

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

FINANCIAL STATEMENTS,
INDEPENDENT AUDITOR'S REPORT AND
SUPPLEMENTAL INFORMATION

JUNE 30, 2011

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

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INDEPENDENT AUDITOR'S REPORT

To the Members of the
Lincoln County Board of Public Utilities:

I have audited the accompanying financial statements of the Lincoln County Board of Public Utilities of Lincoln County, Tennessee, as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Lincoln County Board of Public Utilities' management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinion.

As discussed in Note 1, the financial statements present only the Lincoln County Board of Public Utilities and do not purport to, and do not present fairly the financial position of Lincoln County, Tennessee as of June 30, 2011, and the changes in its financial position and cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lincoln County Board of Public Utilities of Lincoln County, Tennessee as of June 30, 2011, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated February 29, 2011 on my consideration of the Lincoln County Board of Public Utilities' internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of my 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 read in conjunction with this report in considering the results of my audit.

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

Accounting principles generally accepted in the United States of America require that the Schedule of Pension Funding Progress on page 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's response to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

My audit was conducted for the purpose of forming an opinion on the financial statements of the Lincoln County Board of Public Utilities taken as whole. The other supplementary information listed as supporting schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. This information is the responsibility of the Board's management. Such information, except for the portion marked "unaudited", on which I express no opinion, has been subjected to the auditing procedures applied in the audit of the financial statements and, in my opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

February 29, 2012

DAVID A. KIDD

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

BALANCE SHEET

JUNE 30, 2011

ASSETS

CURRENT ASSETS:

Cash	\$ 1,170,799
Accounts receivable, net of allowance for doubtful accounts of \$2,200	274,268
Materials and supplies inventory	161,343
Prepaid expenses	3,683
	<u>1,610,093</u>

RESTRICTED ASSETS:

Cash	<u>288,879</u>
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WATER PLANT AND EQUIPMENT:

Water plant, buildings and equipment	34,113,557
Construction in progress	283,299
Less accumulated depreciation	(13,247,405)
	<u>21,149,451</u>

OTHER ASSETS:

Deposits	<u>750</u>
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Total assets	<u>\$ 23,049,173</u>
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(See accompanying notes to financial statements.)

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:

Accounts payable	\$ 68,124
Accrued liabilities	68,311
Advance payments from developers	25,800
Accrued interest	9,407
Accrued leave	13,920
Current maturities of long-term debt	172,289
Payable from restricted assets:	
Customer deposits	13,385
	<u>371,236</u>

LONG-TERM LIABILITIES:

Bonds and capital notes	7,842,979
Capital leases	39,376
Less current maturities	<u>(172,289)</u>
	<u>7,710,066</u>
Total liabilities	<u>8,081,302</u>

NET ASSETS:

Invested in capital assets, net of related debt	13,267,096
Restricted for debt service	275,494
Unrestricted	<u>1,425,281</u>
Total net assets	<u>14,967,871</u>
Total liabilities and net assets	<u>\$ 23,049,173</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

FOR THE YEAR ENDED JUNE 30, 2011

OPERATING REVENUES:

Water sales	\$ 4,096,003
Penalties, service charges, and other	204,231
Connection fees	88,644
Total operating revenues	<u>4,388,878</u>

OPERATING EXPENSES:

Salaries and wages	1,179,016
Employee taxes and benefits	367,384
Water purchases	362,812
Water plant repair and maintenance	313,803
Utilities	292,131
Vehicle and equipment	160,765
Connection materials	27,194
Insurance	101,949
Professional fees	35,090
Water chemicals and testing	73,062
Office supplies	44,938
Postage	32,003
Telephone	23,007
Advertising	18,621
Miscellaneous	36,272
Provision for depreciation	853,790
Total operating expenses	<u>3,921,837</u>
Operating income	<u>467,041</u>

NON-OPERATING REVENUES (EXPENSES):

Interest income	2,847
Interest expense	(351,872)
Total non-operating revenues (expenses)	<u>(349,025)</u>
Increase in net assets before capital contributions	<u>118,016</u>

CAPITAL CONTRIBUTIONS:

Customer and developer contributions	101,605
Increase in net assets	219,621
Net assets, beginning of period	14,748,250
Net assets, end of period	<u>\$ 14,967,871</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 2011

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers for sales and service charges	\$ 4,281,627
Payments to vendors for goods and services	(1,886,049)
Payments to employees for services	(1,180,816)
Received from customers for connections	88,644
Customer deposits returned	(648)
Net cash provided by operating activities	<u>1,302,758</u>

CASH FLOWS FROM CAPITAL AND RELATED
FINANCING ACTIVITIES:

Acquisition and construction of capital assets	(731,269)
Principal advances on bond anticipation notes	136,142
Principal paid on notes, bonds and leases	(172,423)
Interest paid on notes, bonds and leases	(351,866)
Received from equipment dispositions	16,700
Developer contributions	81,805
Net cash used by capital and related financing activities	<u>(1,020,911)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest on cash, certificates of deposit, and note receivable	2,847
Principal received on note receivable	20,833
Net cash provided by investing activities	<u>23,680</u>

Decrease in cash and restricted cash	305,527
Cash and restricted cash, beginning of period	1,154,151
Cash and restricted cash, end of period	<u>\$ 1,459,678</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

STATEMENT OF CASH FLOWS (CONTINUED)

FOR THE YEAR ENDED JUNE 30, 2011

RECONCILIATION OF OPERATING INCOME TO NET CASH
PROVIDED BY OPERATING ACTIVITIES:

Operating income	\$ 467,041
Adjustments to reconcile operating income to net cash provided by operating activities:	
Provision for depreciation	853,790
Changes in assets and liabilities:	
Increase in accounts receivable	(18,607)
Increase in inventory	(20,545)
Decrease in prepaid expenses	782
Increase in accrued liabilities	26,808
Decrease in accounts payable	(4,063)
Decrease in customer deposits	(648)
Increase in accrued leave	(1,800)
Net cash provided by operating activities	<u>\$ 1,302,758</u>

NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES:

Equipment acquired by capital lease	\$ 43,304
Depreciation capitalized in line extensions	28,700
Distribution lines transferred to the Board by developers	19,800
Total non-cash capital and related financing activities	<u>\$ 91,804</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

(1) **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

Organization and reporting entity - The Lincoln County Board of Public Utilities (the "Board") is an enterprise fund established under Tennessee Code Annotated 5-16-101 by Lincoln County, Tennessee. The Board sells drinking water to residents of Lincoln County and has an ongoing program to expand its distribution system in an effort to provide public water to residents of the County not served by municipal systems. The Board is operated by a five member Board of Commissioners appointed by the Lincoln County Commission. The Board of Commissioners employs a Superintendent who is responsible for day-to-day operations of the water system including hiring its other employees. The Board is responsible for generating its own revenue and servicing its debt. The Board has the authority to acquire assets in the name of Lincoln County. The Lincoln County Commission has the authority to approve or reject budgets presented by the Board and to approve bonds issued by the Board. Some bonds issued for the Board are secured by a pledge of the taxing authority of Lincoln County.

The financial information of the Board is included as an enterprise fund in the Lincoln County, Tennessee Annual Financial Report. Complete financial statements of Lincoln County, Tennessee can be obtained directly from the County's administrative offices.

Basis of accounting - The Board is classified as a proprietary fund by the Governmental Accounting Standards Board (GASB) and is accounted for using a total economic resources measurement focus. The Board is intended to be operated in a manner whereby the costs of providing water distribution services and system expansion are recovered through user charges. The financial statements are prepared on the accrual basis of accounting. Under this basis, revenues are recognized when earned and expenses are recognized when the related liability is incurred. Under Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Board has elected to not follow pronouncements of the Financial Accounting Standards Board issued subsequent to November 30, 1989.

The principal operating revenues of the Board are charges to customers for water sales and related services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation of utility plant assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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. The most significant estimates relate to depreciation and the value of distribution lines contributed to the system.

Water plant and equipment, depreciation and maintenance - Water plant and equipment is depreciated on the group straight-line basis over its estimated useful life. Under the group depreciation method, gains and losses on asset dispositions are applied against accumulated depreciation and are not reflected as gains or losses in the statement of revenues, expenses and changes in net assets.

Plant assets and buildings are depreciated over 25-50 years, while vehicles and equipment are depreciated over 6-10 years. Repairs and maintenance are expensed as incurred.

Extensions and betterments are capitalized at cost, which includes payroll and related benefits, materials, and equipment costs related to plant construction. Contributed waterlines are capitalized at estimated current cost of construction. The Board capitalizes equipment additions with a cost in excess of \$500 and plant additions in excess of \$2,000.

Materials and supplies inventory - Inventory consists of repair and maintenance supplies and extension materials and is stated at the lower of average cost or replacement value.

Contributions in aid of construction - Connection fees charged to customers (including developers) in excess of the actual cost of installation of new services are reflected as non-operating revenues in the period of new service installation. Amounts contributed related to new line construction are reflected as capital contributions in the period of construction completion.

Revenues - Revenues from water sales are recognized based on meter reading dates. No asset is recorded for water delivered between the last meter reading in the period and the end of the period. Revenues from connection fees and developer charges are recognized when service is activated.

Construction period interest - Interest on costs incurred during the period of plant construction, net of interest earned on temporary investment of financing proceeds, is capitalized until such plant is substantially complete and placed into service. Interest of \$1,154 was capitalized in the year ended June 30, 2011.

Allowance for doubtful accounts - The Board charges doubtful accounts arising from water sales receivable to bad debts when it is probable that the account will be uncollectible. Bad debts offset against water sales revenues in 2011 were \$20,351.

Budgets - State law requires the Board to adopt a budget for submission to the Lincoln County Board of Commissioners prior to the start of each fiscal year. The Board adopts its budget considering all cash receipts and disbursements.

Compensated employee absences - Employees accrue twelve days sick leave each year with no accumulation limit. Sick leave does not vest, and accordingly, employees can be paid sick leave only when sick. Since the employees' accumulating rights to receive compensation for future illnesses are contingent upon the absences being caused by future illnesses and such amounts cannot be reasonably estimated, a liability for unused sick leave is not recorded in the financial statements. Employees accrue vacation leave of from one to three weeks annually based on years of service. In the event of termination, an employee is reimbursed for any unused accumulated leave. Vacation leave is used or lost if not taken by each employee's employment anniversary date. The amount of accrued leave was \$13,920 at June 30, 2011, all of which was considered a current liability.

Cash flows - For purposes of the statement of cash flows, the Board considers all checking, savings and investment accounts with original maturities of three months or less to be cash or cash equivalents.

(2) **NET ASSETS:**

Net assets are classified as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds and notes attributable to the acquisition or improvement of those assets.
- Restricted – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors, grantors, or laws or regulations of other governments.
- Unrestricted net assets – This component of net assets consists of assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

(3) LONG - TERM DEBT:

Bonds and notes are payable from revenues of the Board and are also secured by Lincoln County property taxes for the Series 2002, 2004, 2007, and 2008 issues. All debt may be prepaid. Parity bonds may be issued if net revenues of the Board are at least 120% of scheduled bond payments. The Board’s net revenues exceeded this requirement in the year ended June 30, 2011. The Board had the following bonds and notes outstanding at June 30:

	<u>2011</u>	<u>2010</u>
Water Revenue and Tax Bond Anticipation Note Series 2010, issued February 17, 2011, quarterly interest due at 2.45% with principal due February 17, 2013	\$ 136,142	\$ -
Water Revenue and Tax Bonds, Series 2007, issued April 23, 2008, due monthly to USDA in annual principal and interest amounts of \$90,360 through 2046 at 4.125%	1,667,038	1,688,155
Water Revenue and Tax Capital Outlay Note, Series 2008, issued May 14, 2008, due in annual principal installments of \$30,000 to \$45,000 through 2020 with interest at 3.98%	335,000	365,000
Water Revenue and Tax Bonds, Series 2004, issued September 22, 2005, due monthly to USDA in annual principal and interest amounts of \$73,308 through 2043 at 4.25%	1,283,302	1,301,642
Waterworks Revenue and Tax Bonds, Series 2002, issued March 27, 2003, due monthly to USDA in annual principal and interest amounts of \$21,384 through 2041 at 4.75%	339,075	344,219
Waterworks Revenue Bond, Series 2000, issued October 18, 2001, due monthly to USDA in annual principal and interest amounts of \$60,888 through 2039 at 4.375%	984,864	1,002,247
Waterworks Revenue Bond, Series 1998, issued January 13, 2000, due monthly to USDA in annual principal and interest amounts of \$42,756 through 2038 at 4.75%	642,037	653,985
Waterworks Revenue Bond, Series 1996, issued August 22, 1997, due monthly to USDA in annual principal and interest amounts of \$173,880 through 2035 at 4.875%	<u>2,455,521</u>	<u>2,508,284</u>
Total	7,842,979	7,863,532
Less current portion of long-term debt	<u>(161,774)</u>	<u>(156,621)</u>
Long-term portion, net	<u>\$ 7,681,205</u>	<u>\$ 7,706,911</u>

Changes in principal balances during the year ended June 30, 2011 are summarized as follows:

Beginning balance	\$ 7,863,532
Advances on bond anticipation note	136,142
Principal paid on other bonds and notes	<u>(156,695)</u>
	<u>\$ 7,842,979</u>

On February 17, 2011 the Board issued a bond anticipation note to provide funding for the Phase V construction project. The note has a total principal amount of \$4,702,000, is due on February 17, 2013, and is payable from the proceeds of the Water Revenue and Tax Bond, Series 2010. The bond has a maximum principal amount of \$4,827,000, a maximum interest rate of 3.25%, and is payable over 38 years. At the maximum principal advance and interest rate, the monthly payment required for the bond will be \$18,450.

Principal and interest payments on bonds and notes outstanding at June 30, 2011, excluding bond anticipation notes are summarized as follows:

FISCAL YEAR	PAYABLE MONTHLY TO USDA	CAPITAL NOTES	TOTAL PRINCIPAL	TOTAL INTEREST	TOTAL
2012	\$ 131,774	\$ 30,000	\$ 161,774	\$ 344,135	\$ 505,909
2013	138,694	35,000	173,694	336,021	509,715
2014	145,175	35,000	180,175	328,147	508,322
2015	151,961	35,000	186,961	319,968	506,929
2016	158,368	35,000	193,368	312,168	505,536
2017-2021	913,325	165,000	1,078,325	1,416,271	2,494,596
2022-2026	1,148,161	-	1,148,161	1,164,719	2,312,880
2027-2031	1,443,731	-	1,443,731	869,149	2,312,880
2032-2036	1,638,040	-	1,638,040	501,066	2,139,106
2037-2041	961,750	-	961,750	207,878	1,169,628
2042-2046	<u>540,858</u>	<u>-</u>	<u>540,858</u>	<u>47,855</u>	<u>588,713</u>
	<u>\$7,371,837</u>	<u>\$ 335,000</u>	<u>\$7,706,837</u>	<u>\$5,847,377</u>	<u>\$13,554,214</u>

(4) CAPITAL LEASES:

In the 2009 fiscal year, the Board entered into a capital lease agreement of \$39,020 to finance the acquisition of construction equipment. During the current year the Board entered into an additional lease to finance \$43,304 of the total cost of construction equipment. The leased equipment has been capitalized and depreciated along with the Board's other equipment. The leases bear interest at the rates of 5.76% and 3.25% and require 60 monthly payments of \$750 and \$781, respectively. Principal paid on capital leases in 2011 was \$15,728. Scheduled future payments on the leases are as follows:

<u>Fiscal Year</u>	<u>PRINCIPAL</u>	<u>INTEREST</u>	<u>TOTAL</u>
2012	\$ 10,515	\$ 1,105	\$ 11,620
2013	8,559	811	9,370
2014	8,841	529	9,370
2015	9,133	237	9,370
2016	<u>2,328</u>	<u>14</u>	<u>2,342</u>
	<u>\$ 39,376</u>	<u>\$ 2,696</u>	<u>\$ 42,072</u>

(5) CAPITAL ASSETS:

Major classes of utility plant are as follows:

	<u>BALANCE JUNE 30, 2010</u>	<u>ADDITIONS</u>	<u>DISPOSALS</u>	<u>TRANSFERS</u>	<u>BALANCE JUNE 30, 2011</u>
Non-depreciable:					
Land	\$ 527,695	\$ -	\$ -	\$ -	\$ 527,695
Construction in progress	<u>306,508</u>	<u>638,683</u>	<u>-</u>	<u>(661,892)</u>	<u>283,299</u>
	<u>834,203</u>	<u>638,683</u>	<u>-</u>	<u>(661,892)</u>	<u>810,994</u>
Depreciable:					
Distribution lines and tanks	25,782,021	-	(2,100)	661,892	26,441,813
Wells and treatment plant	4,590,887	-	-	-	4,590,887
Buildings and equipment	<u>2,513,875</u>	<u>233,390</u>	<u>(194,103)</u>	<u>-</u>	<u>2,553,162</u>
	<u>32,886,783</u>	<u>233,390</u>	<u>(196,203)</u>	<u>661,892</u>	<u>33,585,862</u>
Total	<u>\$33,720,986</u>	<u>\$ 872,073</u>	<u>\$ (196,203)</u>	<u>\$ -</u>	<u>\$ 34,396,856</u>

Accumulated depreciation of major classes of utility plant is as follows:

Distribution and tanks	\$ 9,481,950	\$ 627,670	\$ -	\$ -	\$ 10,109,620
Wells and treatment plant	1,108,840	107,200	-	-	1,216,040
Buildings and equipment	<u>1,904,628</u>	<u>147,620</u>	<u>(130,503)</u>	<u>-</u>	<u>1,921,745</u>
	<u>\$12,495,418</u>	<u>\$ 882,490</u>	<u>\$ (130,503)</u>	<u>\$ -</u>	<u>\$ 13,247,405</u>

(6) RESTRICTED ASSETS:

Cash is held in sinking fund reserve funds which are to be accumulated up to the maximum annual debt service and used for bond payments in the event funds are not otherwise available. These funds are mandated by bond covenants for bonds not secured by property taxes of Lincoln County. The Board pays scheduled bond payments from unrestricted funds leaving bond reserve funds intact. Restricted assets also include amounts held for payment of customer deposits. Balances in the restricted funds at June 30, 2011 were:

Sinking fund reserve fund - 1996 Bond	\$ 173,880
Sinking fund reserve fund - 1998 Bond	42,756
Sinking fund reserve fund - 2000 Bond	58,858
Customer deposits	<u>13,385</u>
	<u>\$ 288,879</u>

(7) DEPOSITS AND INVESTMENTS:

State law and bond covenants in general restrict the Board's investments to either United States Treasury or Agency obligations or to certificates of deposit insured or collateralized by direct United States Treasury obligations. The laws of the State of Tennessee require that collateral be pledged at 105% of the value of uninsured deposits. The Board does not have policies regarding deposits, investments, and related risks. At June 30, 2011 all of the Board's deposits were insured by the FDIC or on deposit with a bank that participates in the State Collateral Pool. In 2011 the Board's interest earned was from liquid fund accounts which were carried at cost.

(8) PENSION PLAN:

PLAN DESCRIPTION:

Effective October 1, 2001, the Board's employees became members of the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and year of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the system become vested after five years of service.

Benefit provisions are established in state statute found in Title 8, Chapter 34-37 of the Tennessee Code Annotated (TCA). State statutes are amended by the Tennessee General Assembly. Political subdivisions such as Lincoln County Board of Public Utilities participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. That report may be obtained by writing to Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230 or can be accessed at www.tn.gov/treasury/tcrs/PS/.

FUNDING POLICY:

Lincoln County Board of Public Utilities requires employees to contribute 5.0 percent of earnable compensation.

Lincoln County Board of Public Utilities is required to contribute at an actuarially determined rate. The rate for the fiscal year ending June 30, 2011 was 8.96% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for Lincoln County Board of Public Utilities is established and may be amended by the TCRS Board of Trustees.

ANNUAL PENSION COST:

For the year ending June 30, 2011, Lincoln County Board of Public Utilities' annual pension cost of \$109,340 to TCRS was equal to Lincoln County Board of Public Utilities' required and actual contributions. The required contribution was determined as part of the July 1, 2009 actuarial valuation using the frozen liability actuarial cost method. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 7.5 percent a year compounded annually, (b) projected salary increases of 4.75 percent (graded) annual rate (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 3.5 percent annual increases in the Social Security wage base, and (d) projected post-retirement increases of 2.5 percent annually. The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the market value of investments over a five-year period. Lincoln County Board of Public Utilities' unfunded actuarial accrued liability is being amortized as a level dollar amount on a closed basis. The remaining amortization period at July 1, 2009 was 12 years. An actuarial valuation was performed as of July 1, 2009 which established a contribution rate effective July 1, 2010.

TREND INFORMATION:

<u>FISCAL YEAR</u> <u>ENDING</u>	<u>ANNUAL PENSION</u> <u>COST (APC)</u>	<u>PERCENTAGE OF</u> <u>APC CONTRIBUTED</u>	<u>NET PENSION</u> <u>OBLIGATION</u>
June 30, 2011	\$109,340	100%	\$0.00
June 30, 2010	128,844	100%	0.00
June 30, 2009	123,042	100%	0.00

As of July 1, 2009, the most recent actuarial valuation date, the plan was 67.35% funded. The actuarial accrued liability for benefits was \$1,789,000, and the actuarial value of assets was \$1,205,000, resulting in an unfunded actuarial accrued liability (UAAL) of \$584,000. The covered payroll (annual payroll of active employees covered by the plan) was \$1,133,000, and the ratio of the UAAL to the covered payroll was 51.52%.

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

The annual required contribution (ARC) was calculated using the aggregate actuarial cost method. Since the aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities, information about funded status and funding progress has been prepared using the entry age actuarial cost method for that purpose, and this information is intended to serve as a surrogate for the funded status and funding progress of the plan. (Dollar amount in thousands)

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Plan Assets</u> (a)	<u>Actuarial Accrued Liability (AAL) -Entry Age</u> (b)	<u>Unfunded AAL (UAAL)</u> (b) - (a)	<u>Funded Ratio</u> (a/b)	<u>Covered Payroll</u> (c)	<u>UAAL as a Percentage of Covered Payroll</u> ((b-a)/c)
July 01, 2009	\$1,205	\$1,789	\$584	67.35%	\$1,133	51.52%
July 01, 2007	823	1,057	234	77.85%	899	26.03%

(9) WATER SOURCES:

The Board's primary sources of water are the Taft and Flintville well fields with additional sources being the Elora well field and the City of Fayetteville. The City of Fayetteville is the sole supplier of water to 9% of the Board's customers and is a supplemental and primary backup source of water for the remaining customers.

(10) RISK MANAGEMENT AND LIABILITY:

The Board is exposed to various risks of loss related to torts, loss of assets, errors and omissions, and employee injuries. During 2011, the Board participated in a public entity risk pool for coverage of general liability, property, and workers' compensation losses. The Board participated in the Local Government Fund, a public entity risk pool established by an association of Tennessee local governments. The Board pays an annual premium to the pool for the insurance coverage. The pool is created to be self-sustaining through member premiums.

The Board is self-insured for employee health claims between \$250 and \$4,000 (\$3,000 prior to April 1, 2011) per year per covered individual. Employees are responsible for the first \$250 of covered claims, with commercial insurance responsible for amounts over \$4,000. The plan liability at year-end is determined based on subsequent payments. The change in the liability for medical benefits for the years ended June 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ 3,330	\$ 3,922
Payments made	(26,545)	(18,127)
Incurred claims	<u>29,050</u>	<u>17,535</u>
Balance, end of year	<u>\$ 5,835</u>	<u>\$ 3,330</u>

The Board continues to carry commercial insurance for other risks of loss, including employee bonds and employee health and accident losses above the \$4,000 level. Settled claims from these losses have not exceeded commercial insurance coverage in any of the past three fiscal years.

(11) ASSET SALE AND RELATED LOAN RECEIVABLE:

On July 27, 2004 the Board sold its water lines located in Moore County, Tennessee to Metropolitan Lynchburg/Moore County for \$150,000 with \$25,000 paid at closing and \$125,000 to be paid over six years with interest accruing at 4%. The final amount due under the loan of \$20,833 was collected in the year ended June 30, 2011.

(12) RELATED PARTY TRANACTIONS:

The Board provides water to Lincoln County related entities at the same billing rate as other customers. In the year ended June 30, 2011 these sales totaled \$34,675 and accounts receivable at June 30, 2011 related to these sales were \$1,846. During the year ended June 30, 2011, Lincoln County contributed \$13,125 towards the cost of the Smith Mill Road line extension.

(13) CURRENT AND PLANNED PROJECTS:

Substantially all of the distribution line additions and improvements in 2011 were constructed by the Board's employees. At June 30, 2011, construction in progress costs of \$20,983 had been incurred on two line additions.

The Board is requesting permits from the State of Tennessee that would allow for the construction of a water treatment plant on the Elk River. The plant would enhance the water available from the Board's current wells that are the primary source of water to 91% of the Board's customers. At June 30, 2011 the Board had purchased land for \$202,000, and had recorded construction in progress cost of \$124,695 related to roadway, other site development costs, and engineering and permitting costs. The estimated cost of the treatment plant and related distribution lines is \$18,000,000. No significant costs are anticipated to be incurred in the near-term and actual plant construction is not expected to begin within the next four years.

At June 30, 2011, the Board had incurred engineering, interest, and legal costs of \$137,621 on the Phase V project. The project will consist of the replacement of approximately 22 miles of waterline in Park City and the surrounding area. Construction began in the July 2011 and will take approximately three years to complete. The project cost of \$6,638,000 will be funded by a Rural Utility Service bond of \$4,827,000 and grant of \$1,811,000. Both the bond and grant require compliance with requirements of the American Recovery and Reinvestment Act of 2009. Monthly debt service on the bond is anticipated to be approximately \$18,450. The Board approved a monthly \$1.50 per customer rate increase in September 2010 and anticipates an additional \$.70 increase in the future to allow for debt service. The Board will also be required to make monthly additions of \$29,000 to an asset management reserve to fund short-lived equipment and system costs that are currently paid for from current operations.

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF PENSION FUNDING PROGRESS

JUNE 30, 2011

For the year ended June 30, 2011 the Lincoln County Board of Public Utilities' employees participated in the Political Subdivision Pension Plan administered by the Tennessee Consolidated Retirement System. Funding progress of the pension plan is summarized as follows:

(Dollar amounts in thousands)

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
July 1, 2009	\$1,205	\$1,789	\$584	67.35%	\$1,133	51.52%
July 1, 2007	823	1,057	234	77.86%	899	26.03%

The Governmental Accounting Standards Board (GASB) requires the plan to prepare this schedule using the entry age actuarial cost method. The requirement to present this schedule using the entry age actuarial cost method went into affect during the 2007 actuarial valuation, therefore only the two most recent valuation are presented.

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES
SCHEDULE OF INSURANCE IN FORCE - UNAUDITED

JUNE 30, 2011

		<u>COVERAGE</u>	<u>EXPIRATION</u>
Coverage obtained through Lincoln County:			
Local Government Property and Casualty Fund	Buildings and tanks	\$20,522,000	07-01-11
	Contents	\$ 1,405,894	
	Equipment and vehicles	\$ 1,286,342	
	General and vehicle liability	\$ 1,000,000	
	Errors and omissions	\$ 1,000,000	
	Employee blanket bond	\$ 150,000	
Local Government Workers' Compensation Fund	Workers' compensation	Statutory	07-01-11
Other coverage:			
State Automobile Mutual Insurance	Employee dishonesty bond- Superintendent and Chairman	\$ 475,000	10-07-11

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

RATES IN FORCE AND NUMBER OF CUSTOMERS

JUNE 30, 2011

<u>METER TYPE</u>	<u>CUSTOMERS</u>	<u>GALLONS</u>	<u>RATES IN FORCE</u> <u>RATE/1,000</u>
Residential and Commercial	8,534	First 1,000	\$ 23.99
		Next 4,000	4.02
		Over 5,000	4.05
Multi-user (Total of 456 units. Rates are based on usage for each unit.)	132	First 1,000	\$ 19.99
		Next 4,000	4.02
		Over 5,000	4.05
Total	<u>8,666</u>		

OTHER CHARGES

Tap Fee -- individual lot	\$ 1,100
per subdivision lot	1,200
Service initiation -- individual lot	100
subdivision lot	200

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

SCHEDULE OF UNACCOUNTED FOR WATER

JUNE 30, 2011

Water Treated and Purchased:	(All Amounts are in Gallons)
Water pumped (potable)	732,032,409
Water purchased	96,932,910
Total Water Treated and Purchased	<u>828,965,319</u>
Accounted for Water	
Water sold	494,541,564
Metered for consumption-in house usage	162,070
Fire department usage	320,230
Flushing	2,437,120
Tank cleaning/filling	-
Street cleaning	-
Bulk sales	-
Water bill adjustments	8,637,871
Total Accounted for Water	<u>506,098,855</u>
Unaccounted for Water	<u>322,866,464</u>
Percent Unaccounted for Water	<u>38.95%</u>

All amounts included in this schedule are supported by documentation on file at the water system. If no support is on file for a line item or if the line item is not applicable a "-" is shown.

Gallonage information is based on readings from the Board's and supplier's meters.

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

SCHEDULE OF PRINCIPAL OFFICERS

JUNE 30, 2011

LINCOLN COUNTY:

Peggy Bevels	County Executive	8-31-14
Phyllis Counts	County Clerk	8-31-14
Mary Jane Porter	County Trustee	8-31-14

BOARD:

Wade Williams	Board Chairman	6-30-12
Hugh Moffett	Board Vice-Chairman/Treasurer	6-30-13
Larry Craig	Board Secretary	6-30-13
David Gordon	Board Member	6-30-12
Ron Stanley	Board Member	6-30-14
Billy Wiley	Superintendent	-
Ronnie Braden	Superintendent (effective February 15, 2012)	-

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011

<u>Federal Program Title</u>	<u>Federal CFDA Number</u>	<u>Program or Award Type/Amount</u>	<u>Federal Expenditures</u>
U. S. Department of Agriculture Water and Waste Disposal Systems for Rural Communities-ARRA	10.781	Phase V Loan/\$4,827,000	<u>\$ 137,621</u>

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

February 29, 2012

To the Members of the
Lincoln County Board of Public Utilities:

I have audited the financial statements of the Lincoln County Board of Public Utilities as of and for the year ended June 30, 2011, and have issued my report thereon dated February 29, 2012. I conducted my 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 my audit, I considered the Lincoln County Board of Public Utilities' internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the effectiveness of the Lincoln County Board of Public Utilities' internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Lincoln County Board of Public Utilities' internal control over financial reporting.

My consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, I identified deficiencies in internal control over financial reporting described in the accompanying schedule of findings and responses that I consider to be material weaknesses in internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. I consider the deficiencies described in the accompanying schedule of findings and responses as items 2011-1 and 2011-2 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lincoln County Board of Public Utilities' financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2011-2 and 2011-3.

Lincoln County Board of Public Utilities' responses to the findings identified in my audit are described in the accompanying schedule of findings and responses. I did not audit Lincoln County Board of Public Utilities' responses and, accordingly, I express no opinion on them.

I noted certain other matters that I reported to management of the Board in a separate letter dated February 29, 2012.

This report is intended solely for the information and use of management, Board members, the Lincoln County Tennessee Board of Commissioners, and the United States Department of Agriculture, and is not intended to be and should not be used by anyone other than these specified parties.

DAVID A. KIDD

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

SCHEDULE OF FINDINGS, QUESTIONED COSTS, AND RESPONSES

FOR THE YEAR ENDED JUNE 30, 2011

FINDINGS-FINANCIAL STATEMENTS AUDIT

FINDING 2011-1: Financial statement preparation: The Lincoln County Board of Public Utilities does not employ anyone with training in preparing financial statements and related notes for external reporting in accordance with accounting principles generally accepted in the United States of America. The Board should determine if it would be feasible to train or hire someone to prepare the financial statements and related notes.

Management response: It is the Board's position that the cost of training personnel on financial reporting or the addition of trained personnel would outweigh the benefit.

FINDING 2011-2: Payroll procedures: The Tennessee Comptroller of the Treasury, Division of County Audit is currently conducting a special review of the Board's payroll expenses and procedures and other areas of Board operations. The review includes questions regarding the superintendent's authority to set employee compensation levels. The review includes more than the current year and the amount of compensation under review is significant. Findings and recommendations resulting from the review are not yet available.

Management response: We have made changes in some payroll areas and are in the process of formulating a new payroll procedures manual. Recommendations from the Comptroller's review will be incorporated into this process.

FINDING 2011-3: Project requirements: The USDA established requirements for the Board to meet related to the Rural Development waterline replacement project that was started in the year ended June 30, 2011. One of those requirements was that Rural Development must approve any agreements for engineering and design services consisting of certain EJCDC (Funding Agency Edition) documents. These documents were not completed and engineering services in the amount of \$124,300 were paid related to the project. The Board should review the USDA requirements and insure that all are complied with.

Management response: The engineering firm used on the project was referenced in other areas of the project documentation but the specific documents noted were not completed. We are in the process of completing those documents for submission to Rural Development.