
	Fund	Fund	Total
OPERATING REVENUES			
Water sales	\$ 1,070,600	\$ -	\$ 1,070,600
Sewer service	-	653,175	653,175
Miscellaneous	24,737	4,558	29,295
Total operating revenues	1,095,337	657,733	1,753,070
OPERATING EXPENSES			
Salaries	311,544	184,901	496,445
Depreciation	382,932	179,962	562,894
Taxes and retirement	86,515	49,002	135,517
Utilities	108,863	61,085	169,948
Supplies	275,700	37,296	312,996
Insurance	89,589	72,668	162,257
Contract labor	32,189	95,849	128,038
Sludge hauling	-	580	580
Miscellaneous	28,451	3,508	31,959
Total operating expenses	1,315,783	684,851	2,000,634
OPERATING INCOME (LOSS)	(220,446)	(27,118)	(247,564)
NON-OPERATING REVENUES (EXPENSES)			
Interest income	1,481	219	1,700
Grant income	121,437	82,465	203,902
Interest expense	(96,577)	(188,095)	(284,672)
Total non-operating revenues (expenses)	26,341	(105,411)	(79,070)
INCOME (LOSS) BEFORE OPERATING TRANSFERS AND CAPITAL CONTRIBUTIONS	(194,105)	(132,529)	(326,634)
CAPITAL CONTRIBUTIONS (TAPS)	2,875	-	2,875
INCREASE (DECREASE) IN NET ASSETS	(191,230)	(132,529)	(323,759)
NET ASSETS, JUNE 30, 2009	6,111,791	2,974,184	9,085,975
NET ASSETS, JUNE 30, 2010	\$ 5,920,561	\$ 2,841,655	\$ 8,762,216

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2010

	Business-Type Activities		
	Water Fund	Sewer Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers	\$ 1,080,154	\$ 658,907	\$ 1,739,061
Cash payments to suppliers for goods and services	(561,692)	(272,521)	(834,213)
Cash payments to employees	(390,956)	(231,690)	(622,646)
Other operating revenues	24,737	4,558	29,295
Net cash provided by (used for) operating activities	152,243	159,254	311,497
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:			
Grant income	121,437	82,465	203,902
Change in customer deposits	9,125	-	9,125
Net cash provided by (used for) non-capital financing activities	130,562	82,465	213,027
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Acquisition and construction of capital assets	(269,725)	-	(269,725)
Proceeds from debt	419,655	-	419,655
Principal paid on long-term debt	(305,852)	(46,140)	(351,992)
Interest paid on long-term debt	(97,645)	(188,996)	(286,641)
Capital contributions	2,875	-	2,875
Net cash used for capital and related financing activities	(250,692)	(235,136)	(485,828)
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest income	1,481	219	1,700
Net cash provided by investing activities	1,481	219	1,700
Net increase (decrease) in cash and cash equivalents	33,594	6,802	40,396
Cash and cash equivalents, June 30, 2009	189,783	13,608	203,391
Cash and cash equivalents, June 30, 2010	\$ 223,377	\$ 20,410	\$ 243,787
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES			
Operating loss	\$ (220,446)	\$ (27,118)	\$ (247,564)
Adjustments:			
Depreciation	382,932	179,962	562,894
Changes in assets and liabilities:			
(Increase) decrease in accounts receivable	9,554	5,732	15,286
Increase (decrease) in accounts payable	(26,900)	(1,535)	(28,435)
Increase (decrease) in other accrued liabilities	7,103	2,213	9,316
Net cash provided by (used for) operating activities	\$ 152,243	\$ 159,254	\$ 311,497

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2010

	Original Budget	Revisions	Revised Budget	Actual	Variance Positive (Negative)
Revenues					
Property taxes	\$ 220,000	\$ -	\$ 220,000	\$ 204,904	\$ (15,096)
Delinquent taxes	15,000	-	15,000	23,647	8,647
Franchise taxes	50,000	-	50,000	71,172	21,172
Intergovernmental revenues	15,000	-	15,000	-	(15,000)
Occupational license fee	700,000	-	700,000	837,295	137,295
Arrest fees, fines and forfeitures	-	-	-	9,981	9,981
Garbage collections	360,000	-	360,000	341,811	(18,189)
Tourism tax	235,000	-	235,000	308,039	73,039
Insurance premium tax	375,000	-	375,000	328,393	(46,607)
Parks and recreation	40,000	-	40,000	38,936	(1,064)
Grant income	14,000	-	14,000	280,868	266,868
Coal severance	80,000	-	80,000	50,714	(29,286)
Municipal road aid	35,000	-	35,000	140,598	105,598
Interest income	-	-	-	446	446
Other income	150,000	-	150,000	172,769	22,769
Total revenues	2,289,000	-	2,289,000	2,809,573	520,573
Expenditures					
General government	461,600	-	461,600	886,112	(424,512)
Police	475,000	-	475,000	454,927	20,073
Fire	275,000	-	275,000	184,575	90,425
Park	210,000	-	210,000	411,736	(201,736)
Street	193,000	-	193,000	231,879	(38,879)
Sanitation	310,000	-	310,000	399,706	(89,706)
Social service	14,400	-	14,400	14,400	-
Capital outlay	-	-	-	143,620	(143,620)
Debt service	379,000	-	379,000	1,296,711	(917,711)
Total expenditures	2,318,000	-	2,318,000	4,023,666	(1,705,666)
Excess (deficiency) of revenues over (under) expenditures	(29,000)	-	(29,000)	(1,214,093)	(1,185,093)
Other financing sources (uses):					
Proceeds from debt	-	-	-	1,058,620	1,058,620
Total other financing sources (uses)	-	-	-	1,058,620	1,058,620
Net change in fund balances	(29,000)	-	(29,000)	(155,473)	(126,473)
Fund balance, beginning of year	29,000	-	29,000	1,096,789	1,067,789
Fund balance, end of year	\$ -	\$ -	\$ -	\$ 941,316	\$ 941,316

The accompanying notes to financial statements are
an integral part of this statement.

CITY OF JACKSON, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting methods and procedures adopted by the City of Jackson, Kentucky (the "City") conform to U.S. generally accepted accounting principles. The following notes are an integral part of the City of Jackson, Kentucky's financial statements.

The City of Jackson, Kentucky was created by the Acts of the Kentucky General Assembly and operates under an elected Mayor and City Council form of government and provides such services as police, fire, streets, sanitation, parks and recreation, and social service.

a. Reporting Entity

In evaluating how to define the City, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The basic, but not the only, criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility including, but not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the City is able to exercise oversight responsibilities.

Based upon these criteria, the City has no component units to be reported in these financial statements.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the activities of the City. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are 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 function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds and proprietary funds. The City considers all governmental and proprietary funds to be major funds, due to their belief that all of these funds present financial information which is important to the financial statement users. Thus, individual governmental funds and individual proprietary funds are reported as separate columns in the fund financial statements.

c. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund financial

statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The City reports the following major Governmental Fund:

General Fund - The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

The City reports the following major Proprietary Fund:

Utility Fund - The Utility Fund is used to account for water and sewer services for the City and surrounding communities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The City has elected not to follow subsequent private sector guidance.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City Utility Fund and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the City's Enterprise Funds, are charges to customers for sales and services. Operating expenses for Enterprise Funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

d. Budgeting

Prior to June 30, the Mayor submits to the City Council a proposed budget for the fiscal year commencing the following July 1. The proposed budget includes proposed operating and capital expenditures and the means of financing them. The Mayor is authorized to transfer budgeted amounts within departments of any fund; however, any revisions that alter the total expenditures of any department or fund must be approved by the City Council. Therefore, the level of control on budgetary items is maintained at the department level. Management is of the opinion that its method of adopting the budget is in compliance with applicable regulations.

e. Investments

The City has adopted GASB No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools", whereby all investments are reported at fair value in the balance sheet. Unrealized gains and losses are included in other revenues in the combined statement of revenues, expenditures, and changes in fund balances - all governmental funds.

f. Capital Assets and Depreciation

General capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the proprietary funds are reported both in the business-type activities column of the government-wide statement of net assets and in the respective funds.

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the date received. Improvements are capitalized; the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend an assets life are not.

All reported capital assets are depreciated with the exception of land and construction in progress. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives for both general capital assets and proprietary fund assets:

<u>Description</u>	<u>Estimated Lives</u>
Water and Sewer Systems	40-50 years
Equipment & Vehicles	3-10 years
Buildings	40 years

The City is required by GASB 34 to prospectively report general infrastructure assets in the statement of net assets. During the 2010 fiscal year, there were no additions considered to be infrastructure assets.

g. Statement of Cash Flows

For the purpose of the Statement of Cash Flows, the Proprietary Funds consider all highly liquid investments (including restricted cash) with a maturity of three months or less when purchased to be cash equivalents.

(2) **CASH AND INVESTMENTS**

Deposits - The funds of the City must be deposited and invested under the terms of a contract. The depository bank places approved pledged securities for safekeeping and trust with the City's

agent bank in an amount sufficient to protect City's funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance.

At June 30, 2010, the carrying amount of the City's deposits (including amounts in restricted asset accounts) was \$317,191 and the bank balances totaled \$370,784. The difference between the carrying amounts and the bank balances was due to items in transit. Of the bank balances, \$323,350 was covered by the Bank Insurance Fund and \$47,434 was secured by collateral held by the pledging bank in the City's name as of June 30, 2010.

a. Restricted Cash

The Jackson Municipal Waterworks System is required to maintain restricted bank accounts in accordance with ordinances established in connection with the sale of the Waterworks Revenue Bond issues of 1979, 1980, 1983, 1999, and 2005. Specified amounts of current operating receipts are to be deposited to the restricted bank accounts monthly. Disbursements from the accounts are restricted as specified to the retirement of outstanding bonds, semiannual interest payments, and utility plant additions or replacements.

In addition, the General Fund is required to maintain restricted accounts in connection with a KADD capital lease obligation whereby \$8,847 of the semi-annual payment is set aside until the balance reaches \$358,700. The balance of this debt service reserve fund at June 30, 2010 was \$358,703.

(3) **PROPERTY TAXES**

Property is assessed at its value on January 1 of each year. Taxes are payable in one installment on or before January 31 of the next year. The City bills and collects its own property taxes.

The 2010 assessed value for real property was \$87,243,598. The tax rate adopted was \$.214 per \$100 valuation.

(4) **INVESTMENTS**

Investments are administered utilizing the services of the trust department of a bank. A summary of investments at June 30, 2010 is as follows:

	<u>Cost</u>	<u>Fair Market Value</u>	<u>Unrealized Gain (Loss)</u>
General Fund -			
Fixed income bond funds	\$ 358,703	\$ 358,703	\$ -
	<u>\$ 358,703</u>	<u>\$ 358,703</u>	<u>\$ -</u>

(5) **CAPITAL ASSETS**

A summary of changes in the City's capital assets is as follows:

	<u>June 30, 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2010</u>
<u>Governmental Activities</u>				
Capital Assets, Not Depreciated:				
Land	\$ 329,000	\$ -	\$ -	\$ 329,000
Capital Assets, Depreciated:				
City Hall	1,169,527	-	-	1,169,527
Administrative office & equipment	25,360	-	-	25,360
Infrastructure	220,822	-	-	220,822
Street equipment	93,670	-	-	93,670
Fire equipment & vehicles	1,244,580	-	-	1,244,580
Fire department buildings	776,431	-	-	776,431
Parks and recreation	3,562,895	-	-	3,562,895
Sanitation equipment	122,600	143,620	-	266,220
Police equipment & vehicles	65,675	-	-	65,675

Totals	7,610,560	143,620	-	7,754,180
Less: Accumulated Depreciation	(3,083,498)	(364,463)	-	(3,447,961)
Governmental Activities				
Capital Assets, Net	<u>\$ 4,527,062</u>	<u>\$ (220,843)</u>	<u>\$ -</u>	<u>\$ 4,306,219</u>
<u>Business-type Activities</u>				
Capital Assets, Not Depreciated:				
Land	\$ 536,862	\$ -	\$ -	\$ 536,862
Construction in-progress	-	269,725	-	269,725
Capital Assets, Depreciated:				
Distribution plant and equipment	20,319,118	-	-	20,319,118
Machinery and equipment	<u>1,704,418</u>	<u>-</u>	<u>-</u>	<u>1,704,418</u>
Totals	22,560,398	269,725	-	22,830,123
Less: Accumulated Depreciation	(7,450,393)	(562,894)	-	(8,013,287)
Business-type Activities				
Capital Assets, Net	<u>\$ 15,110,005</u>	<u>\$ 293,169</u>	<u>\$ -</u>	<u>\$ 14,816,836</u>

Depreciation expense was allocated to functions/programs of the primary government as follows:

Governmental activities:	
General government	\$ 28,628
Police	6,881
Fire	112,699
Street	6,211
Sanitation	41,357
Park	157,646
Infrastructure	<u>11,041</u>
	<u>\$ 364,463</u>
Business-type activities:	
Utilities	<u>\$ 562,894</u>

(6) LONG-TERM DEBT

Business-Type Activities

Long-term debt of Proprietary Funds at June 30, 2010 consists of the following:

Bonds Payable:

\$184,000 City of Jackson Waterworks and Sewer System Revenue Bonds, Issue of 1979, Series C, payable in annual installments ranging from \$6,000 to \$11,000 through 2015, with interest paid semi-annually at 5.00% \$ 49,000

\$750,000 City of Jackson Waterworks and Sewer System Revenue Bonds, Issue of 1980, payable in annual installments ranging from \$18,000 to \$42,000 through 2020, with interest paid semi-annually at 5.00% 344,000

\$60,000 City of Jackson Waterworks and Sewer System Revenue Bonds, Issue of 1983, payable in annual installments ranging from \$2,000 to \$3,000 through 2022, with interest paid semi-annually at 5.00% 31,000

\$2,217,000 City of Jackson Waterworks and Sewer

System Revenue Bonds, Issue of 2006, payable in annual installments ranging from \$60,000 to \$120,000 through 2044, with interest paid semi-annually at 4.5 %	2,091,000
\$550,000 City of Jackson Waterworks and Sewer System Revenue Bonds, Issue of 2006B, payable in annual installments ranging from \$10,000 to \$30,000 through 2044, with interest paid semi-annually at 4.5 %	519,000
\$140,000 City of Jackson Waterworks and Sewer System Revenue Bonds, Issue of 1999, payable in annual installments ranging from \$1,500 to \$7,100 through 2039, with interest paid semi-annually at 4.50 %	124,200
	<u>3,158,200</u>
<u>Capital Lease Obligation:</u>	
\$450,000 capital lease obligation with the Kentucky League of Cities, payable in monthly installments of \$3,514 through November, 2022, with interest at 3.82 %	390,221
\$550,000 capital lease obligation with the Kentucky League of Cities, payable in monthly installments of \$3,324 through November, 2028, with interest at 3.0 %	521,564
	<u>911,785</u>
<u>Installment Notes Payable:</u>	
\$151,500 unsecured note payable to a local bank, with monthly interest payments at 5.25 % and principal Payment due October, 2010	85,202
\$1,500,000 subordinated ARRA assistance agreement to the Kentucky Infrastructure Authority ("KIA"), payable in annual installments in the amount of \$39,789 through 2030 with interest paid semi-annually at 1.0 %	268,155
\$1,606,068 subordinated assistance agreement to the Kentucky Infrastructure Authority ("KIA"), payable in annual installments ranging from \$50,390 to \$51,199 through 2011 with interest paid semi-annually at 2.2 % *	633,384
\$681,983 subordinated assistance agreement to the Kentucky Infrastructure Authority ("KIA"), payable in annual installments ranging from \$20,398 to \$20,958 through 2018 with interest paid semi-annually at 1.8 %	461,514
	<u>1,448,255</u>
Total long-term debt - proprietary funds	5,518,240
Less - current portion	<u>(927,633)</u>
	<u>\$ 4,590,607</u>

* The City is in the process of working out a revised payment plan with KIA. No payments have been made on this loan since the year ending June 30, 2007.

The debt service requirements on the above proprietary fund indebtedness are as follows:

Year Ending June 30,	Principal	Interest	Total
2011	\$ 927,633	\$ 233,892	\$ 1,161,525
2012	214,678	185,527	400,205
2013	222,239	178,481	400,720
2014	229,157	171,306	400,463
2015	236,732	164,074	400,806
2016-2020	1,038,356	705,536	1,743,892
2021-2025	659,205	541,902	1,201,107
2026-2030	505,740	447,516	953,256
2031-2035	473,000	331,120	804,120
2036-2040	590,500	227,934	818,434
2041-2045	421,000	76,782	497,782
	<u>\$ 5,518,240</u>	<u>\$3,264,070</u>	<u>\$ 8,782,310</u>

The revenue bonds require monthly deposits to the reserve account of approximately \$780 to attain a balance of \$90,940 as of June 30, 2010. The City had revenue bond reserve funds of \$14,282 at June 30, 2010. The Kentucky Infrastructure Authority installment notes payable also require annual deposits to the reserve account of \$24,137 to attain a balance of \$124,373 as of June 30, 2010. However, the City had \$19,382 of KIA reserve funds at June 30, 2010.

The following is a summary of changes in long-term debt (including current portions) of the City for the year ended June 30, 2010:

	Balance June 30, 2009	Additions	Deletions	Balance June 30, 2010
<u>Governmental Activities</u>				
General obligation bonds - \$1,475,000 originally issued with interest rates ranging from 4.50% to 5.90%	\$ 940,000	\$ -	\$ 940,000	\$ -
General obligation bonds - \$915,000 originally issued with interest rate of 2.0% with annual payments through June, 2019, secured by park assets and tourism tax	-	915,000	80,000	835,000
Capital lease obligation, KADD, \$4,260,000 with interest rates ranging from 4.0% to 5.5%, with semi-annual payments through May, 2027, secured by buildings and equipment	4,010,000	-	135,000	3,875,000
4.99% Capital lease obligation with a bank, \$143,620 with monthly				

payments of \$2,698 through
August, 2014, secured by a 2009
Freightliner

-	143,620	22,030	121,590
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6.00% Capital lease obligation
with a bank, \$443,372 with monthly
payments of \$14,882 through
May, 2019, secured by a 2009 fire
truck

443,372	-	32,122	411,250
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4.29% Capital lease obligation
with a bank, \$87,100 with monthly
payments of \$1,616 through
April, 2011, secured by a sanitation
truck

34,121	-	18,279	15,842
<u>\$ 5,427,493</u>	<u>\$1,058,620</u>	<u>\$1,227,431</u>	<u>\$ 5,258,682</u>

	Balance June 30, 2009	Additions	Deletions	Balance June 30, 2010
<u>Business-type Activities</u>				
Notes payable	\$ 1,264,737	\$ 419,655	\$ 236,137	\$ 1,448,255
Capital lease obligation	954,040	-	42,255	911,785
Bonds payable	<u>3,231,800</u>	<u>-</u>	<u>73,600</u>	<u>3,158,200</u>
Total Business-type Activities	<u>\$ 5,450,577</u>	<u>\$ 419,655</u>	<u>\$ 351,992</u>	<u>\$ 5,518,240</u>

Governmental Activities

The annual requirements to amortize the City's indebtedness as of June 30, 2010
(including interest payments) are as follows:

Year Ending June 30,	Principal	Interest	Total
2010	\$ 305,054	\$ 234,065	\$ 539,119
2011	301,230	222,422	523,652
2012	315,002	210,349	525,351
2013	333,992	197,460	531,452
2014	325,715	184,090	509,805
2015-2019	1,652,689	696,794	2,349,483
2020-2024	1,365,000	328,735	1,693,735
2025-2028	660,000	20,614	680,614
	<u>\$ 5,258,682</u>	<u>\$ 2,094,529</u>	<u>\$ 7,353,211</u>

(7) LEGAL CONTINGENCIES

The City is a defendant in various legal actions arising from normal business operations. The City's legal counsel believes these actions are without merit, adequately covered by insurance, or that the ultimate liability, if any, will not materially effect the City's financial position.

(8) RISK MANAGEMENT

Significant losses are covered by commercial insurance. There have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

(9) RETIREMENT

The City contributes to the County Employee's Retirement System ("CERS"), a cost sharing, multiple-employer defined benefit pension plan administered by the Kentucky General Assembly. It covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the CERS. CERS provides for retirement, disability, and death benefits to plan members. Cost of living adjustments are provided at the discretion of the State legislature.

The CERS issues a publicly available financial report included in the Kentucky Retirement Systems Annual Report that includes financial statements and the required supplementary information for CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky, 40601, or by calling (502) 564-4646.

Plan members are required to contribute 5% of their annual creditable compensation, and the City is required to contribute 16.16% of the employee's total compensation. Plan members in hazardous positions are required to contribute 8% of their annual creditable compensation, and the City is required to contribute 32.97% of the employees' compensation. The contribution requirements of CERS members and the City are established and may be amended by the CERS Board of Trustees. The contribution requirements of CERS members and the City are established and may be amended by the CERS Board of Trustees. The City's contributions to CERS for the years ending June 30, 2010, 2009, and 2008, were \$174,652, \$146,890, and \$182,139, equal to the required contributions for the year.

(10) CONTINGENCY

During fiscal year 2010, the City could not demonstrate compliance with the Disaster Grants - Public Assistance (FEMA) guidelines. Quarterly progress reports were required to be filed with the State on all large projects. The City could only locate one of the reports that showed the funds had not been fully spent. The City is in the process getting in compliance and will cooperate with the State as needed to fulfill the compliance requirements of the grant.

(11) FUTURE GASB PRONOUNCEMENTS

The Governmental Accounting Standards Board (GASB) has recently issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* which the City will be required to be implement in the fiscal year beginning July 1, 2010. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds, as well as clarifying the definitions of the various governmental fund types. The City does not anticipate that the adoption of GASB 54 will have a material impact on its future financial statements.

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010**

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Grant Number</u>	<u>Expenditures</u>
<u>U. S. Department of Homeland Security</u>			
Passed through Kentucky Division of Emergency Management - Disaster Grants - Public Assistance	97.036	KY-1841-DR	\$ 484,770
Total Department of Homeland Security			<u>484,770</u>
<u>U.S. Department of Agriculture</u>			
Passed Through the Kentucky Infrastructure Authority - ARRA - Water and Waste Disposal Systems for Rural Communities	10.781	F2 09-09	268,155
Total Department of Agriculture			<u>268,155</u>
<u>U.S. Department of Transportation</u>			
Passed through the Kentucky Office of Highway Safety - Highway Safety Grant	20.600	K4CP-10-25	8,000
Total Department of Transportation			<u>8,000</u>
Total Expenditures of Federal Awards			<u>\$ 760,925</u>

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

NOTE A - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the City of Jackson, Kentucky under programs of the federal government for the year ended June 30, 2010. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Government, and Non-Profit Organizations. Because the schedule presents only a selected portion of operations of the City of Jackson, it is not intended to and does not present the financial position, changes in net assets or cash flows of the City.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, Cost Principles for State and Local Governments, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the schedule represents adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.



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

The Honorable Mayor
and Members of City Council
City of Jackson
Jackson, Kentucky

We have audited the financial statements of the governmental activities, the business-type activities, and each major fund of the City of Jackson, Kentucky (the "City") as of and for the year ended June 30, 2010 and have issued our report thereon dated January 24, 2011, wherein we disclaimed an opinion on the financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States 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'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's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore there could be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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

detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses, 2010-01, 2010-02, 2010-03, 2010-04, and 2010-05.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2010-06 and 2010-07.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Mayor, members of the City Council, others within the entity and the Kentucky Department of Local Government and is not intended to be and should not be used by anyone other than these specified parties.

Kelley, Galloway & Company, PSC

January 24, 2011



Kelley,
Galloway &
Company, PSC

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH REQUIREMENTS THAT COULD HAVE A DIRECT
AND MATERIAL EFFECT ON EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

The Honorable Mayor
and Members of City Council
City of Jackson
Jackson, Kentucky

Compliance

We were engaged to audit the City of Jackson, Kentucky's (the "City") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2010. The City'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's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

As described in findings 2010-8 and 2010-9 in the accompanying schedule of findings and questioned costs, we were unable to obtain sufficient documentation supporting the compliance of the City of Jackson, Kentucky, with its Public Assistance Grants CFDA #97.036, major program regarding all applicable compliance requirements, nor were we able to satisfy ourselves as to the City's compliance with those requirements by other auditing procedures.

Because of the audit scope limitation described in the preceding paragraph and in findings 2010-8 and 2010-9, our work was not sufficient to enable us to express and we do not express an opinion on the City's compliance with requirements applicable to the Public Assistance Grants (CFDA #97.036) major program for the year ended June 30, 2010.

Internal Control Over Compliance

The management of the City 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'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 internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

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

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2010-08 and 2010-09 to be material weaknesses.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board, management, others within the entity, the Kentucky Department of Local Government, 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.

Kelley, Balloway & Company, PSC

January 24, 2011

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2010**

(A) SUMMARY OF AUDIT RESULTS

Type of Auditor's report issued:

Disclaimer

Internal Control over financial reporting:

Material weakness(es) identified?

☒ yes ☐ no

Significant deficiency(ies) identified
that are not considered to
material weaknesses?

☐ yes ☒ none reported

Noncompliance material to the financial
statements noted?

☒ yes ☐ no

Federal Awards

Internal control over major programs:

Material weakness(es) identified?

☒ yes ☐ no

Significant deficiency(ies) identified
that are not considered to be material
weakness(es).

☐ yes ☒ none reported

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

Disclaimer of Opinion

Any audit findings disclosed that are
required to be reported in accordance
with Section 510(a) of Circular A-133?

☒ yes ☐ no

The District had the following major programs with CFDA numbers in parentheses for the
year ended June 30, 2010:

Disaster Grants – Public Assistance (97.036)

Dollar threshold to distinguish between Type A
and Type B Programs:

\$ 300,000

The District qualified as a low risk auditee

☐ yes ☒ no

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010**

**(B) FINDINGS RELATED TO FINANCIAL STATEMENTS IN ACCORDANCE WITH
GENERALLY ACCEPTED GOVERNMENTAL AUDITING STANDARDS**

2010-1 Water and Sewer Funds

Statement of Condition: We noted that transfers made between bank accounts within the same fund for the Water and Sewer Funds are recorded as transfer income and expense rather than making the appropriate entry to the cash account on the general ledger. As a result, none of the bank accounts for the Water and Sewer Funds reconcile to the general ledger at any point during the year and water and sewer revenue accounts are misstated.

Criteria for Condition: Bank reconciliations should be prepared and agreed to the general ledger to ensure that all transactions have been properly recorded.

Cause of Condition: Bank reconciliations are prepared; however, they are not agreed to the general ledger and do not agree due to recording transfers incorrectly.

Effect of Condition: Errors in posting are not being corrected on a timely basis.

Recommendation for Correction: We recommend that all reconciliations be agreed to the general ledger and any adjustments be identified and corrected on a timely basis.

Management Response and Corrective Action Plan: City management will try to see that all reconciliations be agreed to the general ledger and that all corrections be made on a timely basis.

2010-2 City Bank Accounts

Statement of Condition: We noted the activity for certain bank accounts is not maintained in the general ledger throughout the year. Annual audit adjustments are made to include the whole year's activity in the general ledger for the following accounts:

- Police Department Account
- State Road Aid Coal Severance Street Fund
- 1999 Bond Depreciation Account
- Tourism Promotion Account
- Fire Reserve Account
- 2006 KADD Bond Account

Criteria for Condition: All bank accounts owned by the City should be recorded in the financial records for a complete set of financial statements.

Cause of Condition: These accounts are not everyday operating accounts and have never had their activity included in the general ledger until the audit.

Effect of Condition: As a result, financial statements prepared during the year would give an incomplete picture of the City's finances. However, currently the City relies on cash activity reports of each bank account rather than financial statements generated through the City's general ledger system.

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010**

Recommendation for Correction: We recommend that these accounts be treated the same as the everyday operating accounts and included in the general ledger. They could be set-up as a special revenue fund separate from the General Fund to avoid confusion on budget comparisons.

Management Response and Corrective Action Plan: These accounts will be added to the general ledger. Management plans to set them up as Special Revenue Funds.

2010-3 Payables and Receivables

Statement of Condition: We had several audit adjustments related to unrecorded accounts payable, accrued liabilities, and accounts receivable at June 30, 2010. The City is not utilizing the accounts payable function within their software; therefore, accounts payable balances are not accurate.

Criteria for Condition: Modified accrual or accrual (for Proprietary Fund Types) basis of accounting is recommended by the American Institute of Certified Public Accountants in its industry audit guide, "Audits of State and Local Governmental Units".

Cause of Condition: The City currently does not maintain its accounting records on a modified accrual or accrual basis.

Effect of Condition: As a result, financial statements prepared during the year could be misleading.

Recommendation for Correction: We recommend that the City utilize the accounts payable function within their accounting system to be able to view at any point in time open invoices/accounts payable and to adjust the other liabilities and accounts receivable balances on at least an annual basis.

Management Response and Corrective Action Plan: The City is currently looking at their system to see if they need to change accounting software or learn to use the accounting software that they currently have to its fullest. The City plans to correct this as soon as possible.

2010-4 Retirement Expense

Statement of Condition: We noted that the City's portion of retirement expense is being charged to the liability account rather than the expense account. An adjustment in the amount of \$108,444.37 was needed to properly record the retirement expense for the General Fund for the year ending June 30, 2010.

Criteria for Condition: The employer portion of retirement should be recorded as an expense of the City.

Cause of Condition: An incorrect account coding has been set-up for the employer portion of the retirement payment.

Effect of Condition: As a result, financial statements and budget comparisons made during the year can be misleading.

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010**

Recommendation for Correction: We recommend that the coding be corrected for the employer portion of retirement payments. We also recommend that someone independent of the financial statement preparation review the monthly balance sheets for reasonableness, so that errors in coding can be detected.

Management Response and Corrective Action Plan: The City will correct the account coding for the employer portion of the retirement payments. The City will also have the monthly balance sheets reviewed, so that errors, if any, will be caught sooner.

2010-5 Debt Service

Statement of Condition: We noted that debt payments are being charged against liability accounts in the General Fund rather than as debt service expense as required for the modified cash basis of accounting for governmental funds. These amounts increased expenses by \$236,314.27.

Criteria for Condition: All long-term debt payments should be recorded as debt service expense.

Cause of Condition: An incorrect account coding has been set-up for the long-term debt payments within the liability section rather than the expenses of the City.

Effect of Condition: As a result, financial statements and budget comparisons made during the year would contain errors.

Recommendation for Correction: We recommend that the coding be corrected for the long-term debt payments. We also recommend that someone independent of the financial statement preparation review the monthly balance sheets for reasonableness, so that errors in coding can be detected.

Management Response and Corrective Action Plan: The City will correct the coding for long-term debt payments. In addition, the City plans to have the monthly balance sheets reviewed by a third party so that errors might be caught sooner.

2010-6 Budgeting

Statement of Condition: The City had revenues and expenditures in excess of budgeted amounts.

Criteria for Condition: KRS 91A.030 states that no city shall expend any moneys from any governmental or proprietary fund, except in accordance with the budget ordinance adopted.

Cause of Condition: The City received unanticipated grant funds and loan proceeds and did not amend the budget as a result.

Effect of Condition: Noncompliance with state laws.

Recommendation for Correction: We recommend that when the City anticipates additional revenues and/or expenditures that the budget be amended to incorporate those amounts.

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010**

Management Response and Corrective Action Plan: To correct the City's non-compliance with State Law KRS 91A.030, the City intends to amend the budget as additional revenues or expenditures occur in order to comply with the law.

2010-7 Payment of Invoices

Statement of Condition: We noted several invoices that did not contain the signature of the Mayor or the Superintendent indicating proper approval. In addition, dual signature checks are required; however, a signature stamp is utilized for the Mayor and Superintendent's signature when one of the signers is absent. We noted instances where the signature stamp was used for both signatures on the check. We also noted instances where only one signature was on the check.

Criteria for Condition: KRS 65.140 requires local governments to pay for purchases within 30 days. Additionally, dual signature checks is a good internal control, but not when a signature stamp is utilized for both signatures and both stamps are maintained by the persons who write the checks. Thus, proper approval of disbursements is not evident on either the check or the invoice in these instances.

Cause of Condition: It is sometimes difficult for both the Mayor and Superintendent to sign checks and easier to use stamps.

Effect of Condition: This creates improper segregation of duties, since one person writes the checks, signs the checks with a signature stamp, and posts the entry to the general ledger.

Recommendation for Correction: We recommend that all invoices be approved by the Mayor or Superintendent, as applicable, and such approval be indicated with their initials. We also recommend that only one signature stamp be utilized on each check and that all bank reconciliations be reviewed by an independent person and indicated as such on the reconciliation with the reviewer's initials and date.

Management Response and Corrective Action Plan: All invoices are now approved by the Mayor and the Mayor's initials are placed on the invoices before they can be paid. The practice of two signature stamps has been halted.

(C) FINDINGS AND QUESTIONED COSTS RELATED TO FEDERAL AWARDS

2010-8 FEMA

Federal Program: CFDA # 97.036 – Public Assistance Grants

Federal Agency: Department of Homeland Security

Pass-Through Agency: Commonwealth of Kentucky, Division of Emergency Management

Compliance: All applicable areas

Amount of Questioned Costs: \$342,564

Condition: The City received advance grant funds from FEMA and the Commonwealth of Kentucky for repair costs under FEMA major disasters designated 1841-DR. The City was unable to provide an accounting for the actual costs incurred for the large projects.

**CITY OF JACKSON, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONCLUDED)
FOR THE YEAR ENDED JUNE 30, 2010**

Criteria: The grant agreements specify that all backup documentation and cost information is to be maintained in the City's files. The agreement further states that if actual costs are less than the approved amount for large projects, then the FEMA share will be based upon the actual costs.

Effect: Noncompliance with 44 CFR section 13.21 requirements.

Recommendation: We recommend the City carefully review all grant expenditures and maintain all records as required by grant agreements. The City should also consider meeting with FEMA representatives and agree to a plan of correction.

Management Response and Corrective Action Plan: The City will carefully maintain all records in regards to all grants and their expenditures. They will review all requirements and meet the agreements as required. The City plans to meet with FEMA representatives to make any corrections needed.

2010-9 FEMA GRANT REPORTING

Federal Program: CFDA # 97.036 – Public Assistance Grants

Federal Agency: Department of Homeland Security

Pass-Through Agency: Commonwealth of Kentucky, Division of Emergency Management

Compliance: Reporting

Amount of Questioned Costs: \$0

Condition: The City did not maintain evidence of quarterly progress reports being made on FEMA large projects for the quarters ending 12/31/09, 3/31/10, and 6/30/10 to the Kentucky Division of Emergency Management.

Criteria: The grant agreements specify that quarterly progress reports be used to report progress on large projects. For 2009, the threshold is \$64,200 or greater. The City had 3 large projects. These quarterly reports are used by the state to certify that reported costs were incurred in the performance of eligible work, that the approved work was completed, that the project is in compliance with the FEMA-State Agreement, and that payments for the project have been made in accordance with 44 CFR section 13.21 requirements for payment. The City (subgrantee) is required to make similar accounting and certifications to the State.

Effect: Noncompliance with 44 CFR section 13.21 requirements.

Recommendation: We recommend the City carefully review all grant agreements to ensure compliance with all requirements and to immediately get caught up on their quarterly reporting requirements.

Management Response and Corrective Action Plan: It has been determined that Mayor Miller needed to file these reports for 12/31/09, 3/31/10 and 6/30/10. The City will be meeting with FEMA and the Kentucky Division of Emergency Management to correct this issue. At this time, the City is not sure which projects were completed and how much money was spent on these projects.

**CITY OF JACKSON, KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

Finding 09-01

Accounting Records

The City currently does not maintain its accounting records on a modified accrual or accrual basis. Therefore, numerous year end adjustments are required to record accounts receivable, accounts payable, prepaid expenses, accrued liabilities, etc. Modified accrual or accrual (for Proprietary Fund Types) basis of accounting is recommended by the American Institute of Certified Public Accountants in its industry audit guide, "Audits of State and Local Governmental Units".

Resolution

This finding is repeated in the current year at 2010-3.

Finding 09-02

Budgeting

The City had revenues and expenditures in excess of budgeted amounts. We recommend that when the City anticipates additional revenues and/or expenditures that the budget be amended to incorporate those amounts.

Resolution

This finding is repeated in the current year at 2010-6.

Finding 09-03

Payment of Invoices

We noted several invoices that did not contain the signature of the Mayor or the Superintendent indicating proper approval. In addition, dual signature checks are required; however, a signature stamp is utilized for the Mayor and Superintendent's signature when one of the signers is absent. We noted instances where the signature stamp was used for both signatures on the check. We also noted instances where only one signature was on the check. Thus, proper approval of disbursements is not evident on either the check or the invoice in these instances. This creates improper segregation of duties, since one person writes the checks, signs the checks with a signature stamp, and posts the entry to the general ledger. We recommend that all invoices be approved by the Mayor or Superintendent, as applicable, and such approval be indicated with their initials. We also recommend that only one signature stamp be utilized on each check and that all bank reconciliations be reviewed by an independent person and indicated as such on the reconciliation with the reviewer's initials and date.

Resolution

This finding is repeated in the current year at 2010-7.

CITY OF JACKSON, KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (CONCLUDED)
FOR THE YEAR ENDED JUNE 30, 2010

Finding 09-04

Travel Reimbursements

We noted several mileage reimbursements whereby the only support was a listing of cities traveled to along with the roundtrip mileage at the rate of \$.485 per mile. However, the purpose of these trips was not clearly evident on the reimbursement request. We recommend that the City adopt a travel reimbursement policy which requires the business purpose be clearly noted on the request and that such requests made by the Mayor and approved by City Council either individually or through a budget line item. Mileage reimbursements made to the Mayor in FY '09 totaled \$21,142.

Resolution

These mileage reimbursements continued to be made to the previous Mayor in FY '10; however, he is no longer Mayor and the new Mayor had no such reimbursements in FY '10.