

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

**FINANCIAL STATEMENTS**

**JUNE 30, 2015 AND 2014**

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

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JUNE 30, 2015 AND 2014

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors  
Kentucky Local Correctional  
Facilities Construction Authority

### 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, 2015 and 2014, 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 opinions.

### 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, 2015 and 2014, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### Report on Required Supplementary Information

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 December 8, 2015, 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 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  
December 8, 2015

# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

## MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2015 AND 2014

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As management of the Kentucky Local Correctional Facilities Construction Authority (the Authority), a component unit of the Commonwealth of Kentucky (the Commonwealth), 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, 2015 and 2014. We encourage readers to read it in conjunction with the Authority's financial statements and the accompanying notes.

### **FINANCIAL HIGHLIGHTS**

During fiscal year 2015 the Authority collected the remaining outstanding balance on lease agreements receivable and paid off the remaining outstanding principal balance on the revenue bonds payable. During January 2015, there was a non-reciprocal payment of \$6,462,310 made to the Commonwealth for all remaining funds.

Going forward the Authority will continue to serve as an administrative conduit for the approval of new construction or the repair of existing correctional facilities in the Commonwealth.

- Cash, cash equivalents, and investments decreased \$5,211,457 (100%)
- Revenue bonds payable and other liabilities decreased \$2,441,754 (100%)
- The Authority's net position decreased \$5,775,772 (100%)
- Operating revenues decreased \$2,299,889 (76.42%)
- Operating expenses decreased \$102,425 (67.66%)
- Income from operations decreased \$2,197,464 (76.88%)
- Income from investments decrease \$50,936 (66.43%)

### **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 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.

# **KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2015 AND 2014**

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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 14-23.

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2015 AND 2014

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**FINANCIAL ANALYSIS OF THE AUTHORITY**

**Condensed Financial Information (in thousands)  
Statements of Net Position  
As of June 30**

	<u>2015</u>	<u>% Increase (Decrease)</u>	<u>2014</u>	<u>% Increase (Decrease)</u>	<u>2013</u>
Current assets	\$ -0-	-100.0%	\$ 8,179	2.5%	\$ 7,977
Non-current assets	<u>-0-</u>	0.0%	<u>-0-</u>	-100.0%	<u>2,671</u>
Total assets	<u>-0-</u>	-100.0%	<u>8,179</u>	-23.2%	<u>10,648</u>
Deferred outflow of resources	<u>-0-</u>	-100.0%	<u>39</u>	0.0%	<u>154</u>
Total assets and deferrals	<u>\$ -0-</u>	-100.0%	<u>\$ 8,218</u>	-23.9%	<u>\$ 10,802</u>
Current liabilities	-0-	-100.0%	2,442	-10.9%	2,741
Non-current liabilities	<u>-0-</u>	0.0%	<u>-0-</u>	-100.0%	<u>2,421</u>
Total liabilities	<u>-0-</u>	-100.0%	<u>2,442</u>	-52.7%	<u>5,162</u>
Restricted net position	<u>-0-</u>	-100.0%	<u>5,776</u>	-2.4%	<u>5,640</u>
Total liabilities and net position	<u>\$ -0-</u>	100.0%	<u>\$ 8,218</u>	23.9%	<u>\$ 10,802</u>

**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.

**Deferred outflow of resources** represent unamortized deferred amount on refunding bonds.

# **KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2015 AND 2014**

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In providing funds for the construction and improvement of correctional facilities, the Authority obtained its funding through the issuance of revenue bonds and the receipt of court costs remittances. When revenue bonds were issued, the Authority incurred long-term obligations that were repaid primarily by revenue received from annual court costs receipts. When construction grants were awarded to local governments, the disbursements were immediately reflected as operating expenses. Due to the timing of these transactions, the Authority periodically incurred 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.

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, 2011 and 2012, as a result of the decline in court cost receipts in recent years. In 2014, the Authority made a non-reciprocal payment to the Commonwealth of Kentucky for \$2,800,000 pursuant to House Bill 265 (2012 Regular Session). During the 2014 Regular Session House Bill No. 235 authorized non-reciprocal payments to the Commonwealth of Kentucky for the years ended June 30, 2015 and 2016, in the amount of \$2,800,000 each year. Subsequent to the passage of House Bill No. 235, the Authority paid off the remaining outstanding principal balance on the revenue bonds payable and was directed by Office of State Budget Director to make a non-reciprocal payment to the Commonwealth of Kentucky of all remaining funds in the amount of \$6,462,310.

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2015 AND 2014

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

	<u>2015</u>	<u>% Increase (Decrease)</u>	<u>2014</u>	<u>% Increase (Decrease)</u>	<u>2013</u>
Operating revenues:					
Court costs receipts	\$ 711	-75.8%	\$ 2,944	-11.5%	\$ 3,325
Interest income-leases	6	-79.3%	29	-44.2%	52
Other	(7)	-119.4%	36	-43.8%	64
Total operating revenues	<u>710</u>	-76.4%	<u>3,009</u>	-12.6%	<u>3,441</u>
Operating expenses:					
Interest expense	24	-79.3%	116	-53.0%	247
Other	25	-28.6%	35	-22.2%	45
Total operating expenses	<u>49</u>	-67.5%	<u>151</u>	-48.3%	<u>292</u>
Income from operations	<u>661</u>	-76.9%	<u>2,858</u>	-9.2%	<u>3,149</u>
Non-operating revenues (expenses)	<u>(6,437)</u>	136.4%	<u>(2,723)</u>	-3636.4%	<u>77</u>
Change in net assets	(5,776)	-4378.5%	135	-95.8%	3,226
Restricted net position, beginning of year	<u>5,776</u>	-2.4%	<u>5,641</u>	-133.6%	<u>2,415</u>
Restricted net position, end of year	<u>\$ -0-</u>	-100.0%	<u>\$ 5,776</u>	-2.4%	<u>\$ 5,641</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 were submitted to the Authority on a monthly basis through October 2014. Any receipts collected above the \$5,400,000 each fiscal year were 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.

# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

## MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2015 AND 2014

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

**Interest expense** represents the interest that was due semi-annually each May 1 and November 1 on the revenue bonds payable. Also reflected within interest expense was 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 2013 to 2014 to 2015 due to the consistent balances in the Authority's average investment balance, as well as a consistency in interest rates. In 2014, the amount decreased with the payment to the Commonwealth of Kentucky for \$2,800,000. In 2015, the amount decrease with the transfer of the remaining balances to the Commonwealth of Kentucky.

In 2014, the Authority made a payment to the Commonwealth for \$2,800,000 pursuant to House Bill 265 (2012 Regular Session).

### **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.

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2015 AND 2014**

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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, 2015, 2014, and 2013.

	<u>2015</u>	% Increase <u>(Decrease)</u>	<u>2014</u>	% Increase <u>(Decrease)</u>	<u>2013</u>
Revenue bonds payable	\$ -0-	-100.0%	\$ 2,365	-51.7%	\$ 4,895
Unamortized premium	<u>-0-</u>	-100.0%	<u>56</u>	-75.0%	<u>224</u>
Revenue bonds payable, net	<u>\$ -0-</u>	-100.0%	<u>\$ 2,421</u>	-52.7%	<u>\$ 5,119</u>

**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, 2015 AND 2014

	<u>2015</u>	<u>2014</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ -0-	\$ 5,211,457
Investments-debt service reserve	-0-	2,335,178
Court costs receivable	-0-	241,575
Accrued interest receivable-investments	-0-	12,515
Accrued interest receivable-leases	-0-	5,887
Lease agreement receivables	-0-	372,292
Total current assets	<u>-0-</u>	<u>8,178,904</u>
 Total assets	 <u>-0-</u>	 <u>8,178,904</u>
Deferred outflow of resources:		
Unamortized deferred amount on refunding	 <u>-0-</u>	 <u>38,622</u>
Total assets and deferrals	<u>\$ -0-</u>	<u>\$ 8,217,526</u>
<b>LIABILITIES</b>		
Current liabilities:		
Revenue bonds payable	\$ -0-	\$ 2,421,060
Accrued interest payable	-0-	20,694
Total current liabilities	<u>-0-</u>	<u>2,441,754</u>
Total liabilities	<u>-0-</u>	<u>2,441,754</u>
<b>NET POSITION</b>		
Restricted net position	<u>-0-</u>	<u>5,775,772</u>
Total liabilities and net position	<u>\$ -0-</u>	<u>\$ 8,217,526</u>

*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, 2015 AND 2014

	<u>2015</u>	<u>2014</u>
Operating revenues:		
Court costs receipts	\$ 710,429	\$ 2,944,133
Interest income-leases	5,886	29,076
Amortization of premium and discount on leases	<u>(6,563)</u>	<u>36,432</u>
Total operating revenues	<u>709,752</u>	<u>3,009,641</u>
Operating expenses:		
Interest expense	23,950	116,125
Other operating expenses	<u>25,000</u>	<u>35,250</u>
Total operating expenses	<u>48,950</u>	<u>151,375</u>
Income from operations	<u>660,802</u>	<u>2,858,266</u>
Non-operating revenues (expenses):		
Income from investments	25,736	76,672
Payment to the Commonwealth	<u>(6,462,310)</u>	<u>(2,800,000)</u>
Total non-operating revenues (expenses)	<u>(6,436,574)</u>	<u>(2,723,328)</u>
Change in net position	(5,775,772)	134,938
Net position, beginning of year	<u>5,775,772</u>	<u>5,640,834</u>
Net position, end of year	<u>\$ -0-</u>	<u>\$ 5,775,772</u>

*See accompanying notes to the financial statements.*

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2015 AND 2014

	2015	2014
Cash flows from operating activities:		
Cash received from court costs	\$ 952,004	\$ 2,949,522
Lease payments collected, including interest	377,501	378,214
Cash payments for services	(25,000)	(35,250)
Net cash flows from operating activities	1,304,505	3,292,486
Cash flows from non-capital financing activities:		
Payment to the Commonwealth	(6,462,310)	(2,800,000)
Cash flows from capital and related financing activities:		
Principal paid on revenue bonds	(2,365,000)	(2,530,000)
Interest paid on revenue bonds	(62,081)	(190,575)
Net cash flows from financing activities	(2,427,081)	(2,720,575)
Cash flows from investing activities:		
Investment income received	38,251	76,672
Proceeds from maturity of investments	2,335,178	-0-
Net cash flows from investing activities	2,373,429	76,672
Net change in cash and cash equivalents	(5,211,457)	(2,151,417)
Cash and cash equivalents, beginning of year	5,211,457	7,362,874
Cash and cash equivalents, end of year	\$ -0-	\$ 5,211,457

*See accompanying notes to the financial statements.*

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2015 AND 2014

	2015	2014
Reconciliation of income from operations to net cash flows from operating activities:		
Income from operations	\$ 660,802	\$ 2,858,266
Interest paid on revenue bonds	62,081	190,575
Amortization of premium and discount on leases	6,563	(36,432)
Amortization of bond premium	(56,060)	(168,179)
Amortization of deferred amount on refunding	38,622	115,866
Decrease in assets:		
Court costs receivable	241,575	5,389
Accrued interest receivable-leases	5,887	5,531
Lease agreement receivables	365,729	343,607
Decrease in liabilities:		
Accrued interest payable	(20,694)	(22,137)
Net cash flows from operating activities	\$ 1,304,505	\$ 3,292,486

*See accompanying notes to the financial statements.*

# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

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## 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 was to provide up to 75 percent of the cost of construction, improvement, or repair of any jails operated by Kentucky local governments. Upon the passage of House Bill 463 in 2011, the function of the Authority changed from a financing entity to an administrative conduit for the approval of new construction or the repair of existing correctional facilities in the Commonwealth.

During fiscal year 2015 the Authority collected the remaining outstanding balance on lease agreements receivable and paid off the remaining outstanding principal balance on the revenue bonds payable. During January 2015, there was a transfer of \$6,462,310 made to the Commonwealth for all remaining funds.

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.

# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

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## 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

Generally accepted accounting principles require the classification of net position into three components – net investment in capital assets; restricted; and unrestricted. These classifications are defined as follows:

*Net investment in capital assets* – This component of net position 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. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of net investment in capital assets. Rather, that portion of the debt is included in the same net position component as unspent proceeds.

*Restricted* – This component of net position consists of constraints placed on the use of net position through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

*Unrestricted* – This component of net position consists of net position that does not meet the definition of “restricted” or “net investment in capital assets.”

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# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

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## Amortization of Premium/Discount on Lease Agreement Receivables

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

## Amortization of Bond Premium/Discount

The bond premium (Series 2004 bonds)/discount (Series 1994 bonds) were amortized on the straight-line method over the life of the bond issues. The results of this method did not materially differ from those that would be obtained by applying the effective interest method. The amortization of the bond premium/discount was 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 was amortized on the straight-line method over the life of the Series 2004 bonds. The results of this method did not materially differ from those that would be obtained by applying the effective interest method. The amortization was 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.

## 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 provided 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, 2015 AND 2014

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## 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 could be made from the Construction Account unless the Trustee received 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

The Debt Service Reserve Fund maintained 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" was defined to 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.

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

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Payment, Surplus, and Operating Fund

The Payment, Surplus, and Operating Fund maintained 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 could 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.

Revenue Fund

All of the pledged receipts of the Authority, including court costs, investment earnings, rental payments, and supplemental rental payments, were 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, 2015 and 2014, the components of the revenue bond accounts are as follows:

	2015	2014
Debt service fund - principal account	\$ -0-	\$ 1,182,507
Debt service reserve fund	-0-	2,335,178
Payment, surplus, and operating fund	-0-	1,092,729
Revenue fund	-0-	2,936,221
Total cash, cash equivalents, and investments	-0-	7,546,635
Less non-current debt service reserve investments	-0-	-0-
Total current cash and cash equivalents, and investments	\$ -0-	\$ 7,546,635

At June 30, 2014, the Authority's investments were as follows:

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

# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2015 AND 2014

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At June 30, 2014, 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, 2015 and 2014, 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.

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

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**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, 2015 and 2014, no allowance for uncollectible balances is considered necessary.

The counties and their respective amounts are as follows:

	2015	2014
Adair	\$ -0-	\$ 31,674
Estill	-0-	13,433
Franklin	-0-	132,277
Fulton	-0-	23,729
Knox	-0-	35,874
McCreary	-0-	21,673
Montgomery	-0-	62,580
Powell	-0-	17,929
Simpson	-0-	26,561
	-0-	365,730
Net premium (discount) on leases	-0-	6,562
Net lease agreement receivable	-0-	372,292
Less current portion	-0-	(372,292)
Non-current lease agreement receivables	\$ -0-	\$ -0-

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.

**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.

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

Activity within revenue bonds payable (Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004) during the year ended June 30, 2015 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Serial bonds	\$ 2,365,000	\$ -0-	\$ 2,365,000	\$ -0-	\$ -0-
Unamortized premium	56,060	-0-	56,060	-0-	-0-
	<u>\$ 2,421,060</u>	<u>\$ -0-</u>	<u>\$ 2,421,060</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

There are no outstanding bonds at June 30, 2015. The bonds matured on November 1, 2014.

Activity within revenue bonds payable during the year ended June 30, 2014 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Serial bonds	\$ 4,895,000	\$ -0-	\$ 2,530,000	\$ 2,365,000	\$ 2,365,000
Unamortized premium	224,239	-0-	168,179	56,060	56,060
	<u>\$ 5,119,239</u>	<u>\$ -0-</u>	<u>\$ 2,698,179</u>	<u>\$ 2,421,060</u>	<u>\$ 2,421,060</u>

The Series 2004 bonds were 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, were payable from the pledged receipts as described below:

1. The Authority was 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 were collected by all circuit clerks in Kentucky and submitted on a monthly basis. Any receipts collected above the \$5,400,000 each fiscal year were 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.

# KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2015 AND 2014

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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 was reported in the accompanying statements of net position as a deferred outflow of resources as of June 30, 2014.

### 5. PAYMENT TO THE COMMONWEALTH

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 was 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.

During the 2014 Regular Session House Bill No. 235 authorized non-reciprocal payments to the Commonwealth of Kentucky for the years ended June 30, 2015 and 2016, in the amount of \$2,800,000 each year. Subsequent to the passage of House Bill No. 235, the Authority paid off the remaining outstanding principal balance on the revenue bonds payable and was directed by Office of State Budget Director to make a non-reciprocal payment to the Commonwealth of Kentucky of all remaining funds in the amount of \$6,462,310.

### 6. 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. The Authority reimbursed OFM \$25,000 for these costs during both 2015 and 2014, respectively.

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**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2015 AND 2014

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**7. 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.



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**REPORTS 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

Report on the Financial Statements

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), which comprise the statement of financial position as of June 30, 2015, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 8, 2015.

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.

*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 Authority'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.

To the Board of Directors  
Kentucky Local Correctional  
Facilities Construction Authority

### Compliance and Other Matters

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*.

### Purpose of this Report

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  
December 8, 2015

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY**

SCHEDULE OF FINDINGS  
YEAR ENDED JUNE 30, 2015

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Schedule of auditor's results

We have issued an unmodified opinion dated December 8, 2015, on the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2015.

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, 2015

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Findings relating to the prior year financial statements

The audit disclosed no findings that were required to be reported in accordance with *Government Auditing Standards* for the year ended June 30, 2014.