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KENTUCKY INFRASTRUCTURE AUTHORITY

FRANKFORT, KENTUCKY

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT

June 30, 2004 and 2003

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KENTUCKY INFRASTRUCTURE AUTHORITY
FRANKFORT, KENTUCKY

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Kentucky Infrastructure Authority
Frankfort, Kentucky

We have audited the accompanying financial statements of the Kentucky Infrastructure Authority, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Kentucky Infrastructure Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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.

As discussed in Note 1, the financial statements present only the Kentucky Infrastructure Authority and are not intended to present fairly the financial position of the Commonwealth of Kentucky and the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kentucky Infrastructure Authority, as of June 30, 2004, and the results of its operations and its cash flows for the year 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 October 1, 2004, on our consideration of the Kentucky Infrastructure Authority's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts and grants.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Kentucky Infrastructure Authority, taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Berger + Company CPA PSC

Berger & Company, CPA, PSC
October 1, 2004

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Management's Discussion and Analysis

As management of the Kentucky Infrastructure Authority, we offer readers of the Kentucky Infrastructure Authority's financial statements this brief narrative overview and analysis of the financial activities of the Kentucky Infrastructure Authority for the fiscal year ended June 30, 2004.

Financial Highlights

- As of the close of the current fiscal year, the Kentucky Infrastructure Authority reported combined ending retained earnings of $507,561,546, an increase of $101,418,376 in comparison with the prior year.
- The Kentucky Infrastructure Authority's total debt decreased by $4,266,813 (1.8%) during the current fiscal year. The key factor in this decrease was the issuance of only one new money composite bond issue for State General Fund supported debt.
- The Kentucky Infrastructure Authority disbursed $40,489,450 to borrowers for assistance agreements and $45,280,500 to local governmental entities in state grants. Principal and interest in the amount of $40,535,653 was collected from borrowers for assistance agreements.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the Kentucky Infrastructure Authority's basic financial statements. The Kentucky Infrastructure Authority's basic financial statements comprise two components: 1) proprietary fund financial statements, and 2) notes to the financial statement. This report also contains other supplementary information in addition to the basic financial statements themselves.

1. Overview of the Financial Statements

Proprietary fund financial statements. The proprietary fund financial statements are designed to provide readers with a broad overview of the Kentucky Infrastructure Authority's finances, in a manner similar to a private-sector business. The Kentucky Infrastructure Authority is a proprietary fund component unit of the Commonwealth of Kentucky.

The proprietary fund financial statements can be found on pages 6 through 9 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the proprietary fund financial statements. The notes to the financial statements can be found on pages 10 through 22 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents the schedule of expenditure of federal awards, together with related notes, as required by the Single Audit Act Amendments of 1996. The schedule of expenditure of federal awards and related notes can be found on pages 23-24 of this report.

Individual fund statements and schedules can be found on pages 26 through 29 of this report.

2. Proprietary Fund Financial Analysis

Retained Earnings. The Kentucky Infrastructure Authority's combined retained earnings increased 24.97% between fiscal years 2003 and 2004 to $507,561,546 (See Table A-1.) despite an operating loss of $45,896,392 (See Table A-2) which resulted from increased expenditures related to initiatives set forth in SB409 from the 2000 General Assembly, the increased number of grant expenditures as opposed to loans and a transfer of $1,000,000 to the State's general fund to assist in balancing the budget. In addition, the Kentucky Infrastructure Authority administered 111 water and sewer grants funded by single county coal severance tax receipts that were assigned to the Department for Local Government. The Kentucky Infrastructure Authority received no increase in state appropriation to cover the cost of project

administration. The Department for Local Government, in the Comprehensive Annual Financial Report, reports expenditures for these grants for the Commonwealth of Kentucky.

Federal grant revenue decreased 29 percent due to the decreased number of loans approved by the Board in FY2003 for the Waste Water Revolving Loan Program. The number of loans decreased by half over the number approved in FY2002, thereby reducing the amount of borrowers drawing construction funds in FY2004. In FY2004, staff began efforts to streamline the application process in order to expedite project approval. Investment interest income decreased 6.6 percent to $6,113,550 in spite of cash and investment increases due to the recession and poor market conditions.

Table A-1
Kentucky Infrastructure Authority's Retained Earnings

	Total 2003	Total 2004	Total Percentage Change 2003-2004
Current Assets	157,768,106	157,967,921	0.13%
Equipment (Net)	33,716	16,858	-50.00%
Long Term Investment	98,587,707	179,227,501	81.79%
Long Term Receivables (Net)	364,444,208	381,492,193	4.68%
Other Assets	2,113,319	1,958,553	-7.32%
Total Assets	622,947,056	720,663,026	15.69%
Current Liabilities	17,893,636	18,176,863	1.58%
Long Term Liabilities	198,910,250	194,924,617	-2.00%
Total Liabilities	216,803,886	213,101,480	-1.71%
Retained Earnings	406,143,170	507,561,546	24.97%
Total Liabilities & RE	622,947,056	720,663,026	15.69%

Table A-2
Changes in Kentucky Infrastructure Authority's Retained Earnings

	Total 2003	Total 2004	Total Percentage Change 2003-2004
Program revenues			
Assistance agreements	12,542,351	12,908,688	2.92%
General revenues			
Interest	6,544,898	6,113,550	-6.59%

Net decrease in FMV investments	2,756,454	-4,681,463	-269.84%
Other	2,659	25,152	845.92%
Total Revenues	21,846,362	14,365,927	
Expenses			
Clean Water SRF (Fund A)	2,445,132	2,602,333	6.43%
Infrastructure Revolving (Fund B)	18,543,798	51,353,177	176.93%
Governmental Agencies (Fund C)	3,381,214	3,238,887	-4.21%
Solid Waste (Fund E)	893,729	1,086,302	21.55%
Drinking Water SRF (Fund F)	1,473,296	1,981,620	34.50%
Total Expenses	26,737,169	60,262,319	125.39%
Operating Income (Loss)	-4,890,807	-45,896,392	838.42%
Federal grants	30,267,009	21,486,086	-29.01%
Excess (deficiency) before special items and transfers	25,376,202	-24,410,306	-196.19%
Transfer to State General Fund	-1,000,000	-1,000,000	0.00%
State Appropriation	0	109,530,000	100.00%
Transfers for debt service	16,441,283	17,298,682	5.21%
Net Income	40,817,485	101,418,376	148.47%

3. Long-term Debt

At year-end, the Kentucky Infrastructure Authority had $212 million in bonds outstanding – a decrease of 2.2 percent from last year – as shown in Table A-3. More detailed information about the Kentucky Infrastructure Authority's long-term liabilities is presented in Note 7 to the financial statements.

New debt resulted from issuing state appropriation supported bonds to fund the state share of the federally assisted wastewater and drinking water programs in the amount of $11.3 million.

Bond Ratings. The Kentucky Infrastructure Authority's appropriation supported debt rating is A+ from Standard & Poor's, AA- from Fitch and Aa3 from Moody's. This is one step below the Commonwealth's general obligation credit rating of AA- and Aa2. Standard & Poor's has rated the revenue bonds of the Kentucky Infrastructure Authority A- since October 2002.

Limitations on Debt. The Kentucky Infrastructure Authority is required by KRS 56.870(1) to obtain General Assembly approval for issuance of general fund appropriation supported debt. For debt related to issues that require no appropriation of state funds, General Assembly approval must be obtained for bonds or notes having a final maturity extending beyond three (3) years, if the aggregate principal amount of the bonds or notes outstanding under any trust indenture or bond resolution exceeds the sum of five hundred million dollars ($500,000,000). Our outstanding debt in the Fund C program, which meets this criterion, is significantly below this limit.

Table A-3
Kentucky Infrastructure Authority's Outstanding Debt

	Total 2003	Total 2004	Total Percentage Change 2003-2004
General fund appropriation supported debt	152,800,000	154,205,000	.9%
Program revenue supported debt	64,025,000	57,910,000	-9.6%
Total	216,825,000	212,115,000	-2.2%

4. Items Expected to have a Significant Impact on Future Financial Position

In the coming year, the Kentucky Infrastructure Authority will continue to administer the remainder of water and sewer related projects funded through coal severance tax receipts in order to provide a single state agency contact for the industry. While the Department for Local Government will actually disburse funds, the Kentucky Infrastructure Authority will provide project administration activities. There has been no increase in state appropriation to cover administrative costs including staff.

The 2002 General Assembly abolished the legal authority for the Kentucky Infrastructure Authority's solid waste program. It is anticipated that the remaining funds in the program will be used to complete the Certified Clean Counties program within the next 1-2 years.

The 2003 General Assembly identified 267 projects totaling $59,071,343 for tobacco impacted counties and $54,861,998 for coal producing counties to be disbursed and administered by KIA as grants from proceeds of bonds in the amount of $54,765,000 (first year debt service to be paid from tobacco settlement funds) and $54,765,000 (first year debt service to be paid from multi-county coal severance tax receipts). There was no increase in state appropriation to cover the cost of administering these projects. In 2004, $24.5 million was disbursed to grantees. The remainder will be disbursed over the next several years along with project administration services.

Authority staff will continue to facilitate streamlining activities in the federally assisted wastewater and drinking water programs. Streamlining efforts consist of elimination of unnecessary steps and paperwork, and modification of planning processes, which will speed processing times and move projects more quickly through the system.

As of July 1, 2004, there is not a state budget approved by the Legislature. The Kentucky Infrastructure Authority, along with all other agencies of the Commonwealth, is operating on a spending plan implemented by the Governor through Executive Order.

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Contacting the Kentucky Infrastructure Authority's Financial Management

This financial report is designed to provide our legislators, citizens, taxpayers, customers, and federal government officials, as well as, investors and creditors with a general overview of the Kentucky Infrastructure Authority's finances and to demonstrate the Kentucky Infrastructure Authority's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Fiscal Officer, 375 Versailles Road, Frankfort, Kentucky, 40601-3646.

KENTUCKY INFRASTRUCTURE AUTHORITY
BALANCE SHEETS
JUNE 30, 2004 AND 2003

ASSETS

	2004	2003
Current assets:		
Cash and cash equivalents	$ 85,034,826	$ 81,728,245
Investments, current portion	46,174,421	51,609,285
Federal Funds Receivable	538,201	532,081
Accrued interest receivable, investments	1,562,451	1,801,116
Accrued interest receivable, loans	1,150,464	1,196,438
Current maturities of long-term receivables	23,507,558	20,900,941
Total current assets	157,967,921	157,768,106
Equipment, Net of Accumulated Depreciation (Note 12)	16,858	33,716
Investments	179,227,501	98,587,707
Long-term receivables:		
Assistance agreements receivable:		
Principal	422,623,564	410,917,950
Less:		
Current maturities	(23,507,558)	(20,900,941)
Deposit reserve	(13,031,268)	(19,531,690)
Unamortized discounts	(4,492,400)	(4,852,976)
Funds held for governmental agencies	(100,145)	(1,188,135)
Total long-term receivables	381,492,193	364,444,208
Other assets:		
Unamortized costs of issuance	1,958,553	2,113,319
Total assets	$ 720,663,026	$ 622,947,056

See accompanying notes.

KENTUCKY INFRASTRUCTURE AUTHORITY
BALANCE SHEETS
JUNE 30, 2004 AND 2003

LIABILITIES AND RETAINED EARNINGS

	2004	2003
Current Liabilities		
Current maturities of revenue bonds payable, less unamortized discounts, premiums and deferred loss on early retirement of debt	$ 15,074,958	$ 15,356,138
Accrued interest payable	1,788,631	1,996,619
Due to Division of Water	193,759	391,028
Due to Commonwealth of Kentucky General Fund	1,000,000	
Other payables	119,515	149,851
Total current liabilities	18,176,863	17,893,636
Long-term debt:		
Revenue bonds payable, less current maturities and net of unamortized discounts, premiums and deferred loss on early retirement of debt	194,924,617	198,910,250
Total long-term debt	194,924,617	198,910,250
Total liabilities	213,101,480	216,803,886
Retained Earnings		
Invested in Capital Assets net of related debt of $0	16,858	33,716
Restricted (Note 13)	507,544,688	406,109,454
Total retained earnings	507,561,546	406,143,170
Total liabilities and retained earnings	$ 720,663,026	$ 622,947,056

See accompanying notes.

KENTUCKY INFRASTRUCTURE AUTHORITY
STATEMENTS OF REVENUES, EXPENSES
AND CHANGES IN RETAINED EARNINGS
Years ended June 30, 2004 and 2003

	2004	2003
Operating revenues:		
Assistance agreements:		
Servicing fee	$ 733,536	$ 691,281
Interest	8,372,402	8,246,659
Interest Received Securing Revenue Bonds	3,333,442	3,140,229
Amortization of discount	403,344	398,658
Amortization of bond premiums	65,964	65,524
Income from investments	6,113,550	6,544,898
Miscellaneous Income	25,152	2,659
Net increase (decrease) in fair market value of investments	(4,681,463)	2,756,454
Total operating revenues	14,365,927	21,846,362
Operating expenses:		
General and administrative	2,423,627	1,641,555
Intergovernmental administrative expense reimbursement	1,279,632	1,466,697
Grants	45,280,500	12,912,366
Depreciation	16,857	16,857
Revenue bonds payable:		
Amortization of discount	72,324	96,320
Amortization of costs of issuance	227,314	169,596
Interest on reserves	167,796	285,638
Interest	10,794,269	10,148,140
Total operating expenses	60,262,319	26,737,169
Operating income (loss)	(45,896,392)	(4,890,807)
Nonoperating revenues:		
Federal grants and reimbursements	21,486,086	30,267,009
Income (loss) before operating transfers	(24,410,306)	25,376,202
Operating transfers to State general fund	(1,000,000)	(1,000,000)
State Appropriation	109,530,000	
Operating transfers in for debt service	17,298,682	16,441,283
Net income	101,418,376	40,817,485
Retained earnings, beginning of year,	406,143,170	365,325,685
Retained earnings at end of year	$ 507,561,546	$ 406,143,170

See accompanying notes.

KENTUCKY INFRASTRUCTURE AUTHORITY
STATEMENTS OF CASH FLOWS
Years ended June 30, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Cash received from customers	$ 733,536	$ 691,281
Collections on assistance agreements	28,783,835	21,489,774
Advances on assistance agreements	(40,489,450)	(52,285,952)
Grants	(45,280,500)	(12,912,366)
Miscellaneous income	25,152	2,659
Interest received on loans	11,751,818	11,356,035
Cash payments to suppliers for goods and services	(3,930,864)	(3,218,890)
Net cash used in operating activities	(48,406,473)	(34,877,459)
Cash flows from noncapital financing activities:		
Proceeds from the issuance of revenue and revenue refunding bonds	11,300,000	30,295,000
Receipt of grants, net	21,479,966	30,416,374
State appropriation for debt service	17,298,682	16,441,283
Receipt of State Appropriation	109,530,000	
Transfer to State General Fund		(1,000,000)
Payment of Deposit Reserve to borrowers	(6,601,650)	
Payment of Funds Held to borrowers	(1,087,991)	
Receipt of bond premiums and accrued interest on bond proceeds	31,890	670,740
Payment of bond discount and costs of issuance	(72,546)	(821,780)
Payment to refund bond escrow agent		(24,725,486)
Principal payments on long-term debt	(15,895,000)	(15,270,000)
Interest paid on long-term debt	(10,751,639)	(10,099,400)
Net cash provided by noncapital financing activities	125,231,712	25,906,731
Cash flows from investing activities:		
Purchase of investment securities	(148,826,922)	(147,007,994)
Proceeds from sale and maturities of investment securities	68,956,049	172,045,619
Investment income received	6,352,215	6,449,977
Net cash provided by (used in) investing activities	(73,518,658)	31,487,602
Increase (decrease) in cash and cash equivalents	3,306,581	22,516,874
Cash and cash equivalents at beginning of year	81,728,245	59,211,371
Cash and cash equivalents at end of year	$ 85,034,826	$ 81,728,245
Reconciliation of operating income to net cash used in operating activities:		
Operating income	$ (45,896,392)	$ (4,890,807)
Adjustments to reconcile operating income to net cash used in operating activities:		
Amortization and Depreciation	316,495	282,773
Amortization of discount	(403,344)	(398,658)
Amortization of bond premium	(65,964)	(65,524)
Investment Income	(6,113,550)	(6,544,898)
Interest expense	10,962,065	10,433,778
Net (increase) decrease in fair market value of investments	4,681,463	(2,756,454)
Change in assets and liabilities:		
Increase (decrease) in other payables	(30,336)	(312,975)
Decrease (increase) in accrued loan interest receivable	45,974	(30,853)
Increase (decrease) in due to Division of Water	(197,269)	202,337
Increase in assistance agreements receivable	(11,705,615)	(30,796,178)
Net cash used in operating activities	$ (48,406,473)	$ (34,877,459)

See accompanying notes.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Kentucky Infrastructure Authority is presented to assist in understanding the combined financial statements. The combined financial statements and notes are representations of the Kentucky Infrastructure Authority's management who is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the combined financial statements.

Basis of Presentation:

The financial statements of the Authority are accounted for on the accrual basis of accounting. Accordingly, revenues are recognized when they are earned and expenditures 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 issued on or before November 30, 1989, unless those FASB pronouncements conflict with or contradict GASB pronouncements.

Use of Estimates:

Management uses estimates and assumptions in preparing the financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and reported revenues and expenses.

Scope of Entity:

In 1972, the General Assembly of Kentucky established the Kentucky Pollution Abatement Authority after determining that pollution was seriously harming the Commonwealth's water resources and would, if unchecked, endanger the health, safety, welfare and well being of the public, and would also destroy the natural chemical, physical and biological integrity of the waters of the Commonwealth. The Act was also adopted to maximize federal grant participation in the Commonwealth in respect of works and facilities undertaken by local governmental units in the Commonwealth for the abatement of water pollution and to provide an alternate source of financing for local governmental units. The Act was amended in 1974 and 1978 (a) to remove the prior requirement that federal grant participation be obtained by local units of government as a condition precedent to Authority aid and (b) to grant to the Authority the power to issue tax-exempt industrial development bonds for pollution control facilities.

The General Assembly again amended the Act in 1984 (a) to grant to the Authority the ability to assist local government units with the implementation of water resource projects intended to conserve and develop the water resources of the Commonwealth, including, among other things, all aspects of water supply, flood damage abatements, navigation,

water-related recreation and land conservation facilities and (b) to change the name of the Authority to the "Kentucky Pollution Abatement and Water Resources Finance Authority." In 1988, the Act was further amended to, among other things (a) broaden the scope of the Authority's powers to finance "infrastructure projects," (b) establish two revolving funds to assist in the financing of infrastructure projects and (c) change the name of the Authority to the "Kentucky Infrastructure Authority." A further amendment to the Act in 1990 provided for the establishment of (a) an additional revolving fund to assist in the financing of solid waste projects and (b) a solid waste grant fund, jointly administered with the Natural Resources Cabinet, intended to defray the capital costs associated with promotion of recycling and other similar solid waste management activities. Amendments to the Act in 2000 expanded the role of the Authority to include regional infrastructure planning coordination, promotion of higher levels of technical, managerial, and financial capacity of water based utilities, as well as expanding the Authority's more traditional role of infrastructure financing for both governmental agencies and investor owned, private utilities by adding a new account, the 2020 account, to its array of grant and subsidized loan programs.

The Kentucky Infrastructure Authority is a component unit of the Commonwealth of Kentucky and is included in the Commonwealth of Kentucky's comprehensive annual financial report.

Investments:

The Authority has adopted Statement No. 31 of the Governmental Accounting Standards Board, "Accounting for Certain Investments and for External Investment Pools" in 1998. Under Statement No. 31, all investments are valued at their fair values in the balance sheets. Unrealized gains and losses are included in the statements of revenues, expenses and changes in retained earnings.

Legally authorized investments generally include: obligations of or guaranteed by the United States; obligations of any corporation of the United States Government; asset backed securities; U.S. dollar denominated corporate securities; collateralized certificates of deposits; bankers' acceptances; commercial paper; and repurchase agreements.

Amortization of Discounts on Assistance Agreements:

Discounts on assistance agreement receivables are amortized using the straight-line method over the life of the related receivable.

Amortization of Bond Discount and Debt Issuance Costs:

Bond discounts and debt issuance costs are amortized on the straight-line method over the life of the bond issue.

Amortization of Deferred Loss on Early Retirement of Debt:

Deferred loss on early retirement of debt is amortized on the straight-line method over the original remaining life of the old debt or the life of the new debt, whichever is less.

Statement of Cash Flows:

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

Operating Revenues and Expenses:

The Authority considers interest income received on loans to be operating revenue. In order not to overstate the income from operations, the Authority also includes the interest paid on bonds issued to fund such loans and investment interest received on the unspent proceeds of these bonds as operating income and expense as well. For the statement of cash flows, the Authority includes interest income received on loans as an operating receipt but list investment interest income and bond interest paid as nonoperating items in order to match them in the same cash flow category with the corresponding bond principal or investment on the statement of cash flows.

Industrial Development Bonds:

The Authority has issued Pollution Control Revenue Bonds in accordance with the statutes governing the issuance of Industrial Revenue Bonds for various projects since 1980. These bonds do not constitute a general debt, liability or moral obligation of the Authority or the Commonwealth of Kentucky. Accordingly, these financial statements do not include any assets or liabilities related to the issuance of these bonds.

NOTE 2 - FUND DESCRIPTIONS

The Authority is authorized by KRS Chapter 224A to issue notes and bonds to provide loans to governmental agencies and private, investor owned utilities in Kentucky. The provisions of KRS 224A.165 dictate certain limits on the amount of notes and bonds the authority can have outstanding. The purpose of the loans is to assist such entities in financing the construction of infrastructure projects. The following provides a description of the Authority's various programs:

Fund A - Waste Water Revolving Loan Program:

Local waste water treatment facilities that qualify under the U.S. Environmental Protection Agency requirements can be financed through this program. Jointly administered by the KIA and the Natural Resources Cabinet, loans will be provided at below-market interest

rates with repayments not exceeding twenty years. The state share of construction is funded with state appropriation supported bonds. The Commonwealth appropriates an amount equal to this fund's debt service to make its bond payments.

Fund B - Infrastructure Revolving Loan Program:

This fund was established to provide financing for any type of infrastructure that will enhance economic development and job creation. Loans are made to governmental entities of the Commonwealth that are unable to finance a complete project through other public grant or loan programs, through commercial credit at reasonable rates or from its own resources.

The loans will be at or below market interest rates and will not exceed thirty years. Grants are available, but are reserved for borrowers where the Authority determines both a hardship and extreme health hazard exist. The Commonwealth appropriates an amount equal to this fund's debt service to make its bond payments.

As part of this program, a 2020 water service account has been established to assist in making potable water available to all Kentuckians by the year 2020. Loans or grants are made to utilities with emphasis on regionalization, uniform system of accounts and cost based rates.

Two new Water and Sewer Resource Development Funds were created and authorized by the 2002 General Assembly to be administered by the Kentucky Infrastructure Authority. Fifty-four million, seven hundred and sixty-five thousand dollars ($54,765,000) was authorized for each of these two programs with one program directed toward coal producing counties and including 103 individual line-item projects enumerated in the Appropriations Act and the companion fund enumerating some 164 projects to tobacco counties throughout the Commonwealth. Activity for these programs is accounted for in Fund B.

Fund C – Governmental Agencies Program:

This program provides local governmental agencies access to funding through the municipal bond market at better terms than could be obtained on an individual basis. Financial assistance is available on a loan basis for up to thirty years for any infrastructure owned by governmental entities in the Commonwealth. The loans may be used to totally fund a construction project or they can be used to supplement grants or cash contributions.

Fund E - Solid Waste Revolving Loan Program:

This fund was established to assist local government units in the financing of solid waste projects. Financial assistance is available for the useful life of the project or thirty years, whichever is shorter. Grants are also available from this fund. Jointly administered by the Environmental and Public Protection Cabinet, the fund provides grants up to $75,000 per project per funding cycle to defray capital costs associated with solid waste management activities. The Commonwealth appropriates an amount equal to this fund's debt service to make its bond payments.

Fund F – Drinking Water Revolving Loan Fund

This fund was established to assist in financing local drinking water treatment and distribution facilities that qualify under U. S. Environmental Protection Agency (EPA) requirements. Projects must be recommended by the Kentucky Division of Water from the Project Priority List and must be financially feasible as determined by KIA staff. Loan funds are available on short terms for planning and preliminary design work. The state share of construction is funded with state appropriation supported bonds. The Commonwealth appropriates an amount equal to this fund's debt service to make its bond payments.

NOTE 3 - REVENUE BOND FUND ACCOUNTS

Components of the Revenue Bond Fund accounts by cash, cash equivalents and investments at June 30, 2004 are summarized below:

	Cash and Cash Equivalents	Investments	Total
Operating fund	$ 513,937	$ 2,039,609	$ 2,553,547
Revolving fund	27,410,604	108,207,200	135,617,804
Government agency fund	36,881,898	8,739,566	45,621,464
Debt service reserve fund	3,509,441	4,619,254	8,128,696
Debt service fund	4,702,509	-	4,702,509
Revenue fund	999,773	-	999,773
Surplus fund	4,946,602	20,521,269	25,467,870
Rebate fund	86	-	86
Cost of issuance fund	54,370	-	54,370
Cash in State System	6,015,605	81,275,024	87,290,629
Total	$ 85,034,826	$225,401,922	$ 310,436,748

Components of the Revenue Bond Fund accounts by cash, cash equivalents and investments at June 30, 2003 are summarized below:

	Cash and Cash Equivalents	Investments	Total
Operating fund	$ 367,953	$ 1,895,524	$ 2,263,477
Revolving fund	18,684,249	97,662,081	116,346,330
Government agency fund	44,984,364	10,645,306	55,629,670
Debt service reserve fund	4,008,666	4,824,249	8,832,915
Debt service fund	4,924,088	-	4,924,088
Revenue fund	770,480	-	770,480
Surplus fund	6,496,488	32,070,055	38,566,543
Rebate fund	86	86	86
Cost of issuance fund	48,722	-	48,722
Cash in State System	1,443,235	3,099,691	4,542,926
Total	$ 81,728,245	$150,196,992	$ 231,925,237

Trust indentures contain provisions which establish that specific accounts be maintained by the Authority to properly account for the financial activities as described below:

A. Operating Fund

Designated for paying operating costs incurred by the Authority.

B. Revolving Fund

Designated to receive debt service payments from the revolving loan program in order to recycle money for new loans.

C. Government Agency Fund

This account is for funds invested during the construction phase of new loans. The money is disbursed under the direction of the Authority in accordance with the loan assistance agreement.

D. Debt Service Reserve Fund

Designated as an allowance or reserve for the payment of principal and interest on revenue bonds as to which there would otherwise be a default in payment.

E. Debt Service Fund

Funds designated for the sole purpose of paying principal and interest on revenue bonds payable as they come due.

F. Revenue Fund

This fund is for receipt of principal and interest payments from governmental agencies and which are subsequently transferred to the Debt Service Fund or other funds as needed.

G. Surplus Fund

This fund is a reserve for the 1989 Series A refunding issue, advances to municipalities in anticipation of new bond issues, and transfers to other funds to cover deficiencies.

H. Rebate Fund

Funds designated for the purpose of paying anticipated liability due to municipalities based on excess earnings of specific bond issues.

I. Cost of Issuance Fund

Upon issuance, a portion of the proceeds are set aside to pay the cost associated with the issue (attorneys' fees, etc.). After all fees are paid, any remaining funds are transferred to the Bond or Note Payment Fund.

J. Capitalized Interest Fund

Funds designated for the purpose of paying capitalized interest associated with the revenue bond and bond anticipation notes.

K. Project Fund

Funds designated for the purpose of construction projects associated with the issuance of revenue bond anticipation notes.

NOTE 4 - CASH AND CASH EQUIVALENTS AND INVESTMENTS

The following schedules present the carrying of cash and cash equivalents by credit risk category at June 30:

	Category 1	Category 2	Category 3	Carrying Amount
June 30, 2004				
U.S. Government Securities	$	$ 28,707,303	$	$ 28,707,303
U.S. Government Money Market		50,311,908		50,311,908
Total	$ -0-	$79,019,211	$ -0-	$79,019,211
Cash Deposited With State				6,015,615
Total				$85,034,826
June 30, 2003				
Cash	$	$ 25,089,634	$	$ 25,089,634
U.S. Government Money Market		55,195,376		55,195,376
Total	$ -0-	$80,285,010	$ -0-	$80,285,010
Cash Deposited With State				1,443,235
Total				$81,728,245

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

Category (1) - Amounts covered by federal depository insurance or collateralized with securities held by the Authority or the Authority's agent in the Authority's name. (An agent is an organization with which the Authority has a contractual relationship to hold securities owned or pledged to the Authority.)

Category (2) - Amounts collateralized with securities held by the pledging financial institution's trust department or agent in the Authority's name.

Category (3) - Amounts which are uninsured and uncollateralized or which are collateralized, but the securities are held by the financial institution's trust department or agent in the institution's name.

The following schedules present the carrying amounts of investments by credit risk category at June 30:

June 30, 2004	Category 1	Category 2	Category 3	Carrying Amount
U.S. Government Agency Securities	$	$144,126,898		$144,126,898
	$ -0-	$144,126,898	$ -0-	$144,126,898
Cash Deposited With State			4	81,275,024
				225,401,922
Less: Current portion: State			0	
Current portion: Other			46,174,421	46,174,421
				$179,227,501
June 30, 2003				
U.S. Government Agency Securities	$	$135,685,029		$135,685,029
Commercial paper		11,412,272		11,412,272
	$ -0-	$147,097,301	$ -0-	$147,097,301
Cash Deposited With State				3,099,691
				150,196,992
Less: Current portion: State			0	
Current portion: Other			51,609,285	51,609,285
				$98,587,707

The above schedules classify the carrying amounts of investments as to credit risk by the three categories described below:

Category (1) - Securities which are either fully insured, registered or which are held by the Authority or the Authority's agent in the Authority's name.

Category (2) - Securities which are neither insured nor registered, but are held by the Authority's counter party in the Authority's name. (A counter party is the issuer of a security or the purchasing agent for the Authority. If an organization is both an agent and counter party then the organization is considered to be a counter party.)

Category (3) - Uninsured and unregistered securities which are held by the Authority's agent or counter party, but not in the Authority's name.

NOTE 5 - ASSISTANCE AGREEMENTS RECEIVABLE

Assistance agreements receivable are loans made to governmental entities for construction of infrastructure projects. The principal and interest are due in periodic installments used to either meet the principal and interest requirements of the Authority's revenue bonds or used to fund additional projects.

A total loan amount is approved for each governmental entity. In addition to the $422,623,564 in assistance agreements receivable at June 30, 2004, the Authority has commitments remaining to disburse funds summarized as follows:

Fund A - Waste Water Revolving Loan Program	$ 23,729,294
Fund C - Governmental Agencies Program	10,007,010
Fund F – Drinking Water Revolving Loan Program	8,317,483
Total commitments outstanding	$ 42,053,787

NOTE 6 - DEPOSIT RESERVE

Fund C bond indentures have established a debt service reserve. The municipalities' initial deposit from the revenue bond proceeds to the debt service reserve is a restricted asset of the Authority established for additional security in the event of any loan defaults regarding the assistance agreements receivable. The Authority has legal title to such funds, subject to the right of bondholders to claim such funds in the event the Authority fails to make timely payment on such bonds. It is the intent of the Authority to rebate these deposits to the governmental agencies upon repayment of loans.

NOTE 7 - LONG-TERM DEBT REVENUE BONDS PAYABLE

The required annual payments for all debt for each of the next five fiscal years are as follows:

	Principal	Interest	Total
2005	$ 15,485,000	$ 10,242,062	$ 25,727,062
2006	16,180,000	9,582,316	25,762,316
2007	16,830,000	8,826,412	25,656,412
2008	17,625,000	8,025,974	25,650,974
2009	18,380,000	7,187,592	25,567,592
2010-2014	69,950,000	24,622,658	94,572,658
2015-2019	41,965,000	9,797,995	51,762,995
2020-2024	15,700,000	1,539,213	17,239,213
	$ 212,115,000	$ 79,824,222	$ 291,939,222

Long-term debt consist of the following:

Kentucky Infrastructure Authority Revenue Bonds:	June 30, 2004		
	Balance	Current	Long-term
Fund A, Waste Water Revolving Fund Revenue and Revenue Refunding Bonds, interest of 3.00% to 7.10%, due semi-annually, principal due annually to June 1, 2024	$44,370,000	$2,940,000	$41,430,000
Fund B, Infrastructure Revolving Fund Revenue Bonds, interest of 4.00% to 8.40%, due semi-annually, principal due annually to June 1, 2021	90,200,000	6,750,000	83,450,000
Fund C, Governmental Agencies Program Revenue and Revenue Refunding Bonds, interest of 3.10% to 7.85%, due semi-annually, principal due annually to August 1, 2018	57,910,000	4,725,000	53,185,000
Fund E, Solid Waste Revolving Fund Revenue Bonds, interest of 3.00% to 6.80%, due semi-annually, principal due annually to June 1, 2015	5,135,000	470,000	4,665,000
Fund F, Drinking Water Revolving Fund Revenue Bonds, interest of 3.00% to 6.00%, due semi-annually, principal due annually to June 1, 2024	14,500,000	600,000	13,900,000
	$212,115,000	$ 15,485,000	$196,630,000
Plus: Unamortized premiums	1,599,219	109,985	1,489,234
Less: Unamortized discounts	(718,777)	(72,324)	(646,453)
Unamortized deferred loss on early retirement of debt	(2,995,867)	(447,703)	(2,548,164)
	$209,999,575	$ 15,074,958	$194,924,617

Except for cash deposited with the State, all assets of the Authority are held by trustee banks. Most of these assets are pledged as collateral for bond indebtedness and have certain investment restrictions as outlined in the bond indentures.

NOTE 8 PRIOR YEARS' DEBT DEFEASANCE

In prior years, the Authority has defeased various bond issues by creating separate irrevocable trust funds. New debt has been issued and the proceeds have been used to purchase U.S. government securities that were placed in the trust funds. The investments and fixed earnings from the investments are sufficient to fully service the defeased debt until the debt is called or matures. For financial reporting purposes, the trust account assets and the liabilities for the defeased bonds has been considered defeased and therefore removed as a liability from the Authority's financial statements. The total amount of defeased debt from advance refunding that remains outstanding at June 30, 2004 is $19,445,000.

NOTE 9 GRANT COMMITTMENTS

KIA has committed to disburse grants totaling $136,426,827 and $1,641,594 in Fund B and Fund E, respectively, as follows:

Fund		Amount
B	$	10,449,812
B - 2020	$	27,494,889
B - Coal Development	$	45,300,456
B - Tobacco Development	$	53,181,670
E	$	1,641,594

NOTE 10 – SUBSEQUENT EVENTS

Two events occurred subsequent to June 30, 2004 to the date of this report which are significant enough to warrant disclosure in this report as follows:

1. Fund C Restructuring – On July 29, 2004, the Authority issued $25,640,000 Revenue Refunding and Improvement Bonds Series 2004A and $17,375,000 Taxable Revenue Refunding Bonds, Series 2004B to refund or defease all existing debt outstanding in Fund C for the purpose of restructuring the program. The goals of the restructuring were to remove the Commonwealth's moral obligation pledge and have the bonds rated on the credit quality of the loan pool thus improving the bond rating, to eliminate the required funding of the debt service reserve (DSR) fund by the borrower allowing the Authority to credit the borrowers for their share of the DSR and consequently reducing future debt service payments and to make changes in the program that would make the Fund C program more attractive to new borrowers.

2. Reorganization – On July 29, 2004, Governor Ernie Fletcher issued Executive Order 2004-728 which attached the Authority to the Governor's Office of Local Development for administrative purposes and transferred the Gas Systems Restoration and Development Project Account to the Authority.

NOTE 11 – COMMONWEALTH'S SPENDING PLAN

As of July 1, 2004, the Authority, along with all other agencies of the Commonwealth, has operated on a spending plan implemented by the Governor due to the absence of an enacted adopted budget for the Commonwealth. Unless otherwise determined by the judicial branch, this spending plan will remain in effect until a budget is enacted by the General Assembly.

NOTE 12 – FIXED ASSETS

The Authority's policy is to capitalize purchases of assets over $5,000 with a useful life of more than one year. During the fiscal year ended June 30, 2004 there were no such purchases and thus, the historical cost of equipment did not change from the previous year. The Authority's accumulated depreciation increased from the prior year's balance of $50,573 by the current year's depreciation expense of $16,857 for an ending balance of $67,431. The only capitalized assets consist of computer equipment which the Authority depreciates over five (5) years using the straight-line method.

NOTE 13 – RETAINED EARNINGS

Since the use of the Authority's resources is mandated by the General Assembly of Kentucky and the United State's Environmental Protection Agency, the Authority considers all of its retained earnings to be restricted. However, the Authority does have significant latitude in how it uses much of its resources.

NOTE 14 – RECLASSIFICATION FROM PRIOR YEARS

Certain prior year balances have been reclassified to more closely compare to the current year amounts. Interest received on Fund C loans have been separately listed on the Statement of Revenue, Expenses and Changes in Retained Earnings to disclose interest received to secure revenue bonds. Retained earnings has been reclassified as "restricted" in accordance with Note13 above.

KENTUCKY INFRASTRUCTURE AUTHORITY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED JUNE 30, 2004

Grant Name	CFDA Number	Grant Period	Expenditures	Passed Through To Other Agencies (Including Revenue Redistributions)
U.S. Environmental Protection Agency				
Direct Programs:				
Capitalization Grants for Clean Water State Revolving Funds	66.458	10/1998 - 9/2003	-	-
Capitalization Grants for Clean Water State Revolving Funds	66.458	9/1999 - 9/2003	-	-
Capitalization Grants for Clean Water State Revolving Funds	66.458	10/2000 - 9/2003	4,177,768	-
Capitalization Grants for Clean Water State Revolving Funds	66.458	10/2001 - 9/2004	4,025,566	-
Capitalization Grants for Clean Water State Revolving Funds	66.458	10/1/03 - 9/30/05	-	316,493
Total Capitalization Grants for Clean Water State Revolving Funds			$ 8,203,334	$ 316,493
Direct Programs:				
Capitalization Grants for Drinking Water State Revolving Fund	66.468	9/1998 - 9/2003	54,749	
Capitalization Grants for Drinking Water State Revolving Fund	66.468	4/1999 - 9/2003	-	
Capitalization Grants for Drinking Water State Revolving Fund	66.468	7/2000 - 9/2003	2,493	
Capitalization Grants for Drinking Water State Revolving Fund	66.468	10/2000 - 9/2003	5,066,054	193,759
Capitalization Grants for Drinking Water State Revolving Fund	66.468	1/2002 - 9/2004	7,556,747	702,151
Capitalization Grants for Drinking Water State Revolving Fund	66.468	1/2002 - 9/2005		577,480
Total Capitalization Grants for Drinking Water State Revolving Funds			$ 12,680,043	$ 1,473,390
Total U. S. Environmental Protection Agency			$ 20,883,377	$ 1,789,884
Total All Programs			$ 20,883,377	$ 1,789,884

See notes to the schedule of expenditures of federal awards.

KENTUCKY INFRASTRUCTURE AUTHORITY
NOTES TO THE SUPPLEMENTARY SCHEDULE OF
EXPENDITURES OF FEDERAL AWARDS
Year ended June 30, 2004

NOTE 1 - BASIS OF ACCOUNTING

The supplementary schedule of expenditures of federal awards is presented on the modified cash basis of accounting.

NOTE 2 – PASSED THROUGH TO OTHER AGENCIES

CFDA #	Grant Name		Amount	Passed Through To Whom?
66.458	Clean Water State Revolving Funds	$	316,493	Environmental and Public Protection Cabinet
66.468	Drinking Water State Revolving Funds	$	1,473,390	Environmental and Public Protection Cabinet

BERGER & COMPANY
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INDEPENDENT AUDITOR'S REPORT ON THE SUPPLEMENTAL INFORMATION

To the Board of Directors
Kentucky Infrastructure Authority
Frankfort, Kentucky

Our report on our audit of the basic financial statements of the Kentucky Infrastructure Authority for the year ended June 30, 2004, appears on page 1. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information included in the schedules on pages 26 through 29 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Berger + Company CPA PSC

Berger & Company, CPA, PSC
October 1, 2004

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KENTUCKY INFRASTRUCTURE AUTHORITY
COMBINING BALANCE SHEET
June 30, 2004

ASSETS

	Fund A	Fund B
Current assets:		
Cash and cash equivalents	$ 30,254,744	$ 34,229,392
Investments, current portion	34,337,466	6,581,361
Federal Funds Receivable	211,047	
Accrued interest receivable, investments	1,146,257	235,007
Accrued interest receivable, loans	549,462	157,030
Current maturities of long-term receivables	13,622,544	2,949,045
Total current assets	80,121,520	44,151,835
Equipment, Net of Accumulated Depreciation (Note 12)		16,858
Investments	60,670,827	92,801,137
Long-term receivables:		
Assistance agreements receivable:		
Principal	244,394,698	52,998,537
Less:		
Current maturities	(13,622,544)	(2,949,045)
Deposit reserve		
Unamortized discounts/premiums		
Funds held for governmental agencies		
Total long-term receivables	230,772,154	50,049,492
Other assets:		
Unamortized costs of issuance	487,550	742,816
Total assets	$ 372,052,051	$ 187,762,138

LIABILITIES AND RETAINED EARNINGS

Current liabilities:		
Current maturities of revenue bonds payable, less unamortized discounts and deferred loss on early retirement of debt	$ 2,861,554	$ 6,457,996
Accrued interest payable	148,815	373,496
Due to Division of Water		
Due to Commonwealth of Kentucky General Fund		1,000,000
Other payables	-	-
Total current liabilities	3,010,369	7,831,492
Long-term debt:		
Revenue bonds payable, less current maturities and unamortized discounts and deferred loss on early retirement of debt	40,752,386	82,783,156
Total liabilities	43,762,755	90,614,648
Retained Earnings:		
Invested in Capital Assets net of related debt of $0		16,858
Restricted (Note 13)	328,289,296	97,130,632
Total retained earnings	328,289,296	97,147,490
Total liabilities and retained earnings	$ 372,052,051	$ 187,762,138

	Fund C	Fund E	Fund F	Total
	$ 14,233,358	$ 546,757	$ 5,770,575	$ 85,034,826
	3,273,419	757,773	1,224,402	46,174,421
			327,154	538,201
	114,712	25,368	41,107	1,562,451
	285,148	11,155	147,669	1,150,464
	5,113,697	557,248	1,265,024	23,507,558
	23,020,334	1,898,301	8,775,931	157,967,921
				16,858
	22,179,304	1,437,732	2,138,501	179,227,501
	66,400,700	2,036,520	56,793,109	422,623,564
	(5,113,697)	(557,248)	(1,265,024)	(23,507,558)
	(13,031,268)			(13,031,268)
	(4,492,400)			(4,492,400)
	(100,145)			(100,145)
	43,663,190	1,479,272	55,528,085	381,492,193
	535,495	46,949	145,743	1,958,553
	$ 89,398,323	$ 4,862,254	$ 66,588,260	$ 720,663,026
	$ 4,721,532	$ 434,864	$ 599,012	$ 15,074,958
	1,206,400	20,569	39,351	1,788,631
			193,759	193,759
				1,000,000
	119,515	-		119,515
	6,047,447	455,433	832,122	18,176,863
	53,092,022	4,410,326	13,886,727	194,924,617
	59,139,469	4,865,759	14,718,849	213,101,480
				16,858
	30,258,854	(3,505)	51,869,411	507,544,688
	30,258,854	(3,505)	51,869,411	507,561,546
	$ 89,398,323	$ 4,862,254	$ 66,588,260	$ 720,663,026

KENTUCKY INFRASTRUCTURE AUTHORITY
COMBINED STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN RETAINED EARNINGS
Year ended June 30, 2004

	Fund A	Fund B
Operating revenues:		
Assistance agreements:		
Servicing fee	$ 440,913	$ 107,912
Interest	5,716,909	1,575,109
Interest Received Securing Revenue Bonds		
Amortization of loan premiums	39,744	
Amortization of bond premiums		65,964
Income from investments	2,978,651	1,568,231
Miscellaneous Income		4
Net increase (decrease) in fair market value of investments	(2,147,337)	(438,320)
Total operating revenues	7,028,880	2,878,900
Operating expenses:		
General and administrative	530,649	1,636,443
Intergovernmental administrative expense reimbursement		
Grants	9,821	44,494,295
Depreciation		16,857
Revenue bonds payable:		
Amortization of discount	18,300	8,808
Amortization of costs of issuance	49,812	123,334
Interest on reserves		
Interest	1,993,751	5,073,440
Total operating expenses	2,602,333	51,353,177
Operating income (loss)	4,426,547	(48,474,277)
Nonoperating revenues:		
Federal grants and reimbursements	8,519,827	
Net Income (loss) before operating transfers	12,946,374	(48,474,277)
Operating transfer to State General Fund		(1,000,000)
State Appropriation		109,530,000
Operating transfers in for debt service	4,482,355	11,216,646
Net income (loss)	17,428,729	71,272,369
Retained earnings (deficit), beginning of year	310,860,567	25,875,121
Retained earnings (deficit) at end of year	$ 328,289,296	$ 97,147,490

Fund C	Fund E	Fund F	Total
$ 102,288	$ 5,130	$ 77,293	$ 733,536
	72,914	1,007,470	8,372,402
3,333,442			3,333,442
360,576	3,024		403,344
			65,964
1,290,779	103,661	172,228	6,113,550
25,148			25,152
(1,942,926)	(53,496)	(99,384)	(4,681,463)
3,169,307	131,233	1,157,607	14,365,927
48,868	1,008	206,659	2,423,627
		1,279,632	1,279,632
	776,384		45,280,500
			16,857
39,828	3,720	1,668	72,324
41,472	5,364	7,332	227,314
167,796			167,796
2,940,923	299,826	486,329	10,794,269
3,238,887	1,086,302	1,981,620	60,262,319
(69,580)	(955,069)	(824,013)	(45,896,392)
		12,966,259	21,486,086
(69,580)	(955,069)	12,142,246	(24,410,306)
			(1,000,000)
			109,530,000
	722,068	877,613	17,298,682
(69,580)	(233,001)	13,019,859	101,418,376
30,328,434	229,496	38,849,552	406,143,170
$ 30,258,854	$ (3,505)	51,869,411	$ 507,561,546

BERGER & COMPANY
CPA, PSC

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

To the Board of Directors
Kentucky Infrastructure Authority
Frankfort, Kentucky

We have audited the financial statements of the Kentucky Infrastructure Authority as of and for the year ended June 30, 2004, and have issued our report thereon dated October 1, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

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

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

Berger + Company CPA PSC

Berger & Company, CPA, PSC
October 1, 2004

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors
Kentucky Infrastructure Authority
Frankfort, Kentucky

Compliance

We have audited the compliance of the Kentucky Infrastructure Authority with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular 33 Compliance Supplement that are applicable to its major federal program for the year ended June 30, 2004. The Kentucky Infrastructure Authority's major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the Kentucky Infrastructure Authority's management. Our responsibility is to express an opinion on the Kentucky Infrastructure Authority's compliance based on our audit.

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

In our opinion, the Kentucky Infrastructure Authority complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2004.

Internal Control Over Compliance

The management of the Kentucky infrastructure Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

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Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of the Board of Directors, management, the Auditor of Public Accounts of the Commonwealth of Kentucky, and federal awarding agencies and passthrough entities. However, this report is a matter of public record and its distribution is not limited.

Berger + Company CPA PSC

Berger & Company, CPA, PSC
October 1, 2004

KENTUCKY INFRASTRUCTURE AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2004

Summary of Auditor's Results

We have issued an unqualified opinion, dated October 1, 2004, on the financial statements of Kentucky Infrastructure Authority as of and for the year ended June 30, 2004.

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

We have issued an unqualified opinion, dated October 1, 2004, on the Kentucky Infrastructure Authority's compliance for major programs.

Our audit disclosed no findings required to be reported under the provisions of OMB Circular A-133.

The Kentucky Infrastructure Authority's major federal programs for the year ended June 30, 2004, were the U.S. Environmental Protection Agency, CFDA Numbers 66.458 and 66.468.

The Kentucky Infrastructure Authority qualified as a low-risk auditee under the provisions of OMB Circular A-133.

Findings Relatinq to the Financial Statements

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

Findings and Questioned Costs for Federal Awards

Our audit disclosed no findings or questioned costs for federal awards as defined by OMB Circular A-133.

KENTUCKY INFRASTRUCTURE AUTHORITY
SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTIONS
Year ended June 30, 2004

The prior-year's audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards.*