

Financial Statements

EAST SEVIER COUNTY UTILITY DISTRICT

Year Ended June 30, 2010

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INDEPENDENT ACCOUNTANTS' AUDIT REPORT

Board of Commissioners
East Sevier County Utility District
Sevierville, Tennessee

We have audited the accompanying statement of net assets of East Sevier County Utility District as of June 30, 2010, and the related statement of revenue, expenses, and change in net assets and statement of cash flows for the year then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 of America. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of East Sevier County Utility District as of June 30, 2010, and changes in its financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 3 to 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion thereon.

Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise East Sevier County Utility District's basic financial statements. The accompanying financial information listed as supplementary information in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 3, 2011 on our consideration of East Sevier County Utility District's internal control over financial reporting and on 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.

Mitchell Emert & Hill

January 3, 2011

EAST SEVIER COUNTY UTILITY DISTRICT
1529 Alpine Drive
Sevierville, TN 37876
865-453-6704

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the East Sevier County Utility District, we offer readers of the District's financial statements this narrative overview and analysis of the District's performance during the fiscal year ending June 30, 2010. Please read it in conjunction with the District's financial statements, which follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report includes this management's discussion and analysis report, the independent auditors report and the basic financial statements of the District. The financial statements also include notes that explain in more detail some of the information in the financial statements.

REQUIRED FINANCIAL STATEMENTS

The financial statements of the District report information using accounting methods similar to those used by private companies. These statements offer both short-term and long-term financial information about its activities. The Statement of Net Assets includes all of the District's assets and liabilities and provides information about where the District has invested its resources (assets) and the obligations to the District's credit (liabilities).

All of the current year's revenue and expenses are accounted for in the Statement of Revenue, Expenses and Change in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all of its expenses through customer fees.

The final required financial statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balances during the reporting period.

FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District's finances is "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Assets and the Statement of Revenue, Expenses and Change in Net Assets report information about the District's activities in a way that will help answer this question. The statements report the difference between assets and liabilities as one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. A summary of the District's net assets and change in them is presented below:

SUMMARIZED FINANCIAL INFORMATION

	<u>2010</u>	<u>2009</u>
NET ASSETS		
Current assets	\$ 136,651	\$ 113,275
Capital assets	<u>621,483</u>	<u>641,471</u>
Total assets	<u>\$ 758,134</u>	<u>\$ 754,746</u>
Current liabilities	\$ 59,511	\$ 78,148
Long term liabilities	<u>0</u>	<u>4,982</u>
Total liabilities	<u>59,511</u>	<u>83,130</u>
Net assets:		
Invested in capital assets, net of related debt	616,241	621,876
Unrestricted	<u>82,381</u>	<u>49,740</u>
	<u>698,623</u>	<u>671,616</u>
Total liabilities and net assets	<u>\$ 758,134</u>	<u>\$ 754,746</u>
CHANGE IN NET ASSETS		
Operating revenue	\$ 377,458	\$ 346,019
Operating expenses	<u>349,220</u>	<u>409,387</u>
Operating income(loss)	28,237	(63,368)
Non-operating revenue	1,177	1,911
Non-operating expense	<u>(2,408)</u>	<u>(1,994)</u>
Change in net assets	27,007	(63,450)
Beginning net assets	<u>671,616</u>	<u>735,067</u>
Ending net assets	<u>\$ 698,623</u>	<u>\$ 671,616</u>

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

As can be seen from the summarized financial information, the District's net assets increased by \$27,007 during the year ended June 30, 2010 and decreased \$63,450 during the year ended June 30, 2009. Operating revenue increased at a rate of 9% (decreased by 15% in 2009) while expenses decreased at a rate of 15% (increased by 3% in 2009). Operating revenue increased primarily due to the District changing the utility rate structure in June 2008 from billing based on water line size to billing based on metered consumption. Operating expenses decreased primarily due to decreased salary expenses.

THE DISTRICT'S NET ASSETS

The District completed the year with net assets of \$698,623 which is \$27,007 more than the prior year's ending net assets of \$671,616.

BUDGETARY HIGHLIGHTS

The District adopts an annual operating budget, which includes proposed expenses and the means for paying these expenses. As conditions change during the year, the budget may be amended to prevent budget overruns.

CAPITAL ASSETS

The District's investment in capital assets amounts to \$932,249 with accumulated depreciation of \$310,766. Capital assets include land, distribution and collection systems, and machinery and equipment. During the year ended June 30, 2010 the District had capital asset additions totaling \$13,682.

ECONOMIC FACTORS AND FUTURE NEEDS

The District continues to add new customers subsequent to June 30, 2010. In addition to water and sewer service provided to the English Mountain subdivision including The Preserve, sewer service is provided to the Sherwood Forest, Bear Creek Crossing, Smoky Mountain Ridge, Lashbrooke and Parkside Resort subdivisions.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

The discussion and analysis is designed to provide our customers with a general view of the District's finances and to show the District's accountability for the money it receives. If you have any questions or need additional information, contact the following commissioners at the address on the letterhead.

Steve Tackett
Barbara Darby
Patrick Williston

EAST SEVIER COUNTY UTILITY DISTRICT

STATEMENT OF NET ASSETS

June 30, 2010

ASSETS

PLANT IN SERVICE

Land		\$ 3,325
Distribution and collection system		799,388
Equipment		<u>129,536</u>
		932,249
Accumulated depreciation		<u>(310,766)</u>
		621,483

CURRENT ASSETS

Cash	\$ 35,161	
Certificate of deposit	48,931	
Prepaid insurance	3,305	
Accounts receivable, net of allowance for uncollectible accounts of \$28,613	43,729	
Deposits	<u>5,525</u>	

TOTAL CURRENT ASSETS

<u>136,651</u>
<u>\$ 758,134</u>

See the accompanying notes to the financial statements.

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts payable		\$ 8,608
Payroll taxes payable		2,158
Accrued wages		3,137
Deferred revenue		8,982
Customer deposits		31,385
Current portion of long-term debt		<u>5,241</u>

TOTAL CURRENT LIABILITIES 59,511

NET ASSETS

Invested in capital assets, net of related debt	\$ 616,241	
Unrestricted	<u>82,381</u>	<u>698,623</u>

\$ 758,134

EAST SEVIER COUNTY UTILITY DISTRICT

STATEMENT OF REVENUE, EXPENSES AND CHANGE IN NET ASSETS

Year Ended June 30, 2010

OPERATING REVENUE

Water sales	\$ 133,377
Sewer services	224,034
Tap fees	9,250
Contractual fees	4,351
Penalties and interest	<u>6,445</u>

TOTAL OPERATING REVENUE 377,458

OPERATING EXPENSES

Salaries	\$ 115,418
Payroll taxes	9,186
Health insurance	3,900
Plant utilities	32,613
Plant and line maintenance	73,426
Depreciation	33,670
Vehicle expense	16,528
Mileage expense	70
Insurance	17,274
Rent	3,675
Telephone	5,896
Office supplies	4,148
Legal fees	2,635
Audit expense	5,475
Professional fees	16,847
Commissioner fees	1,800
Miscellaneous	<u>6,659</u>

TOTAL OPERATING EXPENSES 349,220

INCOME FROM OPERATIONS 28,237

EAST SEVIER COUNTY UTILITY DISTRICT

STATEMENT OF REVENUE, EXPENSES AND CHANGE IN NET ASSETS

(continued)

Year Ended June 30, 2010

NON-OPERATING REVENUE(EXPENSE)

Interest income

1,177

Interest expense

(2,408)

(1,231)

CHANGE IN NET ASSETS

27,007

NET ASSETS AT THE BEGINNING OF THE YEAR

671,616

NET ASSETS AT THE END OF THE YEAR

\$ 698,623

See the accompanying notes to the financial statements

EAST SEVIER COUNTY UTILITY DISTRICT

STATEMENT OF CASH FLOWS

Year Ended June 30, 2010

**CASH PROVIDED(USED) BY
OPERATING ACTIVITIES**

Cash received from customers	\$ 376,138
Cash paid to employees	(116,613)
Cash paid to suppliers	<u>(205,937)</u>

**NET CASH PROVIDED BY
OPERATING ACTIVITIES**

53,587

**CASH PROVIDED(USED) BY CAPITAL AND RELATED
FINANCING ACTIVITIES**

Acquisition of capital assets	\$ (13,682)
Principal payments on long-term debt	(14,354)
Interest paid	<u>(2,408)</u>

**NET CASH (USED) BY CAPITAL AND
RELATED FINANCING ACTIVITIES**

(30,444)

**CASH PROVIDED(USED) BY
INVESTING ACTIVITIES**

Interest received	1,177
Increase in certificate of deposit	<u>(1,088)</u>

**NET CASH PROVIDED BY
INVESTING ACTIVITIES**

89

NET INCREASE IN CASH

23,232

CASH AT THE BEGINNING OF THE YEAR

11,928

CASH AT THE END OF THE YEAR

\$ 35,161

EAST SEVIER COUNTY UTILITY DISTRICT

STATEMENT OF CASH FLOWS

(continued)

Year Ended June 30, 2010

**RECONCILIATION OF INCOME FROM OPERATIONS
TO NET CASH PROVIDED BY OPERATING
ACTIVITIES**

Income from operations		\$ 28,237
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	\$ 33,670	
(Increase)decrease in:		
Accounts receivable	497	
Prepaid insurance	949	
Deposits	(500)	
Increase(decrease) in:		
Accounts payable	(8,555)	
Payroll taxes payable	(149)	
Accrued wages	754	
Deferred revenue	154	
Customer deposits	(1,470)	
		<u>25,350</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES		<u><u>\$ 53,587</u></u>

See the accompanying notes to the financial statements.

EAST SEVIER COUNTY UTILITY DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

June 30, 2010

NOTE A - DESCRIPTION OF ORGANIZATION

East Sevier County Utility District (the District) was created under the authority of Title 7, Chapter 82 of the 1937 Utility District Law of the State of Tennessee. The Board of Commissioners is appointed by the Sevier County Mayor for a term of four years. Sevier County does not have any fiscal or budgetary control over the District. Operations are funded by water and sewer rates established by the Board of Commissioners.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting

The District follows all pronouncements of the Governmental Accounting Standards Board (GASB) and only pronouncements of the Financial Accounting Standards Board (FASB) issued on or before November 30, 1989. The District has not elected to follow FASB pronouncements issued after November 30, 1989.

The District uses the “economic resources” measurement focus and the accrual basis of accounting. Accordingly, all assets and liabilities (whether current or non-current) are included in the Statement of Net Assets. The statement of Revenue, Expenses and Change in Net Assets presents increases (revenues) and decreases (expenses) in total net assets. Under the accrual basis of accounting, revenue is recognized in the period in which it is earned while expenses are recognized in the period in which the liability is incurred. Revenue is recorded when billed to their customers, based on a monthly meter reading cycle.

The District distinguishes operating revenue and expenses from non-operating items. Operating revenue for proprietary funds is revenue that is generated from the primary operations of the District. The principal operating revenue of the District is charges to customers for water sales and sewer services. The District also recognizes as operating revenue the portion of connection fees intended to recover the cost of connecting new customers to the system. Revenue from sewer only customers is recognized in the month service is provided. Sewer only customers are billed a flat rate one month in advance which is reported as deferred revenue. All other revenue is reported as non-operating revenue. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All other expenses are reported as non-operating expenses.

EAST SEVIER COUNTY UTILITY DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

(continued)

June 30, 2010

The District prepares its financial statements in accordance with the Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis - for State and Local Governments*. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting reporting purposes into the following three net assets groups:

Invested in capital assets, net of related debt

This category includes capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets. Invested in capital assets, net of related debt at June 30, 2010 has been calculated as follows:

Capital assets	\$ 932,249
Accumulated depreciation	(310,766)
Principal balance on long-term debt	<u>(5,241)</u>
	<u>\$ 616,241</u>

Restricted

This category includes net assets whose use is subject to externally imposed stipulations that can be fulfilled by actions of the District pursuant to those stipulations or that expire by the passage of time. Restricted net assets of the District consist of funds restricted for debt payments and future construction. When both restricted and unrestricted resources are available for use, it is the District’s policy to use restricted resources first, then unrestricted resources as they are needed. The District had no restricted net assets at June 30, 2010.

Unrestricted

This category includes net assets that are not subject to externally imposed stipulations and that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”. Unrestricted net assets may be designated for specific purposes by action of the board or may otherwise be limited by contractual agreement with outside parties.

Prepaid Expenses

Payments made for insurance premiums that will benefit periods beyond June 30, 2010 are recorded as prepaid expenses.

EAST SEVIER COUNTY UTILITY DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

(continued)

June 30, 2010

Plant in Service

Plant in Service is recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 7 to 50 years.

Allowance for Uncollectible Accounts

Allowance for uncollectible accounts is provided based upon historical trends. Allowance for uncollectible accounts at June 30, 2010 is \$28,613.

NOTE C - CASH AND INVESTMENTS

Cash and cash equivalents consist of cash, savings and short-term certificates of deposit with an original maturity of three months or less.

State of Tennessee law authorizes the District to invest in obligations of the United States or its agencies, non-convertible debt securities of certain federal agencies, other obligations guaranteed as to principal and interest by the United States or any of its agencies, secured certificates of deposit and other evidences of deposit in state and federal banks and savings and loan associations, and the state treasurer's investment pool. The pool contains investments in certificates of deposit, U.S. Treasury securities and repurchase agreements, backed by the U.S. Treasury securities. The Treasurer of the State of Tennessee administers the investment pool. Although the District may participate in the state investment pool, it elects not to.

District policy dictates that collateral meet certain requirements, such as be deposited in an institution which participates in the state collateral pool or be deposited in an escrow account in another institution for the benefit of the District and must be a minimum of 105% of the value of the deposits placed in the institution less the amount protected by federal deposit insurance. The state collateral pool is administered by the State of Tennessee. Members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional agreement, public fund accounts covered by the pool are considered to be classified as category one insured credit risk in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements*.

All of the District's accounts are fully insured through the Federal Deposit Insurance Corporation.

EAST SEVIER COUNTY UTILITY DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

(continued)

June 30, 2010

NOTE D - PLANT IN SERVICE

	<u>Balance</u> <u>7/1/09</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>6/30/10</u>
<u>Capital assets not being depreciated</u>				
Land	\$ 3,325	\$ 0	\$ 0	\$ 3,325
<u>Capital assets being depreciated</u>				
Collection system	294,003			294,003
Distribution system	492,333	13,053		505,386
Machinery and equipment	114,354	629	0	114,983
Office equipment	<u>14,553</u>	<u>0</u>	<u>0</u>	<u>14,553</u>
	915,242	13,682	0	928,924
<u>Accumulated depreciation</u>				
Collection system	(72,364)	(6,216)		(78,580)
Distribution system	(131,068)	(19,890)		(150,958)
Machinery and equipment	(68,665)	(5,121)	0	(73,786)
Office equipment	<u>(4,997)</u>	<u>(2,443)</u>	<u>0</u>	<u>(7,440)</u>
	<u>(277,096)</u>	<u>(33,670)</u>	<u>0</u>	<u>(310,766)</u>
	<u>\$ 641,471</u>	<u>\$ (19,988)</u>	<u>\$ 0</u>	<u>\$ 621,483</u>

EAST SEVIER COUNTY UTILITY DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

(continued)

June 30, 2010

NOTE E - LONG-TERM DEBT

Capital outlay note, due in monthly installments
of \$1,321 including interest at 3.75% per annum,
balance due in full on October 16, 2010 secured
by certificate of deposit.

	\$ 5,241
Less current maturities	<u>(5,241)</u>
	<u>\$ 0</u>

Future maturities of long-term debt as of June 30, 2010 are as follows:

<u>Year ending</u> <u>June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 5,241	\$ 41	\$ 5,282

Changes in long-term debt were as follows:

Balance, July 1, 2009	\$ 19,595
Principal payments	<u>(14,354)</u>
Balance, June 30, 2010	<u>\$ 5,241</u>

NOTE F - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance for all risks of loss, including general liability, workers' compensation coverage, and employee dishonesty bonds. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

EAST SEVIER COUNTY UTILITY DISTRICT

NOTES TO THE FINANCIAL STATEMENTS

(continued)

June 30, 2010

NOTE G - COMMITMENTS

The District rents its office on a month-to-month lease. Rent expense for the year ended June 30, 2010 was \$3,675.

NOTE H - SUBSEQUENT EVENT

Subsequent to the date of the financial statements, the District purchased a building, at a cost of \$62,750 for its office space. This purchase was entirely financed by a five year loan, with monthly payments of \$1,172.

SUPPLEMENTARY INFORMATION

EAST SEVIER COUNTY UTILITY DISTRICT

INSURANCE COVERAGE

June 30, 2010

<u>Description</u>	<u>Insurer</u>	<u>Expiration Date</u>	<u>Amount of Coverage</u>
Property, equipment, office contents, and other assets	Selective Insurance Company	2/12/11	\$ 691,000
Automobile liability and physical damage	Selective Insurance Company	2/12/11	1,000,000
General liability	Selective Insurance Company	2/12/11	2,000,000
Employee dishonesty	Selective Insurance Company	2/12/11	10,000
Public officials liability	Mt. Vernon Fire Insurance Company	5/13/11	1,000,000
Workers compensation	Selective Insurance Company	2/12/11	500,000

See the accompanying independent accountants' audit report.

EAST SEVIER COUNTY UTILITY DISTRICT

CUSTOMERS AND UTILITY RATES

June 30, 2010

Tap Fees:

English Mountain subdivision	
Water	\$ 750.00
Sewer	1,250.00
Other subdivisions, where applicable	
Sewer	750.00

Utility Rates:

Water:	
Residential - first 3,000 gallons	24.88
Commercial - first 3,000 gallons	43.54
Commercial - over 3,000 gallons	174.16

Sewer:	
English Mountain subdivision:	
Residential - first 3,000 gallons	29.00
Commercial - first 3,000 gallons	50.75
Commercial - over 3,000 gallons	203.00
Other subdivisions - unmetered service	35.00

Number of customers 500

See the accompanying independent accountants' audit report.

EAST SEVIER COUNTY UTILITY DISTRICT

UNACCOUNTED FOR WATER

June 30, 2010

(All amounts in gallons)

Water Treated and Purchased:

Water pumped (potable)	37,740,320
Water purchased	<u>0</u>

Total Water Treated and Purchased 37,740,320

Accounted for Water:

Water sold	9,217,139
Metered for consumption (in house usage)	0
Fire department usage	20,000
Flushing	127,000
Tank cleaning and filling	0
Street cleaning	0
Bulk sales	0
Water bill adjustments	<u>0</u>

Total Accounted for Water 9,364,139

Unaccounted for Water 28,376,181

Percent Unaccounted for Water 75%

Other: 0

Explain Other: None

All amounts included in this schedule are supported by documentation on file at the District. If no support is on file for a line item or if the line item is not applicable, a "0" is shown.

See the accompanying independent accountants' audit report.

EAST SEVIER COUNTY UTILITY DISTRICT

BOARD OF COMMISSIONERS

June 30, 2010

Steve Tackett

Patrick Williston

Sam Hassen (resigned September 9, 2010)

Barbara Darby (appointed November 1, 2010)

See the accompanying independent accountants' audit report.

INTERNAL CONTROL

AND

COMPLIANCE

INDEPENDENT ACCOUNTANTS' 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*

Board of Commissioners
East Sevier County Utility District
Sevierville, Tennessee

We have audited the financial statements of East Sevier County Utility District as of and for the year ended June 30, 2010 and have issued our report thereon dated January 3, 2011. 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 of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered East Sevier County Utility District'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 East Sevier County Utility District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of East Sevier County Utility District'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 East Sevier County Utility District'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*.

However, we noted certain matters that we reported to the management of East Sevier County Utility District in a separate letter dated January 3, 2011.

This report is intended solely for the information and use of management and government regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.

Mitchell Emert & Hill

January 3, 2011