KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2013 AND 2012

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

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JUNE 30, 2013 AND 2012

CPAs / ADVISORS

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Kentucky Local Correctional
Facilities Construction Authority
Frankfort, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Kentucky Local Correctional Facilities Construction Authority (the Authority), a component unit of the Commonwealth of Kentucky, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kentucky Local Correctional Facilities Construction Authority as of June 30, 2013 and 2012, and the respective changes in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

<u>Required Supplementary Information</u>

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3–8 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 financial statements in an appropriate operational, economic, or historical context. We 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 responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 10, 2013, on our consideration of the Kentucky Local Correctional Facilities Construction Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Kentucky Local Correctional Facilities Construction Authority's internal control over financial reporting and compliance.

Blue & Co., LLC

Lexington, Kentucky
September 10, 2013

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Kentucky Local Correctional Facilities Construction Authority (the Authority), a component unit of the Commonwealth of Kentucky, we offer the readers of the Authority's financial statements this narrative overview and analysis of the financial performance of the Authority for the fiscal years ended June 30, 2013 and 2012. We encourage readers to read it in conjunction with the Authority's financial statements and the accompanying notes.

FINANCIAL HIGHLIGHTS

- Cash, cash equivalents, and investments increased $1,367,273 (22.80%)
- Court costs receivable decreased $350,128 (58.64%)
- Non-current lease agreement receivables (net of premium and discount on leases) decreased $280,023 (45.47%)
- Revenue bonds payable and other liabilities decreased $2,473,312 (33.06%)
- The Authority's net position increased $3,193,687 (128.25%)
- Operating revenues decreased $203,168 (5.57%)
- Operating expenses decreased $103,398 (24.16%)
- Income from operations decreased $99,770 (3.10%)
- Income from investments remained consistent year over year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This financial report consists of three parts: Management's Discussion and Analysis (this section), the basic financial statements, and the accompanying notes to the financial statements. The Kentucky Local Correctional Facilities Construction Authority is a self-supporting entity and follows enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Enterprise fund statements offer short and long-term financial information about the activities and operations of the Authority. These statements are presented in a manner similar to those of a private business.

The statement of net position presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

The statement of revenues, expenses, and changes in net position presents information showing how the Authority's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The statement of cash flows provides relevant information about the cash receipts and cash payments of the Authority during the fiscal year. The statement should help users assess the Authority's ability to generate future net cash flows, meet future obligations as they become due, the Authority's need for future external financing, the reasons for differences in operating and related cash receipts and cash payments, and the effects on financial position of cash and non-cash investing, capital, non-capital, and financing activities.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 13-24.

FINANCIAL ANALYSIS OF THE AUTHORITY

Condensed Financial Information (in thousands)
Statement of Net position
As of June 30

	2013	% Increase (Decrease)	2012	% Increase (Decrease)	2011
Current assets	$ 7,978	14.9%	$ 6,944	21.6%	$ 5,712
Non-current assets	2,714	-10.3%	3,027	-8.8%	3,318
Total assets	10,692	7.2%	9,971	10.4%	9,030
Current liabilities	2,573	4.4%	2,464	4.2%	2,364
Non-current liabilities	2,435	-51.5%	5,017	-32.8%	7,469
Total liabilities	5,008	-33.1%	7,481	-23.9%	9,833
Restricted net position	$ 5,684	128.3%	$ 2,490	410.1%	$ (803)

Current assets consist primarily of the operating and program cash and cash equivalents, court cost receivables, and the current portion of lease agreement receivables.

Non-current assets consist primarily of debt service reserve investments and the non-current portion of lease agreement receivables.

Current liabilities consist primarily of the current portion of the revenue bonds payable due annually on November 1.

Non-current liabilities represent the non-current portion of the revenue bonds payable.

In providing funds for the construction and improvement of correctional facilities, the Authority obtains its funding through the issuance of revenue bonds and the receipt of court costs remittances. When revenue bonds are issued, the Authority incurs long-term obligations that are repaid primarily by revenue received from annual court costs receipts. When construction grants are awarded to local governments, the disbursements are immediately reflected as operating expenses. Due to the timing of these transactions, the Authority periodically incurs losses from operations. In addition, during 2009, House Bill No. 406 authorized non-reciprocal payments to the Commonwealth during fiscal years 2010 and 2009 of $2,427,500 and $2,430,800, respectively for local correctional facility and operational support. During 2007 and 2008 House Bill No. 380 authorized non-reciprocal payments to the Commonwealth of Kentucky in the amounts of $4,000,000 and $1,500,000, respectively. During 2003, House Bill No. 269 authorized a non-reciprocal payment to the Commonwealth in the amount of $15,000,000. As a result of these transactions, the Authority had accumulated a net deficit at June 30, 2011.

During 2010, House Bill No. 290 authorized non-reciprocal payments to the Commonwealth of Kentucky during fiscal years 2011 and 2012 of $2,427,500 each year, for local correctional facility and operational support. Subsequent to the passage of House Bill No. 290, the Authority came to an agreement with the Office of State Budget Director to waive the payment to the Commonwealth of Kentucky for the years ended June 30, 2012 and 2013, as a result of the decline in court cost receipts in recent years.

Condensed Financial Information (in thousands)
Statement of Revenues, Expenses, and Changes in Net position
For the Fiscal Years Ended June 30

	2013	% Increase (Decrease)	2012	% Increase (Decrease)	2011
Operating revenues:					
Court costs receipts	$ 3,325	-5.2%	$ 3,507	-1.9%	$ 3,574
Interest income-leases	52	-29.7%	74	-14.9%	87
Other	64	0.0%	64	0.0%	64
Total operating revenues	3,441	-2.2%	3,645	-2.1%	3,725
Operating expenses:					
Interest expense	247	-33.4%	371	-24.0%	488
Other	77	35.1%	57	-16.2%	68
Total operating expenses	324	-24.3%	428	-23.0%	556
Income from operations	3,117	-3.1%	3,217	1.5%	3,169
Non-operating revenues (expenses)	77	1.3%	76	0.0%	76
Change in net assets	3,194	-3.0%	3,293	1.5%	3,245
Accumulated net deficit, beginning of year	2,490	410.1%	(803)	80.2%	(4,048)
Restricted net position, end of year	$ 5,684	128.3%	$ 2,490	410.1%	$ (803)

Court costs receipts represent 10.8% or $10.80 of each $100.00 court cost, up to $5,400,000 each fiscal year, taxed against a defendant upon conviction in each case tried in a state Circuit or District Court. The court costs are collected by all circuit clerks in Kentucky and are submitted on a monthly basis. Any receipts collected above the $5,400,000 each fiscal year are paid into the Commonwealth's General Fund.

Interest income-leases represents the portion of the rental payments received by the Authority under the leases from Local Governments in repayment of, and as interest on, a Local Government's agreed participation.

Other operating revenues consist of the amortization of the net premium on leases.

Interest expense represents the interest that is due semi-annually each May 1 and November 1 on the revenue bonds payable. Also reflected within interest expense is the amortization expense relative to the bond premium/discount and the deferred amount on refunding.

Other operating expenses are primarily representative of the amounts due to the Office of Financial Management (OFM) to reimburse OFM for expenses incurred on behalf of the Authority and the amortization of the debt issuance costs.

Non-operating revenues (expenses) consist in part of income from investments, which remained flat from 2011 to 2012 to 2013 due to the consistent balances in the Authority's average investment balance, as well as a consistency in interest rates.

During its 2010 Special Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 290 which contained a provision that, not-withstanding KRS 441.605 to 441.695 for fiscal year ends June 30, 2011 and 2012 funds in the amount $2,427,500 each year shall be expended from the Kentucky Local Correctional Facilities Construction Authority for local correctional facility and operational support consistent with contractual covenants in accordance with bond indentures of the Authority. The Authority came to an agreement with the Office of State Budget Director to waive the payment to the Commonwealth of Kentucky for the years ended June 30, 2011 and 2012 as a result of the decline in court cost receipts in recent years.

DEBT ADMINISTRATION

On October 13, 2004, the Authority issued $21,670,000 in Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004, to redeem and discharge $26,895,000 of the outstanding Series 1994 bonds. More detailed information about the Authority's debt is presented in Note 4 to the financial statements.

The following summarizes the changes (in thousands) in the Authority's debt principally resulting from the refunding during 2005 and the regularly scheduled principal and interest payments during the fiscal years ended June 30, 2013, 2012, and 2011.

	2013	% Increase (Decrease)	2012	% Increase (Decrease)	2011
Revenue bonds payable	$ 4,895	-32.9%	$ 7,295	-23.8%	$ 9,575
Unamortized premium	224	-42.9%	392	-30.1%	561
Unamortized deferred amount on refunding	(154)	43.0%	(270)	30.1%	(386)
Revenue bonds payable, net	$ 4,965	-33.1%	$ 7,417	-23.9%	$ 9,750

CURRENTLY KNOWN FACTS, DECISIONS, OR CONDITIONS

During its 2012 Regular Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 265 which contained a provision that, notwithstanding KRS 441.605 to 441.695, for the fiscal year ended June 30, 2014, funds of $2,800,000 shall be expended from the Kentucky Local Correctional Facilities Construction Authority for local correctional facility and operational support consistent with contractual covenants in accordance with bond indentures of the Authority.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Authority's finances for all of those with an interest. If you have any questions concerning the information provided in this report or need additional financial information, contact the Office of Financial Management, Finance and Administration Cabinet, Commonwealth of Kentucky, Room 76, Capitol Annex, Frankfort, Kentucky, 40601.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF NET POSITION
JUNE 30, 2013 AND 2012

	2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,362,874	$ 5,995,602
Court costs receivable	246,964	597,091
Accrued interest receivable-investments	12,515	12,515
Accrued interest receivable-leases	11,418	16,612
Lease agreement receivables	343,606	322,825
Total current assets	7,977,377	6,944,645
Non-current assets:		
Investments-debt service reserve	2,335,178	2,335,178
Lease agreement receivables	335,861	615,884
Debt issuance costs, net of accumulated amortization of $280,226 in 2013 and $247,892 in 2012	43,112	75,446
Total non-current assets	2,714,151	3,026,508
Total assets	10,691,528	9,971,153
LIABILITIES		
Current liabilities:		
Revenue bonds payable	2,530,000	2,400,000
Accrued interest payable	42,831	63,831
Total current liabilities	2,572,831	2,463,831
Non-current liabilities:		
Revenue bonds payable	2,434,751	5,017,063
Total liabilities	5,007,582	7,480,894
NET POSITION		
Restricted net position	$ 5,683,946	$ 2,490,259

See accompanying notes to the financial statements.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	2013	2012
Operating revenues:		
Court costs receipts	$ 3,325,456	$ 3,507,117
Interest income-leases	52,066	73,573
Amortization of premium and discount on leases	63,584	63,584
Total operating revenues	3,441,106	3,644,274
Operating expenses:		
Interest expense	246,674	370,572
Amortization of debt issuance costs	32,334	32,334
Other operating expenses	45,500	25,000
Total operating expenses	324,508	427,906
Income from operations	3,116,598	3,216,368
Non-operating revenues:		
Income from investments	77,089	76,327
Change in net position	3,193,687	3,292,695
Accumulated net position, beginning of year	2,490,259	(802,436)
Restricted net position, end of year	$ 5,683,946	$ 2,490,259

See accompanying notes to the financial statements.

KENTUCKY LOCAL CORRECTIONAL
FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	2013	2012
Cash flows from operating activities:		
Cash received from court costs	$ 3,675,583	$ 3,219,893
Lease payments collected, including interest	380,087	392,261
Cash payments for services	(45,500)	(25,000)
Net cash flows from operating activities	4,010,170	3,587,154
Cash flows from capital and related financing activities:		
Principal paid on revenue bonds	(2,400,000)	(2,280,000)
Interest paid on revenue bonds	(319,987)	(442,835)
Net cash flows from financing activities	(2,719,987)	(2,722,835)
Cash flows from investing activities:		
Investment income received	77,089	76,327
Net change in cash and cash equivalents	1,367,272	940,646
Cash and cash equivalents, beginning of year	5,995,602	5,054,956
Cash and cash equivalents, end of year	$ 7,362,874	$ 5,995,602

See accompanying notes to the financial statements.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	2013	2012
Reconciliation of income from operations to net cash flows from operating activities:		
Income from operations	$ 3,116,598	$ 3,216,368
Interest paid on revenue bonds	319,987	442,835
Amortization of premium and discount on leases	(63,584)	(63,584)
Amortization of debt issuance costs	32,334	32,334
Amortization of bond premium	(168,179)	(168,179)
Amortization of deferred amount on refunding	115,866	115,866
(Increase) decrease in assets:		
Court costs receivable	350,127	(287,224)
Accrued interest receivable-leases	5,194	4,880
Lease agreement receivables	322,827	313,808
Decrease in liabilities:		
Accrued interest payable	(21,000)	(19,950)
Net cash provided by operating activities	$ 4,010,170	$ 3,587,154

See accompanying notes to the financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Kentucky Local Correctional Facilities Construction Authority (the Authority) is presented to assist in understanding the Authority's financial statements. The financial statements and notes are representations of the Authority's management, who is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

Nature of Organization

The Authority is a public corporation and governmental agency of the Commonwealth of Kentucky created in 1982 by an Act of the Kentucky General Assembly. The purpose of the Authority is to provide up to 75 percent of the cost of construction, improvement, or repair of any jails operated by Kentucky local governments.

As a component unit of the Commonwealth of Kentucky, the accompanying financial statements are included in the Commonwealth's Comprehensive Annual Financial Report as a discretely presented component unit.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The activities of the Authority are accounted for as an enterprise fund on the accrual basis of accounting. Accordingly, revenues are recognized when they are earned and expenses are recognized when they are incurred.

As a result of adopting Governmental Accounting Standards Board Statement No. 34, "*Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments,*" in the year ended June 30, 2002, the financial statements include a Management's Discussion and Analysis (MD&A) section providing an analysis of the Authority's overall financial position and results of operations.

Use of Estimates

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

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Authority considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Investments

Investments are reported at fair market value. Unrealized gains and losses (income/loss from investments) are included in the statement of revenues, expenses, and changes in net position.

Net Position

Net position (when applicable) is displayed in three components:

a. Invested in capital assets, net of related debt - Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

b. Restricted net position - Consists of net position with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.

c. Unrestricted net position - All other net position that do not meet the definition of "invested in capital assets, net of related debt" or "restricted."

Amortization of Premium/Discount on Lease Agreement Receivables

Premiums and discounts on lease agreement receivables are amortized on the straight-line method over the life of the related receivable. The results of this method do not materially differ from those that would be obtained by applying the effective interest method.

Amortization of Bond Premium/Discount and Debt Issuance Costs

The bond premium (Series 2004 bonds)/discount (Series 1994 bonds) and the debt issuance costs are amortized on the straight-line method over the life of the bond issues. The results of this method do not materially differ from those that would be obtained by applying the effective interest method. The amortization of the bond premium/discount is charged to interest expense on the accompanying statements of revenues, expenses, and changes in net position.

Amortization of Deferred Amount on Refunding

The deferred amount on refunding is amortized on the straight-line method over the life of the Series 2004 bonds. The results of this method do not materially differ from those that would be obtained by applying the effective interest method. The amortization is charged to interest expense on the accompanying statements of revenues, expenses, and changes in net position.

Operating Revenues and Expenses

Operating revenues and expenses for enterprise funds are those that result from providing services. It also includes all revenues and expenses not related to capital and related financing, non-capital financing, or investing activities.

Implementation of New Accounting Principles

For the year ending June 30, 2013, the Authority implemented the following statement of financial accounting standards issued by the Governmental Accounting Standards Board:

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Infows of Resources, and Net Position. GASB Statement No. 63 provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. Concepts Statement 4 identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Pursuant to the issue of the Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004 (see Note 4), the Authority entered into a Trust Indenture Agreement with U.S.

Bank National Association of Louisville, Kentucky as Trustee. The Trust Indenture provides for the issuance of the bonds and the establishment of the following special accounts with the Trustee.

Construction Account

Funded from the bond proceeds of any Series required to be deposited therein, available funds of the Authority, or other sources as determined by Series resolution, to be applied to the acquisition, construction, reconstruction, and equipping of the projects designated and the necessary expenses incidental thereto. No disbursements shall be made from the Construction Account unless the Trustee receives a written Requisition for Funds approved by the Authority.

Costs of Issuance Account

Established from bond proceeds for the purpose of paying the costs of issuing such bonds.

Debt Service Fund

Interest Account:
To receive transfers from the Revenue Fund for payments of the interest becoming due on the bonds on said interest payment dates.

Principal Account:
To receive transfers from the Revenue Fund for payments of the principal becoming due on the bonds on said principal payment dates.

Debt Service Reserve Fund

There shall be paid into the Debt Service Reserve Fund any proceeds of bonds or a surety bond (or other credit facility) so provided to be deposited therein by any Series resolution, as well as the pledged receipts from the Revenue Fund, an amount equal to the payment of the principal installments of, or interest on, any outstanding bonds (the "aggregate debt service reserve requirement"), but only to the extent amounts in the Debt Service Fund and the Revenue Fund are not adequate for such purpose. The "aggregate debt service reserve requirement" shall mean an amount equal to the lesser of (a) 10% of the stated aggregate principal amount of the bonds, (b) the maximum annual debt service requirement in the current year or any succeeding bond fiscal year with respect to all outstanding bonds, or (c) 125% of the average annual debt service requirement with respect to all outstanding bonds.

Payment, Surplus, and Operating Fund

There shall be paid into the Payment, Surplus, and Operating Fund the amounts required to be so paid by the provisions of the Trust Indenture, including amounts transferred from the Revenue Fund. Notwithstanding anything in the Trust Indenture to the contrary, monies in the Payment, Surplus, and Operating Fund may be withdrawn and paid out by the Trustee to or at the direction of the Authority for any lawful purpose of the Authority, including, but not limited to, paying reasonable or necessary operating costs and making grants to Local Governments. When amounts permitted are so withdrawn and paid out, such monies shall be free and clear of any lien, pledge, or assignment in trust created by this Trust Indenture.

Revenue Fund

All of the pledged receipts of the Authority, including court costs, investment earnings, rental payments, and supplemental rental payments, shall be deposited in the Revenue Fund and disbursed for payment of interest and principal which will come due on the bonds on said interest and principal payment dates.

At June 30, 2013 and 2012, the components of the revenue bond accounts are as follows:

	2013	2012
Debt service fund - principal account	$ 2,530,053	$ 2,400,072
Debt service reserve fund	2,335,178	2,335,178
Payment, surplus, and operating fund	3,927,676	3,315,200
Revenue fund	905,145	280,330
Total cash, cash equivalents, and investments	9,698,052	8,330,780
Less non-current debt service reserve investments	(2,335,178)	(2,335,178)
Total current cash and cash equivalents	$ 7,362,874	$ 5,995,602

At June 30, 2013 and 2012, the Authority's investments are as follows:

Investment Type	Fair Value	Maturity
U.S. Treasury Department Treasury Bonds, State and Local Government Series	$ 2,335,178	October 31, 2014

At June 30, 2013 and 2012, the Authority's remaining funds on deposit with the Trustee (money market funds reported as cash and cash equivalents) were invested in the First American Government Obligation Fund.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority has no formal policy on custodial credit risk. At June 30, 2013 and 2012, the Authority's investments are neither insured nor registered, but are held by the Authority's counterparty in the Authority's name.

Credit Risk: The Trustee, on behalf of the Authority, is permitted to invest Authority funds in the following:

- obligations backed by the full faith and credit of the United States
- obligations of any corporation of the United States Government
- collateralized or uncollateralized certificates of deposit issued by banks or other interest-bearing accounts in depository institutions chartered by Kentucky or by the United States
- bankers acceptances
- commercial paper
- securities issued by a State or local government, or any instrumentality or agency thereof in the United States
- United States denominated corporate, Yankee, and Eurodollar securities, excluding corporate stocks, issued by foreign and domestic issuers
- asset-backed securities
- shares of mutual funds, not to exceed 10% of the total funds available for investment
- State and local delinquent property tax claims

Concentration of Credit Risk: The Authority places no limit on the amount the Authority may invest in any one issuer, with the exception of investments in mutual funds as indicated above.

Interest Rate Risk: The Authority maintains its investment in U.S. Treasury Department

Treasury Bonds, State and Local Government Series (SLGS) to comply with federal arbitrage tax law provisions under the trust indenture and, accordingly, does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates relative to its investment in the SLGS.

3. LEASE AGREEMENT RECEIVABLES

Lease agreement receivables represent the participating counties' agreed amount of bond principal required to finance the counties' share of project costs funded through the bond issue. As of June 30, 2013 and 2012, no allowance for uncollectible balances is considered necessary.

The counties and their respective amounts are as follows:

	2013	2012
Adair	$ 61,459	$ 89,468
Estill	26,065	37,944
Franklin	256,668	373,643
Fulton	45,976	66,834
Knox	69,610	101,334
McCreary	41,938	60,888
Montgomery	121,428	176,768
Powell	34,699	50,385
Simpson	51,493	74,898
	709,336	1,032,162
Less net premium and discount on leases	(29,869)	(93,453)
Net lease agreement receivable	679,467	938,709
Less current portion	(343,606)	(322,825)
Non-current lease agreement receivables	$ 335,861	$ 615,884

Premiums and discounts on leases represent the difference between the amount of bond principal assigned and bond proceeds allocated to the participating counties, which reflects the counties' share of bond issuance costs.

Future minimum lease payments required under the lease agreement receivables at June 30, 2013 are as follows:

Year Ending June 30		
2014	$	343,606
2015		365,730
	$	709,336

4. REVENUE BONDS PAYABLE

On October 13, 2004, the Authority issued $21,670,000 in Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004, to redeem and discharge $26,895,000 of outstanding Series 1994 bonds.

Activity within revenue bonds payable (Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004) during the year ended June 30, 2013 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Serial bonds	$ 7,295,000	$ -0-	$ 2,400,000	$ 4,895,000	$ 2,530,000
Unamortized premium	392,418	-0-	168,179	224,239	-0-
Unamortized deferred amount on refunding	(270,355)	-0-	(115,867)	(154,488)	-0-
	$ 7,417,063	$ -0-	$ 2,452,312	$ 4,964,751	$ 2,530,000

The bonds outstanding at June 30, 2013 are serial bonds at an interest rate of 5.25%, with principal due annually on November 1 in amounts ranging from $2,365,000 to $2,530,000 through November 1, 2014. Interest is due semiannually each May 1 and November 1.

Activity within revenue bonds payable during the year ended June 30, 2012 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Serial bonds	$ 9,575,000	$ -0-	$ 2,280,000	$ 7,295,000	$ 2,400,000
Unamortized premium	560,597	-0-	168,179	392,418	-0-
Unamortized deferred amount on refunding	(386,222)	-0-	(115,867)	(270,355)	-0-
	$ 9,749,375	$ -0-	$ 2,332,312	$ 7,417,063	$ 2,400,000

The Series 2004 bonds are not subject to redemption prior to maturity. The Series 2004 bonds are, however, subject to special redemption, without premium, to the extent of casualty insurance proceeds, condemnation awards, and monies received from a Local Government electing to purchase its project. The Series 2004 bonds are also subject to extraordinary redemption, without premium, due to the failure by a Local Government to initiate construction of its project within the time permitted under the lease and participation agreement.

Bonds to be redeemed due to a special or extraordinary redemption shall be bonds which mature, or are subject to mandatory sinking fund redemption, on the principal installment dates that correspond to the dates the principal portion of the rental payments under the related lease and participation agreement were due.

The scheduled payments of principal and interest, when due, are guaranteed under a financial guaranty insurance policy issued by National Public Finance Guarantee Corporation. All cash, cash equivalents, and investments of the Authority held by the Trustee bank are pledged as collateral for the bond indebtedness.

The Series 2004 bonds are special and limited obligations of the Authority and, except to the extent payable from the proceeds of such bonds or other monies pledged under the Trust Indenture, are payable from the pledged receipts as described below, to the extent such sources exist.

1. The Authority is entitled to 10.8% or $10.80 of each $100.00 court cost, up to $5,400,000 each fiscal year, taxed against a defendant upon conviction in each case tried in a State Circuit or District Court. The court costs are collected by all circuit clerks in Kentucky and are submitted on a monthly basis. Any receipts collected above the $5,400,000 each fiscal year are paid into the Commonwealth's General Fund.

2. Rental payments received by the Authority under the leases from Local Governments in repayment of and as interest on a Local Government's agreed participation.

3. All interest earned and gains realized on investment obligations acquired with monies on deposit under the Trust Indenture other than the Payment, Surplus, and Operating Fund.

4. Any gifts or grants received from any agency of government, both Federal and State, to the extent not otherwise required to be applied.

5. Any and all appropriations made to the Authority by the General Assembly of the Commonwealth of Kentucky to the extent not otherwise committed during any fiscal period of the Authority.

As a result of the 2004 refunding, the Authority recognized a deferred amount on the refunding in the amount of $1,158,663. This amount represents the difference between the reacquisition price relative to the Series 1994 bonds outstanding (including the 102% call premium) and the net carrying amount of the Series 1994 bonds (including the unamortized discount and debt issuance costs). The unamortized deferred amount on the refunding is reported in the accompanying statement of net assets as a deduction from the outstanding revenue bonds payable as of June 30, 2013 and 2012.

Debt service requirements at June 30, 2013 are as follows:

Year Ending June 30	Principal	Interest
2014	$ 2,530,000	$ 190,575
2015	2,365,000	62,081
	$ 4,895,000	$ 252,656

5. PAYMENT TO THE COMMONWEALTH

During its 2010 Regular Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 290 which contained a provision that, notwithstanding KRS 441.605 to 441.695, for each of the fiscal years ended June 30, 2011 and 2012, funds of $2,427,500 shall be expended from the Kentucky Local Correctional Facilities Construction Authority for local correctional facility and operational support consistent with contractual covenants in accordance with bond indentures of the Authority. Subsequent to the passage of the Bill, the Authority came to an agreement with the Office of State Budget Director to waive the payments for the years ended June 30, 2011 and 2012.

During its 2012 Regular Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 265 which contained a provision that, notwithstanding KRS 441.605 to 441.695, for the fiscal year ended June 30, 2014, funds of $2,800,000 shall be expended from the Kentucky Local Correctional Facilities Construction Authority for local correctional facility and operational support consistent with contractual covenants in accordance with bond indentures of the Authority.

6. RESTRICTED NET POSITION

Since the use of the Authority's resources is mandated by Kentucky Revised Statute 441, the Authority considers the net position not restricted for debt service to be restricted by law. Restricted net assets consist of the following at June 30, 2013:

Restricted by law	$ 3,348,768
Restricted for debt service	2,335,178
Total restricted net position	$ 5,683,946

7. RELATED PARTY TRANSACTIONS

The Authority receives the benefit of accounting and administrative services from the Office of Financial Management (OFM). OFM serves as staff to the Authority and is reimbursed for accounting and administrative costs. During 2013 and 2012, the Authority reimbursed OFM $25,000 for these costs.

8. RISK MANAGEMENT

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; and errors and omissions. The Authority utilizes the Commonwealth of Kentucky's Risk Management Fund to cover the exposure to these potential losses. The Commonwealth of Kentucky's Comprehensive Annual Financial Report should be referred to for additional disclosures related to the Risk Management Fund.

9. RECENT GASB PRONOUNCEMENTS

Management has not currently determined what, if any, effects of implementation of the following statement may have on the financial statements:

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, issued March 2012, is effective for periods beginning after December 15, 2012. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

Concepts Statement No. 4, Elements of Financial Statements, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations.

The requirements of this Statement will improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting.

CPAs / ADVISORS

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

To the Board of Directors
Kentucky Local Correctional
Facilities Construction Authority
Frankfort, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Kentucky Local Correctional Facilities Construction Authority (the Authority) as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated September 10, 2013.

Internal Control Over Financial Reporting

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

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

<u>Compliance and Other Matters</u>

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

<u>Purpose of this Report</u>

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

Blue & Co., LLC

Lexington, Kentucky
September 10, 2013

SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2013

Schedule of auditor's results

We have issued an unqualified opinion dated September 10, 2013 on the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2013.

Our audit disclosed no instances of noncompliance which are material to the Authority's financial statements.

Findings relating to the financial statements

Our audit disclosed no findings that are required to be reported in accordance with *Government Auditing Standards*.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTION
YEAR ENDED JUNE 30, 2013

Findings relating to the financial statements

The audit disclosed no findings that are required to be reported in accordance with *Government Auditing Standards* for the year ended June 30, 2012.