

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

FINANCIAL STATEMENTS,
INDEPENDENT AUDITOR'S REPORT AND
SUPPLEMENTAL INFORMATION

JUNE 30, 2012

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

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DAVID A. KIDD
Certified Public Accountant

115 N. Main ❖ P.O. Box 66
Fayetteville, TN 37334

(931) 433-0128
Fax (931) 433-0650

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, 2012, 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, 2012, 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, 2012, 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 25, 2013 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 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 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. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is 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 25, 2013

D. A. KIDD

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

BALANCE SHEET

JUNE 30, 2012

ASSETS

CURRENT ASSETS:

Cash	\$ 1,817,750
Accounts receivable, net of allowance for doubtful accounts of \$2,200	251,760
Materials and supplies inventory	138,766
Prepaid expenses	4,100
	<u>2,212,376</u>

RESTRICTED ASSETS:

Cash	<u>290,539</u>
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WATER PLANT AND EQUIPMENT:

Water plant, buildings and equipment	34,506,637
Construction in progress	3,074,977
Less accumulated depreciation	(14,140,400)
	<u>23,441,214</u>

OTHER ASSETS:

Deposits	<u>750</u>
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Total assets	<u>\$ 25,944,879</u>
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(See accompanying notes to financial statements.)

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:

Accounts payable	\$ 51,222
Accrued liabilities	53,435
Contractor payable	161,065
Contractor retainage payable	131,946
Advance payments from developers	25,800
Accrued interest	10,619
Accrued leave	14,223
Current maturities of long-term debt	173,694
Payable from restricted assets:	
Customer deposits	13,015
	<u>635,019</u>

LONG-TERM LIABILITIES:

Bonds and capital notes	10,163,221
Less current maturities	<u>(173,694)</u>
	9,989,527
Total liabilities	<u>10,624,546</u>

NET ASSETS:

Invested in capital assets, net of related debt	13,277,993
Restricted for debt service	277,524
Unrestricted	<u>1,764,816</u>
Total net assets	<u>15,320,333</u>
Total liabilities and net assets	<u>\$ 25,944,879</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, 2012

OPERATING REVENUES:

Water sales	\$ 4,146,488
Penalties, service charges, and other	235,222
Connection fees	70,031
Total operating revenues	<u>4,451,741</u>

OPERATING EXPENSES:

Salaries and wages	1,084,021
Employee taxes and benefits	358,886
Water purchases	295,354
Water plant repair and maintenance	297,872
Utilities	282,426
Vehicle and equipment	160,287
Connection materials	20,090
Insurance	116,811
Professional fees	31,246
Water chemicals and testing	81,639
Office supplies	45,573
Postage	28,686
Telephone	24,730
Advertising	10,468
Miscellaneous	34,102
Provision for depreciation	883,344
Total operating expenses	<u>3,755,535</u>
Operating income	<u>696,206</u>

NON-OPERATING REVENUES (EXPENSES):

Interest income	1,776
Interest expense	<u>(345,520)</u>
Total non-operating revenues (expenses)	<u>(343,744)</u>
Increase in net assets before capital contributions	<u>352,462</u>

Net assets, beginning of period	14,967,871
Net assets, end of period	<u>\$ 15,320,333</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 2012

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers for sales and service charges	\$ 4,404,218
Payments to vendors for goods and services	(1,797,788)
Payments to employees for services	(1,083,718)
Received from customers for connections	70,031
Customer deposits returned	(370)
Net cash provided by operating activities	<u>1,592,373</u>

CASH FLOWS FROM CAPITAL AND RELATED
FINANCING ACTIVITIES:

Acquisition and construction of capital assets	(2,920,561)
Principal advances on bond anticipation notes	2,448,101
Payoff of bond anticipation notes	(2,584,243)
Principal advances on bond anticipation notes	2,619,000
Principal paid on notes, bonds and leases	(201,992)
Interest paid on notes, bonds and leases	(344,308)
Received from equipment dispositions	38,465
Net cash used by capital and related financing activities	<u>(945,538)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest on cash, certificates of deposit, and note receivable	<u>1,776</u>
Net cash provided by investing activities	<u>1,776</u>

Increase in cash and restricted cash	648,611
Cash and restricted cash, beginning of period	<u>1,459,678</u>
Cash and restricted cash, end of period	<u>\$ 2,108,289</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

STATEMENT OF CASH FLOWS (CONTINUED)

FOR THE YEAR ENDED JUNE 30, 2012

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

Operating income	\$ 696,206
Adjustments to reconcile operating income to net cash provided by operating activities:	
Provision for depreciation	883,344
Changes in assets and liabilities:	
Decrease in accounts receivable	22,508
Decrease in inventory	22,577
Increase in prepaid expenses	(417)
Decrease in accrued liabilities	(14,876)
Decrease in accounts payable	(16,902)
Decrease in customer deposits	(370)
Increase in accrued leave	303
Net cash provided by operating activities	<u>\$ 1,592,373</u>

NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES:

Depreciation capitalized in line extensions	\$ 33,436
Contractor payable and retainage payable on construction in progress	293,011
Total non-cash capital and related financing activities	<u>\$ 326,447</u>

(See accompanying notes to financial statements.)

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012

(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 \$35,682 was capitalized in the year ended June 30, 2012.

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 2012 were \$24,319.

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 \$14,223 at June 30, 2012, 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.

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.”

(2) **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, 2008 and 2010 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, 2012. The Board had the following bonds and notes outstanding at June 30:

	<u>2012</u>	<u>2011</u>
Water Revenue and Tax Bond Anticipation Note Series 2010, issued February 17, 2011, quarterly interest due at 2.45%. Paid off by Interim Certificate of Indebtedness issued June 18, 2012	\$ -	\$ 136,142
Interim Certificate of Indebtedness Series 2010, issued June 18, 2012, with interest of 2.75% and principal due February 17, 2015	2,619,000	-
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%	1,645,033	1,667,038
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%	305,000	335,000
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%	1,264,167	1,283,302
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%	333,681	339,075
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%	966,704	984,864
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%	629,509	642,037
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>2,400,127</u>	<u>2,455,521</u>
Total	10,163,221	7,842,979
Less current portion of long-term debt	<u>(173,694)</u>	<u>(161,774)</u>
Long-term portion, net	<u>\$ 9,989,527</u>	<u>\$7,681,205</u>

Changes in principal balances during the year ended June 30, 2012 are summarized as follows:

Beginning balance	\$ 7,842,979
Advances on bond anticipation note	2,448,101
Payoff of bond anticipation notes	(2,584,243)
Issuance of interim certificate of indebtedness	2,619,000
Principal paid on other bonds and notes	<u>(162,616)</u>
	<u>\$ 10,163,221</u>

On February 17, 2011 the Board issued a bank bond anticipation note to provide funding for the Phase V construction project. On June 18, 2012 the bank bond anticipation note was paid off with the proceeds of a USDA interim certificate of indebtedness. The interim certificate of indebtedness has a total principal amount of \$4,702,000, accrues interest at 2.75%, 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 2.75%, and is payable over 38 years. At the maximum principal advance and interest rate, the monthly payment required for the bond will be \$17,088. The interim certificate of indebtedness was originally due February 13, 2013 but was extended to February 13, 2015 in February 2013.

Principal and interest payments on bonds and notes outstanding at June 30, 2012, excluding the interim certificate of indebtedness are summarized as follows:

FISCAL YEAR	PAYABLE MONTHLY TO USDA	CAPITAL NOTES	TOTAL PRINCIPAL	TOTAL INTEREST	TOTAL
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	166,472	40,000	206,472	302,671	509,143
2018-2022	956,064	125,000	1,081,064	1,366,965	2,448,029
2023-2027	1,201,947	-	1,201,947	1,110,934	2,312,881
2028-2032	1,511,155	-	1,511,155	801,725	2,312,880
2033-2037	1,536,558	-	1,536,558	428,294	1,964,852
2038-2042	876,064	-	876,064	168,261	1,044,325
2043-2047	<u>396,763</u>	<u>-</u>	<u>396,763</u>	<u>28,090</u>	<u>424,853</u>
	<u>\$7,239,221</u>	<u>\$ 305,000</u>	<u>\$7,544,221</u>	<u>\$5,503,244</u>	<u>\$13,047,465</u>

(3) CAPITAL LEASES:

In the 2009 and 2011 fiscal year, the Board entered into capital lease agreements of \$39,020 and \$43,304 to finance the acquisition of construction equipment. The leased equipment has been capitalized and depreciated along with the Board's other equipment. During the current year the Board paid off both leases with total principal paid in 2012 of \$39,376.

(4) **CAPITAL ASSETS:**

Major classes of utility plant are as follows:

	BALANCE JUNE 30, 2011	ADDITIONS	DISPOSALS	TRANSFERS	BALANCE JUNE 30, 2012
Non-depreciable:					
Land	\$ 527,695	\$ -	\$ -	\$ -	\$ 527,695
Construction in progress	<u>283,299</u>	<u>3,056,100</u>	<u>-</u>	<u>(264,422)</u>	<u>3,074,977</u>
	<u>810,994</u>	<u>3,056,100</u>	<u>-</u>	<u>(264,422)</u>	<u>3,602,672</u>
Depreciable:					
Distribution lines and tanks	26,441,813	-	-	264,422	26,706,235
Wells and treatment plant	4,590,887	-	-	-	4,590,887
Buildings and equipment	<u>2,553,162</u>	<u>190,908</u>	<u>(62,250)</u>	<u>-</u>	<u>2,681,820</u>
	<u>33,585,862</u>	<u>190,908</u>	<u>(62,250)</u>	<u>264,422</u>	<u>33,978,942</u>
Total	<u>\$34,396,856</u>	<u>\$ 3,247,008</u>	<u>\$ (62,250)</u>	<u>\$ -</u>	<u>\$ 37,581,614</u>

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

Distribution and tanks	\$10,109,620	\$ 631,390	\$ -	\$ -	\$ 10,741,010
Wells and treatment plant	1,216,040	107,200	-	-	1,323,240
Buildings and equipment	<u>1,921,745</u>	<u>178,190</u>	<u>(23,785)</u>	<u>-</u>	<u>2,076,150</u>
	<u>\$13,247,405</u>	<u>\$ 916,780</u>	<u>\$ (23,785)</u>	<u>\$ -</u>	<u>\$ 14,140,400</u>

The addition to accumulated depreciation includes \$883,344 depreciation expense and \$33,436 depreciation capitalized.

(5) **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, 2012 were:

Sinking fund reserve fund - 1996 Bond	\$ 173,880
Sinking fund reserve fund - 1998 Bond	42,756
Sinking fund reserve fund - 2000 Bond	60,888
Customer deposits	<u>13,015</u>
	<u>\$ 290,539</u>

(6) 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, 2012 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 2012 the Board's interest earned was from liquid fund accounts which were carried at cost.

(7) PENSION PLAN:

PLAN DESCRIPTION:

Employees of the Lincoln County Board of Public Utilities are 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 years 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 after July 1, 1979 become vested after five years of service and members joining prior to July 1, 1979 were vested after four 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 the Board 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:

The Board requires employees to contribute 5.0 percent of earnable compensation.

The Board is required to contribute at an actuarially determined rate; the rate for the fiscal year ending June 30, 2012 was 8.96% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for the Board is established and may be amended by the TCRS Board of Trustees.

ANNUAL PENSION COST:

For the year ending June 30, 2012, the Board's annual pension cost of \$98,955 to TCRS was equal to the Board's required and actual contributions. The required contribution was determined as part of the July 1, 2009 actuarial valuation using the frozen entry age actuarial cost method. Significant actuarial assumptions used in the valuation include (a) rate of return on investment on of present and future assets of 7.5 percent a year compounded annually, (b) projected 3.0 percent

annual rate of inflation, (c) 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), (d) projected 3.5 percent annual increase in the Social Security wage base, and (e) projected post retirement increase of 2.5 percent annually. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of total investments over a ten-year period. The Board's 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, 2011, which established contribution rates effective July 1, 2012.

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, 2012	\$ 98,955	100%	\$0.00
June 30, 2011	109,340	100%	0.00
June 30, 2010	128,844	100%	0.00

As of July 1, 2009, the most recent actuarial valuation date, the plan was 86.90% funded. The actuarial accrued liability for benefits was \$2.12 million, and the actuarial value of assets was \$1.84 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$0.28 million. The covered payroll (annual payroll of active employees covered by the plan) was \$1.23 million, and the ratio of the UAAL to the covered payroll was 22.50%.

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.

<u>Actuarial</u> <u>Valuation</u> <u>Date</u>	<u>Actuarial</u> <u>Value of</u> <u>Plan Assets</u> <u>(a)</u>	<u>Actuarial</u> <u>Liability</u> <u>(AAL)</u> <u>-Entry Age</u> <u>(b)</u>	<u>Unfunded</u> <u>AAL</u> <u>(UAAL)</u> <u>(b) - (a)</u>	<u>Funded</u> <u>Ratio</u> <u>(a/b)</u>	<u>Covered</u> <u>Payroll</u> <u>(c)</u>	<u>UAAL as a</u> <u>Percentage</u> <u>of Covered</u> <u>Payroll</u> <u>((b-a)/c)</u>
July 01, 2011	\$1,841	\$2,119	\$278	86.90%	\$ 1,234	22.50%
July 01, 2009	1,205	1,205	0	100.00%	1,133	0.00%
July 01, 2007	823	823	0	100.00%	899	0.00%

(8) 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.

(9) 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 2012, 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 \$5,000 (\$4,000 prior to April 1, 2012) 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, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Balance, beginning of year	\$ 5,835	\$ 3,330
Payments made	(28,670)	(26,545)
Incurred claims	<u>23,548</u>	<u>29,050</u>
Balance, end of year	<u>\$ 713</u>	<u>\$ 5,835</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.

(10) 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, 2012 these sales totaled \$38,262 and accounts receivable at June 30, 2012 related to these sales were \$1,382.

(11) CURRENT AND PLANNED PROJECTS:

Substantially all of the distribution line additions and improvements in 2012 were constructed by the Board's employees. At June 30, 2012, construction in progress costs of \$11,500 had been incurred on one line addition.

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, 2012 the Board had purchased land for \$202,000, and had recorded construction in progress cost of \$150,228 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, 2012, the Board had incurred costs of \$2,913,249 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 \$17,088. The Board approved a monthly \$1.50 per customer rate increase in September 2010 to assist with 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, 2012

For the year ended June 30, 2012 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, 2011	\$1,841	\$2,119	\$278	86.90%	\$1,234	22.50%
July 1, 2009	1,205	1,205	-	100.00%	1,133	0.00%
July 1, 2007	823	823	-	100.00%	899	0.00%

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

JUNE 30, 2012

		<u>COVERAGE</u>	<u>EXPIRATION</u>
Coverage obtained through Lincoln County:			
Local Government Property and Casualty Fund	Buildings and tanks	\$20,522,000	07-01-12
	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	07-01-12
Other coverage:			
State Automobile Mutual Insurance	Employee dishonesty bond- Superintendent and Chairman	\$ 475,000	10-07-12

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

RATES IN FORCE AND NUMBER OF CUSTOMERS

JUNE 30, 2012

<u>METER TYPE</u>	<u>CUSTOMERS</u>	<u>GALLONS</u>	<u>RATES IN FORCE</u> <u>RATE/1,000</u>
Residential and Commercial	8,636	First 1,000	\$ 23.99
		Next 4,000	4.02
		Over 5,000	4.05
Multi-user (Total of 428 units. Rates are based on usage for each unit.)	128	First 1,000	\$ 19.99
		Next 4,000	4.02
		Over 5,000	4.05
Total	<u>8,764</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, 2012

Water Treated and Purchased:	(All Amounts are in Gallons)
Water pumped (potable)	710,628,391
Water purchased	<u>75,127,624</u>
Total Water Treated and Purchased	785,756,015
Accounted for Water	
Water sold	486,676,500
Metered for consumption-in house usage	142,910
Fire department usage	198,650
Flushing	2,599,065
Tank cleaning/filling	-
Street cleaning	-
Bulk sales	-
Water bill adjustments	<u>8,044,887</u>
Total Accounted for Water	<u>497,662,012</u>
Unaccounted for Water	<u>288,094,003</u>
Percent Unaccounted for Water	<u>36.66%</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.

Gallonge information is based on readings from the Board's and supplier's meters that correspond to the Board's billing cycles for the year.

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES

SCHEDULE OF PRINCIPAL OFFICERS

JUNE 30, 2012

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 Stanly	Board Member	6-30-14
Ronnie Braden	Superintendent	-

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012

<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>\$2,775,628</u>

DAVID A. KIDD
Certified Public Accountant

115 N. Main ❖ P.O. Box 66
Fayetteville, TN 37334

(931) 433-0128
Fax (931) 433-0650

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 25, 2013

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, 2012, and have issued my report thereon dated February 25, 2013. 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

Management of the Lincoln County Board of Public Utilities is responsible for establishing and maintaining effective 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 as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion 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, as described in the accompanying schedule of findings, questioned costs and responses, I identified certain deficiencies in internal control over financial reporting 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 questioned costs as items 2011-1, 2011-2 and 2012-1 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as item 2011-2.

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 25, 2013.

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

DAVID A. KIDD
Certified Public Accountant

115 N. Main ❖ P.O. Box 66
Fayetteville, TN 37334

(931) 433-0128
Fax (931) 433-0650

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

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

I have audited the Lincoln County Board of Public Utilities' compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Lincoln County Board of Public Utilities' major federal programs for the year ended June 30, 2012. The Lincoln County Board of Public Utilities' major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Lincoln County Board of Public Utilities' management. My responsibility is to express an opinion on Lincoln County Board of Public Utilities' compliance based on my audit.

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

In my opinion, the Lincoln County Board of Public Utilities complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2012.

Internal Control over Compliance

Management of the Lincoln County Board of Public Utilities is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing my audit, I considered the Lincoln County Board of Public Utilities' internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing my opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of Lincoln County Board of Public Utilities' internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

My consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. I did not identify any deficiencies in internal control over compliance that I consider to be material weaknesses as defined above.

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.

February 25, 2013

D. A. KIDD

LINCOLN COUNTY BOARD OF PUBLIC UTILITIES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012

PART I, SUMMARY OF AUDITOR'S RESULTS

1. Our report on the financial statements of the Lincoln County Board of Public Utilities is unqualified.
2. The audit of the financial statements of the Lincoln County Board of Public Utilities disclosed material weaknesses in internal control.
3. The audit disclosed one instance of noncompliance that is material to the financial statements of the Lincoln County Board of Public Utilities.
4. The audit disclosed no significant deficiencies in internal control over the major program.
5. An unqualified opinion was issued on compliance for the major program.
6. The audit revealed no findings that are required to be reported under Section 510(a) of OMB Circular A-133.
7. The U.S. Department of Agriculture Water and Waste Disposal Systems for Rural Communities-ARRA (CFDA 10.781) was determined to be a major program.
8. A \$300,000 threshold was used to distinguish between Type A and Type B federal programs.
9. The Lincoln County Board of Public Utilities did not qualify as a low-risk auditee.

PART II, FINDINGS RELATED TO THE FINANCIAL STATEMENTS

Findings and recommendations, as a result of my examination, are presented below. I reviewed these findings and recommendations with management to provide an opportunity for their response. The superintendent and office manager provided responses, which are paraphrased in this report.

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: Compensation is now based on employee rates reviewed and approved by the Board as part of the budget process. Newly hired employees are paid based on standard compensation guidelines issued by TAUD. A new employee handbook was adopted at the October 2012 Board meeting that clarifies employee policies.

FINDING 2012-1: Check signing authority: During the year ended June 30, 2012 the office manager was given check signing authority. The office manager also is primarily responsible for accounting functions (including bank reconciliations) which is incompatible with check signing authority. The office manager's check signing authority should be transferred to someone else in the organization.

Management response: Board approval will be requested to reassign check signing duties.