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2527 Nelson Miller Parkway
Suite 104
Louisville, Kentucky 40223

Case No 2007-00488

(502) 245-6133
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November 20, 2007

VIA UPS

Ms. Beth A. O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

RECEIVED

NOV 21 2007

PUBLIC SERVICE
COMMISSION

Re: Application of Auxier Water Co. to Transfer
Its Water System to the Prestonsburg City's
Utilities Commission

Dear Ms. O'Donnell:

Enclosed are the original and ten (10) copies of an Application of Auxier Water Co., Floyd County, Kentucky for Authorization of its Proposed Sale and Conveyance of all of its Water Distribution System and customer deposits to the City of Prestonsburg, Kentucky, filed on behalf of Auxier Water Co.

Also enclosed is one additional copy of this Application. Please indicate the receipt by your office of this Application by placing your file-stamp on the enclosed extra copy and returning it to me in the enclosed self-addressed envelope. Thank you for your assistance.

Very truly yours,

Kipley J. McNally
Counsel for Prestonsburg City's
Utilities Commission

KJM:jlr
Enclosures
cc: David M. Ellis, Superintendent (w/enclosure)
Tom Smith, Esq. (w/enclosure)

BEFORE THE PUBLIC SERVICE COMMISSION
COMMONWEALTH OF KENTUCKY

RECEIVED

In the Matter of:

THE APPLICATION OF AUXIER WATER)
CO., FLOYD COUNTY, KENTUCKY FOR)
AUTHORIZATION OF ITS PROPOSED SALE)
AND CONVEYANCE OF ALL OF ITS WATER)
DISTRIBUTION SYSTEM AND CUSTOMER)
DEPOSITS TO THE CITY OF PRESTONSBURG,)
KENTUCKY)

NOV 21 2007

PUBLIC SERVICE
COMMISSION

2007-00488

APPLICATION

Pursuant to KRS 278.202(5) and 807 KAR 5:001§8, AUXIER WATER CO.

(“Applicant”) hereby submits to the Public Service Commission of Kentucky

(“Commission”) its application for the transfer of its water distribution system and customer deposits to the City of Prestonsburg.

1. Applicant is a Kentucky corporation, organized under and operating pursuant to KRS Chapter 271B. It is a “utility,” as defined in KRS 278.010(3)(d) and is subject to the jurisdiction of the Commission pursuant to KRS 278.040. Applicant’s service territory covers portions of Floyd and Johnson County, Kentucky within which there are approximately 1,100 water service customers.

2. Applicant’s address is 392 John Centre Mayo Avenue, Auxier, Kentucky 41602.

3. Pursuant to 807 KAR 5:001§8(3), a copy of the Applicant’s certified articles of incorporation are filed herewith as Exhibit “A”.

4. Applicant desires to transfer its water distribution system and customer deposits to the City. To that end, Applicant and the City have executed a sale and

purchase Contract (“Contract”) filed herewith as Exhibit “B”. Pursuant to the Contract, Applicant will transfer its water distribution system and customer deposits to the City in exchange for the payment of Two Million Six Hundred Fifty Thousand Dollars (\$2,650,000.00) and other valuable consideration, including certain commitments of the City respecting water service in Applicant’s service territory.

5. The City, by and through its Utilities Commission, serves the City of Prestonsburg and the surrounding environs, including, but not limited to, the City of Martin, Sandy Valley Water District and Auxier Water Company, Inc. all in Floyd County, Kentucky. The City, acting by and through its Utilities Commission, has the financial, technical and managerial capability to serve the present customers of Applicant, having provided water pursuant to an approved contract for several years, and the City also has the capability to serve future customers in Applicant’s service territory.

6. A statement of the Superintendent of the Prestonsburg City’s Utilities Commission, demonstrating its financial, technical and managerial capability and willingness to serve these customers is filed herewith as Exhibit “C”. (Copies of the Prestonsburg City’s Commission’s separate Annual Reports for the period ending June 30, 2005 and June 30, 2006 are supplied).

7. The Prestonsburg City’s Utilities Commission is not a “utility,” as defined in KRs 278.010(3), therefore Applicant has not attached a Notice of Adoption, described in 807 KAR 5:011, §11.

WHEREFORE, pursuant to KRS 278.020(5), Applicant Auxier Water Co. prays that the Public Service Commission enter an Order that finds that the City of Prestonsburg, acting by and through its Utilities Commission, is financially, technically

**ACKNOWLEDGMENT ON THE PART OF THE
PRESTONSBURG CITY'S UTILITIES COMMISSION**


The Utilities Commission of the City of Prestonsburg, Kentucky, although not a formal party hereto, is the agency of the City which will be charged by the City with the administrative duties assumed by the City of Prestonsburg under the provisions of the foregoing Contract and has authorized its Superintendent to sign this endorsement only to evidence the familiarity of the Utilities Commission with the provisions of this Application and the Contract referenced herein.

PRESTONSBURG CITY'S
UTILITIES COMMISSION

BY: 

DAVID M. ELLIS, Superintendent

ATTEST:


JIMMY A. CALHOUN, CHAIRMAN
OF THE PRESTONSBURG CITY'S
UTILITIES COMMISSION

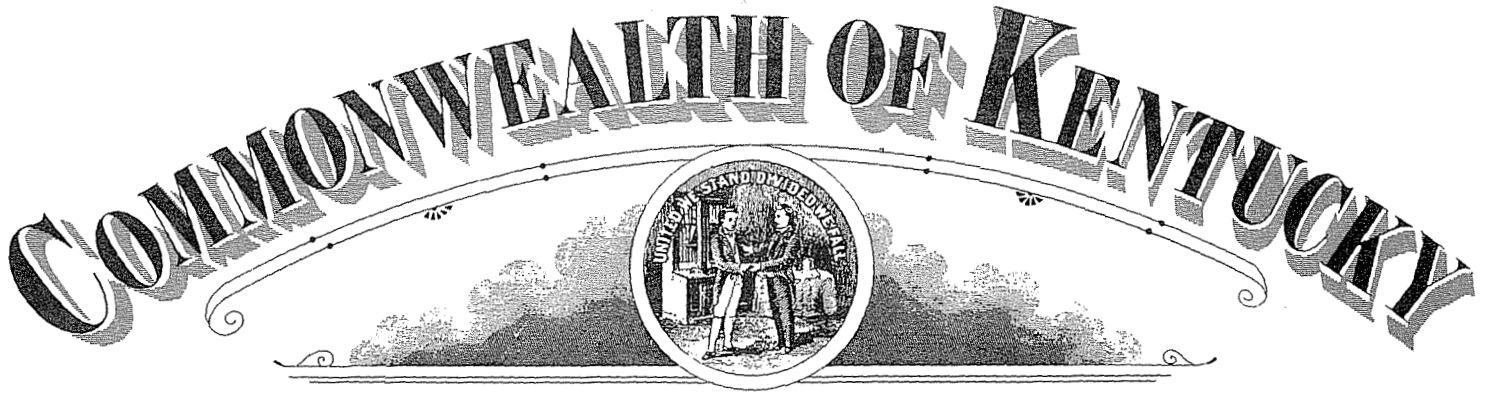
BY: 

KIPLEY J. McNALLY, ESQ.
KIPLEY J. McNALLY, PLC
2527 Nelson Miller Parkway, Suite 104
Louisville, Kentucky 40223
(502) 245-6133

SPECIAL COUNSEL FOR THE CITY
OF PRESTONSBURG AND THE
PRESTONSBURG CITY'S UTILITIES
COMMISSION

**INDEX
TO
APPLICATION**

- A. Certified Articles of Incorporation for Auxier Water Co.
- B. Acquisition Contract
- C. Statement in Support
- D. Audited Financial Statements for the Prestonsburg City Utilities Commission for the years ended June 30, 2005 and 2006



Trey Grayson
Secretary of State

Certificate

I, Trey Grayson, Secretary of State for the Commonwealth of Kentucky, do hereby certify that the foregoing writing has been carefully compared by me with the original thereof, now in my official custody as Secretary of State and remaining on file in my office, and found to be a true and correct copy of

ARTICLES OF INCORPORATION OF
AUXIER WATER CO. FILED FEBRUARY 17, 1978.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Official Seal at Frankfort, Kentucky, this 26th day of October, 2007.

Commonwealth of Kentucky

OFFICE OF
SECRETARY OF STATE

DREXELL R. DAVIS
Secretary



FRANKFORT,
KENTUCKY

CERTIFICATE OF INCORPORATION

I, DREXELL R. DAVIS, Secretary of State of the Commonwealth of Kentucky, do hereby certify that Articles of Incorporation of

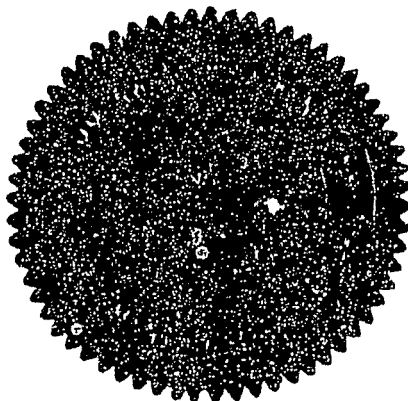
ALEXTER WATER CO.

whose initial agent for process is FURFEST MUSIC

P. O. BOX 134

and whose address is ALEXTER, KENTUCKY

duly signed according to law, have been filed in my office. I further certify that all taxes, fees and charges payable upon the filing of said Articles of Incorporation have been paid.



SECRETARY OF STATE

Given under my hand and seal of Office as Secretary of State, at Frankfort, Kentucky, this 17TH day of FEBRUARY, 19 78.

Drexell R. Davis
SECRETARY OF STATE

ASSISTANT SECRETARY OF STATE

FEB 17 1978

ARTICLES OF INCORPORATION
OF
AUXIER WATER CO.

FEB 17 1978
CA 25
Commonwealth of Kentucky

Dwight P. Davis
SECRETARY OF STATE

The undersigned, being a natural person over the age of ~~18~~ 18 years, for the purpose of forming a corporation pursuant to the Kentucky Business Corporation Act, does hereby certify:

1. NAME. The name of this corporation shall be Auxier Water Co.

2. DURATION. The duration of the corporation shall be perpetual.

3. OBJECTS AND PURPOSES. The purposes for which the corporation is formed are:

(a) To sell water.

(b) To own, hold, buy, sell, convey, lease, mortgage, encumber or deal in water, a water system and all appurtenances thereto, including equipment, office records and supplies, real estate, or other property for investment or resale or leasing, and for any other lawful purpose.

(c) Generally to enjoy all rights, privileges and powers necessary or incidental to the conduct of said businesses and any lawful business.

(d) To transact and carry on any or all lawful businesses for which corporations may be incorporated, and to have and exercise all power and authority granted to corporations under the Kentucky Business Corporation Act.

4. AUTHORIZED SHARES. The aggregate number of shares which the corporation shall have authority to issue is 100 shares without par value, all of one class, which shall be designated common stock, each share to have one vote.

5. REGISTERED OFFICE. The initial registered office of the corporation shall be P. O. Box 134, Auxier, Kentucky 41602.

6. REGISTERED AGENT. The name and address of the initial registered agent is Forrest Music, ^{P.O. Box 134} Auxier, Kentucky 41602.

7. DIRECTORS. There shall be three directors constituting the initial Board of Directors, and the names and addresses of the persons who are to serve as directors until the first annual meeting of shareholders, or until their successors be elected and qualified, are as follows:

Forrest Music, Auxier, Kentucky 41602

Phil Ward, P. O. Box 134, Auxier, Kentucky 41602

Doyle Music, P. O. Box 257, Auxier, Kentucky 41602

8. INCORPORATOR. The name and address of the incorporator of the corporation is as follows:

Forrest Music, Auxier, Kentucky 41602

IN WITNESS WHEREOF, the undersigned has signed these Articles of Incorporation this 28th day of November, 1977.

Forrest Music
FORREST MUSIC

STATE OF KENTUCKY

COUNTY OF Floyd

The foregoing instrument was acknowledged before me by Forrest Music this 28th day of November, 1977.

My commission expires: 11-28-81

David R. [Signature]
NOTARY PUBLIC

PREPARED BY:

Tom Underwood
507 Security Trust Building
Lexington, Kentucky 40507
606-255-6609

Tom Underwood

RE: CITY OF PRESTONSBURG, KENTUCKY
For acquisition of the Water System of Auxier Water Company, Inc.

ACQUISITION CONTRACT

This CONTRACT, made as of the ~~24th~~^{September} day of ~~August~~, 2007, by and between AUXIER WATER COMPANY, INC. (hereinafter "Auxier"), a Kentucky corporation situated in Floyd County, Kentucky, created and existing according to the provisions of Chapter 271B of the Kentucky Revised Statutes ("KRS"), the CITY OF PRESTONSBURG, KENTUCKY (hereinafter the "City"), a Kentucky municipal corporation of the Fourth Class pursuant to KRS 81:010(4) acting by and through its utilities commission, PRESTONSBURG CITY'S UTILITIES COMMISSION (hereinafter "Utilities Commission").

WITNESSETH:

That in consideration of the mutual benefits flowing to each of the parties hereto, Auxier, the City, and the Utilities Commission agree as follows:

ARTICLE I

DEFINITIONS

Section 101. In and throughout this Contract it will be appropriate and necessary to make repetitive reference to certain words, phrases and clauses, and in order to avoid repeating them at length it is deemed convenient and expedient to set forth certain definitions and shortened identifications thereof; and accordingly, wherever such defined or shortened references are utilized, the same shall have the following meanings unless a contrary intent shall clearly appear from the context, in which event the context shall be controlling:

“Auxier’s Water Rates” -- The schedule of rates and charges for water service as presently promulgated, enforced and collected within the Service Territory, being the same schedule of rates and charges established by Order of the Public Service Commission, now in full force and effect, a copy of which is attached hereto as Exhibit A.

“Service Territory” -- The area in Floyd County, Kentucky, lying within the territory served by Auxier.

“President” -- The President of Auxier.

“City” -- The City of Prestonsburg, Kentucky, a Kentucky municipal corporation of the Fourth Class, so classified in KRS 81.010(4).

“City Council” -- The lawful governing body of the City.

“City’s Inside Water Rates” -- The schedule of water service rates and charges presently promulgated, enforced and collected by the City and its Utilities Commission, applicable to water users inside the corporate limits of the City, as the same may be adjusted from time to time (a copy of the schedule of such rates and charges now in effect being attached hereto as Exhibit C.

“City’s Outside Water Rates” -- The schedule of water service rates and charges presently promulgated, enforced and collected by the City and its Utilities Commission, applicable to water users outside the corporate limits of the City, except in the Service Territory, or areas within the boundaries of other Water Districts (a copy of which is attached hereto as Exhibit B).

“Closing Date” -- The date upon which the parties hereto have consummated all of the actions contemplated by this Contract respectively by them to be performed; which shall be on the ____ day of _____, 2007, unless another date, before or after that date, is fixed by mutual agreement of the parties.

“Board of Directors” -- The proper and official governing body of Auxier.

“KRS” -- The Kentucky Revised Statutes, as amended to the date of this Contract, and as the same may hereafter be amended from time to time.

“Mayor” -- The duly elected, qualified and acting mayor of the City.

“Public Service Commission” -- The Public Service Commission of Kentucky, having jurisdiction over Auxier pursuant to KRS Chapter 278.

“Rural Development” -- The Rural Development of the Department of Agriculture of the United States of America.

“Utilities Commission” -- The Commission appointed by the Mayor and City Council of the City, in which is vested the operation, management and control of the City’s combined and consolidated Water, Sewer and Natural Gas System for the City.

“Water Purchase Contract” -- A written agreement made by the City and Auxier dated February 11, 1998, and approved at the regular meeting of the Utilities Commission on February 17, 1998, whereby Auxier purchases water from the City for distribution to water customers in the Service Territory.

“Acquisition Debt” -- The Utility Commission may obtain financing from a third-party to finance the entire acquisition cost of the water distribution system of Auxier.

Section 102. The words “herein,” “hereof,” “hereinbefore,” and “hereinafter” are references to the text of this Contract.

ARTICLE II

RECITALS AND REPRESENTATIONS

Section 201. Recitals. The parties agree that the following is a true and accurate statement of certain history, facts and circumstances material to the making of this Contract, and is supplied in order to serve as a guide to the intentions of the parties, deemed to be useful in the understanding and interpretation of the provisions hereof, in the event such provisions are otherwise ambiguous in any way:

(1) The City is the owner of the plants, works and facilities through which water service, sanitary sewer service and natural gas service are provided to the citizens and inhabitants of the City and its environs; and since 1963 the same have been combined and consolidated and are presently operated as a single combined and consolidated Water, Sewer and Natural Gas System. In that connection the City has outstanding, as of the date hereof, certain Revenue Bonds, payable as to principal and interest solely from a pledge of and lien upon water, sewer and natural gas service revenues, as indicated in the most recent series of Revenue Bond titled:

\$890,000 principal amount (after January 1, 2006) of “City of Prestonsburg Water, Sewer and Natural Gas System Revenue Bonds,” dated November 1, 1963, (the “City Bonds of 2004”), of an original issue of \$890,000 principal amount;

The City has various other outstanding revenue bonds purchased by Rural Development and loans from KIA as cross-referenced in the 2004 Bond Ordinance which is incorporated by reference herein, that have retained a lien on the revenue stream and assets of the City and Utility Commission.

(2) Auxier is the owner of the water distribution system constructed and installed by Auxier.

(3) Auxier obtains its supply of water, for distribution to its water customers, from the City and its utilities system pursuant to the Water Purchase Contract, and has no independent water supply or facilities for the treatment and purification of water.

Section 202. Representations of Auxier.

(1) Auxier represents that it is a corporate entity created and existing pursuant to KRS Chapter 271B and as of date hereof is not in default in the payment of principal of

or interest on its loans, and has full authority in law to carry out all of the provisions of this Contract on its part to be performed.

(2) Auxier represents that all of the assets of its water distribution system and other assets described in Section 301 of this Contract shall be transferred free and clear of all liens, mortgages, encumbrances and all other obligations.

(3) Auxier represents that it will satisfy all outstanding bonds, notes, liens and other obligations from retained assets that are not part of the water distribution system, and other assets transferred to the City and its Utility Commission.

Section 203. Representations of the City and Its Utilities Commission. The City and its Utilities Commission represent that the City has outstanding no revenue bonds which are payable from water, sewer and natural gas revenues, except such as are enumerated in Section 201 hereof; that as of the date hereof there is no default in the payment of principal of or interest on any of said bonds.

ARTICLE III

AGREEMENTS OF THE PARTIES

The parties hereby agree, respectively, as follows:

Section 301. Agreements of Auxier. Auxier agrees that:

(1) At or prior to the Closing Date it will execute and deliver to the City all such deeds, bills of sale and assignments as are deemed necessary by the Utilities Commission's Counsel in order to vest in the City the complete ownership of all of the water distribution system and appurtenances (including, but not limited to land where pump stations and water storage tanks are located) heretofore acquired and presently

owned by Auxier together with its inventory of materials and supplies then on hand, and customer deposits.

(2) Immediately after the execution of this Contract by all parties hereto, Auxier will join the City in instituting such proceedings as are required by law before the Public Service Commission, seeking approval of such transfer of title and ownership.

(3) That it will deliver to the City, on the Closing Date, a true, complete and accurate list and statement of Auxier's customer deposits as of the Closing Date.

(4) On the Closing Date, Auxier will deliver to the City and its Utilities Commission (a) all sums of money which it then holds, representing deposits made by Auxier's water users as security for the payment of water bills, together with a true and accurate list of the names and addresses of the persons or parties by whom such deposits were made, and the amount of interest, if any, which shall have accrued on such deposits to the Closing Date at such rate as Auxier may have agreed to pay; upon condition that the City and its Utilities Commission shall agree to hold such deposits in the same manner and for the same purpose, and for application in the same manner, as Auxier has agreed to do (with or without future accrual of interest thereon, conforming to whatever policies and practices the City has established), and according to the same terms and conditions as Auxier has provided in that connection.

(5) On the Closing Date, Auxier will deliver to the City a true and accurate list of (i) its meter-readings as of the Closing Date, representing water service rendered but not yet billed in order that the City and its Utilities Commission may effect an orderly

transition of customer billings, and (ii) Auxier shall issue a “Final Water Bill” to its Customers as of the Closing Date.

Section 302. Agreements of the City. The City agrees:

(1) That immediately after the execution of this Contract by all of the parties hereto, it will join Auxier in proper proceedings before the Public Service Commission, seeking such approving orders as are required by law insofar as Auxier is concerned.

(2) The City and its Utilities Commission shall apply for Acquisition Debt to pay for the cost of the assets transferred by Auxier pursuant to Section 301(1).

(3) That it will receive from Auxier such meter deposits as are delivered to it by the District and will hold the same, without interest, and apply the same, according to the conditions under which such deposits were exacted by Auxier from water customers.

(4) That it will pay from and after the Closing Date, from money collected by the City for water service rendered in the Service Territory of Auxier the principal and interest due for the Acquisition Debt.

(5) That from and after the Closing Date it will render water service directly to the present water uses of Auxier and to such water users within the Service Territory of Auxier as may hereafter be interconnected with the water facilities upon compliance with the rules and regulations of the City, as the same may prevail from time to time; that the City and its Utilities Commission will furnish such water service at the greater of: (i) Auxier’s Rates currently in effect (Exhibit A); or (ii) City’s Outside Water Rates, until such time as the City shall have retired therefrom the Acquisition Debt; that the City and its Utilities Commission shall maintain a separate accounting of water revenues received

from customers in the Service Territory of Auxier in order to demonstrate and account for the same; that upon the City's retirement of its Acquisition Debt, and the interest thereon, from the water revenues received from water users in the Service Territory of Auxier, it will continue to furnish such water service at the City's Outside Rates (Exhibit B), or as the same may be adjusted from time to time; and that if any portion or all of the Service Territory of Auxier shall hereinafter be annexed to the City by proper legal proceedings, it will furnish such water service to water users in the area so annexed, at the City's Inside Rates (Exhibit C), or as the same may be adjusted from time to time.

(6) At the closing, the City and its Utility Commission shall deliver payment in the amount of Two Million Six Hundred Fifty Thousand Dollars (\$2,650,000.00).

Section 303. Water Purchase Contract Will Be Superseded. The City and Auxier agree that on the Closing Date and upon consummation of this Contract in all of its aspects, this Contract shall supersede the Water Purchase Contract.

Section 304. If Material Litigation Is Pending At the Closing Date. Auxier, the City and the Utility Commission are in mutual agreement that this Contract will not be consummated if, upon the Closing Date, there is litigation pending in any court of competent jurisdiction (or known by any of the parties to be threatened) challenging the legality of material actions proposed to be taken by the parties as herein provided. In the event such litigation has been filed or is known to be imminently threatened, the parties may (a) by mutual agreement postpone the Closing Date for a reasonable period of time, or (b) any party may cancel this Contract upon notice to the other parties. In the event of cancellation, the parties will remain in the same status as if this Contract had not been

executed, without liability of any party to any other party; and each party shall absorb and pay any expense which it has incurred up to that time.

Section 305. Conditions Precedent to Closing.

(1) The City and its Utility Commission's obligation to perform under this Contract is contingent upon obtaining financing on terms satisfactory to the City and its Utility Commission.

(2) The City and its Utility Commission shall obtain the written consent of Rural Development for the acquisition and the financing facility prior to the Closing.

(3) A letter of Good Standing for Auxier from the Kentucky Department of Revenue that demonstrates that Auxier has no outstanding obligations to the Commonwealth of Kentucky.

(4) Prior to the Closing, the City and its Utility Commission shall give a written thirty (30) day notice to the Kentucky Infrastructure Authority (KIA) of the acquisition and financing facility as required by KIA Assistance Agreement Fund B dated October 1, 2000 – Project No. B99-01.

(5) The City and its Utility Commission shall obtain such other written consents for the acquisition and financing facility as may be required by applicable law.

ARTICLE IV

EXECUTION AND RECITATION OF AUTHORITY

Section 401. Auxier has caused this Contract to be executed in its name and on its behalf by its President, and has caused its seal to be affixed, attested by its Secretary,

and represents that due authority has been vested in such officers by a Resolution of Auxier, now in full force and effect.

Section 402. The City has caused this Contract to be executed in its name and on its behalf by its Mayor and its seal to be affixed, attested by its City Clerk, all being done pursuant to a Resolution or Ordinance duly adopted by the City Council, approved by the Mayor, and now in full force and effect.

Section 403. The Utilities Commission has caused this Contract to be executed by its Superintendent and represents that said Superintendent is vested with full authority in law to execute the same.

Section 404. This Contract may be executed in any number of counterparts, each of which shall constitute an original, for all purposes.

Section 405. This Contract is made as of the year and day first above written, and shall be effective as of that date without regard to the fact that execution hereof by the parties shall have been effected at the same time or at other times.

AUXIER WATER COMPANY

(SEAL)

By: Philip S. Ward
President

ATTEST:

Deborah Ward
Secretary

CITY OF PRESTONSBURG, KENTUCKY

(SEAL)

By: _____
Mayor

and represents that due authority has been vested in such officers by a Resolution of Auxier, now in full force and effect.

Section 402. The City has caused this Contract to be executed in its name and on its behalf by its Mayor and its seal to be affixed, attested by its City Clerk, all being done pursuant to a Resolution or Ordinance duly adopted by the City Council, approved by the Mayor, and now in full force and effect.

Section 403. The Utilities Commission has caused this Contract to be executed by its Superintendent and represents that said Superintendent is vested with full authority in law to execute the same.

Section 404. This Contract may be executed in any number of counterparts, each of which shall constitute an original, for all purposes.

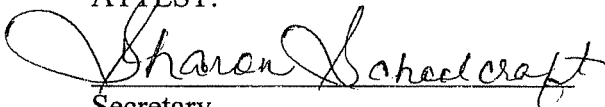
Section 405. This Contract is made as of the year and day first above written, and shall be effective as of that date without regard to the fact that execution hereof by the parties shall have been effected at the same time or at other times.

AUXIER WATER COMPANY

(SEAL)

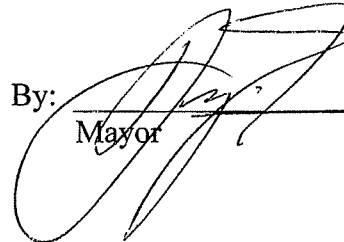
By: _____
President

ATTEST:


Secretary

(SEAL)

CITY OF PRESTONSBURG, KENTUCKY

By:  _____
Mayor


City Clerk

* * * *

ACKNOWLEDGMENT OF THE PART OF THE UTILITIES COMMISSION
OF THE CITY OF PRESTONSBURG, KENTUCKY

The Utilities Commission of the City of Prestonsburg, Kentucky, is the agency of the City which will be charged by the City with the administrative duties assumed by the City of Prestonsburg under the provisions of the foregoing Contract and has authorized its Chairman to sign this endorsement only to evidence the familiarity of the Utilities Commission with the provisions of this Contract, especially in connection with the commitment of the City that a separate accounting will be kept concerning the water service revenues hereafter to be received by the City from water customers located in the Service Territory of Auxier in order that it may be possible to demonstrate when, from such revenues, the City will have paid in full the principal of and interest on its Acquisition Debt.

UTILITIES COMMISSION OF THE
CITY OF PRESTONSBURG, KENTUCKY

By: 

DAVID M. ELLIS,
SUPERINTENDENT

ATTEST:

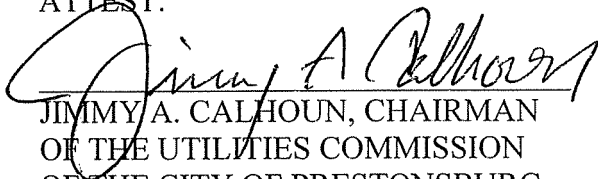

JIMMY A. CALHOUN, CHAIRMAN
OF THE UTILITIES COMMISSION
OF THE CITY OF PRESTONSBURG,
KENTUCKY

EXHIBIT A

FOR ENTIRE AREA SERVED _____

P.S.C. KY. NO. _____ 5 _____

4th Revised SHEET NO. _____ 1 _____

CANCELING P.S.C. KY NO. _____ 5 _____

3rd Revised SHEET NO. _____ 1 _____

Auxier Water Company, Inc.
Name of Issuing Corporation

CLASSIFICATION OF SERVICE

	Rate Per Unit
First 1,000 Gallons "Minimum"	\$12.21 per 1,000 gallons
Next 1,000 Gallons	\$ 7.36 per 1,000 gallons
Next 6,000 Gallons	\$ 6.51 per 1,000 gallons
Next 6,000 Gallons	\$ 5.51 per 1,000 gallons
Over 14,000 Gallons	\$ 4.61 per 1,000 gallons

REGENCY PARK APARTMENTS

Meter No.'s 1 and 2

First 14,000 Gallons	\$12.21 per 1,000 gallons
Over 14,000 Gallons	\$ 4.61 per 1,000 gallons

Meter No. 3

First 13,000 Gallons	\$12.21 per 1,000 gallons
Over 13,000 Gallons	\$ 4.61 per 1,000 gallons

DATE OF ISSUE MARCH 30 2006 DATE EFFECTIVE _____

ISSUED BY Philip S. Lister _____

NAME OF OFFICER

President
TITLE

PUBLIC SERVICE COMMISSION

OF KENTUCKY

EFFECTIVE FEBRUARY 1 2006

MONTH 2/1/2006 DAY YEAR

P.O. Box 99, Auxier, KY 41602

ADDRESS

By _____

Executive Director

EXHIBIT B
CITY'S OUTSIDE WATER RATES

First 1,000 Gallons	\$10.50 Minimum
Next 99,000 Gallons	\$5.49 Per 1,000 Gallons
All Over 100,000 Gallons	\$4.19 Per 1,000 Gallons

EXHIBIT C
CITY'S INSIDE WATER RATES

First 1,000 Gallons	\$7.25 Minimum
Next 99,000 Gallons	\$3.99 Per 1,000 Gallons
All Over 100,000 Gallons	\$3.53 Per 1,000 Gallons

BEFORE THE PUBLIC SERVICE COMMISSION
COMMONWEALTH OF KENTUCKY

In the Matter of:

THE APPLICATION OF AUXIER WATER)
CO. FLOYD COUNTY, KENTUCKY FOR)
AUTHORIZATION OF ITS PROPOSED SALE AND) NO. _____
CONVEYANCE OF ALL OF ITS WATER)
DISTRIBUTION SYSTEM AND CUSTOMER)
DEPOSITS TO THE CITY OF PRESTONSBURG,)
KENTUCKY)

**STATEMENT OF THE PRESTONSBURG CITY'S UTILITIES
COMMISSION IN SUPPORT OF THE APPLICATION
OF AUXIER WATER CO.**

I, David M. Ellis, duly sworn, state that I am Superintendent of the Prestonsburg City's Utilities Commission (hereinafter the "Utilities Commission") and make the following statement on its behalf in support of the Application of Auxier Water Co. (hereinafter the "Applicant") for authorization to transfer its water distribution system and customer deposits to the City of Prestonsburg, acting by and through its Utilities Commission.

1. The Utilities Commission is a municipally owned utility and is managed by its Board of Commissioners pursuant to KRS 58.010, et. seq.
2. The Utilities Commission obtains its supply of water from the Levisa Fork of the Big Sandy River and maintains and operates a filtering and treatment plant in Prestonsburg, Kentucky.
3. As of year ended December, 2006, the Utilities Commission served 6,885 residential, commercial, industrial and other accounts, as well as 250.7 miles of main.


The average daily pumpage for the calendar year 2006 was 2,700,761 gallons per day. The water treatment plant has a practical capacity of 4.0 million gallons per day.

4. The Utilities Commission's Water Treatment Plant is operated by four persons certified as operators of a Class IVA water treatment plant as set out in 401 KAR 8:030, Section 8(2)(g), and five class III operators. The Utilities Commission Water Distribution System is operated by persons certified as operators of a Class IIID water distribution system as set out in 401 KAR 8:030, Section 8(3)(c).

5. The Utilities Commission is financially sound and has adequate operating capital to conduct its operations and to add to its system the distribution system of Applicant. Attached hereto are copies of the separate Annual Reports of the Utilities Commission for the fiscal year ended June 30, 2005 and June 30, 2006 which set forth factual information to show that the Utilities Commission has the financial and managerial ability to serve Applicant's customers.

6. Presently, the Utilities Commission is the sole supplier of potable water for the Applicant's water distribution system.

PRESTONSBURG CITY'S UTILITIES
COMMISSION

BY: 
DAVID M. ELLIS, Superintendent
2560 South Lake Drive
Prestonsburg, Kentucky 41653

Subscribed and sworn to before me this 16th day of November, 2007.

My Commission Expires: SEPTEMBER 26, 2009


NOTARY PUBLIC, STATE-AT-LARGE

Michael R. Spears, CPA, PSC

Certified Public Accountant

PRESTONSBURG CITY UTILITIES COMMISSION

REPORT ON AUDIT OF FINANCIAL STATEMENTS
for the years ended June 30, 2006 & 2005

CONTENTS

Independent Auditor's Report	1
Management Discussion And Analysis	3-6
Basic Financial Statements	
Statements Of Net Assets	7-8
Statements Of Revenues, Expenses And Changes In Net Assets	9-10
Statements Of Cash Flows	11-12
Notes To Basic Financial Statements	13-21
Required Supplementary Information	
Budgetary Comparison Schedule	22-23
Other Supplementary Information	
Comparative Analysis Of Revenues And Expenses	24
Schedule Of Plant, Equipment And Depreciation	25
Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With <i>Government Auditing Standards</i>	26

Michael R. Spears, C.P.A., P.S.C.

Certified Public Accountant

Independent Auditor's Report

To the Board of Commissioners
Prestonsburg City's Utilities Commission
Prestonsburg, Kentucky

We have audited the accompanying financial statements of the business-type activities of Prestonsburg City's Utilities Commission, component unit of the City of Prestonsburg, Kentucky, as of and for the year then ended June 30, 2006, which collectively comprise the Commission's basic financial statements as listed in the table of contents. The financial statements for the year ended June 30, 2005 were audited by Jones, Pack & Associates. Their report was dated November 4, 2005 and they issued an unqualified opinion for the year then ended. These financial statements are the responsibility of the Prestonsburg City's Utilities Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note A, the financial statements present only the activities of the Prestonsburg City's Utilities Commission, and are not intended to present fairly the financial position and result of operations of the City of Prestonsburg, Kentucky, and the results of its operations and its cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the June 30, 2006 financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of Prestonsburg City's Utilities Commission of the City of Prestonsburg as of June 30, 2006, and the results of operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 29, 2006, on our consideration of Prestonsburg City's Utilities Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 3 through 6 and pages 22 and 23, are not a required part of the basic financial statements 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 audits were performed for the purpose of forming an opinion on the financial statements of the Prestonsburg City's Utilities Commission, taken as a whole. The introductory section and accompanying supplementary financial information listed in the table of contents, is not a required part of the basic financial statements. The introductory section, budgetary comparison information and statistical tables have not been subjected to the auditing procedures applied to the audit of the basic financial statements and, accordingly, we express no opinion on them.

A handwritten signature in cursive script that reads "Michael R. Spears CPA".

Michael R. Spears, CPA, PSC
December 29, 2006

MANAGEMENT DISCUSSION AND ANALYSIS

Our discussion and analysis of the Prestonsburg City's Utilities Commission's financial performance provides an overview of the Commission's financial activities for the year ended June 30, 2006. Please read it in conjunction with the Commission's financial statements, which begin on page 7.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statements of Net Assets and the Statements of Revenues, Expenses and Changes in Net Assets (pages 7-10) report the Commission's operations in detail. The Commission is a component unit of the City of Prestonsburg and presents only fund financial statements.

Reporting the Commission as a Whole

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets

Our analysis of the Commission as a whole begins on page 4. One of the most important questions asked about the Commission's finances is, "Is the Commission as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Commission as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Commission's net assets and changes in them. You can think of the Commission's net assets—the difference between assets and liabilities—as one way to measure the Commission's financial health, or financial position. Over time, increases or decreases in the City's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the Commission's service area and condition of existing water and gas lines, to assess the overall health of the Commission.

In the Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets, the Commission reports only one type of activity:

- Business-type activity—The Commission charges a fee to customers to help it cover all or most of the cost of certain services it provides. The City of Prestonsburg's water, sewer, and natural gas systems are reported here.

Reporting the Commission's Most Significant Funds

Fund Financial Statements

The fund financial statements begin on page 7 and provide detailed information about the fund. The Commission has only one fund type:

- Proprietary funds—When the Commission charges customers for the services it provides these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

PRESTONSBURG CITY'S UTILITIES COMMISSION
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2006

The Commission As A Whole

The Commission's net assets changed slightly from a year ago, decreasing from 20.7 million to 19.7 million. For the years ending June 30, 2006 and June 30, 2005, net assets changed as follows:

	Business-type Activities	
	2006	2005
Beginning net assets	\$ 20.7	\$ 20.0
Increase (decrease) in net assets	(1.0)	.7
Ending net assets	<u>\$ 19.7</u>	<u>\$ 20.7</u>

This reflects a decrease of 4.8%. The Commission generally can only use these net assets to finance the expansion and continuing operations of the water, gas and sewer system.

Business-type Activities

Water rates were increased by 3.5% effective February 1, 2006. Gas rates were increased 3.5% effective May 1, 2006. The rates were increased due to the Commission's rising cost to obtain natural gas and increased costs to expand the water and sewer system throughout the service area.

GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget, final budget and actual results are as follows:

	Budget Basis Original	Actual Amount GAAP Basis
Operating Revenue	\$ 4,934,350	\$ 5,066,728
Operating Expenses	(5,507,085)	(6,536,101)
Non-Operating Revenue/Expenses	(20,100)	169,862
Capital Contributions	1,200,000	261,703
Change in Net Assets	<u>\$ 607,165</u>	<u>\$ (1,037,808)</u>

Operating revenue was budgeted based upon prevailing rates at June 30, 2006. Actual operating revenues billed varied from the original budget by 2.7%. This variance was due in part to increases in water and gas billing rates. Actual operating expenses varied from the original budget by 18.7%. This variance was due in large part to increases in natural gas purchase prices. The variance in non-operating revenues net of non-operating expenses is due primarily to a conservative estimate of interest income. Actual capital contributions were under budget. The decrease in capital contributions accounts for the Commission closing the year with a decrease in net assets.

PRESTONSBURG CITY'S UTILITIES COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2006

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of June 30, 2006, the Commission had \$36.6 million invested in capital assets including land, buildings and improvements, machinery and equipment and water, sewer, and gas lines, compared to \$36.3 million at June 30, 2005. This represents a net increase of \$.3 million, or a 1% increase over last year.

	Business-Type Activities	
	2006	2005
Land	\$ 287,832	\$ 217,336
Buildings	561,114	577,673
Improvements	29,777	29,777
Vehicles	1,170,727	1,281,575
Office and other equipment	529,241	431,995
Water, sewer and gas lines	34,053,743	33,720,119
TOTALS	<u>\$ 36,632,434</u>	<u>\$ 36,258,475</u>

Debt

At year-end, the Commission had \$5.38 million in outstanding bonds, notes and capital leases compared to \$5.67 million last year. That is a decrease of approximately 5.1% as shown in the following table.

	2006	2005
Revenue notes (backed by system revenues)	\$ 2,375,000	\$ 2,401,500
KIA loans (backed by system revenues)	2,619,463	2,828,581
Capital lease obligations (secured by asset purchased)	389,871	440,596
TOTALS	<u>\$ 5,384,334</u>	<u>\$ 5,670,677</u>

New debt issued this year consisted of two notes totaling \$71,194. These notes were used to purchase vehicles. Other obligations of the Commission included accrued compensated absences. More detailed information about the Commission's long-term liabilities is presented in Note H to the basic financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Commission's business-type activities will see a substantial change due to water, sewer, and gas rate increases. Water and sewer rates were increased effective February 1, 2006. The increase in rates amounted to approximately 3.5% across the board for residential customers and 2% for wholesale customers currently served. Gas rates were increased effective May 1, 2006 and amounted to an increase of approximately 3.5% across the board. The effects of both increases are reflected in the operating budget for Fiscal Year 2007.

PRESTONSBURG CITY'S UTILITIES COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2006

CONTACTING THE COMMISSION'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Commission's finances and to show the Commission's accountability for the money it receives. If you have questions about this report or need additional information, contact the Chief Financial Officer of the Prestonsburg City's Utilities Commission at 2560 South Lake Drive, Prestonsburg, Kentucky 41653.

PRESTONSBURG CITY UTILITIES COMMISSION
STATEMENT OF NET ASSETS
JUNE 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
Current Assets		
Cash - (Note A)	\$ 992,461	\$ 457,179
Cash - restricted (Notes A and B)	-	-
Accounts receivable, net - (Note C)	622,957	681,267
Due from other funds	437,359	393,031
Inventory	99,928	87,223
Other current assets - (Note D)	9,155	167,423
	<u>2,161,860</u>	<u>1,786,123</u>
Total Current Assets	2,161,860	1,786,123
Noncurrent Assets		
Investments - (Notes A and B)	1,779,741	1,755,869
Investments - restricted (Notes A and B)	1,220,259	1,922,966
	<u>3,000,000</u>	<u>3,678,835</u>
Total Noncurrent Assets	3,000,000	3,678,835
Capital Assets - (NoteE)		
Land and land improvements	317,609	247,113
Buildings	561,114	577,673
Office and other equipment	529,241	431,995
Water plant and equipment	19,281,302	18,954,766
Sewer plant and equipment	14,000,574	14,000,643
Gas distribution system	771,867	764,710
Motor vehicles	1,170,727	1,281,575
	<u>36,632,434</u>	<u>36,258,475</u>
Less: accumulated depreciation	(15,899,514)	(14,646,455)
	<u>20,732,920</u>	<u>21,612,020</u>
Capital assets, net	20,732,920	21,612,020
Total Assets	\$ <u><u>25,894,780</u></u>	\$ <u><u>27,076,978</u></u>

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
STATEMENT OF NET ASSETS
JUNE 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable (Note F)	\$ 451,289	\$ 180,343
Customer meter deposits	247,737	255,170
Current maturities of long-term debt	348,063	341,460
Current maturities of bonds payable	28,500	-
Construction contracts payable	9,500	143,871
Unearned revenue	15,100	15,100
Accrued expenses - (Note G)	116,825	104,014
Total Current Liabilities	<u>1,217,014</u>	<u>1,039,958</u>
Noncurrent Liabilities		
Bonds, notes, and leases payable	<u>5,007,771</u>	<u>5,329,217</u>
Total Liabilities	6,224,785	6,369,175
NET ASSETS		
Investment in capital assets, net of related debt	15,348,586	15,941,343
Unrestricted	<u>4,321,409</u>	<u>4,766,460</u>
Total Net Assets	<u>19,669,995</u>	<u>20,707,803</u>
Total Liabilities and Net Assets	<u>\$ 25,894,780</u>	<u>\$ 27,076,978</u>

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

	2006	2005
OPERATING REVENUES:		
Charges for services:		
Water sales	\$ 2,509,134	\$ 2,423,774
Gas sales	1,587,528	1,593,477
Sewer service	786,407	779,827
Tap fees	48,536	58,525
Penalties and arrears	126,728	110,303
Reconnection and collection fees	8,395	24,905
Total Operating Revenues	5,066,728	4,990,811
 OPERATING EXPENSES:		
Gas purchases	1,381,524	1,327,078
Water purchases	43,381	20,767
Maintenance materials and supplies	596,414	542,377
Lab testing fees	16,864	18,758
Electric power	291,816	277,822
Uniforms	-	9,891
Salaries and wages	1,374,289	1,263,334
Maintenance labor	-	68
Motor vehicle expense	78,615	40,932
Depreciation	1,544,560	1,431,545
Bad debts	8,368	21,766
Insurance	139,404	106,774
Hospitalization insurance	296,313	237,113
Other employee benefits	145,792	115,720
Legal and professional services	58,150	34,284
Engineering, easements and recording fees	50,594	24,979
Postage	23,735	22,613
Equipment rent	38,435	13,837
Office expense	77,470	39,666
Freight	6,025	4,737
Telephone	26,397	20,539
Advertising	6,012	4,252
Sewer sludge disposal	12,958	12,992
Educational and training expense	16,611	7,870
Travel	49	324
Dues and subscriptions	4,339	3,135
Payroll taxes	110,285	91,539
Miscellaneous tax and licenses	2,586	521
Directors fees	2,160	2,495
Gasoline and diesel fuel	88,724	74,065
Janitorial and grounds expense	62,240	35,802
Small tools	14,491	9,998
Miscellaneous	17,500	10,161
Total Operating Expenses	6,536,101	5,827,754
Operating Income (Loss)	\$ (1,469,373)	\$ (836,943)

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

	2006	2005
NONOPERATING REVENUES (EXPENSES)	\$ 183,245	\$ 61,956
Miscellaneous income	-	4,800
Rent income	58,861	48,464
Gain on sale of capital assets	115,163	102,476
Interest income	(187,407)	(186,713)
Interest expense		
Total Nonoperating Revenues (Expenses)	<u>169,862</u>	<u>30,983</u>
 Income (loss) before contributions	 <u>(1,299,511)</u>	 <u>(805,960)</u>
 CAPITAL CONTRIBUTIONS	 <u>261,703</u>	 <u>1,537,255</u>
 Change in net assets	 (1,037,808)	 731,295
Total net assets - beginning	<u>20,707,803</u>	<u>19,976,508</u>
 Total net assets - ending	 <u>\$ 19,669,995</u>	 <u>\$ 20,707,803</u>

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 5,125,038	\$ 4,893,021
Payments to suppliers	(3,629,957)	(3,095,536)
Payments to employees	(1,374,289)	(1,263,334)
Other receipts (payments)	447,065	(452,561)
Customer meter deposits	(7,433)	8,095
Net Cash Provided (Used) for Operating Activities	<u>560,424</u>	<u>89,685</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	71,194	920,421
Capital contributions	261,703	1,537,255
Purchases of capital assets	(678,718)	(2,311,469)
Principal paid on capital debt	(357,537)	(649,808)
Interest paid on capital debt	(187,901)	(183,169)
Proceeds from sale of capital assets	72,119	275,263
Net cash (used) by capital and related financing activities	<u>(819,140)</u>	<u>(411,507)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Rental income	-	4,800
Purchase of investments	-	(98,643)
Proceeds from investments redeemed	678,835	88,598
Interest	115,163	102,476
Net cash (used) by investing activities	<u>793,998</u>	<u>97,231</u>
Net increase (decrease) in cash and cash equivalents	<u>535,282</u>	<u>(224,591)</u>
Balances - beginning of year	<u>457,179</u>	<u>681,770</u>
Balances - end of year	<u>\$ 992,461</u>	<u>\$ 457,179</u>

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

	<u>2006</u>	<u>2005</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	\$ (1,469,373)	\$ (836,943)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation Expense	1,544,560	1,431,545
Miscellaneous Income (Expense)	183,245	61,956
 Change in Net Assets and Liabilities:		
Receivables, net	58,310	(97,790)
Inventories	(12,705)	37,339
Other current assets	113,940	(141,811)
Accounts and other payables	129,142	(340,394)
Accrued expenses	13,305	16,583
Unearned revenue	-	(40,800)
Net cash provided by operating activities	<u>560,424</u>	<u>89,685</u>
 Non-cash capital and related activities:		
Acquisition of vehicles		
Cost of vehicles	\$ -	\$ 97,374
Gain on trade-ins	-	(5,518)
Vehicle loans	-	(68,939)
Cash down payment for vehicles	<u>\$ -</u>	<u>\$ 22,917</u>

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006 and 2005

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

The Prestonsburg City's Utilities Commission (the "Commission") is a municipally owned gas, water and sewer facility created as a public project in 1956 by ordinance of the City of Prestonsburg, Kentucky. The facility is supervised and managed by three commission members each with staggered six-year terms, who are appointed by the Mayor. Gas and sewage services are provided in Prestonsburg, and local surrounding areas; water services are provided in Prestonsburg and extend throughout most of Floyd County, either directly or indirectly through sales to wholesale water customers.

The Commission's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989 (when applicable) that do not conflict with or contradict GASB pronouncements. In June 1999, the Governmental Accounting Standards Board (GASB) unanimously approved Statement No. 34 *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. Certain of the significant changes in the Statement include the following:

1. Reporting Entity

The Commission is a component unit of the City of Prestonsburg and maintains separate and distinct accounting records. The City of Prestonsburg transferred to the Commission, by Ordinance in 1956, all powers of the City to improve, operate and maintain the utility systems, including the power to determine utility rates and financial practices.

2. Basic Financial Statements—Fund Financial Statements

The financial transactions of the Commission are reported as a single fund, accounted for by a separate set of self-balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures/expenses. The Commission uses the following fund type:

- Proprietary Funds

The focus of proprietary fund measurement is based upon determination of operating income, changes in net assets, financial position and cash flows. The generally accepted accounting principles applicable are those similar to businesses in the private sector. The Commission is an Enterprise fund which is required to account for operations for which a fee is charged to external users for goods and services and the activity (a) is financed with debt that is solely secured by a pledge of the net revenues, (b) has third party requirements that the cost of providing services, including capital costs, be recovered with fees and charges or (c) establishes fees and charges based on a pricing policy designed to recover similar costs.

3. Basis of Accounting

Basis of accounting refers to the point at which revenues or expenditures/expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied. The accounting records are maintained on the accrual basis of accounting. Using this method, revenues are recognized when earned and expenses are recognized when incurred.

PRESTONSBURG CITY UTILITIES COMMISSION
 NOTES TO BASIC FINANCIAL STATEMENTS
 JUNE 30, 2006 and 2005

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Proprietary funds distinguish operating revenues and expenses from non-operating revenue items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Commission are for sales of water and natural gas to customers; charges for sewer services; and related tap and connection fees in addition to late payment charges. Operating expenses include the cost of sales, wages, operating and administrative expenses and depreciation of capital assets. All revenue and expenses not meeting this definition are reported as non-operating revenues and expenses.

4. Financial Statement Amounts

a) Cash and cash equivalents

For purposes of reporting cash flows, the Commission considers all cash on hand, cash accounts which are not subject to withdrawal restrictions or penalties and certificates of deposit with original maturities of 90 days or less to be cash or cash equivalents. All cash accounts are insured and collateralized.

b) Restricted cash and investments

Prestonsburg City's Utilities Commission is required by various bond agreements and ordinances to restrict cash amounts as mandated to meet funding requirements by those agreements and ordinances. The policy of the Commission regarding improvements, expansion and major renovation projects is to restrict an amount of cash to adequately fund the projects. As of June 30, Prestonsburg City's Utilities Commission had the following cash and investment amounts restricted:

	<u>2006</u>	<u>2005</u>
Customer Meter Deposits	\$ 247,736	\$ 255,170
Depreciation Reserve Fund	256,768	242,231
Unearned Sewer Tap Fees	15,100	15,100
Operation & Maintenance Reserve Fund	702,990	702,990
Debt Service Fund	547,647	483,834
Retainage -- Construction Contractors	<u>9,500</u>	<u>56,544</u>
	<u>\$ 1,779,741</u>	<u>\$ 1,755,869</u>

The restricted amounts consist of cash, current investments (securities with less than one-year maturity from balance sheet date) and non-current investments. The restricted amount at June 30, 2006 of \$1,220,259 consists of non-current investments. The restricted amount at June 30, 2005 of \$1,922,966 consists of non-current investments. The Depreciation Reserve Fund includes the restricted amounts required by USDA Rural Development and KIA.

- (1) \$ 7,560 - 1998 US 23/Cow Creek Project
- (2) \$ 9,360 - Buffalo Project
- (3) \$ 30,600 - 2001 Mountaintop Bond Issue
- (4) \$ 2,490 - Raw Water Intake Project
- (5) \$ 206,758 - KIA

PRESTONSBURG CITY UTILITIES COMMISSION
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006 and 2005

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

c) Inventory

Inventory is stated at the lower of cost or market value, cost being computed on a first-in, first-out basis.

d) Capital Assets

Capital assets purchased or acquired are reported at historical cost. Contributed assets are reported at fair market value as of the date received. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on all assets is provided on the straight-line basis over their useful lives ranging from 5 to 50 years.

e) Revenues

All revenues are accrued when earned. Utility service charges are billed monthly and collected in the following month. Grants to proprietary funds, which finance either capital or current operations, are reported as non-operating revenue based on GASBS No. 33. In applying GASBS No. 33 to grant revenues, the provider recognizes liabilities and expenses and the recipient recognizes receivables and revenues when the applicable eligibility requirements, including time requirements, are met. Resources transmitted before the eligibility requirements have been met are reported as advances by the provider and as deferred revenue by the recipient.

f) Expenditures

Expenses are recognized when incurred. Inventory costs are reported in the period when the inventory items are used, rather than in the period purchased.

g) Compensated absences

After completion of one (1) year of continuous service each full-time regular employee is granted vacation benefits and sick leave in varying amounts to specified maximums depending on their tenure with the Commission. Employees shall not be compensated for accrued sick leave upon termination or resignation of employment. Employees earn 80 hours of vacation time per year for each year of employment between years one and seven and 120 hours for each year after seven years. Employees may have no more than 40 hours accrued vacation at December 31st that can be carried over to the following calendar year. Once each calendar year, eligible employees may, upon request, be paid for a maximum of 40 hours of unused vacation time. All vacation time is paid at the employee's regular rate of pay. Full-time regular employees are entitled to all accrued vacation leave benefits if they terminate their employment in good standing.

h) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

PRESTONSBURG CITY UTILITIES COMMISSION
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006 and 2005

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

i) Income taxes

The organization was granted tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. Therefore, no provision for income taxes has been made in these financial statements.

j) Advertising

Advertising costs are charged to operations in the year incurred and totaled \$6,012 and \$4,252 for the years ended June 30, 2006 and 2005, respectively.

NOTE B: DEPOSITS AND INVESTMENTS

Deposits

The Commission's deposits are categorized to give an indication of the level of risk assumed by the Commission at fiscal year end. The categories are described as follows:

Category 1 - Insured or collateralized with securities held by the Commission or by its agent in the Commission's name.

Category 2 - Collateralized with securities held by the pledging financial institution's trust department or agent in the Commission's name.

Category 3 - Uncollateralized

The Commission's deposits are all considered to be in the Category 1 level of risk for June 30, 2006 and 2005.

At June 30, 2006 the carrying amount of the Commission's deposits was \$990,850 and the bank balances totaled \$1,198,102. The difference between the carrying amounts and bank balances was due to items in transit. Of the bank balances, \$207,188 was covered by the Bank Insurance Fund and \$990,914 was uninsured but collateralized with pledged securities held by the depositories in the Commission's name.

At June 30, 2005 the carrying amount of the Commission's deposits was \$456,279 and the bank balances totaled \$649,983. The difference between the carrying amounts and the bank balances was due to items in transit. Of the bank balances, \$341,139 was covered by the Bank Insurance Fund and \$552,083 was uninsured but collateralized with pledged securities held by the depositories in the Commission's name.

Investments

The Commission's investments are categorized to give an indication of the level of risk assumed by the Commission at fiscal year end. The categories are described as follows:

Category 1 - Insured, registered or securities held by the Commission or by its agent in the Commission's name.

Category 2 - Uninsured and unregistered, with securities held by the counter party's trust department or agent in the Commission's name.

Category 3 - Uninsured and unregistered, with securities held by the counter party, or its trust department or agent but not in the Commission's name.

PRESTONSBURG CITY UTILITIES COMMISSION
 NOTES TO BASIC FINANCIAL STATEMENTS
 JUNE 30, 2006 and 2005

NOTE B: DEPOSITS AND INVESTMENTS (Continued)

Investing is performed in accordance with investment policies complying with State Statutes and a resolution adopted by the Commission. The following is a summary of the Commission's investments at June 30, 2006 and 2005. These investments are either insured or collateralized with pledged securities held by the depositories in the Commission's name.

	<u>2006</u>	<u>2005</u>
Certificates of Deposit (Non-current)	\$ 3,000,000	\$ 3,678,835
	<u>\$ 3,000,000</u>	<u>\$ 3,678,835</u>

The Commission's investments are all considered to be in the Category 1 level of risk for June 30, 2006 and 2005.

NOTE C: ACCOUNTS RECEIVABLE AND BAD DEBTS

Accounts receivable are summarized as follows:

	<u>2006</u>	<u>2005</u>
Customer Accounts Receivable	\$ 776,404	\$ 769,164
Miscellaneous Accounts Receivable	3,414	61,397
Total Accounts Receivable	<u>779,818</u>	<u>830,561</u>
Less: Allowance for Doubtful Accounts	<u>(156,861)</u>	<u>(149,294)</u>
Accounts Receivable, net	<u>\$ 622,957</u>	<u>\$ 681,267</u>

Bad debts are recognized utilizing the allowance method. The provision for bad debts charged to operations is the amount deemed sufficient to bring the balance of the reserve to an adequate level to absorb future losses based on the Commission's past loss experience and other factors, which, in management's judgment, are necessary in estimating possible bad debts. Bad debt expense recognized for the fiscal years ended June 30, 2006 and 2005 was \$8,368 and \$21,766, respectively. Miscellaneous accounts receivable at June 30, 2006 consisted of miscellaneous sales of water and related supplies. Miscellaneous accounts receivable at June 30, 2005 consisted of refunds due for expense overpayments and miscellaneous sales of water and related supplies.

NOTE D: OTHER CURRENT ASSETS

The other assets account consists of:

- (1) \$1,100 equipment deposit and \$8,055 interest receivable at June 30, 2006.
- (2) \$1,100 equipment deposit, \$133,334 prepaid insurance, \$2,568 interest receivable, and \$30,421 prepaid vehicles at June 30, 2005.

PRESTONSBURG CITY UTILITIES COMMISSION
 NOTES TO BASIC FINANCIAL STATEMENTS
 JUNE 30, 2006 and 2005

NOTE E: PLANT AND EQUIPMENT

Plant and equipment are stated at cost less accumulated depreciation. Depreciation has been provided over the estimated useful lives of the assets on the straight-line method of cost allocation. Maintenance, repairs and minor replacements are charged to expense as incurred; major renewals and betterments are capitalized. At June 30, 2006 and 2005, plant and equipment consisted of the following:

		<u>2006</u>	<u>2005</u>
Water Plant and Distribution System	5-40 Yrs.	\$ 19,288,390	\$ 18,954,766
Sewer Plant and Collection System	5-50 Yrs.	14,000,643	14,000,643
Gas Distribution System	5-50 Yrs.	764,710	764,710
Motor Vehicles	4-5 Yrs.	625,887	732,828
Office and Other Equipment	5-10 Yrs.	529,241	431,995
Office Buildings and Improvements	5-40 Yrs.	561,114	577,673
Land Improvements	20 Yrs.	29,777	29,777
Land		287,832	217,336
Equipment Acquired by Capital Lease	5 Yrs.	<u>544,840</u>	<u>548,747</u>
Total Cost		36,632,434	36,258,475
Less: Accumulated Depreciation		(15,682,534)	(14,497,012)
Less: Accumulated Depreciation -- Capital Leases		<u>(216,980)</u>	<u>(149,443)</u>
Net Plant and Equipment		<u>\$ 20,732,920</u>	<u>\$ 21,612,020</u>

Depreciation expense charged to operations in fiscal year ended June 30, 2006, amounted to \$1,544,560 of this amount \$84,165 was depreciation for equipment obtained by capital lease. Depreciation expense charged to operations for fiscal year June 30, 2005 was \$1,431,545 of this amount \$73,417 was depreciation for equipment obtained by capital lease. A detailed summary of changes in Plant and Equipment for the year ended June 30, 2006 is included as supplementary information on page 25 of this report.

NOTE F: ACCOUNTS PAYABLE

Accounts payable at June 30 consists of:

	<u>2006</u>	<u>2005</u>
Various Trade Vendors	\$ 253,524	\$ 80,638
City of Prestonsburg & Floyd County for collection of sanitation fees	<u>197,765</u>	<u>99,705</u>
Total Accounts Payable	<u>\$ 451,289</u>	<u>\$ 180,343</u>

PRESTONSBURG CITY UTILITIES COMMISSION
 NOTES TO BASIC FINANCIAL STATEMENTS
 JUNE 30, 2006 and 2005

NOTE G: ACCRUED EXPENSES

Accrued expenses as shown on the balance sheet at June 30 consist of the following accounts:

	<u>2006</u>	<u>2005</u>
Accrued Payroll Taxes and Withholding	\$ 25,860	\$ 23,998
Compensated Absences	57,474	44,342
Retirement Payable	25,047	24,716
Accrued Sales Tax	3,823	5,843
Accrued Bond and Note Interest	4,021	4,515
Rent Deposit Payable	<u>600</u>	<u>600</u>
Total Accrued Expenses	<u>\$ 116,825</u>	<u>\$ 104,014</u>

NOTE H: LONG-TERM DEBT

The Commission's outstanding lease agreements include the acquisition of five vehicles in the current year and land, a sewer cleaning machine, construction equipment and a Chevy Tahoe in prior years. These leases qualify as capital leases. The lease term will terminate upon final payment. Outstanding bond and notes payable represent acquisition of water systems and expansion of water and sewer lines in prior years. Bonds, notes and leases payable are summarized as follows:

	Rate	Maturity Date	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Bonds Payable:							
USDA/RD (1998)	4.50%	01/01/38	\$ 176,000	\$ 0	\$ 2,500	\$ 173,500	\$ 2,500
USDA/RD (1999)	4.75%	01/01/27	258,500	0	3,000	255,500	3,500
USDA/RD (2001)	4.50%	01/01/41	1,077,000	0	12,000	1,065,000	13,000
USDA/RD (91-23)	4.50%	01/01/44	740,000	0	7,500	732,500	8,000
USDA/RD (91-25)	4.50%	01/01/44	150,000	0	1,500	148,500	1,500
Total Bonds Payable			<u>2,401,50</u>	<u>0</u>	<u>26,500</u>	<u>2,375,000</u>	<u>28,500</u>
Notes Payable:							
KIA – (B291-11)	2.90%	06/01/14	1,022,200	0	100,943	921,256	103,892
KIA – (B98-01)	1.30%	06/01/19	436,026	0	28,590	407,436	28,962
KIA – (A98-03)	1.80%	12/01/20	740,187	0	41,802	698,385	42,558
KIA – (B99-01)	1.00%	12/01/20	630,168	0	37,782	592,386	38,161
Daimler-Chrysler	4.91%	9/19/08	0	38,553	9,116	29,437	12,685
Community Trust	4.99%	9/2/08	0	32,641	6,661	25,980	12,961
Total Notes Payable			<u>2,828,581</u>	<u>71,194</u>	<u>224,894</u>	<u>2,674,880</u>	<u>239,219</u>
Leases Payable:							
KADD2003_045B	3.59%	4/20/10	285,000	0	55,000	230,000	55,000
Leasing One Corp.	4.78%	04/06/05	56,236	0	19,749	36,487	20,754
Leasing One Corp.	5.27%		99,360	0	31,393	67,967	33,090
Total Leases Payable			<u>440,596</u>	<u>0</u>	<u>106,142</u>	<u>334,454</u>	<u>108,844</u>
Total Long-Term Debt			<u>\$ 5,670,677</u>	<u>\$ 71,194</u>	<u>\$ 357,536</u>	<u>\$ 5,384,334</u>	<u>\$ 376,563</u>

PRESTONSBURG CITY UTILITIES COMMISSION
 NOTES TO BASIC FINANCIAL STATEMENTS
 JUNE 30, 2006 and 2005

NOTE H: LONG-TERM DEBT (Continued)

The annual debt service requirements to maturity for long-term debt are as follows:

	BONDS		NOTES PAYABLE	
	Principal	Interest	Principal	Interest
June 30, 2008	30,000	105,769	242,763	43,860
June 30, 2009	31,500	104,399	227,959	40,084
June 30, 2010	33,000	102,939	227,604	35,350
June 30, 2011	33,500	101,444	232,511	30,443
June 30, 2012	35,000	99,904	237,539	25,414
June 30, 2013-2017	205,000	473,631	863,575	61,614
June 30, 2018-2022	254,500	421,904	403,710	10,869
June 30, 2023-2027	317,500	357,822		
June 30, 2028-2032	395,500	277,899		
June 30, 2033-2037	496,500	178,093		
June 30, 2038-2042	468,500	61,344		
June 30, 2043-2047	46,000	2,071		
	<u>2,346,500</u>	<u>2,287,219</u>	<u>2,435,661</u>	<u>247,634</u>

	LEASES PAYABLE	
	Principal	Interest
June 30, 2008	105,610	8,062
June 30, 2009	60,000	4,800
June 30, 2010	60,000	2,400
June 30, 2011		
June 30, 2012		
	<u>225,610</u>	<u>15,262</u>

NOTE I: RETIREMENT PLAN

On August 18, 1988, the Commission and City of Prestonsburg by Ordinance No. 11-88 as prescribed by the House Bill 398 and KRS Statute 18.510 to 78.852, created the "Prestonsburg City Utilities Commission Retirement System", which is a participant in the County Employees Retirement System. This is a multiple employer public retirement system, providing retirement benefits for all full-time employees. This retirement plan, administered by Kentucky Retirement Systems, was for all electing employees as of August 1, 1988, and any future employees. Employees are vested in the plan after completion of (5) years of service.

Benefit contributions and provisions are established by statute. Normal annual funding is computed at a percentage of gross wages, the percentage to be withheld is 5% and the percentage to be paid by the employer was 10.98% for the year ended June 30, 2006. Employer contributions for retirement were \$145,614 and \$105,769 for the years ending June 30, 2006 and 2005, respectively. Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement System's annual financial report (which is a matter of public record).

NOTE J: CONSTRUCTION COMMITMENTS

Sanitary Sewer Extension - Big Branch Abbott

On September 7, 1995, the Commission accepted a check in the amount of \$40,000 from Big Branch Development Corporation, a construction company planning to build new houses in the Big Branch Abbott Creek

PRESTONSBURG CITY UTILITIES COMMISSION
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006 and 2005

NOTE J: CONSTRUCTION COMMITMENTS (Continued)

area near Prestonsburg, Kentucky. This check was recorded as *unearned sewer tap fees and income is being recognized as the taps are made*. At June 30, 2006 and 2005, the balance of this account was \$15,100 and \$15,100, respectively.

Kentucky 321 Waterline Reinforcement Project

The Commission serves the water demands of the northern area of the city and county as well as the new Big Sandy Federal Prison Complex and parts of Martin County via a line that crosses the Big Sandy River four times between the northern most area of the city and Highlands Regional Medical Center. The Commission plans to replace this line, thus, eliminating the river crossings. Phase I of this project was completed during Fiscal Year 2004 when the 1,000,000-gallon water storage tank at the Highlands Regional Medical Center was constructed. Phase II of the project involves the construction of the new 10" waterline and booster station along the east side of KY Route 321 from the north side of Prestonsburg to the new tank near Highlands Regional Medical Center. The estimated cost of Phase II is \$800,000. Advertising for bids for Phase II is anticipated for the early spring of 2006 with construction expected to commence shortly thereafter. Both state and federal funding assistance is anticipated by the Commission for this project.

Town Branch PRIDE 2005 Sewer Project

During Fiscal Year 2006 the Commission will advertise for both engineering services and construction contractors with the intention of extending force main sewer service to the Town Branch area of Prestonsburg. The estimated cost of this project is \$700,000. It is anticipated that the cost will be funded with Federal PRIDE Program dollars.

NOTE K: COMMITMENTS AND CONTINGENCIES

The Commission is involved in legal action arising in the ordinary course of business. In the opinion of management, the Commission has adequate legal defenses or insurance coverage with respect to each of these actions and does not believe that they will materially affect the company's results of operations or financial position.

NOTE L: RELATED PARTY TRANSACTIONS

Board of Commissioners' Chairman, Jimmy Calhoun is president of Calhoun's Garage, Inc. Calhoun's Garage, Inc. occasionally performs vehicle repairs for the Commission. There were no material transactions individually or in the aggregate.

REQUIRED SUPPLEMENTARY INFORMATION

PRESTONSBURG CITY UTILITIES COMMISSION
 BUDGETARY COMPARISON SCHEDULE
 FOR THE YEAR ENDED JUNE 30, 2006

	Budgeted Basis Original	Actual Amount - GAAP Basis
	\$	\$
OPERATING REVENUES:		
Charges for services:		
Water sales	2,387,000	2,509,134
Gas sales	1,515,000	1,587,528
Sewer service	805,000	786,407
Tap fees	59,000	48,536
Penalties and arrears	100,000	126,728
Reconnection and collection fees	14,350	8,395
Total Operating Revenues	4,880,350	5,066,728
OPERATING EXPENSES:		
Gas purchases	1,225,000	1,381,524
Water purchases	5,500	43,381
Maintenance materials and supplies	446,500	596,414
Lab testing fees	17,050	16,864
Electric power	231,200	291,816
Uniforms	7,255	-
Salaries and wages	1,351,000	1,374,289
Maintenance labor	7,575	-
Motor vehicle expense	42,750	78,615
Depreciation	1,302,000	1,544,560
Bad debts	-	8,368
Insurance	81,075	139,404
Hospitalization insurance	256,780	296,313
Other employee benefits	137,899	145,792
Legal and professional services	22,900	58,150
Engineering, easements and recording fees	16,025	50,594
Postage	23,275	23,735
Equipment rent	15,100	38,435
Office expense	40,550	77,470
Freight	4,150	6,025
Telephone	16,850	26,397
Advertising	2,955	6,012
Sewer sludge disposal	13,505	12,958
Educational and training expense	8,255	16,611
Travel	750	49
Dues and subscriptions	3,195	4,339
Payroll taxes	84,150	110,285
Miscellaneous tax and licenses	905	2,586
Directors fees	2,160	2,160
Bond Issue Costs	3,250	-
Gasoline and diesel fuel	-	88,724
Janitorial and grounds expense	24,895	62,240
Small tools	-	14,491
Miscellaneous	10,305	17,500
Total Operating Expenses	5,404,759	6,536,101
Operating Income (Loss)	(524,409)	(1,469,373)

The accompanying notes are an integral part of these financial statements.

PRESTONSBURG CITY UTILITIES COMMISSION
 BUDGETARY COMPARISON SCHEDULE
 FOR THE YEAR ENDED JUNE 30, 2006

		Budgeted Basis Original		Actual Amount - GAAP Basis
NON-OPERATING REVENUES (EXPENSES):				
Miscellaneous Income	\$	48,000	\$	183,245
Rent Income		-		-
Gain on sale of capital assets		5,000		58,861
Interest Income		54,000		115,163
Interest Expense		(175,426)		(187,407)
Total Non-operating Revenues (Expenses)		<u>(68,426)</u>		<u>169,862</u>
Income (loss) before contributions		<u>(592,835)</u>		<u>(1,299,511)</u>
CAPITAL CONTRIBUTIONS		<u>1,200,000</u>		<u>261,703</u>
Change in Net Assets		607,165		(1,037,808)
Total net assets - beginning		<u>20,287,444</u>		<u>20,707,803</u>
Total net assets - ending	\$	<u>20,894,609</u>	\$	<u>19,669,995</u>

The accompanying notes are an integral part of these financial statements.

OTHER SUPPLEMENTARY INFORMATION

PRESTONSBURG CITY UTILITIES COMMISSION
 SCHEDULE OF PLANT, EQUIPMENT AND DEPRECIATION
 FOR THE YEAR ENDED JUNE 30, 2006

	PLANT AND EQUIPMENT				ALLOWANCE FOR DEPRECIATION			
	Balance 6/30/2005	Additions	Deletions	Balance 6/30/2006	Balance 6/30/2005	Additions	Deletions	Balance 6/30/2006
WATER SYSTEM								
Plant, equipment, storage tanks and service lines	\$ 14,953,574	\$ 189,008	\$ -	\$ 15,142,582	\$ 6,772,730	\$ 515,335	\$ -	\$ 7,288,065
Meters	789,431	137,527	-	926,958	489,865	67,081	-	556,946
Plant expansion	2,061,451	-	-	2,061,451	804,435	69,103	-	873,538
David Water	136,861	-	-	136,861	66,887	3,381	-	70,268
Prater Creek Water	1,013,449	-	-	1,013,449	456,400	25,337	-	481,737
SEWER SYSTEM								
Equipment and service lines	12,709,049	-	68	12,708,981	3,666,111	556,234	-	4,222,345
Plant expansion and renovation	1,291,594	-	-	1,291,594	491,742	64,728	-	556,470
GAS SYSTEM								
Transmission and service lines	651,431	-	-	651,431	323,572	20,990	-	344,562
Meters and regulators	113,279	7,157	-	120,436	80,007	4,992	-	84,999
MOTOR VEHICLES								
	1,281,575	193,843	304,691	1,170,727	799,572	160,080	291,501	668,151
OFFICE AND OTHER EQUIPMENT								
	431,995	97,246	-	529,241	375,827	27,959	-	403,786
OFFICE BUILDING AND IMPROVEMENTS								
	577,673	43,077	-	620,750	305,708	27,364	-	333,062
LAND								
	217,336	10,860	-	228,196	-	-	-	-
LAND ACQUIRED BY CAPITAL LEASE								
	-	-	-	-	-	-	-	-
RENTAL PROPERTY AND IMPROVEMENTS								
	-	-	-	-	-	-	-	-
LAND IMPROVEMENTS								
	29,777	-	-	29,777	13,599	1,986	-	15,585
TOTAL	<u>\$ 36,258,475</u>	<u>\$ 678,718</u>	<u>\$ 304,759</u>	<u>\$ 36,632,434</u>	<u>\$ 14,646,455</u>	<u>\$ 1,544,560</u>	<u>\$ 291,501</u>	<u>\$ 15,899,514</u>

Michael R. Spears, C.P.A., P.S.C.

Certified Public Accountant

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

To the Board of Commissioners
Prestonsburg City's Utilities Commission

We have audited the accompanying financial statements of Prestonsburg City's Utilities Commission as of and for the year ended June 30, 2006, and have issued our report thereon dated December 29, 2006. The financial statements for the year ended June 30, 2005 were audited by Jones, Pack & Associates. Their report was dated November 2, 2005 and they issued an unqualified opinion for the year then ended. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Prestonsburg City's Utilities Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements 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 reportable 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 caused by error or fraud 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.

Compliance

As part of obtaining reasonable assurance about whether Prestonsburg City's Utilities Commission's 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 tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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



Michael R. Spears, CPA, PSC
December 29, 2006