

**KENTUCKY LOCAL CORRECTIONAL
FACILITIES CONSTRUCTION AUTHORITY
FRANKFORT, KENTUCKY**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

June 30, 2004 and 2003



**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
FRANKFORT, KENTUCKY**

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MOORE STEPHENS POTTER LLP

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT

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

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, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 6 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 24, 2004 on our consideration of the Kentucky Local Correctional Facilities Construction Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Moore Stephens Potter, LLP

MOORE STEPHENS POTTER, LLP

August 24, 2004

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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, 2004 and 2003. We encourage readers to read it in conjunction with the Authority's financial statements and the accompanying notes.

FINANCIAL HIGHLIGHTS

- Cash and cash equivalents increased \$916,295 (16.5%)
- Lease agreement receivables (net of premium on leases) decreased \$312,952 (5.2%)
- Revenue bonds payable and other liabilities decreased \$2,019,648 (6.5%)
- The Authority's accumulated net deficit decreased \$2,613,560 (14.3%)
- Operating revenues increased \$406,858 (7.5%)
- Operating expenses decreased \$97,802 (3.0%)
- Income from operations increased \$504,660 (24.0%)
- Income from investments decreased \$79,050 (93.2%)

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 assets presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets 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 assets presents information showing how the Authority's net assets changed during the most recent fiscal year. All changes in net assets 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.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

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 11-19.

FINANCIAL ANALYSIS OF THE AUTHORITY

Condensed Financial Information (in thousands)

Statement of Net Assets

As of June 30

	2004	Percentage Increase (Decrease)	2003	Percentage Increase (Decrease)	2002
Current assets	\$ 3,949	28.5%	\$ 3,073	-82.3%	\$ 17,338
Non-current assets	9,287	-2.9%	9,569	-3.8%	9,949
Total assets	<u>13,236</u>	4.7%	<u>12,642</u>	-53.7%	<u>27,287</u>
Current liabilities	2,291	-0.5%	2,303	5.1%	2,191
Non-current liabilities	26,662	-7.0%	28,670	-6.3%	30,587
Total liabilities	<u>28,953</u>	-6.5%	<u>30,973</u>	-5.5%	<u>32,778</u>
Accumulated net deficit	<u>\$ (15,717)</u>	-14.3%	<u>\$ (18,331)</u>	233.8%	<u>\$ (5,491)</u>

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

Non-current assets consist primarily of debt service reserve cash and cash equivalents and 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 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 2003 House Bill No. 269 authorized the one-time non-reciprocal payment to the Commonwealth in the amount of \$15,000,000 (as discussed on page 5), which has been reported as a non-operating expense in the 2003 financial statements. As a result of these transactions, the Authority has accumulated a **net deficit** as of June 30, 2004.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)

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

	<u>2004</u>	Percentage Increase (Decrease)	<u>2003</u>	Percentage Increase (Decrease)	<u>2002</u>
Operating revenues:					
Court costs receipts	\$ 5,281	8.9%	\$ 4,848	1.0%	\$ 4,802
Interest income-leases	434	-5.7%	460	-5.0%	484
Other	96	0.0%	96	0.0%	96
Total operating revenues	<u>5,811</u>	7.5%	<u>5,404</u>	0.4%	<u>5,382</u>
Operating expenses:					
Construction grants	1,522	0.0%	1,522	0.0%	1,522
Interest expense	1,585	-5.5%	1,677	-4.9%	1,763
Other	96	-5.9%	102	9.7%	93
Total operating expenses	<u>3,203</u>	-3.0%	<u>3,301</u>	-2.3%	<u>3,378</u>
Income from operations	<u>2,608</u>	24.0%	<u>2,103</u>	4.9%	<u>2,004</u>
Non-operating revenues (expenses)	<u>6</u>	100.0%	<u>(14,943)</u>	-5436.8%	<u>280</u>
Change in net assets	2,614	120.4%	(12,840)	-662.2%	2,284
Accumulated net deficit, beginning of year	<u>(18,331)</u>	233.8%	<u>(5,491)</u>	-29.4%	<u>(7,775)</u>
Accumulated net deficit, end of year	<u>\$ (15,717)</u>	-14.3%	<u>\$ (18,331)</u>	233.8%	<u>\$ (5,491)</u>

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 premium on leases.

Construction grants represent the annual installments of funding for construction and improvement of correctional facilities in ten counties throughout the state of Kentucky.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)

Interest expense represents the interest due semi-annually each May 1 and November 1 on the revenue bonds payable.

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 bond discount and the debt issuance costs.

Non-operating revenues (expenses) typically consist primarily of income from investments, which declined approximately \$79,000 (93.2%) from 2003 due to the significant reduction in the Authority's average deposits attributable to the \$15,000,000 non-reciprocal payment to the Commonwealth (included within non-operating expenses on the accompanying 2003 financial statements) during May 2003 (see below), as well as the continued general decline in interest rates during the fiscal year. Income from investments for the year ended June 30, 2003 declined approximately \$224,000 (72.5%) from 2002. Income from investments for the year ended June 30, 2002 declined approximately \$469,000 (60.3%) from 2001.

During its 2003 Regular Session the General Assembly of the Commonwealth of Kentucky passed House Bill No. 269 which contained a provision that, notwithstanding KRS 441.605 to 441.695 for fiscal year ended June 30, 2003, funds in the amount of \$15,000,000 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. Accordingly, the statement of revenues, expenses, and changes in net assets for the year ended June 30, 2003 includes a non-reciprocal payment to the Commonwealth in the amount of \$15,000,000.

Condensed Financial Information (in thousands)

Statement of Cash Flows

For the Fiscal Year Ended June 30

	<u>2004</u>	Percentage Increase (Decrease)	<u>2003</u>	Percentage Increase (Decrease)	<u>2002</u>
Net cash provided by (used in):					
Operating activities	\$ 4,449	6.5%	\$ 4,179	1.8%	\$ 4,106
Non-capital financing activities	0	100.0%	(15,000)	-100.0%	0
Capital and related financing activities	(3,541)	0.1%	(3,536)	-0.1%	(3,541)
Investing activities	<u>8</u>	-99.4%	<u>1,293</u>	281.4%	<u>339</u>
Net change in cash and cash equivalents	916	107.0%	(13,064)	-1545.1%	904
Cash and cash equivalents, beginning of year	<u>5,558</u>	-70.2%	<u>18,622</u>	5.1%	<u>17,718</u>
Cash and cash equivalents, end of year	<u><u>\$ 6,474</u></u>	16.5%	<u><u>\$ 5,558</u></u>	-70.2%	<u><u>\$ 18,622</u></u>

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)

The **net change in cash and cash equivalents** totaled \$916,295 at June 30, 2004 primarily due to the \$449,381 increase in the cash received from court costs during 2004. The **net change in cash and cash equivalents** totaled (\$13,064,508) at June 30, 2003 primarily due to the \$15,000,000 payment to the Commonwealth and the \$1,292,900 net cash provided by investing activities attributable primarily to the \$1,190,000 in proceeds from the sale of investments during 2003. The **net change in cash and cash equivalents** totaled (\$903,907) at June 30, 2002 primarily due to the \$273,336 decline in the cash received from court costs and the \$877,503 decline in the net cash provided by investing activities attributable largely to the decline in investment income received.

DEBT ADMINISTRATION

At year-end, the Authority had \$28,925,000 in revenue bonds principal outstanding (a decrease of 6.3% as shown below). 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 resulting from the regularly scheduled principal and interest payments between fiscal years ended June 30, 2004, 2003, and 2002.

	<u>2004</u>	Percentage Increase (Decrease)	<u>2003</u>	Percentage Increase (Decrease)	<u>2002</u>
Revenue bonds payable	\$ 28,925	-6.3%	\$ 30,865	-5.6%	\$ 32,710
Unamortized discount	<u>(233)</u>	-8.6%	<u>(255)</u>	-8.3%	<u>(278)</u>
Revenue bonds payable, net	<u>\$ 28,692</u>	-6.3%	<u>\$ 30,610</u>	-5.6%	<u>\$ 32,432</u>

CURRENTLY KNOWN FACTS, DECISIONS, OR CONDITIONS

As presented in Note 5 to the financial statements, as of June 30, 2004, the Authority has no further obligations under the Phase 1 Grants (a total obligation of \$784,338 a year since October 1994).

The outstanding 1994 Series Multi-County Correctional Facilities Revenue Refunding Bonds are callable on November 1, 2004 at 102%.

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 & Administration Cabinet, Commonwealth of Kentucky, Room 261, Capitol Annex, Frankfort, Kentucky, 40601.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
STATEMENTS OF NET ASSETS
June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 2,882,135	\$ 2,062,613
Court costs receivable	524,517	485,836
Accrued interest receivable-investments	705	2,707
Accrued interest receivable-leases	106,795	113,349
Lease agreement receivables	435,178	408,963
Total current assets	<u>3,949,330</u>	<u>3,073,468</u>
Non-current assets:		
Cash and cash equivalents-debt service reserve	3,591,752	3,494,979
Lease agreement receivables	5,286,397	5,625,564
Debt issuance costs, net of accumulated amortization of \$408,744 in 2004 and \$369,188 in 2003	408,744	448,300
Total non-current assets	<u>9,286,893</u>	<u>9,568,843</u>
Total assets	<u>13,236,223</u>	<u>12,642,311</u>
<u>LIABILITIES</u>		
Current liabilities:		
Revenue bonds payable	2,030,000	1,940,000
Accounts payable	1,333	87,775
Accrued interest payable	259,693	275,419
Total current liabilities	<u>2,291,026</u>	<u>2,303,194</u>
Non-current liabilities:		
Revenue bonds payable	<u>26,662,289</u>	<u>28,669,769</u>
Total liabilities	<u>28,953,315</u>	<u>30,972,963</u>
<u>NET ASSETS</u>		
Accumulated net deficit	<u>\$ (15,717,092)</u>	<u>\$ (18,330,652)</u>



KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Court costs receipts	\$ 5,280,959	\$ 4,848,283
Interest income-leases	433,735	459,553
Amortization of premium on leases	96,011	96,011
Total operating revenues	<u>5,810,705</u>	<u>5,403,847</u>
Operating expenses:		
Construction grants	1,522,233	1,522,233
Interest expense	1,585,220	1,677,163
Revenue bonds payable:		
Amortization of bond discount	22,520	22,520
Amortization of debt issuance costs	39,556	39,556
Other expenses	33,366	39,225
Total operating expenses	<u>3,202,895</u>	<u>3,300,697</u>
Income from operations	<u>2,607,810</u>	<u>2,103,150</u>
Non-operating revenues (expenses):		
Income from investments	5,750	84,800
Realized loss on the sale of investments	0	(27,525)
Payment to the Commonwealth	0	(15,000,000)
Total non-operating revenues (expenses)	<u>5,750</u>	<u>(14,942,725)</u>
Change in net assets	2,613,560	(12,839,575)
Accumulated net deficit, beginning of year	<u>(18,330,652)</u>	<u>(5,491,077)</u>
Accumulated net deficit, end of year	<u>\$ (15,717,092)</u>	<u>\$ (18,330,652)</u>



KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from court costs	\$ 5,242,279	\$ 4,792,898
Lease payments collected, including interest	849,251	916,237
Cash payments on construction grants	(1,522,233)	(1,522,233)
Cash payments for services	(119,809)	(7,500)
Net cash provided by operating activities	<u>4,449,488</u>	<u>4,179,402</u>
Cash flows from non-capital financing activities:		
Payment to the Commonwealth	<u>0</u>	<u>(15,000,000)</u>
Cash flows from capital and related financing activities:		
Principal paid on revenue bonds	(1,940,000)	(1,845,000)
Interest paid on revenue bonds	(1,600,945)	(1,691,809)
Net cash used in capital and related financing activities	<u>(3,540,945)</u>	<u>(3,536,809)</u>
Cash flows from investing activities:		
Investment income received	7,752	102,900
Proceeds from the sale of investments	0	1,190,000
Net cash provided by investing activities	<u>7,752</u>	<u>1,292,900</u>
Net change in cash and cash equivalents	916,295	(13,064,507)
Cash and cash equivalents, beginning of year	<u>5,557,592</u>	<u>18,622,099</u>
Cash and cash equivalents, end of year	\$ <u><u>6,473,887</u></u>	\$ <u><u>5,557,592</u></u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Current cash and cash equivalents	\$ 2,882,135	\$ 2,062,613
Non-current cash and cash equivalents-debt service reserve	<u>3,591,752</u>	<u>3,494,979</u>
Total cash and cash equivalents per the statements of net assets	\$ <u><u>6,473,887</u></u>	\$ <u><u>5,557,592</u></u>



KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Reconciliation of income from operations to net cash flows from operating activities:		
Income from operations	\$ 2,607,810	\$ 2,103,150
Interest paid on revenue bonds	1,600,945	1,691,809
Amortization of premium on leases	(96,011)	(96,011)
Amortization of bond discount	22,520	22,520
Amortization of debt issuance costs	39,556	39,556
(Increase) decrease in assets:		
Court costs receivable	(38,681)	(55,386)
Accrued interest receivable-leases	6,554	72,352
Lease agreement receivables	408,963	384,333
Increase (decrease) in liabilities:		
Accounts payable	(86,442)	31,725
Accrued interest payable	(15,726)	(14,646)
Net cash provided by operating activities	<u>\$ 4,449,488</u>	<u>\$ 4,179,402</u>



KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 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 Kentucky Local Correctional Facilities Construction 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.

The Authority is a component unit of the Commonwealth of Kentucky and is 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.

The Authority applies all Governmental Accounting Standards Board (GASB) pronouncements as well as the Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB pronouncements prevail. The Authority has further elected not to apply FASB pronouncements issued after November 30, 1989, in accordance with GASB Statement No. 20.

In June 1999, the Governmental Accounting Standards Board (GASB) unanimously approved Statement No. 34, "*Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments.*" Accordingly, 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 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.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Net Assets:

Net assets are 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 assets - Consists of net assets 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 assets - All other net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted."

Amortization of Premium on Lease Agreement Receivables:

Premiums on lease 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 Discount and Debt Issuance Costs:

Bond discount and debt issuance costs are amortized on the straight-line method over the life of the bond issue. The results of this method do not materially differ from those that would be obtained by applying the effective interest method.

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.

NOTE 2 - CASH AND CASH EQUIVALENTS

Pursuant to the issue of the Multi-County Correctional Facilities Revenue Refunding Bonds, Series 1994 (see Note 4), the Authority entered into a Trust Indenture Agreement with Star Bank of Cincinnati, Ohio. The Trust Indenture provides for the issuance of the bonds and the establishment of the following special accounts with the trustee.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 2 - CASH AND CASH EQUIVALENTS (CONTINUED)

Cost of Issuance Account:

Established from Bond proceeds for the purpose of paying the cost of issuing such Bonds.

Operating Account:

Designated for the operating costs of the Authority.

Construction Account:

Established from Bond proceeds, available funds of the Authority and cash contributions of Local Governments not financed through the Authority (the "Local Government Contributions" or "County Contributions") 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 Requisition for Funds approved by the Authority.

Debt Service Fund:

Interest Account:

Established to receive interest on delivery of bonds and transfer of capitalized interest from the Construction Account for Local Governments so requesting. Subsequently, transfers from the Revenue Fund shall be made for payments of the interest becoming due on the Bonds.

Principal Account:

To receive transfers from the Revenue Fund for principal becoming due on the Bonds.

Debt Service Reserve Fund:

Funded from Bond proceeds and funds of the Authority available upon delivery of Bonds in an amount equal to the maximum annual principal and interest requirements on all Bonds issued under the Trust Indenture (the "Aggregate Debt Service Reserve Requirement").

Revenue Fund:

All of the pledged receipts of the Authority, including court costs, investments 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.

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 provision of the Trust Indenture, and there may be paid into the Payment, Surplus, and Operating Fund any monies received by the Authority from any other source, including legislative appropriations of the State unless required to be otherwise applied as provided by the Trust Indenture.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 2 - CASH AND CASH EQUIVALENTS (CONTINUED)

At June 30, 2004 and 2003 the components of the Revenue Bond accounts are as follows:

	<u>2004</u>	<u>2003</u>
Operating account	\$ 5,336	\$ 5,329
Debt service reserve fund	3,591,752	3,494,979
Revenue fund	2,832,986	1,057,310
Payment, surplus, and operating fund	<u>43,813</u>	<u>999,974</u>
Total cash and cash equivalents	6,473,887	5,557,592
Less non-current debt service reserve	<u>(3,591,752)</u>	<u>(3,494,979)</u>
	<u>\$ 2,882,135</u>	<u>\$ 2,062,613</u>

The carrying amounts and market values of cash and cash equivalents by credit risk category are summarized as follows:

	<u>Category</u> <u>1</u>	<u>Category</u> <u>2</u>	<u>Category</u> <u>3</u>	<u>Carrying</u> <u>Amount</u>	<u>Original</u> <u>Cost</u>
<u>June 30, 2004</u>					
U.S. Treasury Reserve Fund	\$ <u>0</u>	\$ <u>0</u>	\$ <u>6,473,887</u>	\$ <u>6,473,887</u>	\$ <u>6,473,887</u>
<u>June 30, 2003</u>					
U.S. Treasury Reserve Fund	\$ <u>0</u>	\$ <u>0</u>	\$ <u>5,557,592</u>	\$ <u>5,557,592</u>	\$ <u>5,557,592</u>

The above schedule classifies the carrying amounts of cash and cash equivalents as to credit risk by the three categories described below:

- Category 1 - Amounts covered by federal depository insurance or collateralized with securities held by the Authority or the Authority's agent in the Authority's name.
- Category 2 - Amounts collateralized with securities held by the pledging financial institution's trust department or agent in the Authority's name.
- Category 3 - Amounts which are uninsured and uncollateralized or which are collateralized, but the securities are held by the financial institution's trust department or agent in the institution's name.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 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. The counties and their respective amounts are as follows:

	<u>2004</u>	<u>2003</u>
Adair	\$ 291,224	\$ 309,190
Estill	123,510	131,130
Franklin	1,216,192	1,291,221
Fulton	215,521	228,572
Johnson	652,694	692,282
Kenton	2,656,341	2,820,214
Knox	329,839	350,187
McCreary	194,556	206,142
Montgomery	575,376	610,872
Powell	161,121	170,731
Simpson	<u>242,407</u>	<u>257,203</u>
	6,658,781	7,067,744
Less premium on leases	<u>(937,206)</u>	<u>(1,033,217)</u>
Net lease agreement receivables	5,721,575	6,034,527
Less current maturities	<u>(435,178)</u>	<u>(408,963)</u>
 Non-current lease agreement receivables	 \$ <u>5,286,397</u>	 \$ <u>5,625,564</u>

Premium on leases represents 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, 2004 are as follows:

<u>Year Ending June 30</u>	
2005	\$ 435,178
2006	463,075
2007	492,765
2008	524,361
2009	557,990
Thereafter	<u>4,185,412</u>
	 \$ <u>6,658,781</u>



KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 4 - REVENUE BONDS PAYABLE

At June 30, 2004, revenue bonds payable (Multi-County Correctional Facilities Revenue Refunding Bonds-Series 1994) consist of the following:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Serial bonds (a)	\$ 13,175,000	\$	\$ 1,940,000	\$ 11,235,000	\$ 2,030,000
Term bonds (b)	<u>17,690,000</u>	<u>0</u>	<u>1,940,000</u>	<u>17,690,000</u>	<u>2,030,000</u>
	30,865,000			28,925,000	2,030,000
Unamortized discount	<u>(255,231)</u>	<u>0</u>	<u>(22,520)</u>	<u>(232,711)</u>	<u>0</u>
	<u>\$ 30,609,769</u>	<u>\$ 0</u>	<u>\$ 1,917,480</u>	<u>\$ 28,692,289</u>	<u>\$ 2,030,000</u>

(a) Serial bonds, 4.95% to 5.40% due annually on November 1 in amounts ranging from \$2,030,000 to \$2,475,000.

(b) Term bonds, 5.50% due November 1, 2014.

At June 30, 2003, revenue bonds payable (Multi-County Correctional Facilities Revenue Refunding Bonds-Series 1994) consist of the following:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Serial bonds	\$ 15,020,000	\$	\$ 1,845,000	\$ 13,175,000	\$ 1,940,000
Term bonds	<u>17,690,000</u>	<u>0</u>	<u>1,845,000</u>	<u>17,690,000</u>	<u>1,940,000</u>
	32,710,000			30,865,000	1,940,000
Unamortized discount	<u>(277,751)</u>	<u>0</u>	<u>(22,520)</u>	<u>(255,231)</u>	<u>0</u>
	<u>\$ 32,432,249</u>	<u>\$ 0</u>	<u>\$ 1,822,480</u>	<u>\$ 30,609,769</u>	<u>\$ 1,940,000</u>

The term bonds are subject to redemption by operation of the Debt Service Fund through mandatory sinking fund installments. The redemption price will be 100% of the principal redeemed plus accrued interest, if any, to the redemption date.

The serial and term bonds maturing on or after November 1, 2005 shall be subject to redemption prior to their stated maturity at the option of the Authority in whole at any time or in part on any interest payment date on or after November 1, 2004, at redemption prices ranging from 100% to 102% of the principal amount redeemed. Such redemption price, plus accrued interest, if any, is payable on the date of redemption.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 4 - REVENUE BONDS PAYABLE (CONTINUED)

The Series 1994 Bonds are also subject to extraordinary redemption, without premium, to the extent of casualty insurance proceeds, condemnation awards, and monies received from a Local Government electing to purchase its Project.

Payments of principal and interest are fully guaranteed by Financial Security Assurance, Inc. All cash and investments of the Authority held by the trustee bank are pledged as collateral for the bond indebtedness.

The bonds are special 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 unless the Trust Indenture or Series 1994 Resolution specifically requires such interest earned or gains realized to be credited to the account of the Authority or a Local Government.
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 to the extent not otherwise committed during any fiscal period of the Authority.

Debt service requirements at June 30, 2004 are as follows:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 2,030,000	\$ 1,503,658
2006	2,135,000	1,399,506
2007	2,240,000	1,287,917
2008	2,355,000	1,168,419
2009	2,475,000	1,039,775
2010-2014	14,455,000	2,686,612
2015	<u>3,235,000</u>	<u>346,363</u>
	\$ <u>28,925,000</u>	\$ <u>9,432,250</u>

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 5 - CONSTRUCTION GRANTS

On September 9, 1994, the Authority adopted a resolution for the funding of regional jails in the counties of Bourbon, Boyd, Hardin, Marshall, and Rockcastle. These awards are to be paid in ten equal annual installments beginning in October 1994. The Authority's total participation in these projects (Phase 1 Grants) is \$7,843,379. As of June 30, 2004, the Authority has no further obligations under the Phase 1 Grants.

On June 10, 1997, the Authority adopted a resolution for the funding of regional jails in the counties of Ballard, Boyle, Calloway, Henderson and Letcher. These awards are to be paid in ten equal annual installments beginning in October 1997. The Authority's total participation in these additional projects (Phase 2 Grants) is \$7,378,954.

Disbursements on these projects through June 30, 2004 and the remaining obligations are as follows:

	<u>Grant Amount</u>	<u>Cumulative Disbursed by Year Ended June 30, 2002</u>	<u>Disbursed Year Ended June 30, 2003</u>	<u>Disbursed Year Ended June 30, 2004</u>	<u>Obligation Remaining at June 30, 2004</u>
<u>Phase 1 Grants</u>					
Bourbon	\$ 1,150,000	\$ 920,000	\$ 115,000	\$ 115,000	\$ 0
Boyd	700,000	560,000	70,000	70,000	0
Hardin	4,259,185	3,407,347	425,919	425,919	0
Marshall	1,612,194	1,289,756	161,219	161,219	0
Rockcastle	122,000	97,600	12,200	12,200	0
<u>Phase 2 Grants</u>					
Ballard	183,442	91,720	18,344	18,344	55,034
Boyle	2,146,589	1,073,295	214,659	214,659	643,976
Calloway	1,530,650	765,325	153,065	153,065	459,195
Henderson	2,974,273	1,487,135	297,427	297,427	892,284
Letcher	<u>544,000</u>	<u>272,000</u>	<u>54,400</u>	<u>54,400</u>	<u>163,200</u>
	<u>\$ 15,222,333</u>	<u>\$ 9,964,178</u>	<u>\$ 1,522,233</u>	<u>\$ 1,522,233</u>	<u>\$ 2,213,689</u>

NOTE 6 - PAYMENT TO THE COMMONWEALTH

During its 2003 Regular Session the General Assembly of the Commonwealth of Kentucky passed House Bill No. 269 which contained a provision that, notwithstanding KRS 441.605 to 441.695, for fiscal year ended June 30, 2003, funds in the amount of \$15,000,000 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. Accordingly, the statement of revenues, expenses, and changes in net assets for the year ended June 30, 2003 includes a non-reciprocal payment to the Commonwealth in the amount of \$15,000,000.



KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 7 - ACCUMULATED NET DEFICIT

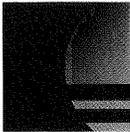
In providing funds for the construction and improvement of correctional facilities, the Authority obtains its funding through the issuance of revenue bonds and the receipt of court costs remittances. When revenue bonds are issued, the Authority incurs long-term obligations that are repaid by revenue 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 2003 House Bill No. 269 authorized the one-time non-reciprocal payment to the Commonwealth in the amount of \$15,000,000 (see Note 6), which has been reported as a non-operating expense in the accompanying 2003 financial statements. As a result of these transactions, the Authority has accumulated a net deficit as of June 30, 2004 in the amount of \$15,717,092.

NOTE 8 - 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 the costs of salaries, fringe benefits, personnel costs, etc. in the amount of \$25,000 per year. During 2004, the Authority reimbursed OFM \$25,000 for these costs.

Additionally during 2004, the Authority reimbursed OFM \$7,034 for professional services it had paid on behalf of the Authority.

At June 30, 2003, the Authority owed the Office of Financial Management \$87,775 (included within accounts payable on the accompanying June 30, 2003 statement of net assets). As of June 30, 2003, OFM was due \$25,000 per year for three years (a total of \$75,000). Additionally, since 2002 OFM had paid on behalf of the Authority a total of \$12,775 for professional services. In July 2003, the Authority paid the \$87,775 due to OFM.



MOORE STEPHENS POTTER LLP

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS ADVISORS

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

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

We have audited the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2004, and have issued our report thereon dated August 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

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

This report is intended solely for the information and use of management, the Board of Directors, and the Auditor of Public Accounts of the Commonwealth of Kentucky, and is not intended to be and should not be used by anyone other than these specified parties.

Moore Stephens Potter, LLP

MOORE STEPHENS POTTER, LLP
August 24, 2004

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KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY
SCHEDULE OF FINDINGS
Year Ended June 30, 2004

Schedule of auditor's results

We have issued an unqualified opinion dated August 24, 2004 on the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2004.

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, 2004

The audit as of and for the year ended June 30, 2003 disclosed no findings that are required to be reported in accordance with *Government Auditing Standards*.