KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

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CPAs / ADVISORS

blue

Blue & Co., LLC / 301 East Main Street, Suite 1100 / Lexington, KY 40507
main 859.253.1100 fax 859.253.1384 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS

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, 2011 and 2010, 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 audit.

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, 2011 and 2010 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated as of the date of this report 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages three through nine 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.

Blue & Co., LLC

October 3, 2011

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, 2011 and 2010. We encourage readers to read it in conjunction with the Authority's financial statements and the accompanying notes.

FINANCIAL HIGHLIGHTS

- Cash, cash equivalents, and investments increased $1,256,772, (33.1%)
- Lease agreement receivables (net of premium on leases) decreased $210,876 (15.1%)
- Revenue bonds payable and other liabilities decreased $2,241,301 (18.6%)
- The Authority's accumulated net deficit decreased $3,245,059 (80.2%)
- Operating revenues decreased $303,882 (7.5%)
- Operating expenses decreased $99,204 (15.1%)
- Income from operations decreased $204,678 (6.1%)
- Income from investments remained consistent year over year.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

The statement of net 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.

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 14-25.

FINANCIAL ANALYSIS OF THE AUTHORITY

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

	2011	% Increase (Decrease)	2010	% Increase (Decrease)	2009
Current assets	$ 5,712	28.7%	$ 4,437	-16.1%	$ 5,291
Non-current assets	3,318	-7.6%	3,590	-7.5%	3,882
Total assets	9,030	12.5%	8,027	-12.5%	9,173
Current liabilities	2,364	4.0%	2,273	2.4%	2,219
Non-current liabilities	7,469	-23.8%	9,802	-18.5%	12,024
Total liabilities	9,833	-18.6%	12,075	-15.2%	14,243
Accumulated net deficit	$ (803)	-80.2%	$ (4,048)	-20.2%	$ (5,070)

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

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

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

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

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

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

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

	2011	% Increase (Decrease)	2010	% Increase (Decrease)	2009
Operating revenues:					
Court costs receipts	$ 3,574	-7.3%	$ 3,857	-9.2%	$ 4,247
Interest income-leases	87	-20.2%	109	-13.5%	126
Other	64	1.6%	63	-1.6%	64
Total operating revenues	3,725	-7.5%	4,029	-9.2%	4,437
Operating expenses:					
Interest expense	488	-16.6%	585	-9.7%	648
Other	68	-2.9%	70	2.9%	68
Total operating expenses	556	-15.1%	655	-8.5%	716
Income from operations	3,169	-6.1%	3,374	-9.3%	3,721
Non-operating revenues (expenses)	76	-103.2%	(2,352)	1.1%	(2,327)
Change in net assets	3,245	217.5%	1,022	-26.7%	1,394
Accumulated net deficit, beginning of year	(4,048)	-20.2%	(5,070)	-21.6%	(6,464)
Accumulated net deficit, end of year	$ (803)	-80.2%	$ (4,048)	-20.2%	$ (5,070)

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.

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

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

Non-operating revenues (expenses) typically consist of income from investments, which remained flat from 2011 to 2010 due to the consistent balances in the Authority's average investment balance, as well as a consistency in interest rates. Income from investments in 2010 declined approximately $28,220 (27.1%) from 2009 due to the significant reduction in the Authority's average deposits attributable to the $2,427,500 non-reciprocal payment to the Commonwealth (included within non-operating expenses on the accompanying 2010 financial statements), as well as a reduction in interest rates.

During its 2008 Regular Session the General Assembly of the Commonwealth of Kentucky passed House Bill No. 406 which contained a provision that, notwithstanding KRS 441.605 to 441.695 for fiscal year ended June 30, 2010 and 2009, funds in the amount of $2,427,500 and $2,430,800, respectively 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 years ended June 30, 2010 and 2009 include non-reciprocal payments to the Commonwealth in the amount of $2,427,500 and $2,430,800, respectively. During its 2010 Special Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 290 which contained a provision that, not-withstanding KRS 441.605 to 441.695 for fiscal year ends June 30, 2011 and 2012 funds in the amount $2,427,500 each year. The Authority came to an agreement with the Office of State Budget Director to waive the payment to the Commonwealth of Kentucky for the year ended June 30, 2011 as a result of the decline in court cost receipts in recent years.

Condensed Financial Information (in thousands)
Statement of Cash Flows
For the Fiscal Years Ended June 30

	2011	(Decrease)	2010	(Decrease)	2009
Net cash provided by (used in):					
Operating activities	$ 3,910	-7.7%	$ 4,236	-8.7%	$ 4,638
Non-capital financing activities	-0-	-100.0%	(2,428)	-0.1%	(2,431)
Capital and related financing activities	(2,730)	-0.8%	(2,753)	0.1%	(2,751)
Investing activities	76	0.0%	76	-31.5%	111
Net change in cash and cash equivalents	1,256	-244.5%	(869)	100.7%	(433)
Cash and cash equivalents, beginning of year	3,798	-18.6%	4,667	-8.5%	5,100
Cash and cash equivalents, end of year	$ 5,054	33.1%	$ 3,798	-18.6%	$ 4,667

The **net change in cash and cash equivalents** totaled $1,256,772 for the year ending June 30, 2011 primarily because of cash received from operating activities exceeded the principal and interest paid on the revenue bonds by approximately $1,181,000.

The **net change in cash and cash equivalents** totaled ($868,864) for the year ending June 30, 2010 primarily because the principal and interest paid on the revenue bonds and the net payments to the Commonwealth during 2010 exceeded cash provided by operating activities by approximately $945,000.

The **net change in cash and cash equivalents** totaled ($432,081) for the year ending June 30, 2009 primarily because the principal and interest paid on the revenue bonds and the net payments to the Commonwealth during 2009 exceeded cash provided by operating activities by approximately $544,000.

DEBT ADMINISTRATION

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

The following summarizes the changes (in thousands) in the Authority's debt principally resulting from the refunding during 2005 and the regularly scheduled principal and interest payments during the fiscal years ended June 30, 2011, 2010, and 2009.

	2011	(Decrease)	2010	(Decrease)	2009
Revenue bonds payable	$ 9,575	-18.5%	$ 11,745	-15.2%	$ 13,850
Unamortized premium	561	-23.0%	729	-18.7%	897
Unamortized deferred amount on refunding	(386)	-23.1%	(502)	-18.8%	(618)
Revenue bonds payable, net	$ 9,750	-18.6%	$ 11,972	-15.3%	$ 14,129

CURRENTLY KNOWN FACTS, DECISIONS, OR CONDITIONS

House Bill No. 290 authorized non-reciprocal payments to the Commonwealth during fiscal years 2011 and 2012 of $2,427,500 for each year for local correctional facility and operational support. The Authority came to an agreement with the Office of State Budget Director to waive the payment to the Commonwealth of Kentucky for the year ended June 30, 2011.

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 ASSETS
JUNE 30, 2011 AND 2010

	2011	2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,054,956	$ 3,798,184
Court costs receivable	309,867	315,086
Accrued interest receivable-investments	12,514	12,514
Accrued interest receivable-leases	21,492	26,077
Lease agreement receivables	313,809	284,964
Total current assets	5,712,638	4,436,825
Non-current assets:		
Investments-debt service reserve	2,335,179	2,335,179
Lease agreement receivables	875,124	1,114,845
Debt issuance costs, net of accumulated amortization of $215,558 in 2011 and $183,225 in 2010	107,779	140,113
Total non-current assets	3,318,082	3,590,137
Total assets	9,030,720	8,026,962
LIABILITIES		
Current liabilities:		
Revenue bonds payable	2,280,000	2,170,000
Accrued interest payable	83,781	102,769
Total current liabilities	2,363,781	2,272,769
Non-current liabilities:		
Revenue bonds payable	7,469,375	9,801,688
Total liabilities	9,833,156	12,074,457
NET ASSETS		
Accumulated net assets (deficit)	$ (802,436)	$ (4,047,495)

See accompanying notes to the financial statements.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
Operating revenues:		
Court costs receipts	$ 3,574,212	$ 3,856,586
Interest income-leases	87,107	108,615
Amortization of premium on leases	63,584	63,584
Total operating revenues	3,724,903	4,028,785
Operating expenses:		
Interest expense	488,346	585,350
Amortization of debt issuance costs	32,334	32,334
Other operating expenses	35,250	37,450
Total operating expenses	555,930	655,134
Income from operations	3,168,973	3,373,651
Non-operating revenues (expenses):		
Income from investments	76,086	76,087
Payment to the Commonwealth	-0-	(2,427,500)
Total non-operating revenues (expenses)	76,086	(2,351,413)
Change in net assets	3,245,059	1,022,238
Accumulated net deficit, beginning of year	(4,047,495)	(5,069,733)
Accumulated net deficit, end of year	$ (802,436)	$ (4,047,495)

See accompanying notes to the financial statements.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
Cash flows from operating activities:		
Cash received from court costs	$ 3,579,434	$ 3,892,462
Lease payments collected, including interest	366,152	380,658
Cash payments for services	(35,250)	(37,450)
Net cash provided by operating activities	3,910,336	4,235,670
Cash flows from non-capital financing activities:		
Payment to the Commonwealth	-0-	(2,427,500)
Cash flows from capital and related financing activities:		
Principal paid on revenue bonds	(2,170,000)	(2,105,000)
Interest paid on revenue bonds	(559,650)	(648,188)
Net cash used in financing activities	(2,729,650)	(2,753,188)
Cash flows from investing activities:		
Investment income received	76,086	76,154
Net change in cash and cash equivalents	1,256,772	(868,864)
Cash and cash equivalents, beginning of year	3,798,184	4,667,048
Cash and cash equivalents, end of year	$ 5,054,956	$ 3,798,184

See accompanying notes to the financial statements.

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
Reconciliation of income from operations to net cash flows from operating activities:		
Income from operations	$ 3,168,973	$ 3,373,651
Interest paid on revenue bonds	559,650	648,188
Amortization of premium on leases	(63,584)	(63,584)
Amortization of debt issuance costs	32,334	32,334
Amortization of bond premium	(168,179)	(168,179)
Amortization of deferred amount on refunding	115,866	115,866
Decrease in assets:		
Court costs receivable	5,219	35,876
Accrued interest receivable-leases	4,585	4,307
Lease agreement receivables	274,460	267,736
Decrease in liabilities:		
Accrued interest payable	(18,988)	(10,525)
Net cash provided by operating activities	$ 3,910,336	$ 4,235,670

See accompanying notes to the financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Nature of Organization:

The 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.

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.

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.

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

Use of Estimates:

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

Cash and Cash Equivalents:

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

Investments:

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

Net Assets:

Net assets (when applicable) 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 agreement receivables are amortized on the straight-line method over the life of the related receivable. The results of this method do not materially differ from those that would be obtained by applying the effective interest method.

Amortization of Bond Premium/Discount and Debt Issuance Costs:

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

Amortization of Deferred Amount on Refunding:

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

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 provides for the issuance of the bonds and the establishment of the following special accounts with the Trustee.

Construction Account:

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

Costs of Issuance Account:

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

Debt Service Fund:

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

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

Debt Service Reserve Fund:

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

Payment, Surplus, and Operating Fund:

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

Revenue Fund:

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

At June 30, 2011 and 2010 the components of the revenue bond accounts are as follows:

	2011	2010
Debt service fund - principal account	$ 2,280,000	$ 1,328
Debt service fund - interest account	-0-	4
Debt service reserve fund	2,335,179	2,335,179
Payment, surplus, and operating fund	2,213,908	1,960
Revenue fund	561,048	3,794,892
Total cash, cash equivalents, and investments	7,390,135	6,133,363
Less non-current debt service reserve investments	(2,335,179)	(2,335,179)
Total current cash and cash equivalents	$ 5,054,956	$ 3,798,184

At June 30, 2011 and 2010 the Authority's investments are as follows:

Investment Type	Fair Value	Maturity
U.S. Treasury Department Treasury Bonds, State and Local Government Series	$ 2,335,179	October 31, 2014

At June 30, 2011 and 2010, the Authority's remaining funds on deposit with the Trustee (money market funds reported as cash and cash equivalents) are 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, 2011 and 2010, the Authority's investments are neither insured nor registered, but are held by the Authority's counterparty in the Authority's name.

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

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

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

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

3. LEASE AGREEMENT RECEIVABLES

Lease agreement receivables represent the participating counties' agreed amount of bond principal required to finance the counties' share of project costs funded through the bond issue. As of June 30, 2011 and 2010, no allowance for uncollectible balances is considered necessary.

The counties and their respective amounts are as follows:

	2011	2010
Adair	$ 115,807	$ 140,575
Estill	59,621	59,621
Franklin	483,643	587,085
Fulton	86,389	104,724
Knox	131,167	159,220
McCreary	78,610	95,183
Montgomery	228,810	277,748
Powell	65,057	78,782
Simpson	96,866	117,493
	1,345,970	1,620,431
Less premium on leases	(157,037)	(220,622)
Net lease agreement receivable	1,188,933	1,399,809
Less current maturities	(313,809)	(284,964)
Non-current lease agreement receivables	$ 875,124	$ 1,114,845

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, 2011 are as follows:

Year Ending June 30		
2012	$	313,809
2013		322,825
2014		343,606
2015		365,730
	$	1,345,970

4. REVENUE BONDS PAYABLE

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

Activity within revenue bonds payable (Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004) during the year ended June 30, 2011 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Serial bonds	$ 11,745,000	$ -0-	$ 2,170,000	$ 9,575,000	$ 2,280,000
Unamortized premium	728,776	-0-	168,179	560,597	-0-
Unamortized deferred amount on refunding	(502,088)	-0-	(115,866)	(386,222)	-0-
	$ 11,971,688	$ -0-	$ 2,222,313	$ 9,749,375	$ 2,280,000

Serial bonds at interest rate of 5.25%, principal due annually on November 1 in amounts ranging from $2,280,000 to $2,530,000 through November 1, 2014, interest due semiannually each May 1 and November 1.

Activity within revenue bonds payable during the year ended June 30, 2010 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Serial bonds	$ 13,850,000	$ -0-	$ 2,105,000	$ 11,745,000	$ 2,170,000
Unamortized premium	896,955	-0-	168,179	728,776	-0-
Unamortized deferred amount on refunding	(617,955)	-0-	(115,867)	(502,088)	-0-
	$ 14,129,000	$ -0-	$ 2,157,312	$ 11,971,688	$ 2,170,000

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

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

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

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

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

collected above the $5,400,000 each fiscal year are paid into the Commonwealth's General Fund.

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

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

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

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

As a result of the 2004 refunding the Authority recognized a deferred amount on the refunding in the amount of $1,158,663. This amount represents the difference between the reacquisition price relative to the Series 1994 bonds outstanding (including the 102% call premium) and the net carrying amount of the Series 1994 bonds (including the unamortized discount and debt issuance costs). The unamortized deferred amount on the refunding is reported in the accompanying statement of net assets as a deduction from the outstanding revenue bonds payable as of June 30, 2011 and 2010.

Debt service requirements at June 30, 2011 are as follows:

Year Ending June 30	Principal	Interest
2012	$ 2,280,000	$ 442,838
2013	2,400,000	319,988
2014	2,530,000	190,575
2015	2,365,000	62,081
	$ 9,575,000	$ 1,015,482

5. PAYMENT TO THE COMMONWEALTH

During its 2008 Regular Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 406 which contained a provision that, notwithstanding KRS 441.605 to 441.695 for fiscal year ended June 30, 2010, funds of $2,427,500 shall be expended from the Kentucky Local Correctional Facilities Construction Authority for local correctional facility and operational support consistent with contractual covenants in accordance with bond indentures of the Authority. Accordingly, the statement of revenues, expenses, and changes in net assets for the year ended June 30, 2010 include non-reciprocal payments to the Commonwealth of $2,427,500. During 2010, House Bill No. 290 authorized non-reciprocal payments for fiscal years ending 2011 and 2012 of $2,427,500 each year. Subsequent to the passage of the Bill, the Authority came to an agreement with the Office of State Budget Director to waive the payment for the year ended June 30, 2011.

6. 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 primarily by revenue received from annual court costs receipts. When construction grants are awarded to local governments the disbursements are immediately reflected as operating expenses. Due to the timing of these transactions, the Authority periodically incurs losses from operations. In addition, during 2003, House Bill No. 269 authorized a non-reciprocal payment to the Commonwealth in the amount of $15,000,000. House Bill No. 380, enacted during the 2006 General Assembly, authorized non-reciprocal payments to the Commonwealth during 2007 and 2008 in the amount of $4,000,000 and $1,500,000, respectively. House Bill No. 406, enacted during the 2008 General Assembly, authorized non-reciprocal payments to the Commonwealth during 2010 and 2009 in the amount of $2,427,500 and $2,430,800, respectively (Note 5). As a result of the above transactions, the Authority has accumulated a net deficit of $802,436 as of June 30, 2011.

For the year ended June 30, 2011 there were no non-reciprocal payments to the Commonwealth.

7. RELATED PARTY TRANSACTIONS

The Authority receives the benefit of accounting and administrative services from the Office of Financial Management (OFM). OFM serves as staff to the Authority and is reimbursed for salaries and related personnel costs. During 2011 and 2010, the Authority reimbursed OFM $25,000 for these costs.

8. RISK MANAGEMENT

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

CPAS / ADVISORS

blue

Blue & Co., LLC / 301 East Main Street, Suite 1100 / Lexington, KY 40507
main 859.253.1100 fax 859.253.1384 email blue@blueandco.com

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

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 (the "Authority") as of and for the year ended June 30, 2011, and have issued our report thereon dated as of the date of this report. 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.

Internal Control Over Financial Reporting

Management of the Authority is responsible for establishing and monitoring effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures 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 control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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*.

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.

Blue & Co., LLC

October 3, 2011

KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY

SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2011

Schedule of auditor's results

We have issued an unqualified opinion dated October 3, 2011 on the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2011.

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*.

SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTION
YEAR ENDED JUNE 30, 2011

Findings relating to the financial statements

The audit disclosed no findings that are required to be reported in accordance with *Government Auditing Standards* for the year ended June 30, 2010.