

CLEARWATER DISPOSAL, INC.

P.O. Box 1425
109 South 24th Street
Middlesboro, Kentucky 40965

RECEIVED

August 25, 2005

AUG 26 2005

PUBLIC SERVICE
COMMISSION

Public Service Commission
P.O. Box 615
Frankfort, KY 40602

RE: Case No. 2004-00527

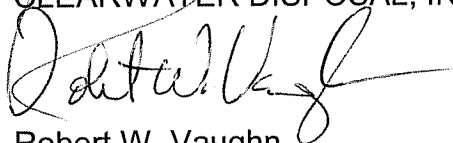
Dear Sir/Madam:

Enclosed are the original and five copies of the requested material in response to items 4, 5, 6, 7, 8a and 8b. These were the items highlighted in your July 20th request.

Please excuse us for being somewhat tardy in responding. I have been out of the office for most of August.

Very truly yours,

CLEARWATER DISPOSAL, INC.



Robert W. Vaughn
Secretary

Item 4

Ambleside

A DEVELOPMENT OF PLANNED COMMUNITIES

July 6, 2005

Dear Ambleside Residents:

The purpose of this letter is to provide everyone with an update on goings-on within Ambleside this summer and fall. Sewer construction, new sewer rates, and the on-going grading project are the topics.

Sewer Construction

Now getting underway is the project to tie the Ambleside sewers to the Middlesboro system. Completion is expected by November.

You will be inconvenienced primarily on Lick Fork Road with the pavement being cut in places for the pipe and manholes. One lane travel will be required at times.

A part of the project is rehabilitation work on sewers on several Ambleside streets. The following will see minor disruption: Wellington Drive, Wellington Court, Stonehenge Way, Nottingham Way, Abbey Lane, Castleford Way and Ennismore Drive.

Funding for the project is through the PRIDE program as a part of the goal of eliminating "package" treatment plants like those in Ambleside. After the connection to the city system, the Ambleside plant will cease operation and a state sanctioned close out plan will be implemented.

New Sewer Rates

Once connected to the City system Middlesboro will bill customers at a rate of \$4.85 per thousand gallons of water used plus any applicable taxes. Maintenance of the sewer system will be by the City.

Clearwater Disposal will cease business once Middlesboro takes over and all accounts collected. Customers are requested to continue to pay Clearwater as usual until notified that the City has taken over. Everyone is requested to bring Clearwater accounts current. Within thirty (30) days after Middlesboro takes over, all accounts will become past due.

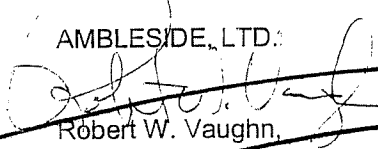
Grade Work Near the Front Entrance

Excavation and grading has begun on the Kings Ridge Community, the last major subdivision in the Ambleside development. Approximately 48 lots are included in Kings Ridge. Sales will begin around mid-year in 2006.

We wish everyone a safe and happy summer.

Very truly yours,

AMBLESIDE, LTD.


Robert W. Vaughn,
President

5. The City of Middlesboro provides public sanitary sewer service for the vast majority of residents of Middlesboro. In addition, they extend sewer service to several residential areas that are located adjacent to the City. Their collection system is primarily a gravity system. They also own approximately 15 sewage lift stations. Their sole wastewater treatment plant is located near the northern city limits boundary. It discharges into Yellow Creek. It is a 2.8 MGD oxidation ditch type plant. The plant routinely meets requirements set forth in their KPDES Discharge Permit.

Arville Anderson is the Wastewater Plant Manager. He is a Class 4 Certified Operator with more than 20 years of experience. Jimmy Anderson is the Sewer Department Superintendent. His primary tasks include the maintenance and routine up keep of the collection system. He also has over 20 years of experience.

6. Middlesboro currently employs six (6) persons who are certified wastewater plant operators. Of these six, three are Class 4 operators, one is a Class 3 operator, one is a Class 2 operator, and one is a Class 1 operator.

8a Clearwater Disposal has never collected customer deposits.
b There are no deposits to return.

**CITY OF MIDDLESBOROUGH, KENTUCKY
REPORT ON AUDIT OF FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
For the Year Ended June 30, 2004**

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Independent Auditor's Report

To the Mayor and City Council
City of Middlesborough, Kentucky

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Middlesborough, Kentucky, as of and for the year ended June 30, 2004, which collectively comprise the basic financial statements of the City's primary government as listed in the table of contents. These financial statements are the responsibility of the City of Middlesborough, Kentucky's management. Our responsibility is to express 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

The City's management has not adopted a methodology for reviewing the collectibility of accounts receivable in the sewer and sanitation funds and, accordingly, has not considered the need to provide an allowance for uncollectible amounts. Accounting principles generally accepted in the United States of America require that an adequate allowance be provided for uncollectible receivables, which would decrease the assets and fund balances and change the revenues in the sewer and sanitation funds. The amount by which this departure would affect the assets, fund balances, and revenues of the sewer and sanitation funds is not reasonably determinable.

The financial statements referred to above include only the primary government of the City of Middlesborough, Kentucky, which consists of all funds, organizations, institutions, agencies, departments, and offices that comprise the City's legal entity. The financial statements do not include financial data for the City's legally separate component units, which accounting principles generally accepted in the United States of America require to be reported with the financial data of the City's primary government. As a result, the primary government financial statements do not purport to and do not, present fairly the financial position of the reporting entity of the City of Middlesborough, Kentucky, as of June 30, 2004, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, except for the effects, if any, of not providing an adequate allowance for uncollectible accounts receivable for the sewer and sanitation funds as described above, the financial statements referred to above present fairly, in all material respects, the respective financial position of the sewer and sanitation funds of the City of Middlesborough, Kentucky, as of June 30, 2004, and the respective changes in financial position.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information for the primary government of the City of Middlesborough, Kentucky, as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note I, the City of Middlesborough, Kentucky has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, Basic financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, as of June 30, 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 1, 2005, on our consideration of the City of Middlesborough, Kentucky’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management’s discussion and analysis and budgetary comparison information on pages 3 through 12 and 44 through 45, are not a required part of the basic financial statements of the City’s primary government, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements of the City of Middlesborough, Kentucky’s primary government. The combining and individual nonmajor fund financial statements, and the schedule of functional expenses are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the City of Middlesborough, Kentucky’s primary government. The combining and individual nonmajor fund financial statements, the schedule of functional expenses and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Martin, Kentucky
March 1, 2005

City of Middlesborough

P.O. Box 756
Middlesboro, Kentucky 40965
(606) 248-5670
Fax (606) 248-1202

BEN HICKMAN
Mayor

TERESA MASSENGILL
City Clerk

Management's Discussion & Analysis For Year Ended June 30, 2004

This discussion and analysis is intended to serve as an introduction to the City's financial statements. Beginning with the fiscal year ended June 30, 2004, the City is implementing Governmental Accounting Standards Board Statement 34, which includes a requirement for this report. The report is designed to be easily readable to those not accustomed to financial reporting and accounting. This report is intended as a companion to the City's annual audit and financial statements, it does not replace them. What follows will be a very general discussion of City activities and our financial position.

OVERVIEW OF OPERATIONS

For the purposes of this report, City operations in three broad categories will be examined, General Governmental Funds, Enterprise Funds and Fiduciary Funds. General Governmental Funds include revenues from government activities such as taxes, fees, licenses, and from intergovernmental sources. These funds are spent for general services associated with municipal operations such as street maintenance, police services, recreation projects, and for the payment of regular debts, bonds, etc.

Enterprise Funds are restricted to business type activities where charges are directly connected to a service provided. The City of Middlesboro primarily operates two enterprise activities, the ambulance service and the sewer service. Direct expenses are charged against revenues in these departments. When possible, other expenses such as insurance are prorated to the extent attributable to the enterprise activity. A third enterprise activity, the sanitation service, has been operated by contract award for over ten years. The City bills and collects residential customer charges and pays the contractor a discounted amount. The relatively small net profit from this activity is intended to cover the postage and personnel costs associated with billing and record keeping.

The City maintains a pension fund (Fiduciary Fund) for police and firefighters. Entry to this system was frozen in 1988 when the City joined the statewide system. The fund income consists of property tax revenue directly apportioned and not shown as revenue for general budget statements. The fund has steady income and declining claims and is in good health.

FINANCIAL HIGHLIGHTS

Revenues – An examination of 2004 General Fund revenues revealed positive growth. Direct revenues, excluding interdepartmental transfers and enterprise funds, grew 2.9% from fiscal 2003. Enterprise fund customer revenues, excluding grant income, increased by 2% for the same period; combined revenue growth was 2.6% in spite of a considerable decrease in Coal Severance income during 2004. This growth was achieved without tax or fee increases.

Expenditures – General Fund operating expenses, excluding intergovernmental programs and transfers, increased by 1.5% this year. Enterprise fund operating expenses excluding depreciation and operating transfers were virtually unchanged (0.1%) compared to 2003. Combined operating expenditures increased by 1.2% and were comfortably under the budgeted amounts.

Special Programs and Revenues – Both revenues and expenditures for ongoing intergovernmental programs such as Municipal Road Aid (MRA) and Local Government Economic Assistance (LGEA) were comparable with recent periods and there were no unusual changes. There was a significant decrease in revenue from the Single County Coal Severance Fund compared to fiscal 2003 (\$412,500 v. \$100,000). These funds are used for special and non-recurring projects and do not affect regular City operations. Also, much of the 2003 Coal Severance funding “flowed through” the City to other agencies such as the Airport and the Little League. These determinations were made at the state level.

The City received three major grant awards in 2004. A grant of nearly \$659,000 from the U.S. Dept of Commerce was used to complete the Carmony Street sewer extension; this was a 100% grant. A grant for over \$212,000 from the U.S. Dept of Transportation completed the renovation of the American Association building. The required 20% match for this grant came from UDAG funds. A FEMA grant in the amount of \$76,000 was awarded to the Fire Department for upgrades to SCBA's. The City also received \$100,000 from Bell County's Coal Severance funds and \$79,000 from the Department for Local Government. These funds will be expended in fiscal 2005 as the required match to a sewer extension grant awarded for the Evans Drive project.

Assets and Liabilities – The City had no significant new land or building acquisitions this year. The completion of the American Association Building renovation will result in additional value to be capitalized. There were additional equipment and vehicle purchases in most departments and those acquisitions will also result in an increase of total assets.

The City incurred no additional long-term debt in fiscal 2004. All current obligations are adequately funded.

BUDGET COMPARISONS

An examination of the fiscal 2004 budgeted to actual revenues and expenditures (table 1) reveals the projected surplus of \$69,620 was understated. The actual surplus of revenues over expenditures was \$476,381. The large surplus was due to several unusual factors and a budgeting anomaly in the police and fire departments. The City received transfers from UDAG and the Bell County Fiscal Court for projects that will not begin until fiscal 2005. These funds were credited to this year's revenue and will appear as part of the beginning balance of the next budget. Sewer Department revenues and expenditures were both overstated for the same reason. Long-term debt in both the police and fire departments was shown on the budget as the entire outstanding balance rather than the amounts due for the budgetary period. This led to the considerable overestimation of General Fund of expenditures.

Table 1

City of Middlesboro Operating Budget FY 2004

	Budget	Actual
Revenues		
General Fund	\$ 4,999,191	\$ 4,065,782
MRA	132,151	152,471
LGEA	55,000	52,755
Ambulance	425,000	554,505
Sewer	<u>1,340,000</u>	<u>1,687,135</u>
Total Revenues	\$ 6,951,342	\$ 6,512,648
Expenditures		
General Fund	\$ 4,943,372	\$ 4,122,538
MRA	131,500	128,154
LGEA	54,000	53,649
Ambulance	415,700	454,059
Sewer	<u>1,336,850</u>	<u>1,277,867</u>
Total Expenditures	<u>6,881,422</u>	<u>6,036,267</u>
Surplus / (Deficit)	<u>\$ 69,920</u>	<u>\$ 476,381</u>

A comparison of actual revenues and expenditures in total for fiscal 2003 v. fiscal 2004 (table 2) shows a steady pattern of growth with the exception of the General Fund. As discussed above, the fiscal 2003 figures contained Coal Severance income and

expenditures for special projects not present in fiscal 2004. The same factors that caused the large surplus in FY2004 also applies to FY2003, both years had grant awards carried forward for ongoing sewer extension projects.

Table 2

**City of Middlesboro
Comparison of Actual Revenues and Expenditures – FY 2004 v. FY 2003**

	2004	2003
Revenues		
General Fund	\$ 4,065,782	\$ 3,997,593
MRA	152,472	141,849
LGEA	52,755	50,089
Ambulance	554,505	585,828
Sewer	<u>1,687,135</u>	<u>1,632,754</u>
Total Revenues	\$ 6,512,649	\$ 6,408,113
Expenditures		
General Fund	\$ 4,122,538	\$ 4,228,958
MRA	128,154	111,768
LGEA	53,649	54,418
Ambulance	454,059	351,015
Sewer	<u>1,277,867</u>	<u>1,226,215</u>
Total Expenditures	<u>6,036,267</u>	<u>5,972,374</u>
Surplus / (Deficit)	<u>\$ 476,382</u>	<u>\$ 435,739</u>

LONG-TERM DEBT

The City's long-term debt consists of five bond issues. Four of these bonds are "Revenue Bonds" and represent limited obligations to the City based on the ability of the revenue producing entity to make payments. Three of the revenue bonds relate to sewer department construction and line extensions and have final maturity dates of 2006, 2010, and 2014. The other revenue bond was issued for the construction of the Police Department to the Middlesboro Kentucky Municipal Improvement Corporation which has a lease agreement with the City. This bond matures in 2026. The final bond is a General Obligation Bond, which means it is secured by the taxing authority of the City. This bond was issued in 1988 and refinanced in 1994 and 2003 and represents the cost of enrolling then current employees into the County Employees Retirement System. This bond matures in 2017. Enterprise activity revenues and debt reserves and general fund

income and reserves are more than sufficient to cover the City's obligations. The total outstanding bonded indebtedness as of June 2004 was \$ 2,005,934.

The City also has long term leases for the purchase of two pumper trucks and a ladder truck for the Fire Department. The final payments will be made during the year ended June 30, 2005.

ENTERPRISE FUNDS

The City's enterprise activities; the ambulance, and sewer & sanitation services, have consistently performed well. The excess revenues are transferred to the General Fund and are a vital component of the City's operations. The combined income statement below (Table 3) demonstrates the overall health of the City's revenue producing departments. It should be noted however, that the sewer department produced grant income that will result in expenditures during the next statement period.

Table 3

City of Middlesboro – Enterprise Funds Combined Income Statement – Year Ended June 30, 2004

	Sewer	Ambulance	Sanitation	
Revenues				
Customer Charges	\$ 979,051	\$ 554,505	\$ 383,106	\$ 1,916,662
Grant Income	662,459			662,459
Intergov. Rev	45,625			45,625
Total Revenues	<u>\$ 1,687,135</u>	<u>\$ 554,505</u>	<u>\$ 383,106</u>	<u>\$ 2,624,746</u>
Expenditures				
Personnel	\$ 407,858	\$ 14,893		\$ 422,751
Administrative	55,330	62,851		118,181
Operations	236,635	45,048		281,683
Service Fees			\$ 334,959	334,959
Interest/Bonds	42,702			42,702
Transfer to GF	100,000	285,000		385,000
Depreciation	435,342	46,267		481,609
Total Expenditures	<u>\$ 1,277,867</u>	<u>\$ 454,059</u>	<u>\$ 334,959</u>	<u>\$ 2,066,885</u>
Net Income (Loss)	<u>\$ 409,268</u>	<u>\$ 100,446</u>	<u>\$ 48,147</u>	<u>\$ 557,861</u>

A review of the combined statement in Table 4 might present a clearer picture of the day-to-day operations of the enterprise activities. These figures are adjusted to exclude grant income and expenses for depreciation and transfers to the General Fund. From this viewpoint, the Ambulance Service appears far more profitable. This must be considered in light of the fact that most of the salaries for this activity are charged to the Fire Department.

The comparison to FY2003 shows appropriate growth for most activities. A decrease in sanitation revenues has been noted and there appears to be an increase in non-payment events. The administration is currently reviewing options for better enforcement and collection.

Table 4

**City of Middlesboro – Enterprise Funds
Combined Statement of Customer Revenues and Operating Expenses
Comparison – FY 2004 to FY 2003**

	2004	2003	% Change
Customer Charges			
Sewer	\$ 979,051	\$ 964,801	1.5
Sanitation	383,106	395,861	-3.2
Ambulance	<u>554,505</u>	<u>518,089</u>	7.0
 Total Revenues*	 <u>\$ 1,916,662</u>	 <u>\$ 1,878,751</u>	 2.0
 Operating Expenses			
Sewer	\$ 742,525	\$ 744,133	-0.1
Sanitation	334,959	339,985	-1.5
Ambulance	<u>122,792</u>	<u>113,032</u>	8.6
 Total Expenses**	 <u>\$ 1,200,276</u>	 <u>\$ 1,197,150</u>	 0.1

* Excluding grant and intergovernmental income

** Excluding depreciation and operating transfers

FIDUCIARY FUND

The Police and Fireman's Pension Fund is funded by property taxes allocated specifically for the fund. The amount of the allocation is set each year as a part of the tax rate ordinance. No new members have entered the fund since 1988, when the City joined the

statewide pension system and the fund's only beneficiaries are those who had already retired on that date. Health insurance is provided for retirees until they reach Medicare eligibility and law allows for annual benefit increases. It is estimated that insurance expenditures will end within two years. The following tables illustrate the continued health of the fund. Revenues are consistently exceeding payments and there is a significant cash balance available. Obviously, the number of retirees will continue to decline and upon dissolution of the system, the fund balance will revert to the City.

Table 5

**Police & Fireman's Pension Fund
Balance Sheet Comparison**

	June 30, 2004	June 30, 2003
ASSETS		
Cash	\$ 293,762	\$ 257,262
Investments	<u>792,420</u>	<u>765,170</u>
Total Assets	\$ 1,086,092	\$ 1,022,432
LIABILITIES & FUND EQUITY		
Liabilities	\$ 0	\$ 0
Fund Equity:		
Retained Earnings	<u>\$ 1,086,092</u>	<u>\$ 1,022,432</u>
Total Liabilities & Fund Equity	\$ 1,086,092	\$ 1,022,432

Table 6

**Police & Fireman's Pension Fund
Revenue & Expenditure Statement Comparison**

	Year Ended June 30, 2004	Year Ended June 30, 2003
REVENUES		
Property Taxes	\$ 337,425	\$ 324,455
Investment Income	<u>30,509</u>	<u>14,389</u>
Total Revenues	\$ 367,934	\$ 338,844
EXPENDITURES		
Benefits Paid	\$ 239,020	\$ 227,546
Health Insurance	<u>65,254</u>	<u>58,807</u>
Total Expenditures	<u>304,274</u>	<u>286,353</u>
Surplus / (Deficit)	\$ 63,660	\$ 52,491

ECONOMIC FACTORS – NEXT YEAR’S BUDGET AND RATES

The City of Middlesboro’s primary sources of general fund revenue are occupational taxes and licenses, insurance premium taxes, franchise fees and property taxes. Enterprise fund revenues are based on direct charges for service. Over the last ten years, rates have been unchanged with two exceptions. The property tax rate was decreased by 25% on two occasions and a cap was placed on residential sewer charges. Despite this, revenues have shown steady increases as wages and property values, etc have risen. With the exception of the closing of the K-Mart store two years ago in the Middlesboro Mall, there have been no significant employment changes in the City. There are no anticipated factors, economic or otherwise, that would impact the City’s budget for 2005-2006.

Budget preparation for the coming year is just beginning. Significant spending increases are expected for personnel costs (salaries, payroll taxes, and pension withholding) and employee health insurance costs. These increases will be partially offset by the retirement of debt for fire trucks scheduled for the current budget period. Other general operating expenses may increase slightly due to normal factors (e.g. rise in utility rates, etc).

Equipment expenditures will remain at levels comparable to the current budget with the exception of increases in the public safety departments. These increases will not be significant as a percentage of the overall budget.

Certain special projects are under consideration. At the time of this writing the Kentucky Legislature is still in session and it is not known if the City will receive money from the Single County Coal Severance Fund. Although this may affect the funding of some special projects, general operations and services are not impacted.

As discussed previously, current growth rates and debt retirement are projected to be sufficient to offset expenditure increases. The City has provided a generous reserve fund for emergencies in addition to restricted balances carried forward for ongoing projects (e.g. sewer extensions, etc). After due consideration of debt service requirements, projected operational spending, construction and maintenance, and calculating reserves for unforeseen expenses, there appears to be no need for rate or fee increases in the coming year and none are planned.

CITY OF MIDDLESBORO, KENTUCKY
Management's Discussion and Analysis - 2004

APPENDIX – ADDITIONAL COMPARATIVE STATEMENTS

City of Middlesboro – General Fund
Revenue Comparison – FY 2004 to FY 2003

	2004	2003	% Change
Property Taxes	\$ 547,802	\$ 527,162	3.9
Licenses & Fees	2,640,565	2,479,214	6.5
Intergovernmental	331,152	580,318	-42.9
Interest	16,024	28,324	-43.4
Service Charges	53,026	44,197	20.0
Other	32,213	23,347	38.0
Operating Transfers	<u>445,000</u>	<u>315,031</u>	41.3
Total Revenues	\$ 4,065,782	\$ 3,997,593	1.7

City of Middlesboro – General Fund
Expenditure Comparison – FY 2004 to FY 2003

	2004	2003	% Change
Administrative	\$ 538,892	\$ 519,593	3.7
Police	1,080,587	1,025,453	5.4
Fire	1,070,037	992,254	7.8
Street	367,328	459,831	-20.0
Parks & Rec.	62,521	111,966	-44.2
General Items	<u>1,003,173</u>	<u>1,119,861</u>	-10.4
Total Expenditures	\$ 4,122,538	\$ 4,228,958	-2.5

**City of Middlesboro – General Fund
Revenues – Year Ended June 30, 2004**

	Budget	Actual
Revenues		
Property Taxes	450,000	547,802
Licenses & Fees	2,268,000	2,640,565
Intergovernmental	291,500	331,152
Interest	20,000	16,024
Service Charges	40,000	53,026
Other	35,000	32,213
Operating Transfers	<u>445,000</u>	<u>445,000</u>
Total General Fund Revenues	3,549,500	4,065,782

**City of Middlesboro – General Fund
Expenditures – Year Ended June 30, 2004**

	Budget	Actual
Expenditures		
Administrative	\$ 575,600	\$ 538,892
Police	1,554,400	1,080,587
Fire	1,080,611	1,070,037
Street	374,000	367,328
Parks & Rec.	159,105	62,521
General Items	<u>1,199,656</u>	<u>1,003,173</u>
Total General Fund Expenditures	\$ 4,943,372	\$ 4,122,538

AUDITED FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

FUND FINANCIAL STATEMENTS

GOVERNMENTAL FUNDS

PROPRIETARY FUNDS

FIDUCIARY FUNDS

NOTES TO FINANCIAL STATEMENTS

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF NET ASSETS
June 30, 2004

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
<u>ASSETS</u>			
Current assets:			
Cash.....	\$ 2,438,520	\$ 2,766,509	\$ 5,205,029
Grants receivable.....	22,285	58,917	81,202
Receivables, net.....	-	608,209	608,209
Loans receivable.....	473,722	-	473,722
Inventories.....	-	5,799	5,799
Total current assets.....	<u>2,934,527</u>	<u>3,439,434</u>	<u>6,373,961</u>
Noncurrent assets:			
Bond issue and deferred bond costs.....	79,858	18,430	98,288
Land.....	1,299,747	345,173	1,644,920
Construction in progress.....	-	40,886	40,886
Property and equipment, net of accumulated depreciation.....	<u>6,383,344</u>	<u>8,855,414</u>	<u>15,238,758</u>
Total noncurrent assets.....	<u>7,762,949</u>	<u>9,259,903</u>	<u>17,022,852</u>
Total assets.....	<u>10,697,476</u>	<u>12,699,337</u>	<u>23,396,813</u>
<u>LIABILITIES</u>			
Current liabilities:			
Accounts payable.....	81,787	97,361	179,148
Accrued payroll liabilities.....	68,130	8,924	77,054
Unearned grant revenue.....	-	179,000	179,000
Due to other governments.....	20,432	-	-
Compensated absences.....	157,362	31,341	188,703
Lease payable.....	88,048	-	88,048
Interest and principal due on bonds.....	<u>94,181</u>	<u>177,800</u>	<u>271,981</u>
Total current liabilities.....	<u>509,940</u>	<u>494,426</u>	<u>983,934</u>
Noncurrent liabilities:			
General obligation bonds payable.....	853,000	-	853,000
Revenue bonds payable.....	476,000	436,016	912,016
Compensated absences.....	<u>100,081</u>	<u>27,021</u>	<u>127,102</u>
Total noncurrent liabilities.....	<u>1,429,081</u>	<u>463,037</u>	<u>1,039,118</u>
Total liabilities.....	<u>1,939,021</u>	<u>957,463</u>	<u>2,896,484</u>
<u>NET ASSETS</u>			
Invested in capital, net of related debt.....	7,107,043	8,469,788	15,576,831
Restricted for:			
Debt service.....	12,489	136,529	149,018
Capital asset repairs.....	23,382	248,272	271,654
Other special revenue.....	1,010,304	-	1,010,304
Unrestricted.....	<u>605,237</u>	<u>2,887,285</u>	<u>3,492,522</u>
Total net assets.....	<u>\$ 8,758,455</u>	<u>\$ 11,741,874</u>	<u>\$ 20,500,329</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
 STATEMENT OF ACTIVITIES
 Year Ended June 30, 2004

FUNCTIONS/PROGRAMS	PROGRAM REVENUES			NET (EXPENSE) REVENUE AND CHANGES IN NET ASSETS			
	EXPENSES	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
Governmental activities:							
General administration.....	\$ 676,067	\$ 267,773	\$ -	\$ -	\$ (408,294)	\$ -	\$ (408,294)
Public protection - police.....	1,340,198	51,339	134,228	5,000	(1,149,631)	-	(1,149,631)
Public protection - fire.....	1,242,159	285	89,085	83,975	(1,068,814)	-	(1,068,814)
Public street service.....	575,682	13,149	158,073	20,397	(384,063)	-	(384,063)
Community development.....	193,639	11,001	38,318	242,805	98,485	-	98,485
Total governmental activities.....	4,027,745	343,547	419,704	352,177	(2,912,317)	-	(2,912,317)
Business-type activities:							
Ambulance.....	169,059	548,802	-	-	-	379,743	379,743
Sanitation.....	334,959	376,643	-	-	-	41,684	41,684
Sewer.....	1,177,868	953,086	-	708,084	-	483,302	483,302
Total business-type activities.....	1,681,886	1,878,531	-	708,084	-	904,729	904,729
Total all activities.....	\$ 5,709,631	\$ 2,222,078	\$ 419,704	\$ 1,060,261	\$ (2,912,317)	\$ 904,729	\$ (2,007,588)
GENERAL REVENUES							
Taxes:							
Property taxes levied for general purposes.....					152,558	-	152,558
Occupational license tax.....					2,171,732	-	2,171,732
Tax levied on insurance premiums.....					337,414	-	337,414
Payments in lieu of taxes.....					57,829	-	57,829
Franchise fees - electric.....					160,349	-	160,349
Franchise fees - cable.....					53,288	-	53,288
					2,933,170	-	2,933,170
Single County Coal Severance Grant - unallocated.....					26,278	-	26,278
Interest earnings.....					16,370	38,131	54,501
Special item - interest paid on pension obligation bond.....					(58,220)	-	(58,220)
Special item - loss on disposition of capital assets.....					(106,863)	-	(106,863)
Special item - receipt of property in loan default.....					300,000	-	300,000
Transfers.....					385,000	(385,000)	-
Total general revenues, special items and transfers.....					3,495,735	(346,869)	3,148,866
Change in net assets.....					583,418	557,860	1,141,278
Net assets, beginning.....					8,175,037	11,184,014	19,359,051
Net assets, ending.....					\$ 8,758,455	\$ 11,741,874	\$ 20,500,329

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2004

	<u>General Fund</u>	<u>Non-major Governmental Funds</u>	<u>Totals</u>
<u>ASSETS</u>			
Cash.....	\$ 1,960,373	\$ 478,147	\$ 2,438,520
Grants receivable.....	-	22,285	22,285
Total assets.....	<u>\$ 1,960,373</u>	<u>\$ 500,432</u>	<u>\$ 2,460,805</u>
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable.....	\$ 52,930	\$ 28,857	\$ 81,787
Accrued payroll and taxes.....	68,130	-	68,130
Due to other governments.....	-	20,432	20,432
Compensated absences.....	157,362	-	157,362
Total liabilities.....	<u>278,422</u>	<u>49,289</u>	<u>327,711</u>
Fund balances:			
Reserved for debt service.....	12,489	-	12,489
Reserved for capital asset repairs.....	23,382	-	23,382
Special revenue funds.....	85,439	451,143	536,582
Unreserved.....	1,560,641	-	1,560,641
Total fund balances.....	<u>1,681,951</u>	<u>451,143</u>	<u>2,133,094</u>
Total liabilities and fund balances.....	<u>\$ 1,960,373</u>	<u>\$ 500,432</u>	<u>\$ 2,460,805</u>

**CITY OF MIDDLESBOROUGH, KENTUCKY
RECONCILIATION OF BALANCE SHEET TO
THE STATEMENT OF NET ASSETS
GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2004**

Total Fund Balance - Governmental Funds **\$ 2,133,094**

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

Capital assets owned by City	(increase in net assets)	7,716,130
Depreciation allocation	(decrease in net assets)	(33,039)

Loans receivable. In past years, the City loaned the proceeds of CDBG and UDAG grants to various businesses. The loans and subsequent repayments of principal and interest are restricted to economic development. As those funds do not represent funds available to finance current City operations, they are recorded in the funds as other financing sources. However, in the statement of net assets, the loans receivable are required to be reported as an asset of the City.

Loan receivables added to assets	(increase in net assets)	473,722
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Compensated absences. Vacation and sick leave not currently payable is recorded as a liability in the statement of net assets and an increase of salary costs in the statement of activities. It is not recorded in the funds as it is not a use of current resources.

Non-current compensated absences added to liabilities	(decrease in net assets)	(100,081)
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Long-term debt. The principal balance on outstanding debt is not recorded in the fund financial statements because it is not due and payable in the current period. Repayment of principal is recorded as an expenditure of the fund. In the statement of net assets, outstanding debt is recorded as a liability and payment of principal is treated as a reduction of that liability. Bond issue costs, expensed in the funds, are amortized over the life of the bond in the statement of activities. Likewise, interest is accrued between payment dates, while it is recorded as an expense in the funds.

Capital leases obligations added to liabilities	(decrease in net assets)	(88,048)
Interest and bond payments due in one year	(decrease in net assets)	(94,181)
Principal balance on bonds less amounts due in one year	(decrease in net assets)	(1,329,000)
Unamortized bond charges included in net assets	(increase in net assets)	79,858

Net Assets - Statement of Net Assets **\$ 8,758,455**

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Year Ended June 30, 2004

	General Fund	Non-major Governmental Funds	Totals
REVENUES			
Property taxes.....	\$ 547,802	\$ -	\$ 547,802
Licenses, permits and fees.....	2,640,565	-	2,640,565
Intergovernmental programs.....	331,152	438,794	769,946
Investment income.....	16,106	973	17,079
Service charges.....	61,101	-	61,101
Other.....	24,056	-	24,056
Total revenues.....	3,620,782	439,767	4,060,549
EXPENDITURES			
Current:			
General administration.....	1,455,191	-	1,455,191
Public protection - police.....	965,760	3,649	969,409
Public protection - fire.....	886,436	-	886,436
Public street service.....	345,501	118,154	463,655
Community development.....	62,521	105,760	168,281
Debt service:			
Principal.....	116,638	-	116,638
Interest.....	129,090	-	129,090
Capital outlay.....	189,102	299,570	488,672
Total expenditures.....	4,150,239	527,133	4,677,372
Excess (deficiency) of revenues over expenditures.....	(529,457)	(87,366)	(616,823)
OTHER FINANCING SOURCES (USES)			
Operating transfers in.....	445,000	556	445,556
Operating transfers out.....	(556)	(60,000)	(60,556)
Refunding bonds issued.....	916,000	-	916,000
Payment to bond refunding agent.....	(887,743)	-	(887,743)
Interest & principal repayments on			
CDBG and UDAG loans.....	-	156,414	156,414
Total other financing sources.....	472,701	96,970	569,671
Excess(deficiency) of revenues and other sources over expenditures.....	(56,756)	9,604	(47,152)
Fund balance, beginning of year as adjusted.....	1,738,707	441,539	2,180,246
Fund balance, end of year.....	\$ 1,681,951	\$ 451,143	\$ 2,133,094

CITY OF MIDDLESBOROUGH, KENTUCKY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL ACTIVITIES
Year Ended June 30, 2004

Net Change in Fund Balance - Governmental Funds \$ (47,152)

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

Capital outlay removed from expenditures	(increase in net assets)	488,672
Depreciation included in expenses	(decrease in net assets)	(33,039)
Capital asset acquisition due to loan default	(increase in net assets)	300,000

Disposition of capital assets. Proceeds from the sale of City property are recorded in the fund financial statements as other financial sources. In the statement of activities, the original cost of the assets as reported in the statement of net assets less the proceeds is reported as a loss on disposition of capital assets. (114,484)

Loans receivable. In past years, the City loaned the proceeds of CDBG and UDAG grants to various businesses. The loans and subsequent repayments of principal and interest are restricted to economic development. As those funds do not represent funds available to finance current City operations, they are recorded in the funds as other financing sources. However, in the statement of net assets, the loans receivable are required to be reported as an asset of the City. Principal payments are recorded as a reduction of the asset, and interest payments are treated as an operating grant to the City's community development function.

Principal repayments removed from other sources	(decrease in net assets)	(118,096)
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Compensated absences. Vacation and sick leave not currently payable is recorded as a liability in the statement of net assets and an increase of salary costs in the statement of activities. It is not recorded in the funds as it is not a use of current resources.

Net increase in non-current compensated absences	(decrease in net assets)	(15,501)
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Long-term debt. The principal balance on outstanding debt is not recorded in the fund financial statements because it is not due and payable in the current period. Repayment of principal is recorded as an expenditure of the fund. In the statement of net assets, outstanding debt is recorded as a liability and payment of principal is treated as a reduction of that liability. Bond issue costs, expensed in the funds, are amortized over the life of the bond in the statement of activities. Likewise, interest is accrued between payment dates, while it is recorded as an expense in the funds.

Principal repayments removed from expenditures	(increase in net assets)	116,638
Accrued interest removed from expenditures	(increase in net assets)	12,522
Amortized bond costs added to expenditures	(decrease in net assets)	(6,142)

Bond refunding. GASB #34 requires that the face value of any bond issued in a refunding be recorded as an other financing source in the fund financial statements. Proceeds held by the escrow agent are recorded as an other financing use and bond issue costs are recorded as an operating expenditure. In the government-wide financial statements, the bonds are recorded in the statement of net assets and bond issue costs are amortized over the life of the bond.

Par value of refunding bond removed from sources	(decrease in net assets)	(916,000)
Amounts held by escrow agent removed from uses	(increase in net assets)	887,743
Bond issue costs removed from expenditures	(increase in net assets)	28,257

Net Change in Net Assets - Statement of Activities \$ 583,418

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2004

	Ambulance Fund	Sanitation Fund	Sewer Fund	Total
ASSETS				
Current assets:				
Cash.....	\$ 814,220	\$ 408,267	\$ 1,544,022	\$ 2,766,509
Grants receivable.....	-	-	58,917	58,917
Receivables, net.....	293,308	136,305	178,596	608,209
Inventories.....	-	-	5,799	5,799
Total current assets.....	1,107,528	544,572	1,787,334	3,439,434
Noncurrent assets:				
Bond issue costs.....	-	-	4,066	4,066
Deferred bond costs.....	-	-	14,364	14,364
Land.....	-	-	345,173	345,173
Construction in progress.....	-	-	40,886	40,886
Property and equipment, net of accumulated depreciation.....	111,887	-	8,743,527	8,855,414
Total noncurrent assets.....	111,887	-	9,148,016	9,259,903
Total assets.....	1,219,415	544,572	10,935,350	12,699,337
LIABILITIES				
Current liabilities:				
Accounts payable.....	9,850	-	87,511	97,361
Accrued payroll liabilities.....	-	-	8,924	8,924
Unearned grant revenue.....	-	-	179,000	179,000
Compensated absences.....	-	-	31,341	31,341
Payable from restricted assets.....	-	-	177,800	177,800
Total current liabilities.....	9,850	-	484,576	494,426
Noncurrent liabilities:				
Bonds payable.....	-	-	436,016	436,016
Compensated absences.....	-	-	27,021	27,021
Total noncurrent liabilities.....	-	-	463,037	463,037
Total liabilities.....	9,850	-	947,613	957,463
NET ASSETS				
Invested in capital, net of related debt.....	111,887	-	8,357,901	8,469,788
Restricted for:				
Debt service.....	-	-	136,529	136,529
Capital asset repairs.....	-	-	248,272	248,272
Unrestricted.....	1,097,678	544,572	1,245,035	2,887,285
Total net assets.....	\$ 1,209,565	\$ 544,572	\$ 9,987,737	\$ 11,741,874

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
Year Ended June 30, 2004

	Ambulance Fund	Sanitation Fund	Sewer Fund	Total
<u>OPERATING REVENUES</u>				
Charges for services.....	\$ 547,846	\$ 376,643	\$ 917,597	\$ 1,842,086
Penalty and interest.....	-	-	27,535	27,535
Connection fees.....	-	-	6,360	6,360
Operating grants.....	-	-	-	-
Miscellaneous income.....	956	-	1,594	2,550
Total operating revenues.....	548,802	376,643	953,086	1,878,531
<u>OPERATING EXPENSES</u>				
Salaries and benefits.....	12,643	-	402,982	415,625
Contractual services.....	46,981	334,959	29,622	411,562
Utilities.....	861	-	76,874	77,735
Maintenance and repairs.....	5,946	-	101,454	107,400
Other supplies and expenses.....	36,361	-	68,891	105,252
Insurance expense.....	20,000	-	20,000	40,000
Depreciation.....	46,267	-	435,342	481,609
Total operating expenses.....	169,059	334,959	1,135,165	1,639,183
Operating income (loss).....	379,743	41,684	(182,079)	239,348
<u>NON-OPERATING REVENUES (EXPENSES)</u>				
Interest income.....	5,703	6,462	25,966	38,131
Interest expense.....	-	-	(34,592)	(34,592)
Amortization of bond issue cost.....	-	-	(8,111)	(8,111)
Total non-operating revenues (expenses).....	5,703	6,462	(16,737)	(4,572)
Income (loss) before contributions and transfers.....	385,446	48,146	(198,816)	234,776
Capital contributions.....	-	-	708,084	708,084
Transfers in.....	-	-	-	-
Transfers out.....	(285,000)	-	(100,000)	(385,000)
	(285,000)	-	608,084	323,084
	100,446	48,146	409,268	557,860
Change in net assets.....				
Net assets, beginning of year as adjusted.....	1,109,119	496,426	9,578,469	11,184,014
Net assets, end of year.....	\$ 1,209,565	\$ 544,572	\$ 9,987,737	\$ 11,741,874

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
Year Ended June 30, 2004

	Ambulance Fund	Sanitation Fund	Sewer Fund	Total
CASH FLOWS from operating activities:				
Receipts from customers.....	\$ 519,440	\$ 344,711	\$ 936,673	\$ 1,800,824
Payments to suppliers.....	(107,126)	(334,959)	(386,329)	(828,414)
Payments to employees.....	(10,679)	-	(304,794)	(315,473)
Net cash provided by operating activities.....	401,635	9,752	245,550	656,937
CASH FLOWS from non-capital financing activities:				
Operating transfers to general fund.....	(285,000)	-	(100,000)	(385,000)
Net cash provided by non-capital financing activities.....	(285,000)	-	(100,000)	(385,000)
CASH FLOWS from capital and related financing activities:				
Acquisition of capital assets.....	-	-	(721,220)	(721,220)
Proceeds of capital grant.....	-	-	887,084	887,084
Principal and revenue bond maturities.....	-	-	(161,751)	(161,751)
Interest paid on loan and revenue bond maturities.....	-	-	(34,592)	(34,592)
Net cash (used) by capital and related financing activities.....	-	-	(30,479)	(30,479)
CASH FLOWS from investing activities:				
Interest income.....	5,704	6,462	25,966	38,132
Net cash provided by investing activities.....	5,704	6,462	25,966	38,132
Net increase (decrease) in cash and cash equivalents.....	122,339	16,214	141,037	664,590
Balances, beginning of year.....	691,881	392,053	1,402,985	2,486,919
Balances, end of year.....	\$ 814,220	\$ 408,267	\$ 1,544,022	\$ 2,766,509
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:				
Operating income (loss).....	\$ 379,743	\$ 41,684	\$ (182,079)	\$ 239,348
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation.....	46,267	-	435,342	481,609
(Increase) decrease in accounts receivable (net).....	(29,274)	(31,932)	(16,413)	(77,619)
(Increase) decrease in grants receivable.....	-	-	9,925	9,925
Increase (decrease) in accounts payable.....	4,899	-	(10,413)	(5,514)
Increase (decrease) in accrued current liabilities.....	-	-	1,911	1,911
Increase (decrease) in compensated absences.....	-	-	7,277	7,277
Net cash provided by operating activities.....	\$ 401,635	\$ 9,752	\$ 245,550	\$ 656,937

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUND
June 30, 2004

	<u>P&F Pension Fund</u>
<u>ASSETS</u>	
Cash and cash equivalents.....	\$ 1,086,092
Total assets.....	<u>1,086,092</u>
 <u>NET ASSETS</u>	
Held in trust for pension benefits.....	<u>\$ 1,086,092</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FIDUCIARY FUND
Year Ended June 30, 2004

	<u>P&F Pension Fund</u>
<u>ADDITIONS</u>	
Employer contributions.....	\$ 337,425
Investment income.....	<u>30,509</u>
Total additions.....	<u>367,934</u>
<u>DEDUCTIONS</u>	
Pension benefits paid.....	239,020
Health insurance.....	<u>65,254</u>
Total deductions.....	<u>304,274</u>
Change in net assets.....	63,660
Net assets, beginning of year.....	<u>1,022,432</u>
Net assets, end of year.....	<u>\$ 1,086,092</u>

See accompanying notes to financial statements.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General Statement

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

The accounting and reporting policies of the City relating to the funds included in the accompanying financial statements conform to the accounting principles generally accepted accounting principles (GAAP). Generally accepted accounting principles for local governments included those principles prescribed by the Government Accounting Standards Board (GASB), the American Institute of Certified Public Accountants in the publication entitled Audits of State and Local Governmental Units and by the Financial Accounting Standards Board (when applicable).

For the year ended June 30, 2004, the City implemented the new financial reporting requirements of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for States and Local Governments*. As a result, an entirely new financial presentation format has been implemented. For the first time the financial statements include:

- a Management Discussion and Analysis (MD&A) section providing an analysis of the City's overall financial position and results of operations
- financial statements prepared using full accrual accounting for all of the City's activities
- a focus on the major funds in the financial statements

B. Financial Reporting Entity

The City's basic financial statements include the accounts of all the accounts of the primary government. They do not include any financial data relating to the City's legally separate component units. The criteria for including organizations as component units within the City's reporting entity is set forth in Section 2100 of GASB's Codification of Governmental Accounting and Financial Reporting Standards and primarily includes those organizations over which the City exercises significant operational or functional control. The criteria includes whether:

- the organization is legally separate (can sue or be sued in their own name)
- the City holds the corporate powers of organization
- the City appoints a voting majority of the organization's board
- the City is able to impose its will on the organization
- the organization has the potential to impose a financial burden on the City
- the organization is fiscally dependent on the City

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

(Financial reporting entity continued)

Based on the criteria listed above, the Middlesborough/Bell County Airport Board, the Municipal Housing Authority, the Library Board and the Tourism Commission are not considered component units of the City of Middlesborough because the City's authority generally does not extend beyond making appointments. The City's one component unit, the Bell County Industrial Foundation, administers the City's revolving loan fund. City council must approve all loans from this fund; however, the City council does not appoint board members nor does it approve management, budgeting or policy decisions of the Foundation. The cash balances of the Foundation are independently audited.

C. Basic of Presentation

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

The statement of activities demonstrate the degree to which the direct expense of a given program or function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific program. They include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by the program and operating and capital grants and contributions restricted to meeting the operational or capital requirements or a particular program. Taxes and other items not properly allocated to program revenues are reported as general revenues.

Fund Financial Statements/Governmental Funds

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

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

General Fund

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

Special Revenue Funds

Special revenue funds are used to account for the proceeds of specific revenue sources that are restricted by law to be expended for specific purposes. The City currently maintains six special revenue funds. The municipal road aid fund is funded by taxes collected by the Commonwealth of Kentucky through its highway use tax and is restricted to providing repairs and maintenance to City streets. The local government economic assistance fund (LGEA) is funded through monies received from coal severance taxes and is restricted to public safety, community development and other specified non-administrative funds. The Local Law Enforcement Block Grant is a federally funded program that provides funds for equipment acquisition. The UDAG repayment fund is maintained to collect the principle and interest payments the City receives for CDBG and UDAG grants received by the City in past years and then loaned to local businesses to stimulate economic development. The use of the funds repaid is restricted to the original purposes of the grants. Two other special revenue funds, the American Association Building fund and the flood control fund are maintained to account for funds received to complete capital projects and will be officially closed when each project is complete.

Proprietary Funds

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

The sewer and sanitation funds report activities which are financed and operated in a manner similar to private business enterprise where the intent of the governing body is that the costs (including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. City employees perform sewer operations. The City has contracted with an outside provider to perform sanitation services. City employees administer the billing and collection functions of both funds.

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

Fiduciary Funds

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

D. Measurement Focus/Basis of Accounting

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

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

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

E. Budgetary Control

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

F. Cash and Investments

Cash of all funds are maintained in interest bearing checking/savings accounts or certificates of deposit.

G. Receivables

Receivables in business-type proprietary funds represent revenues earned or accrued for sewer, sanitation or ambulance services provided through June 30, 2004. In the government-wide financial statements, loans receivables record amounts outstanding on past government grants awarded to the City for loan to certain local businesses to further economic and community development. Details of agreements are discussed in subsequent notes. In both the fund and government-wide financial statements, grants receivable represent amounts due from grantor agencies that are essentially a reimbursement of costs incurred by the City at June 30, 2004.

The City has not adopted a policy to review uncollected accounts receivable in the sewer and sanitation funds. Accounts receivable for services provided are recorded in total, although they represent an extended period of unpaid collections. Generally accepted accounting principles require the establishment of an allowance for doubtful accounts.

H. Fund Changes and Transactions Between Funds

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

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

I. Restricted Net Assets/ Reserved Fund Balances

Certain resources are set aside in accordance with bond ordinances, and other legal or contractual agreements and are not available to fund routine operations. These are classified as restricted assets on the statement of net assets and are reserved in the fund balances of the governmental fund financial statements. Other monies have been similarly designated by the City Council to be invested for future replacement of property and equipment or rate reduction. Designations are not legal restrictions of use and are not recorded on the financial statements. Designations in the sewer fund total \$474,902. \$35,000 is appropriated annually.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

J. Property, Plant and Equipment

Capital assets, which include property, plant and equipment are reported in the applicable governmental or business-type activities columns in the government-wide financial statements and in the fund financial statements for proprietary funds. All assets are recorded at historical cost or estimated historical cost. Donated fixed assets are recorded at fair market value on the date donated. The City does not include public domain ("infrastructure") general fixed assets such as roads, bridges, curbs and gutters, streets and sidewalks and drainage systems acquired before July 1, 2004 with other capital assets for reporting purposes. After the implementation of GASB 34, on July 1, 2004, all infrastructure asset costs will be recorded in the City's capital asset inventory. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized.

Assets capitalized have an original cost of \$5,000 or more. Depreciation is calculated on each class of depreciable property using the straight-line method. Estimated useful lives are as follows:

Buildings	20-50 years
Land Improvements	10-50 years
Sewer System	40 years
Machinery and Equipment	5-20 years
Vehicles	5-10 years
Infrastructure	15-50 years

Under the provisions of GASB 34, the City was not required to estimate the past cost and depreciable value of the capital assets owned by the City and formerly inventoried in the General Fixed Asset account group. In the government-wide financial statements, all capital assets acquired or placed in service after July 1, 2004 are depreciated according to the estimated useful lives listed above.

K. Compensated Absences

The City's policy allows employees to accumulate a maximum of 288 hours of unused sick leave and 192 hours of vacation leave. Employees are compensated for excess sick leave hours at the regular rate of pay each year in December. All excess vacation hours are lost after December 31.

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

II. DEPOSITS AND INVESTMENTS

The City's deposits are categorized to give an indication of the level of risk assumed by the City at June 30, 2004. The categories are described as follows:

- Category 1 Insured or collateralized with securities held by the City or by its agent in the City's name.
- Category 2 Collateralized with securities held by the pledging financial institution's trust department in the City's name.
- Category 3 Uncollateralized.

	Bank <u>Amount</u>	Category			Carrying <u>Amount</u>
		<u>1</u>	<u>2</u>	<u>3</u>	
Deposits	\$3,535,399	200,000	3,335,399	-	\$3,616,492
C.D.s	<u>2,754,722</u>	<u>200,000</u>	<u>2,554,722</u>	-	<u>2,754,722</u>
	<u>\$6,291,121</u>	<u>400,000</u>	<u>5,890,121</u>	-	<u>\$6,371,214</u>

The City's deposits were collateralized at June 30, 2004 with \$400,000 FDIC insurance and additional pledged securities of \$6,000,000 par value.

III. LOANS RECEIVABLE

In past years, the City has entered into various agreements with developers and local business leaders to loan Community and Urban Development Block Grants to encourage economic growth and enhance the community facilities. The CDBG and UDAG agreements require the City to use the proceeds from interest and principle repayment for further community and economic development as specified in Sec. 5305 Activities eligible for assistance.

A. Cumberland Gap Provision

During the past year, the City received \$104,285 in principal and interest from the Cumberland Gap Provision, the developer of a local tourist attraction/arts and craft industry. The original loan agreement of May 1991 for \$910,000 stated a repayment term of ten years at three percent interest. Balance at June 30, 2004 was \$85,858 with pay-off anticipated April 1, 2005. The City remitted \$104,285 to the Bell County Industrial Foundation, the administrator of the City's revolving loan fund. Twenty percent of these monies may be expended on administration of the fund with the balance held for loans to eligible businesses within the City.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

(Loans receivable continued)

B. Moore Medical

In 1987 and 1988, the City provided CDBG and UDAG funds totaling \$504,381 to assist in the development of a medical complex and senior citizens center. Interest of three percent per year accrued on the loans until repayment began in 1992 and 1996. For the year ended June 30, 2004, the City received \$43,754 in interest and principal payments. These were deposited into the City's special revenue fund, the UDAG repayment account. At June 30, 2004, the unpaid balance of the Moore Medical loans totaled \$387,863. Under the current debt repayment schedules, the loans will be paid in full in 2010.

C. Middlesborough Mall/ Default on Obligation

In 1981, the City received a \$2,000,000 UDAG grant that it loaned to David Hocker & Associates to purchase the land to build a shopping mall. The original agreement was secured by a tract of commercial property valued at \$300,000 that was duly recorded in December 1981. The original agreement called for an annual interest payment of 1% of the unpaid balance and 15% of the net cash flows of the shopping center. In 1988, the City agreed to refinance the debt. In 1993, the City agreed to a subordination agreement to allow the developer to obtain a new mortgage and the developer agreed to pay \$10,000 on the principal and begin making monthly installments on the 1% annual interest due. In 1999, the City agreed to a subordination agreement to allow the developer to refinance the debt. The City received \$200,000 repayment of principal.

For the year ended June 30, 2004, the City received \$8,374 in interest payments. Those monies were deposited into the City's separate UDAG repayment fund to be disbursed on eligible activities as specified in Sec. 5305. Activities eligible for assistance.

In January 2004, the primary mortgagor issued the developer a notice of default of obligation and assumed management of the property. The City Council formally accepted the deed to the property that collateralized the original agreement on March 16, 2004. The agreement values the property at \$300,000 and restricts its use to public purposes for fifty years. Acquisition of the property is recorded in the government-wide statement of activities as a special item – receipt of property in loan default and is included in net capital assets in the statement of net assets.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

IV. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, follows:

	Balance 6/30/03	Additions & Adjustments	Retirements & Transfers	Balance 6/30/04
<u>Governmental Activities</u>				
Land	\$1,299,747	\$ -0-	\$ -0-	\$1,299,747
Buildings	3,622,961	585,991	-0-	4,208,952
Equipment	615,666	115,658	51,117	680,207
Vehicles	1,503,568	87,023	63,367	1,527,224
Total capital assets	\$7,041,942	\$788,672	\$114,484	\$7,716,130
Less: Accumulated depreciation	-0-	33,039	-0-	33,039
Net capital assets				<u>\$7,683,091</u>
<u>Business-type Activities</u>				
Land	\$ 345,173	\$ -0-	\$ -0-	\$ 345,173
Construction in progress	29,000	11,886	-0-	40,886
Undepreciated assets	374,173	11,886	-0-	386,059
Buildings	18,000	-0-	-0-	18,000
Sewer plant	12,687,233	663,709	-0-	13,350,942
Equipment	1,866,564	-0-	12,495	1,854,069
Vehicles	437,919	45,625	24,850	458,694
Total depreciable assets	15,009,716	709,334	37,345	15,681,705
Total capital assets	15,383,889	721,220	37,345	16,067,764
Less: Accumulated depreciation	6,382,027	481,609	37,345	6,826,291
Net capital assets				<u>\$9,241,473</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

V. LONG-TERM DEBT

A. Outstanding Debt

Bonds payable

At June 30, 2004, revenue bonds payable consisted of the following individual issues:

	<u>Governmental</u>	<u>Proprietary</u>
Sewer System Refunding and Improvement Revenue Bonds Series A , dated April 1, 1970 payable in annual installments 4.75%, Final maturity April 2010		\$ 273,000
Sewer System Refunding Revenue Bonds , Series of 1996, dated May 1, 1996, payable in annual installments 4.7%, Final maturity April, 2006		\$ 245,000
Middlesborough, Kentucky, Municipal Improvement Corporation Mortgage Revenue Bonds , Series of 1996, payable in annual installments 5%, Final maturity January, 2026	\$ 488,000	
Kentucky Infrastructure Authority, Fund A , dated December, 1991, payable semi-annually 1.9%, through June, 2014		\$ 91,934
Kentucky League of Cities Funding Trust General Obligation Refunding Bonds dated September 1, 2003 payable in annual installments 2.0%-4.5%, Final maturity August, 2017	\$ 908,000	-
Total bond principal, June 30, 2004	\$ 1,396,000	\$ 609,934
<i>Included in Interest and Principal due on Bonds in the Statement of Net Assets</i>	<u>67,000</u>	<u>173,918</u>
	<u>\$ 1,329,000</u>	<u>\$ 436,016</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

(Long-term debt continued)

Revenue Bonds

The Sewer System Revenue Bonds. The Sewer System Revenue Bonds are limited obligations of the City and do not constitute an indebtedness or pledge of the full faith and taxing power of the City. Principal and interest are payable from the income and revenues derived from the operation of the City's sewer system.

The Sewer System Refunding and Improvement Revenue Bonds, Series A, B, and C, were issued April 1970 in the amount of \$1,244,000 to construct the original sewage treatment plant. The Sewer System Refunding Revenue Bonds, Series of 1996, were issued to provide an irrevocable escrow for the purpose of advancing and defeasing Sewer Revenue Bonds, Series D, of 1986, dated April 1, 1986, and to pay all costs incident to the issuance of the 1996 bonds.

Municipal Improvement Corporation Mortgage Revenue Bonds. In November 1996, the City issued \$551,000 in mortgage revenue bonds for the purpose of financing the cost of acquisition, construction, and equipping the Police Department/Public Safety Building. The bonds are payable from the gross revenues and rental income of the facility derived from the lease of the property to the City of Middlesborough.

The bonds were purchased by the Rural Development / U.S. Department of Agriculture, bear an interest rate of 5%, payable in January and July through the year 2026, and are secured by the lease agreement and a fore-closeable mortgage lien against the City.

Kentucky Infrastructure Authority. The City entered into an agreement with the Kentucky Infrastructure Authority in December 1991, to borrow \$178,085 at 1.9% interest to provide funding for additional sewer lines.

General Obligation Bonds/ Debt Refunding

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

Due to favorable interest rates, in September of 2003, \$916,000 of series 2003 General Obligation Refunding Bonds were issued to advance refund \$830,000 of the City's previously issued and outstanding Series 1994 KLC bonds. Proceeds of \$887,743 were deposited with an escrow agent to continue interest payments until the bonds were old bonds were redeemed in August 2004. The re-acquisition price

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

(Long Term Debt continued)

exceeded the net carrying amount of the old debt by \$57,743 and bond issue costs totaled \$28,257. These costs are recorded as a deferred asset in the statement of net assets and are amortized over the life of the bond. In the fund financial statements the face value of the new bonds and the amount paid to the escrow agent to defease the old bonds is reported as other financing sources (uses). Bond issue costs are recorded as an expenditure of the administrative function of the general fund. The old bonds are considered to be defeased and the unredeemed balance of the bonds is not a liability of the City at June 30, 2004.

These new refunding bonds were issued at interest rates ranging from 2.0% to 4.5% and are to mature in August 2017. The City expects to save \$85,000 (~ \$67,000 net present value) in interest due on the newly issued bonds as a result of the refunding. These bonds are direct obligations issued on a pledge of the general taxing power of the City to repay its debt obligations

Reserves

The bond ordinances require the City establish reserves to facilitate the payment of principal and interest as it comes due, and to provide for future extraordinary repairs and replacement of the Sewer System and Public Safety Building. The City has adequately funded the reserve accounts in compliance with the bond ordinances.

The City's reserves at June 30, 2004 are summarized as follows:

	<u>Governmental Activities</u>	<u>Business-type Activities</u>
<u>Restricted assets</u>		
Bond-sinking fund	\$ 12,489	\$136,529
Depreciation	<u>23,382</u>	<u>248,272</u>
	<u>\$ 35,871</u>	<u>\$384,801</u>

Capital leases

The City has entered into two lease agreements to acquire fire rescue equipment. The final payments will be made in fiscal year ended June 30, 2005.

Compensated absences

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

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

B. Changes in Outstanding Debt

Transactions for the year ended June 30, 2004 are summarized as follows:

	Balance 6/30/03	Issues or Additions	Payments or Expenditures	Balance 6/30/04
<u>Governmental Activities</u>				
General obligation bonds	\$ 844,074	\$916,000	\$ 852,074	\$ 908,000
Revenue bonds	500,000	-0-	12,000	488,000
Capital leases	170,612	-0-	82,564	88,048
Compensated absences	84,580	15,501	-0-	100,081
Total	\$1,599,266	\$931,501	\$ 946,638	\$1,584,129
<u>Business-type Activities</u>				
Revenue bonds	\$ 771,685	-0-	161,751	\$ 609,934
Compensated absences	22,145	4,876	-0-	27,021
Total	\$ 793,830	\$ 4,876	\$ 161,751	\$ 636,955
Total all fund types	\$2,393,096	\$936,377	\$1,108,389	\$2,221,084

C. Annual Requirements to Retire Debt Obligations

Fiscal Year End	<u>Governmental Activities</u>		<u>Business-type Activities</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005	67,000	55,152	173,918	27,047
2006	66,000	53,472	181,088	18,739
2007	71,000	51,722	59,262	9,958
2008	69,000	49,806	62,639	7,407
2009	74,000	47,663	87,802	5,618
2010-2014	414,000	194,381	45,225	2,377
2015-2019	418,000	99,421		
2020-2024	148,000	40,100		
2025-2026	69,000	5,200		
	\$ 1,396,000	\$ 596,917	\$ 609,934	\$ 71,146

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

VI. INTERFUND TRANSFERS

Interfund transfers during the year ended June 30, 2004 were as follows:

	<u>Operating Transfers In</u>	<u>Operating Transfers Out</u>
<u>Governmental funds</u>		
General Fund	\$445,000	\$ 556
Municipal Road Aid	-0-	10,000
Coal and Mineral Severance Tax	-0-	50,000
LGEA	556	-0-
Total governmental	<u>445,556</u>	<u>\$ 60,556</u>
<u>Business-type activities</u>		
Ambulance	-0-	285,000
Sewer	-0-	100,000
Total business-type	<u>0-</u>	<u>385,000</u>
Total transfers	<u>\$445,556</u>	<u>\$445,556</u>

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

VII. PROPERTY TAX CALENDAR

Property taxes for fiscal year ended June 30, 2004 were levied August 5, 2003, on the assessed valuation of property located within the City limits as of January 1, 2003, the lien date. The due date and collection periods of all property taxes, exclusive of vehicle taxes, are as follows:

Due date for payment: December 31, 2003

2% discount period: to November 30, 2003

Face value payment dates: to December 31, 2003

Delinquent date, 10% penalty, 1% interest per month: January 1, 2004

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

VIII. PENSION PLAN

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

A. The Police and Fireman's Retirement Fund

The City contributes to a single employer retirement fund for eligible employees of the Police and Fire Department. In August 1988, the City froze admission of new entrants who now join the statewide County Employees Retirement System. Members who had already retired at August 1988 remained in the plan and continue to receive monthly benefits. At June 30, 2004, the fund had fourteen members or beneficiaries receiving annuities. The pension board may order annual increases in retiree and beneficiary benefits up to the increase in the consumer price index for that year, to a maximum of 5%.

The City allocates a portion of property tax collections to the fund. For the year ended June 30, 2004, 68.79% of all real and personal property taxes collected were remitted to the pension fund.

B. County Employee's Retirement System

Full-time employees of the City of Middlesborough participate in the statewide County Employee's Retirement System (CERS), a multiple-employer public retirement system. Covered employees are required by statute to contribute 5.0% of their creditable compensation to the plan. Members occupying hazardous positions contribute at a rate of 8% of their creditable compensation. Employer contribution rates are determined by the Board of Trustees of Kentucky Retirement Systems each biennium. The current required rates are 7.34% and 18.51% for non-hazardous and hazardous employees, respectively.

The City's payroll for eligible employees covered by the fund for the year ended June 30, 2004 totaled \$2,503,527; payroll for all employees (including city pensioners) totaled \$2,810,718. The City made required contributions of \$300,887. Employee contributions totaled \$173,946.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess CERS funding status on a going concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and to make comparisons among public employee retirement systems and employers. CERS does not make separate measurements of assets and pension benefit obligations for the individual employer. The pension benefit obligation, net assets available for benefits, and historical trend information for the entire system will be presented in the Commonwealth of Kentucky's Comprehensive Annual Report for the year ended June 30, 2004.

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year ended June 30, 2004

IX. COMMITMENTS AND CONTINGENCIES

A. Lawsuits

Various claims and lawsuits are pending against the City. The City is adequately insured and any potential loss on all claims and lawsuits is not expected to materially effect the City's financial position.

B. Grants

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

C. NPDES

Under the Clean Water Act, small cities with a population over 10,000 were required to submit National Pollutant Discharge Elimination System (NPDES) permits addressing storm water pollution by March 2003. The permit identifies six best management practices and minimum control measures that include public education, public participation, illicit discharge elimination, construction site run-off control and prevention. The permit establishes a timeline for implementation and initial cost estimates. The City has received an estimated cost of implementation of \$631,000 over a five- year period. To date, the City has incurred engineering and design costs totaling \$40, 886. These costs are recorded in the sewer fund as a capital asset - construction in progress. It is uncertain if the project will be subsidized by grantor agencies.

D. Flood Control Project

In January 1996, the City entered into a cooperative agreement with the Department of the Army Corps of Engineers to construct the Middlesborough Flood Control Damage Reduction Project. Initial project costs were estimated at \$28,000,000 of which 95% would be annually funded by congressionally appropriated monies. In February 1996, the City entered into an agreement with the Commonwealth of Kentucky, whereby the General Assembly agreed to provide 95% of the remaining projected costs up to a maximum contribution of \$1,330,000. The City estimated its share of project costs will total \$70,000.

According to the Corps of Engineers the major construction was complete in the fall of 2003. However, in the final inspection, three small areas of erosion were discovered and a decision was made to address the environmental concerns before final close-out. For the year ended June 30, 2004, the Commonwealth of Kentucky released \$20,900 of the interest earned on state funds deposited in the escrow account, and the City released \$1,100 of its earnings to the Corps. This provided the required 5% and allowed the Corp to draw an additional \$440,000 in congressionally appropriated funds to complete the project. Final close-out is anticipated in August 2005. At that time, the cost of the project will be recorded as infrastructure and depreciated according to the City's capitalization policies.

COMBINING FINANCIAL STATEMENTS

NON-MAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Municipal Road Aid Fund

Coal and Mineral Severance Fund

Local Law Enforcement Block Grant

UDAG & CDBG Repayment Fund

American Association Building Fund

Flood Control Project Fund

CITY OF MIDDLESBOROUGH, KENTUCKY
 COMBINING BALANCE SHEET
 NON-MAJOR GOVERNMENTAL FUNDS
 June 30, 2004

	Municipal Road Aid	Coal and Mineral Severance	Local Law Enforcement Block Grant	UDAG & CDBG Repayment Fund	American Association Building	Flood Control Project	Total
ASSETS							
Cash.....	\$ 81,234	\$ 6,077	\$ 8,881	\$ 348,788	\$ 11,655	\$ 21,512	\$ 478,147
Grants receivable.....	-	-	-	22,285	-	-	22,285
Total assets.....	\$ 81,234	\$ 6,077	\$ 8,881	\$ 371,073	\$ 11,655	\$ 21,512	\$ 500,432
LIABILITIES AND FUND BALANCES							
Liabilities:							
Accounts payable.....	\$ 1,000	-	\$ -	\$ 27,857	-	\$ -	\$ 28,857
Due to other governments.....	-	-	-	-	-	20,432	20,432
Total liabilities.....	1,000	-	-	27,857	-	20,432	49,289
Fund balances reserved for:							
Special revenue funds.....	80,234	6,077	8,881	343,216	11,655	1,080	451,143
Total fund balances.....	80,234	6,077	8,881	343,216	11,655	1,080	451,143
Total liabilities and fund balances.....	\$ 81,234	\$ 6,077	\$ 8,881	\$ 371,073	\$ 11,655	\$ 21,512	\$ 500,432

**CITY OF MIDDLESBOROUGH, KENTUCKY
 COMBINING STATEMENTS OF REVENUES, EXPENDITURES
 AND CHANGES IN FUND BALANCES
 NON-MAJOR GOVERNMENTAL FUNDS
 Year Ended June 30, 2004**

	Municipal Road Aid	Coal and Mineral Severance	Local Law Enforcement Block Grant	UDAG & CDBG Repayment Fund	American Association Building	Flood Control Project	Total
REVENUES							
Intergovernmental.....	\$ 152,322	\$ 52,679	\$ 5,000	\$ 228,793	\$ -	\$ -	\$ 438,794
Investment income.....	149	76	57	663	27	1	973
Total revenues.....	152,471	52,755	5,057	229,456	27	1	439,767
EXPENDITURES							
Current:							
Public protection.....	-	3,649	-	-	-	-	3,649
Public works.....	118,154	-	-	-	-	-	118,154
Community development.....	-	-	-	104,292	368	1,100	105,760
Capital outlay.....	-	-	13,579	285,991	-	-	299,570
Total expenditures.....	118,154	3,649	13,579	390,283	368	1,100	527,133
Excess of revenues over expenditures.....	34,317	49,106	(8,522)	(160,827)	(341)	(1,099)	(87,366)
OTHER FINANCING SOURCES (USES)							
Transfers in.....	-	-	556	-	-	-	556
Transfers out.....	(10,000)	(50,000)	-	-	-	-	(60,000)
Interest & principle repayments on CDBG and UDAG loans.....	-	-	-	156,414	-	-	156,414
Total other sources.....	(10,000)	(50,000)	556	156,414	-	-	96,970
Excess of revenues over expenditures and sources.....	24,317	(894)	(7,966)	(4,413)	(341)	(1,099)	9,604
Fund balances (deficit) at beginning of year.....	55,917	6,971	16,847	347,629	11,996	2,179	441,539
Fund balances at end of year.....	\$ 80,234	\$ 6,077	\$ 8,881	\$ 343,216	\$ 11,655	\$ 1,080	\$ 451,143

INDIVIDUAL FUND FINANCIAL STATEMENTS

GOVERNMENTAL ACTIVITIES

General Fund

Includes required budgetary comparison

**CITY OF MIDDLESBOROUGH, KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (CASH BASIS)
GENERAL FUND
Year Ended June 30, 2004**

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance Favorable (Unfavorable)</u>
<u>REVENUES</u>				
Property taxes.....	\$ 450,000	\$ 450,000	\$ 547,802	\$ 97,802
Licenses, permits and fees.....	2,268,000	2,268,000	2,640,565	372,565
Intergovernmental programs.....	291,500	291,500	331,152	39,652
Investment income.....	20,000	20,000	16,106	(3,894)
Service charges.....	40,000	40,000	61,101	21,101
Other.....	35,000	35,000	24,056	(10,944)
Total revenues.....	<u>3,104,500</u>	<u>3,104,500</u>	<u>3,620,782</u>	<u>516,282</u>
<u>EXPENDITURES</u>				
General administration.....	1,570,970	1,570,970	1,542,065	28,905
Public protection - police.....	1,554,400	1,554,400	1,080,031	474,369
Public protection - fire.....	1,079,611	1,080,611	1,070,037	10,574
Public street service.....	374,000	374,000	367,328	6,672
Community development.....	154,000	159,105	62,521	-
Total expenditures.....	<u>4,732,981</u>	<u>4,739,086</u>	<u>4,121,982</u>	<u>520,520</u>
Excess (deficiency) of revenues over expenditures.....	<u>(1,628,481)</u>	<u>(1,634,586)</u>	<u>(501,200)</u>	<u>1,133,386</u>
<u>OTHER FINANCING SOURCES (USES)</u>				
Sewer grant budgeted in general fund.....	100,000	100,000	-	(100,000)
Operating transfers in.....	460,000	445,000	445,000	-
Operating transfers out.....	-	-	(556)	(556)
Total other financing sources.....	<u>560,000</u>	<u>545,000</u>	<u>444,444</u>	<u>(100,556)</u>
Excess (deficiency) of revenues and other sources over expenditures.....	<u>(1,068,481)</u>	<u>(1,089,586)</u>	<u>(56,756)</u>	<u>1,032,830</u>
Fund balance, beginning of year.....	<u>1,140,300</u>	<u>1,145,405</u>	<u>1,738,707</u>	<u>593,302</u>
Fund balance, end of year.....	<u>\$ 71,819</u>	<u>\$ 55,819</u>	<u>\$ 1,681,951</u>	<u>\$ 1,626,132</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
NOTES TO STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND
BALANCE - BUDGET AND ACTUAL
GENERAL FUND
For the Year ended June 30, 2004

I. GENERAL STATEMENT

The budgetary comparison information on the preceding page is not a required part of the basic financial statements but is supplementary information required by the Governmental Standards Accounting Board and is intended to demonstrate the City's compliance in obtaining and using financial resources in accordance with the legally adopted budget.

II. BASIS OF PRESENTATION

The City's budget is presented on the cash basis of accounting which recognizes revenues and expenditures based on the receipt and disbursement of cash. This presentation is different from the modified accrual basis of accounting presented in the fund financial statements. GASBS 34 requires those statements to present the face amount of long-term debt issued, including bonds that have been refunded (refinanced), as an "other financing source" and the refunded debt to be reported as an "other financing use" if paid currently. Advanced refundings paid from existing resources and bond issue costs are reported as expenditures.

	Fund financial statements	Budgetary comparison	<u>Variance</u>
<u>General fund</u>			
Other financing sources	\$916,000	\$ -	\$916,000
Other financing uses	(887,743)	-	(887,743)
Net increase in other financing sources (uses)	<u>\$ 28,257</u>	-	<u>\$ 28,257</u>
Bond issue costs	<u>\$ 28,257</u>	-	<u>\$ 28,257</u>
Net increase in administrative expenses	<u>\$ 28,257</u>	-	<u>\$ 28,257</u>
Change in fund balance (fund financial statement pg. 17)			\$(56,756)
Revenues over expenditures (budgetary comparison pg. 44)			<u>(56,756)</u>
		Net variance	<u>\$ 0</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF PROGRAM REVENUES BY FUNCTION
GOVERNMENTAL FUNDS
Year Ended June 30, 2004

	General Fund Revenues	Non-Major Governmental Fund Revenues	Adjustments	Activity Revenues
General administration:				
Charges for services				
Privilege license.....	\$ 246,804	\$ -	\$ -	\$ 246,804
Permits.....	8,392	-	-	8,392
Base court revenues.....	10,106	-	-	10,106
Other.....	1,807	664	-	2,471
Total	\$ 267,109	\$ 664	\$ -	\$ 267,773
Public protection - police:				
Charges for services				
Housing Authority security.....	\$ 41,117	\$ -	\$ -	\$ 41,117
Fines and arrest fees.....	9,010	-	-	9,010
Other	1,079	133	-	1,212
Operating grants and contributions				
K.L.E.F.P.F. (incentive pay).....	74,780	-	-	74,780
Local Government Economic Assistance.....	-	52,679	-	52,679
Other.....	6,769	-	-	6,769
Capital grants				
L.L.E.B.G.....	-	5,000	-	5,000
Total	\$ 132,755	\$ 57,812	\$ -	\$ 190,567
Public protection - fire:				
Charges for services				
Other	\$ 285	\$ -	\$ -	\$ 285
Operating grants and contributions				
K.F.P.- 2 (incentive pay).....	88,585	-	-	88,585
Other.....	500	-	-	500
Capital grants				
Federal Emergency Management Assistance.....	76,275	-	-	76,275
Single County Coal Severance.....	7,700	-	-	7,700
Total	\$ 173,345	\$ -	\$ -	\$ 173,345
Public street service:				
Charges for services				
Garbage pick-up	\$ 13,000	\$ -	\$ -	\$ 13,000
Other	-	149	-	149
Operating grants and contributions				
Municipal Road Aid.....	-	152,322	-	152,322
Other.....	5,751	-	-	5,751
Capital grants				
Single County Coal Severance.....	20,397	-	-	20,397
Total	\$ 39,148	\$ 152,471	\$ -	\$ 191,619
Community development:				
Charges for services				
Community Center fees.....	\$ 10,974	\$ -	\$ -	\$ 10,974
Other	-	27	-	27
Operating grants and contributions				
Repayment of CDBG and UDAG loans.....	-	156,414	(118,096)	38,318
Capital grants				
National Park Service (skate park).....	14,012	-	-	14,012
Dept. of Transportation (AA Building).....	-	228,793	-	228,793
Total	\$ 24,986	\$ 385,234	\$ (118,096)	\$ 292,124
Total program revenues by function	\$ 637,343	\$ 596,181	\$ (118,096)	\$ 1,115,428

Reconciliation.

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

Principal repayments. The outstanding balances of loans due the City for CDBG and UDAG grants loaned to local business owners in past years are not included in the fund financial statements as they are not available to pay current City expenditures. Repayments are considered an "other financing source when received. In the government-wide financials, principal payments are treated as a reduction of City receivables.

Principal removed from revenue	(decrease in net assets)	\$ (118,096)
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CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FUNCTIONAL EXPENSES
GOVERNMENTAL FUNDS
Year Ended June 30, 2004

	General Fund Expenditures	Non-Major Governmental Fund Expenditures	Adjustments	Activity Expenses
General administration:				
Current:				
Salaries.....	\$ 267,911	\$ -	\$ 1,860	\$ 269,771
Materials and supplies.....	10,136	-	-	10,136
Other program costs.....	273,546	-	-	273,546
Indirect cost allocation:				
Health insurance, retirement and payroll taxes.....	682,050	-	(611,759)	70,291
Insurance.....	221,548	-	(169,225)	52,323
Debt service:				
Principal retirement.....	22,074	-	(22,074)	-
Interest expense and bond issue costs.....	93,057	-	(93,057)	-
Capital outlay.....	-	-	-	-
Depreciation.....	-	-	-	-
Total	\$ 1,570,322	\$ -	\$ (894,255)	\$ 676,067
Public protection - police:				
Current:				
Salaries.....	\$ 863,657	\$ -	\$ 10,386	\$ 874,043
Materials and supplies.....	62,796	3,649	-	66,445
Other program costs.....	39,307	-	-	39,307
Indirect cost allocation:				
Health insurance, retirement and payroll taxes.....	-	-	261,058	261,058
Insurance.....	-	-	71,114	71,114
Debt service:				
Principal retirement.....	12,000	-	(12,000)	-
Interest expense.....	24,700	-	200	24,900
Capital outlay.....	77,571	13,579	(91,150)	-
Depreciation.....	-	-	3,331	3,331
Total	\$ 1,080,031	\$ 17,228	\$ 242,939	\$ 1,340,198
Public protection - fire:				
Current:				
Salaries.....	\$ 815,470	\$ -	\$ 620	\$ 816,090
Materials and supplies.....	44,906	-	-	44,906
Other program costs.....	26,060	-	-	26,060
Indirect cost allocation:				
Health insurance, retirement and payroll taxes.....	-	-	274,812	274,812
Insurance.....	-	-	67,558	67,558
Debt service:				
Principal retirement.....	82,564	-	(82,564)	-
Interest expense.....	11,333	-	-	11,333
Capital outlay.....	89,704	-	(89,704)	-
Depreciation.....	-	-	1,400	1,400
Total	\$ 1,070,037	\$ -	\$ 172,122	\$ 1,242,159

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FUNCTIONAL EXPENSES
GOVERNMENTAL FUNDS
Year Ended June 30, 2004

	<u>General Fund</u> <u>Expenditures</u>	<u>Non-Major</u> <u>Governmental Fund</u> <u>Expenditures</u>	<u>Adjustments</u>	<u>Activity</u> <u>Expenses</u>
Public street service:				
Current:				
Salaries.....	\$ 231,577	\$ -	\$ 2,635	\$ 234,212
Materials and supplies.....	28,768	118,154	-	146,922
Other program costs.....	85,156	-	-	85,156
Indirect cost allocation:				
Health insurance, retirement and payroll taxes.....	-	-	74,760	74,760
Insurance.....	-	-	30,553	30,553
Capital outlay.....	21,827	-	(21,827)	-
Depreciation.....	-	-	4,079	4,079
Total	\$ 367,328	\$ 118,154	\$ 90,200	\$ 575,682
Community development:				
Current:				
Salaries.....	\$ 14,761	\$ -	\$ -	\$ 14,761
Materials and supplies.....	15,430	-	-	15,430
Other program costs.....	32,330	105,760	-	138,090
Indirect cost allocation:				
Health insurance, retirement and payroll taxes.....	-	-	1,129	1,129
Insurance.....	-	-	-	-
Capital outlay.....	-	285,991	(285,991)	-
Depreciation.....	-	-	24,229	24,229
Total	\$ 62,521	\$ 391,751	\$ (260,633)	\$ 193,639
Total general fund programs.....	\$ 4,150,239	\$ 527,133	\$ (649,627)	\$ 4,027,745

Reconciliation.

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

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

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

Net change in non-current compensated absences	\$ 15,501
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Capital assets. When capital assets are purchased or constructed they are reported as an expenditure in the funds. In the government-wide financial statements, the costs associated with the assets are allocated over their estimated useful lives.

Capital outlay removed from expenditures	(488,672)
Depreciation included in expenses	33,039

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

Principal payments removed from expenditures	(116,638)
Bond issue costs and accrued interest removed from expenditures	(34,637)
Interest on pension refunding bond not allocated to a function per GASB 34.	(58,220)
Total decrease in expenditures	<u>\$ (649,627)</u>

SCHEDULES REQUIRED BY OMB A-133

**CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2004**

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Program or Award Amount</u>	<u>Receipts or Revenue Recognized</u>	<u>Federal Expenditures</u>
Federal Emergency Management Agency				
Fire Operations and Firefighter Safety				
EMW-2003-FG-03485.....	83.554	\$ 76,275	\$ 76,275	\$ 76,275
US Department of Transportation				
Federal Highway Admin. Highway Planning & Const. Comm. of Kentucky, Div. Of Multimodel Programs				
American Associations Building Project.....	20.205	300,000	228,793	228,793
U.S. Department of Justice				
Local Law Enforcement Block Grant.....				
Kentucky Justice Council				
LLEB 542-03 and LLEB 469-02.....	16.592	20,720	5,000	13,579
U.S. Department of Interior				
National Park Service				
Outdoor Recreation-Acquisition, Dev & Planning	15.916	25,000	14,012	14,012
U.S. Department of Commerce				
National Oceanic and Atmospheric Administration				
Pride Wastewater Construction Grant	11.469	802,486	658,709	658,709
U.S. Department of Defense				
Department of the Army, Corps of Engineers				
Congressionally appropriated and budgeted	Public law			
Water Resources Development Act of 1996	104.303	\$ 548,370	3,750	3,750
			\$ <u>986,539</u>	\$ <u>995,118</u>

CITY OF MIDDLESBOROUGH, KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2004

I. SUMMARY OF AUDITOR RESULTS

- A. The auditor's report expresses an unqualified opinion on the financial statements of the City of Middlesborough, Kentucky.
- B. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed no instances of noncompliance material to the financial statements.
- C. The audit of the financial statements of the City of Middlesborough, Kentucky disclosed no reportable condition in internal control.
- D. The audit of the City of Middlesborough, Kentucky disclosed no findings related to major federal award programs that is required to be reported.
- E. The auditor's report on compliance for the major federal award programs of the City of Middlesborough, Kentucky expresses an unqualified opinion on all major federal programs.

1. Major Programs:

U.S. Department of Commerce
National Oceanic and Atmospheric Administration
Pride Wastewater Construction Grant

- 2. Dollar threshold between Type A and Type B programs - \$300,000
- 3. Qualifies as a low-risk audit.

II. FINDINGS – FINANCIAL STATEMENT AUDIT

None.

III. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS

None.

IV. PRIOR YEAR FINDINGS

None.

REQUIRED REPORTS

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

To the Mayor and City Council
City of Middlesborough, Kentucky

We have audited the financial statements of the City of Middlesborough, Kentucky's primary government, as listed in the table of contents, as of and for the year ended June 30, 2004, which was qualified due to the omission of the allowance for uncollectible accounts receivable in the sewer and sanitation funds from the financial statements, and have issued our report thereon dated March 1, 2005. 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.


Compliance

As part of obtaining reasonable assurance about whether the City of Middlesborough, Kentucky's primary government financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our test disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that we have reported to management of the City of Middlesborough, Kentucky, in a separate letter dated March 1, 2005.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Middlesborough, Kentucky's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements of the primary government and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the City of Middlesborough, Kentucky, in a separate letter dated March 1, 2005.

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


Martin, Kentucky
March 1, 2005

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

To the Mayor and City Council
City of Middlesborough, Kentucky

Compliance

We have audited the compliance of the City of Middlesborough, Kentucky with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2004. City of Middlesborough, Kentucky's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Middlesborough, Kentucky's management. Our responsibility is to express an opinion on City of Middlesborough, Kentucky's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Middlesborough, Kentucky's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City of Middlesborough, Kentucky's compliance with those requirements.

In our opinion, City of Middlesborough, Kentucky complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2004.

Internal Control Over Compliance

The management of the City of Middlesborough, Kentucky is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered City of Middlesborough, Kentucky's internal control over compliance with 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.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may

occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we considered to be material weaknesses.

This report is intended solely for the information and use of the audit committee, mayor and city council members, management, and the federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Martin, Kentucky
March 15, 2005