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Knox County Utility Commission
Artemus, Kentucky
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Independent Auditors' Report
And Financial Statements
For the Years Ended
December 31, 2012 and 2011

Knox County Utility Commission
Table of Contents

	Page
Independent Auditors' Report	1-2
Basic Financial Statements:	
Statements of Net Position	3-4
Statements of Revenues, Expenses and Changes in Net Position	5
Statements of Cash Flows	6-7
Notes to Financial Statements	8-17
Supplemental Information	
Departmental Statements of Net Position - Water Department	18-19
Departmental Statements of Revenues, Expenses and Changes in Net Position - Water Department	20
Departmental Statements of Cash Flows - Water Department	21-22
Departmental Statements of Net Position - Sewer Department	23
Departmental Statements of Revenues, Expenses and Changes in Net Positon - Sewer Department	24
Departmental Statements of Cash Flows - Sewer Department	25
Independent Auditors' 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*	26-27
Schedule of Findings and Responses	28

Christian Sturgeon
& Associates, PSC
Certified Public Accountants

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Independent Auditors' Report

To the Commissioners
Knox County Utility Commission
Artemus, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Knox County Utility Commission, (the Commission), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Knox County Utility Commission, as of December 31, 2012, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

1075 East Fourth Street P. O. Box 901 London, KY 40743-0901 Phone: (606) 878-0861 Fax: (606) 864-3003

Other Matters

Required Supplementary Information

Management has omitted the Management's Discussion and Analysis 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 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Commission's basic financial statements. The accompanying departmental statements for the water and sewer departments are presented separately for the purpose of additional analysis and are not a required part of the basic financial statements.

The accompanying departmental statements for the water and sewer departments are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

The financial statements of Knox County Utility Commission as of December 31, 2011, were audited by other auditors whose report dated March 29, 2012, expressed an unmodified opinion on those statements.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2013 on our consideration of the Knox County Utility Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Knox County Utility Commission's internal control over financial reporting and compliance.

Christian Sturgeon & Associates, PSC

Christian Sturgeon & Associates, PSC
London, Kentucky

March 22, 2013

Knox County Utility Commission
Statements of Net Position
December 31, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	$ 507,449	$ 586,193
Investments	107,977	107,279
Receivables, less allowance	83,088	80,544
Unbilled accounts receivable	60,857	42,645
Other receivables	-	3,013
Inventories	24,688	31,902
Other current assets	207	100
Total Current Assets	784,266	851,676
Noncurrent assets		
Restricted assets		
Restricted cash and cash equivalents	92,880	87,433
Capital Assets		
Land and improvements	44,619	44,619
Structures and improvements	506,837	497,407
Pumping equipment	125,822	108,133
Meters and meter installation	704,237	683,078
Hydrants	53,816	53,816
Storage tanks	1,148,102	1,148,102
Transmission and distribution plant	10,119,405	10,104,183
Vehicles and other equipment	403,697	377,617
Office equipment	52,465	41,790
Lift stations	344,195	344,195
	13,503,195	13,402,940
Accumulated depreciation	(5,075,724)	(4,601,968)
Net Capital Assets	8,427,471	8,800,972
Other Assets		
Bond issue costs, net of amortization	9,287	10,752
Total Other Assets	9,287	10,752
Total Noncurrent Assets	8,529,638	8,899,157
Total Assets	9,313,904	9,750,833

See accompanying notes to financial statements.

Knox County Utility Commission
Statements of Net Position (Continued)
December 31, 2012 and 2011

	2012	2011
Liabilities		
Current Liabilities		
Current portion of long-term debt	52,000	53,000
Accounts payable	27,821	47,406
Accrued interest payable	47	47
Accrued salaries and taxes payable	18,234	18,448
Total Current Liabilities	98,102	118,901
Noncurrent Liabilities		
Customer deposits	28,099	28,254
Long-term debt, less current portion	2,533,000	2,645,000
Total Noncurrent Liabilities	2,561,099	2,673,254
Total Liabilties	2,659,201	2,792,155
Net Position		
Net investment in capital assets	5,842,471	6,102,972
Restricted	92,880	87,433
Unrestricted	719,352	768,273
Total Net Position	$ 6,654,703	$ 6,958,678

See accompanying notes to financial statements.

Knox County Utility Commission
Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended December 31, 2012 and 2011

	2012	2011
Operating Revenues		
Water sales	$ 1,119,411	$ 1,068,913
Sewer sales	14,528	21,324
Service charges	15,825	15,675
Tap fees	22,474	24,000
Penalties	30,185	30,104
Other revenues	8,151	6,385
Total Operating Revenues	1,210,574	1,166,401
Operating Expenses		
Salaries and wages	267,104	255,857
Employee benefits	174,126	161,332
Purchased power	208,563	221,996
Utilities	55,602	56,247
Chemicals	57,384	73,079
Repairs and maintenance	32,123	61,344
Contracted services	26,711	24,351
Vehicle and equipment expenses	25,891	27,248
Insurance	33,687	33,737
Sewer treatment	9,921	16,493
Amortization	444	553
Depreciation	473,756	469,796
Bad debt expense, net of recoveries	13,248	14,814
Other operating expenses	46,932	48,616
Total Operating Expenses	1,425,492	1,465,463
Operating Loss	(214,918)	(299,062)
Nonoperating Revenues (Expenses)		
Interest income	16,641	19,907
Federal and state grants	14,010	291,258
Other income	-	59,882
Other expense	-	(59,770)
Interest expense	(119,708)	(124,524)
Total Nonoperating Revenues (Expenses)	(89,057)	186,753
Change in Net Position	(303,975)	(112,309)
Net Position, Beginning of Year	6,958,678	7,070,987
Net Position, End of Year	$ 6,654,703	$ 6,958,678

See accompanying notes to financial statements.

Knox County Utility Commission
Statements of Cash Flows
For the Years Ended December 31, 2012 and 2011

	2012	2011
Cash Flows From Operating Activities		
Receipts from customers	$ 1,184,525	$ 1,186,381
Receipts from other activities	8,151	6,385
Payments to employees	(267,318)	(255,537)
Payments to suppliers	(695,645)	(982,970)
Net Cash Provided (Used) by Operating Activities	229,713	(45,741)
Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(100,255)	(277,176)
Principal payments on debt	(113,000)	(50,000)
Interest payments on debt	(119,708)	(124,524)
Federal, state and local grants	14,010	291,258
Miscellaneous non-operating	-	59,882
Miscellaneous non-operating expense	-	(59,770)
Net Cash Used by Capital and Related Financing Activities	(318,953)	(160,330)
Cash Flows From Investing Activities		
Interest on cash and investments	15,943	18,451
Net Cash Provided by Investing Activities	15,943	18,451
Net Decrease in Cash and Cash Equivalents	(73,297)	(187,620)
Cash and Cash Equivalents at Beginning of Year	673,626	861,246
Cash and Cash Equivalents at End of Year	$ 600,329	$ 673,626
Reconciliation of Cash at End of Year		
Cash and Cash Equivalents	$ 507,449	$ 586,193
Restricted Cash and Cash Equivalents	92,880	87,433
Total Cash at End of Year	$ 600,329	$ 673,626

See accompanying notes to financial statements.

Knox County Utility Commission
Statements of Cash Flows (Continued)
For the Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of Operating Loss to Net Cash Provided (Used) by Operating Activities:		
Operating loss	$ (214,918)	$ (299,061)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities		
Depreciation	473,756	469,796
Amortization	444	553
Loss on retirement of debt	1,021	-
(Increase) Decrease in:		
Accounts receivable	(2,544)	10,154
Unbilled accounts receivable	(18,212)	18,355
Other receivables	3,013	(3,013)
Inventory	7,214	(9,554)
Prepaid expenses and other assets	(107)	43
Increase (Decrease) in:		
Accounts payable	(19,585)	(234,202)
Customer deposits	(155)	868
Accrued expenses	(214)	320
Net Cash Provided (Used) by Operating Activities	$ 229,713	$ (45,741)

See accompanying notes to financial statments.

Note 1 – Summary of Significant Accounting Policies

Reporting Entity

The Knox County Utility Commission, of Knox County, Kentucky (the Commission) was created in 2001 from a merger of the East Knox Water District and the Dewitt Water District. Water Districts are organized under Chapter 74 of the Kentucky Revised Statutes. The Commission is governed by a five person board of Commissioners which is appointed by the Knox County Fiscal Court. The Commission is regulated by the Kentucky Public Service Commission.

The Commission is a rural water utility system whose purpose is to provide water and sewer services to its customers in a portion of Knox County, Kentucky. The Commission's primary source of revenue is from water and sewer sales to its customers, including public bodies and local businesses in its service area.

Basis of Accounting, Financial Presentation and Measurement Focus

The basic financial statements of the Commission have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

The Commission applies all relevant Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements, in which case, GASB prevails. In addition, the Commission applies all applicable FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements to its business-type activities.

The Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position display information about the Commission as a whole. These statements include all funds of the Commission. The statements distinguish between governmental and business-type activities. The Commission does not have any governmental activities.

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Operating income reported by the Commission includes revenues and expenses related to the continuing operation of water and sewer service for its customers. Principal operating revenues are charges to customers for services. Principal operating expenses are the costs of providing the services and include administrative expenses and depreciation of capital assets. Other revenues and expenses are classified as non-operating in the financial statements.

Cash and Cash Equivalents

The Commission considers demand deposits and certificates of deposit with maturities of less than three months to be cash equivalents.

Note 1 - Summary of Significant Accounting Policies (Continued)

Investments

The Commission is authorized by state statute to invest in: 1) obligations of the United States and of its agencies and instrumentalities; 2) bonds or certificates of indebtedness of this state and of its agencies and instrumentalities; 3) shares of any savings and loan insured by an agency of the government of the United States up to the amount so insured; 4) interest bearing deposits in nationally chartered or state banks chartered in Kentucky and insured by an agency of the government of the United States up to the amount so insured, and in larger amounts provided such bank shall pledge as security obligations of the United States government, its agencies and instrumentalities.

The Commission's investments consist of certificates of deposits with maturity dates of three months or more. Certificates of deposit in excess of FDIC insurance coverage are collateralized by securities held by the pledging institution.

Accounts Receivable

Receivables include amounts due from customers for water and sewer services. These receivables are due at the time the services are billed. Billing is completed monthly and accounts are considered past due on the twenty-first day after the end of each billing period. Accounts receivable are presented net of uncollectible accounts. The allowance amount is estimated using a percentage of accounts past due more than 90 days. At December 31, 2012 and 2011, the allowance for doubtful accounts totaled $10,500 and $10,500, respectively.

Unbilled Accounts Receivable

Estimated unbilled revenues from water and sewer sales are recognized at the end of each fiscal year on a pro rata basis. The estimated amount is based on billing during the month following the close of the fiscal year.

Inventories and Prepaid Expenses

Inventories consist of expendable supplies held for consumption stated on a first-in, first-out basis. They are reported at cost and are recorded as an expense at the time individual items are used. Prepaid expenses include payments to vendors that benefit future reporting periods and are reported on the consumption basis.

Capital Assets

The Commission's property, plant and equipment with useful lives of more than one year are stated at historical cost. The costs of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized. Capital assets are depreciated using the straight-line method. When assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in operations.

Note 1 – Significant Accounting Policies (Continued)

Capital Assets (Continued)

Estimated useful lives for depreciable assets are as follows:

Asset Classification	Range of Lives
Structures and improvements	10-40 years
Transmission distribution mains	50 years
Meters and services	20 years
Other equipment and vehicles	5-10 years

Customer Deposits

The Commission collects and holds in escrow a $40 deposit from customers to ensure collection of its water and sewer charges. Interest at an annual rate of 2.53% is paid on these deposits.

Use of Estimates

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

Net Position

In 2012, the Commission adopted new accounting guidance, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Amounts have been reclassified in the 2011 financial statements to conform to the new presentation.

Net position is comprised of the various net earnings from operating income, non-operating revenues and expenses, and capital contributions. Net position is classified in the following three components:

Net investment in capital assets – This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted – This component of net position consists of restricted assets less liabilities and deferred inflows of resources related to those assets. Restricted assets are those with limits on their use that are externally imposed constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted – This component of net position consists of net amounts of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of the net investment in capital assets or the restricted component of net position.

Note 2 – Restricted Assets

Under the terms of all loan resolutions, the Commission is required to maintain certain accounts and funds for the benefit and protection of the creditors. In addition, the Commission is also required to collect reasonable and sufficient rates and charges for services rendered, prohibited from selling, leasing or mortgaging any part of the system without prior approval, required to maintain the operating system in good condition and to carry adequate insurance on all properties to protect against loss or damage.

The resolutions require the Commission to establish a depreciation fund or reserve to be used to finance the cost of unusual repairs, renewals and replacements not included in the annual budget and to pay for future system extensions. The balance of these accounts at December 31, 2012 and 2011 was $92,880 and $87,433.

Note 3 – Kentucky Revised Statute

At December 31, 2012 and 2011, all of the cash of the Commission was covered by federal depository insurance and securities pledged as collateral on behalf of the Commission. In accordance with Kentucky Revised Statute (KRS) 91A.060, the deposits are to be insured by the Federal Depository Insurance Corporation or collateralized to the extent uninsured by any obligations permitted by KRS 41.240(4). According to KRS 41.240(4), it shall either pledge or provide as collateral securities or other obligations having an aggregate current face value or current quoted market value at least equal to the deposits. According to KRS 91A.060, the Commission is allowed to invest in obligations of the U.S. Treasury and U.S. agencies, repurchase agreements, obligations of the Commonwealth of Kentucky and its agencies, interest bearing deposits of insured savings and loans, or interest bearing deposits of insured national or state banks. For additional cash descriptive information, see Note 1.

Note 4 – Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of December 31, 2012 and 2011, $566,116 and $645,512 of the Commission's total deposits at banks of $816,116 and $895,512, respectively, were exposed to custodial credit risk as follows:

	2012	2011
Uninsured and uncollateralized	$ -	$ -
Uninsured and collateral held by pledging bank	566,116	645,512
Uninsured and collateral held by pledging bank's trust department not in the District's name	-	-
Total	$ 566,116	$ 645,512

Note 5 – Capital Assets

The following is a summary of capital asset transactions for the year ended December 31, 2012:

	Balance Dec. 31, 2011	Additions	Dispositions	Balance Dec. 31, 2012
Land and land improvements	$ 44,619	$ -	$ -	$ 44,619
Structures and improvements	497,407	9,430	-	506,837
Pumping equipment	108,133	17,689	-	125,822
Meters and meter installation	683,078	21,159	-	704,237
Hyrants	53,816	-	-	53,816
Storage tanks	1,148,102	-	-	1,148,102
Transmission and distribution plant	10,104,184	15,221	-	10,119,405
Vehicles and other equipment	377,616	26,081	-	403,697
Office equipment	41,790	10,675	-	52,465
Lift stations	344,195	-	-	344,195
Totals at historical cost	13,402,940	100,255	-	13,503,195
Less accumulated depreciation for:				
Structures and improvements	368,603	18,896	-	387,499
Pumping equipment	63,931	9,328	-	73,259
Meters and meter installation	392,254	30,965	-	423,219
Hydrants	27,180	3,258	-	30,438
Storage tanks	360,997	47,534	-	408,531
Transmission and distribution plant	2,965,368	322,830	-	3,288,198
Vehicles and other equipment	306,118	25,595	-	331,713
Office equipment	39,584	1,562	-	41,146
Lift stations	77,933	13,788	-	91,721
Total accumulated depreciation	4,601,968	473,756	-	5,075,724
Capital assets - net	$ 8,800,972	$ (373,501)	$ -	$ 8,427,471

Note 5 – Capital Assets (Continued)

The following is a summary of capital asset transactions for the year ended December 31, 2011:

	Balance Dec. 31, 2010	Additions	Dispositions	Balance Dec. 31, 2011
Land and land improvements	$ 44,619	$ -	$ -	$ 44,619
Structures and improvements	497,407	-	-	497,407
Pumping equipment	106,103	2,030	-	108,133
Meters and meter installation	659,421	23,657	-	683,078
Hyrants	48,901	4,915	-	53,816
Storage tanks	741,318	406,784	-	1,148,102
Transmission and distribution plant	9,065,295	1,038,889	-	10,104,184
Vehicles and other equipment	372,977	4,639	-	377,616
Office equipment	41,790	-	-	41,790
Lift stations	344,195	-	-	344,195
Construction in process	1,203,738	246,849	1,450,587	-
Totals at historical cost	13,125,764	1,727,763	1,450,587	13,402,940
Less accumulated depreciation for:				
Structures and improvements	346,647	21,956	-	368,603
Pumping equipment	56,616	7,315	-	63,931
Meters and meter installation	361,738	30,516	-	392,254
Hydrants	24,113	3,067	-	27,180
Storage tanks	311,884	49,113	-	360,997
Transmission and distribution plant	2,644,433	320,935	-	2,965,368
Vehicles and other equipment	283,393	22,725	-	306,118
Office equipment	39,202	382	-	39,584
Lift stations	64,146	13,787	-	77,933
Total accumulated depreciation	4,132,172	469,796	-	4,601,968
Capital assets - net	$ 8,993,592	$ 1,257,967	$ 1,450,587	$ 8,800,972

Note 6 -- Long-Term Debt

The following is a summary of long-term debt transactions for the year ended December 31, 2012:

	Balance Dec. 31, 2011	Additions	Payments	Balance Dec. 31, 2012	Due Within One Year
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2034; interest payable on a semi-annual basis at the rate of 4.5%	$ 335,000	$ -	$ 9,000	$ 326,000	$ 9,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2029; interest payable on a semi-annual basis at the rate of 5.0%	62,000	-	62,000	-	-
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2040; interest payable on a semi-annual basis at the rate of 4.5%	1,986,000	-	37,000	1,949,000	38,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2042; interest payable on a semi-annual basis at the rate of 4.5%	315,000	-	5,000	310,000	5,000
	$ 2,698,000	$ -	$ 113,000	$ 2,585,000	$ 52,000

Note 6 – Long-Term Debt (Continued)

The following is a summary of long-term debt transactions for the year ended December 31, 2011:

	Balance Dec. 31, 2010	Additions	Payments	Balance Dec. 31, 2011	Due Within One Year
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2034; interest payable on a semi-annual basis at the rate of 4.5%	$ 343,000	$ -	$ 8,000	$ 335,000	$ 9,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2029; interest payable on a semi-annual basis at the rate of 5.0%	64,000	-	2,000	62,000	2,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due January 1, 2040; interest payable on a semi-annual basis at the rate of 4.5%	2,021,000	-	35,000	1,986,000	37,000
Loan payable to United States Department of Agriculture, payable annually in varying principal amounts, with final payment due June 1, 2042; interest payable on a semi-annual basis at the rate of 4.5%	320,000	-	5,000	315,000	5,000
	$ 2,748,000	$ -	$ 50,000	$ 2,698,000	$ 53,000

Note 6 – Long-Term Debt (Continued)

The aggregate annual principal repayments on long-term debt are summarized as follows:

Year ending December 31,	Principal	Interest	Total
2013	$ 52,000	$ 117,634	$ 169,634
2014	56,000	115,266	171,266
2015	58,000	112,718	170,718
2016	61,000	110,079	171,079
2017	63,000	107,302	170,302
2018-2022	364,000	490,511	854,511
2023-2027	456,000	399,772	855,772
2028-2032	569,000	286,143	855,143
2033-2037	601,000	151,903	752,903
2038-2042	305,000	24,349	329,349
	$ 2,585,000	$ 1,915,677	$ 4,500,677

Note 7 – Retirement Plan

The Commission's full time employees are covered under the County Employee's Retirement System (CERS), a cost sharing, multiple-employer, public employers retirement system. Funding for the plan is provided through payroll withholdings and contributions by the Commission. Employees hired before September 1, 2008 are withheld at the rate of 5% of the employee's total compensation subject to contribution. Employees hired on or after September 1, 2008 are withheld at the rate of 6% of the employees total compensation subject to contribution. The Commission's contribution rate for the years ended December 31, 2012 and 2011 were 19.55% and 18.96%, respectively.

The Commission's payroll for the years ended December 31, 2012, 2011, and 2010 that was covered by CERS was $246,987, $240,261, and $235,465, respectively.

The Commission's contribution requirement for CERS for the years ended December 31, 2012, 2011, and 2010 was $47,546, $43,230, and $39,007, respectively.

Benefits under the plan will vary based on final compensation, years of service and other factors as fully described in the Plan documents.

The CERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, Kentucky 40601.

Note 8 – Risk Management

The Commission is exposed to various risks of loss related to limited torts; theft of, damage to and destruction of assets; errors and omissions and natural disasters for which the Commission carries commercial insurance. There have been no significant reductions in coverage for the year and settlements have not exceeded coverage in the past three years.

Note 9 - Subsequent Events

Management of the Commission has evaluated subsequent events through March 22, 2013, the date on which the financial statements were available to be issued.

Knox County Utility Commission
Departmental Statements of Net Position - Water Department
December 31, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	$ 492,918	$ 574,732
Investments	107,977	107,279
Receivables, less allowance	81,881	79,494
Unbilled accounts receivable	60,857	42,645
Other receivables	-	3,013
Inventories	24,688	31,902
Other current assets	207	100
Total Current Assets	768,528	839,165
Noncurrent assets		
Restricted assets		
Restricted cash and cash equivalents	92,880	87,433
Capital Assets		
Land and improvements	44,619	44,619
Structures and improvements	506,837	497,407
Pumping equipment	115,204	97,515
Meters and meter installation	704,142	682,983
Hydrants	53,816	53,816
Storage tanks	1,148,102	1,148,102
Transmission and distribution plant	9,589,555	9,574,333
Vehicles and other equipment	402,983	376,903
Office equipment	52,465	41,790
	12,617,723	12,517,468
Accumulated depreciation	(4,909,346)	(4,461,139)
Net Capital Assets	7,708,377	8,056,329
Other Assets		
Bond issue costs, net of amortization	9,287	10,752
Total Other Assets	9,287	10,752
Total Noncurrent Assets	7,810,544	8,154,514
Total Assets	8,579,072	8,993,679

Knox County Utility Commission
Departmental Statements of Net Position - Water Department (Continued)
December 31, 2012 and 2011

	2012	2011
Liabilities		
Current Liabilities		
Current portion of long-term debt	52,000	53,000
Accounts payable	26,758	46,791
Accrued interest payable	47	47
Accrued salaries and taxes payable	18,234	18,448
Total Current Liabilities	97,039	118,286
Noncurrent Liabilities		
Customer deposits	28,099	28,254
Long-term debt	2,533,000	2,645,000
Total Noncurrent Liabilities	2,561,099	2,673,254
Total Liabilties	2,658,138	2,791,540
Net Position		
Net investment in capital assets	5,123,377	5,358,329
Restricted	92,880	87,433
Unrestricted	704,677	756,377
Total Net Position	$ 5,920,934	$ 6,202,139

Knox County Utility Commission
Departmental Statements of Revenues, Expenses and Changes in Net Position - Water Department
For the Years Ended December 31, 2012 and 2011

	2012	2011
Operating Revenues		
Water sales	$ 1,119,411	$ 1,068,913
Service charges	15,825	15,675
Tap fees	22,474	24,000
Penalties	30,185	30,104
Other revenues	8,151	6,385
Total Operating Revenues	1,196,046	1,145,077
Operating Expenses		
Salaries and wages	266,550	255,308
Employee benefits	174,086	161,292
Purchased power	208,563	221,996
Utilities	54,573	55,267
Chemicals	57,384	73,079
Repairs and maintenance	32,123	61,344
Contracted services	26,711	24,351
Vehicle and equipment expenses	25,891	27,248
Insurance	33,687	33,737
Amortization	444	553
Depreciation	448,207	444,307
Bad debt expense, net of recoveries	13,161	14,814
Other operating expenses	46,814	48,590
Total Operating Expenses	1,388,194	1,421,886
Operating Loss	(192,148)	(276,809)
Nonoperating Revenues (Expenses)		
Interest income	16,641	19,907
Federal and state grants	14,010	291,258
Other income	-	59,882
Other expense	-	(59,770)
Interest expense	(119,708)	(124,524)
Total Nonoperating Revenues (Expenses)	(89,057)	186,753
Change in Net Position	(281,205)	(90,056)
Net Position, Beginning of Year	6,202,139	6,292,195
Net Position, End of Year	$ 5,920,934	$ 6,202,139

Knox County Utility Commission
Departmental Statements of Cash Flows - Water Department
For the Years Ended December 31, 2012 and 2011

	2012	2011
Cash Flows From Operating Activities		
Receipts from customers	$ 1,170,154	$ 1,164,966
Receipts from other activities	8,151	6,385
Payments to employees	(266,764)	(254,988)
Payments to suppliers	(684,898)	(963,215)
Net Cash Provided (Used) by Operating Activities	226,643	(46,852)
Cash Flows From Capital and Related Financing Activities		
Purchases of property, plant and equipment	(100,255)	(277,176)
Principal payments on debt	(113,000)	(50,000)
Interest payments on debt	(119,708)	(124,524)
Federal, state and local grants	14,010	291,258
Miscellaneous non-operating	-	59,882
Miscellaneous non-operating expense	-	(59,770)
Net Cash Used by Capital and Related Financing Activities	(318,953)	(160,330)
Cash Flows From Investing Activities		
Interest on cash and investments	15,943	18,451
Net Cash Provided by Investing Activities	15,943	18,451
Net Decrease in Cash and Cash Equivalents	(76,367)	(188,731)
Cash and Cash Equivalents at Beginning of Year	662,165	850,896
Cash and Cash Equivalents at End of Year	$ 585,798	$ 662,165
Reconciliation of Cash at End of Year		
Cash and Cash Equivalents	$ 492,918	$ 574,732
Restricted Cash and Cash Equivalents	92,880	87,433
Total Cash at End of Year	$ 585,798	$ 662,165

Knox County Utility Commission
Departmental Statements of Cash Flows - Water Department (Continued)
For the Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of Operating Loss to Net Cash Provided (Used) by Operating Activities:		
Operating loss	$ (192,148)	$ (276,809)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities		
Depreciation	448,207	444,307
Amortization	444	553
Loss on retirement of debt	1,021	-
(Increase) Decrease in:		
Accounts receivable	(2,387)	10,064
Unbilled accounts receivable	(18,212)	18,355
Other receivables	3,013	(3,013)
Inventory	7,214	(9,554)
Prepaid expenses and other assets	(107)	43
Increase (Decrease) in:		
Accounts payable	(20,033)	(231,986)
Customer deposits	(155)	868
Accrued expenses	(214)	320
Net Cash Provided (Used) by Operating Activities	$ 226,643	$ (46,852)

Knox County Utility Commission
Departmental Statements of Net Position - Sewer Department
December 31, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	$ 14,531	$ 11,461
Receivables, less allowance	1,207	1,050
Total Current Assets	15,738	12,511
Noncurrent assets		
Capital Assets		
Pumping equipment	10,618	10,618
Meters and meter installation	95	95
Transmission and distribution plant	529,850	529,850
Vehicles and other equipment	714	714
Lift stations	344,195	344,195
	885,472	885,472
Accumulated depreciation	(166,378)	(140,829)
Net Capital Assets	719,094	744,643
Total Noncurrent Assets	719,094	744,643
Total Assets	734,832	757,154
Liabilities and Net Position		
Liabilities		
Current Liabilities		
Accounts payable	1,063	615
Total Liabilties	1,063	615
Net Position		
Net investment in capital assets	719,094	744,643
Unrestricted	14,675	11,896
Total Net Position	$ 733,769	$ 756,539

Knox County Utility Commission
Departmental Statements of Revenues, Expenses and Changes in Net Position - Sewer Department
For the Years Ended December 31, 2012 and 2011

	2012	2011
Operating Revenues		
Sewer sales	$ 14,528	$ 21,324
Total Operating Revenues	14,528	21,324
Operating Expenses		
Salaries and wages	554	549
Employee benefits	40	40
Utilities	1,029	980
Sewer treatment	9,921	16,493
Depreciation	25,549	25,489
Bad debt expense, net of recoveries	87	-
Other operating expenses	118	25
Total Operating Expenses	37,298	43,576
Operating Loss	(22,770)	(22,252)
Change in Net Position	(22,770)	(22,252)
Net Position, Beginning of Year	756,539	778,791
Net Position, End of Year	$ 733,769	$ 756,539

Knox County Utility Commission
Departmental Statements of Cash Flows - Sewer Department
For the Years Ended December 31, 2012 and 2011

	2012	2011
Cash Flows From Operating Activities		
Receipts from customers	$ 14,371	$ 21,415
Payments to employees	(554)	(549)
Payments to suppliers	(10,747)	(19,755)
Net Cash Provided by Operating Activities	3,070	1,111
Net Increase in Cash and Cash Equivalents	3,070	1,111
Cash and Cash Equivalents at Beginning of Year	11,461	10,350
Cash and Cash Equivalents at End of Year	$ 14,531	$ 11,461
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:		
Operating loss	$ (22,770)	$ (22,252)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities		
Depreciation	25,549	25,489
(Increase) Decrease in:		
Accounts receivable	(157)	90
Increase (Decrease) in:		
Accounts payable	448	(2,216)
Net Cash Provided by Operating Activities	$ 3,070	$ 1,111

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Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance With *Government Auditing Standards*

To the Commissioners
Knox County Utility Commission
Artemus, Kentucky

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities of Knox County Utility Commission, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Knox County Utility Commission's basic financial statements, and have issued our report thereon dated March 22, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Knox County Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control 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 entity's 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 responses to be material weaknesses. (See 2012-1 and 2012-2)

Compliance and Other Matters

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

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Knox County Utility Commission's Response to Findings

Knox County Utility Commission's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Knox County Utility Commission's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Christian Sturgeon & Associates, PSC

Christian Sturgeon & Associates, PSC
London, Kentucky

March 22, 2013

2012-1

Criteria:
As discussed in *Standards for Internal Control in the Federal Government* published by the General Accounting Office of the United States, internal control is an integral component of an organization's management that provides reasonable assurance that an objective of reliable financial reporting is being achieved. Organizations should implement procedures to ensure this objective is achieved.

Condition:
During the audit procedures performed, instances of this objective not being completely achieved were noted.

Cause:
The Commission's limited internal resources prevents the preparation of financial statements and related note disclosures in accordance with generally accepted accounting principles.

Effect:
The Commission was unable to prepare their financial statements and related note disclosures in accordance with generally accepted accounting principles.

Views of responsible officials and planned corrective actions:
The Commission feels that it would not be cost beneficial to hire the personnel required to complete these tasks.

2012-2

Criteria:
As discussed in *Standards for Internal Control in the Federal Government* published by the General Accounting Office of the United States, internal control is an integral component of an organization's management that provides reasonable assurance that an objective of reliable financial reporting is being achieved. Organizations should implement procedures to ensure this objective is achieved.

Condition:
During the audit procedures performed, instances of this objective not being completely achieved were noted.

Cause:
The size of the Commission's office staff does not allow proper segregation of duties with regard to cash handling, billing, accounts receivable bookkeeping, and payroll processing.

Effect:
This condition creates a weakness in internal controls which could result in unauthorized transactions being processed.

Views of responsible officials and planned corrective actions:
The Commission feels that it would not be cost beneficial to hire the personnel required to complete these tasks.