

**PADUCAH MCCRACKEN JOINT SEWER AGENCY
PADUCAH, KENTUCKY**

**FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016**

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Independent Auditor's Report

Board of Directors
Paducah McCracken Joint Sewer Agency
Paducah, Kentucky

We have audited the accompanying financial statements of the business-type activities of Paducah McCracken Joint Sewer Agency as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Paducah McCracken Joint Sewer Agency, as of June 30, 2017 and 2016, and the respective changes in its financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3 through 8 and schedules of employer's proportionate share of the net pension liability and employer contributions information on pages 24 and 25 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Paducah McCracken Joint Sewer Agency's basic financial statements. The budgetary comparison information on page 26 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The budgetary comparison information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the budgetary comparison information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2017, on our consideration of the Paducah McCracken Joint Sewer Agency'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* in considering Paducah McCracken County Joint Sewer Agency's internal control over financial reporting and compliance.



Paducah, Kentucky
October 26, 2017



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REQUIRED SUPPLEMENTAL INFORMATION



As management of the Paducah McCracken Joint Sewer Agency (JSA), we offer readers of the JSA's financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2017.

Financial Highlights

- Net capital assets increased \$271 thousand over prior FY
- Total net position increased \$607 thousand (1.1%) during the year
- Total revenues up \$819 thousand (10.5%) over FY 2016
- Debt service coverage ratio above level of compliance at 2.46 for FY 2017

Required Financial Statements

Statement of Net Position - The purpose of the Statement of Net Position is to report all of the assets held and liabilities owed by the JSA. The statement shows the JSA's level of investment in resources (assets) and the obligations to creditors (liabilities). The difference between the assets and liabilities is labeled net position and is similar to owners' equity presented by a commercial enterprise. The purpose of the JSA is not to accumulate net assets, but rather to reinvest in the infrastructure and to build sufficient reserves in the event of an emergency. In general, increases in net position indicate that the financial position of the JSA is improving over time.

Statement of Revenues, Expenses and Changes in Net Position - The purpose of this statement is to identify the revenues generated and expenses incurred by the JSA. The focus of this statement is to help the user identify the operating results of the JSA during the fiscal year. The difference between revenues and expenses is called the change in net position and is similar to net income reported by a commercial entity.

Statement of Cash Flows - The purpose of the Statement of Cash Flows is to analyze the cash receipts and disbursements made by the JSA during the fiscal year. The statement reports cash inflows and outflows resulting from three main business activities: operating, financing and investing. The statement addresses the sources and uses of cash, and the change in cash balances from the previous reporting period.

Financial Information

EXHIBIT 1: Condensed Statements of Net Position (in thousands)

	FYE 6/30/17	FYE 6/30/16	Dollar Change	Percent Change
Assets				
Current assets	\$ 13,851	\$ 13,993	\$ (142)	-1.0%
Capital assets	65,714	65,443	271	0.4%
Restricted funds	1,170	1,150	20	1.7%
Deferred charges & other	<u>808</u>	<u>815</u>	<u>(8)</u>	-1.0%
Total assets	<u>81,543</u>	<u>81,401</u>	<u>141</u>	0.2%
Deferred Outflows of Resources	<u>666</u>	<u>503</u>	<u>163</u>	32.4%
Liabilities & net position				
Current liabilities	2,562	2,581	(19)	-0.7%
Noncurrent liabilities	<u>23,541</u>	<u>23,854</u>	<u>(313)</u>	-1.3%
Total liabilities	<u>26,103</u>	<u>26,435</u>	<u>(332)</u>	-1.3%
Deferred Inflows of Resources	<u>68</u>	<u>36</u>	<u>32</u>	88.9%
Invested in capital assets, net	44,079	43,233	846	2.0%
Restricted	1,170	1,150	20	1.7%
Unrestricted	<u>10,789</u>	<u>11,048</u>	<u>(259)</u>	-2.3%
Total net position	<u>\$ 56,038</u>	<u>\$ 55,431</u>	<u>\$ 607</u>	1.1%

Capital Assets and Long-Term Debt Activity

Net capital assets increased by \$271 thousand during FY 2017. At the close of the current fiscal year, JSA had \$102 million in undepreciated cost of total capital assets. Capital assets may be acquired through purchase, by the completion of projects (either in-house or by contractors), or by contribution of assets to the JSA by private developers.

JSA completed and placed the Homewood Avenue Wet Weather Storage Tank in service during the period for a total of \$1.2 million, recording an additional \$510 thousand in draws against a current Kentucky Infrastructure Authority (KIA) loan during the fiscal year. Two additional overflow storage tanks were either in the planning stages or under construction as of June 30, 2017. The building of these tanks was negotiated as part of the Long Term Control Plan (LTCP) required by the Consent Judgment with the Kentucky Environmental and Public Protection Cabinet and Environmental Protection Agency. The Agency will be in search of funding options in the years to come as they complete additional LTCP projects.

The JSA continues to rebuild and rehabilitate the aging sewer infrastructure as well as extend sewers to previously unsewered and undeveloped areas of the city and county. The JSA is committed to capital investments in infrastructure assets to protect the integrity of, and enhance, the existing sewer system.

Total Liabilities and Net Position

Total liabilities decreased during FY 2017 by \$332 thousand or -1.3% over FY 2016. The decrease in notes and bonds payable from \$22.2 million to \$21.6 million was offset by the increase in JSA's net pension liability from \$2.7 million to \$3.0 million.

The JSA's total net position increased by \$607 thousand or 1.1% during FY 2017. Net capital assets less total debt increased by \$846 thousand, but were offset by the \$259 thousand decrease in unrestricted assets.

EXHIBIT 2: Condensed Statements of Revenues, Expenses and Changes in Net Position
(in thousands)

	FYE 6/30/17	FYE 6/30/16	Dollar Change	Percent Change
Revenues				
Operating revenues	\$ 7,949	\$ 7,408	\$ 541	7.3%
Non-operating revenues	<u>654</u>	<u>376</u>	<u>278</u>	73.9%
Total revenues	<u>8,603</u>	<u>7,784</u>	<u>819</u>	10.5%
Expenses				
Depreciation	2,830	2,705	125	4.6%
Operating expenses	4,748	4,447	301	6.8%
Non-operating expenses	<u>482</u>	<u>465</u>	<u>17</u>	3.7%
Total expenses	<u>8,060</u>	<u>7,617</u>	<u>443</u>	5.8%
Contributions	<u>64</u>	<u>208</u>	<u>(144)</u>	-69.2%
Change in net position	607	375	232	61.9%
Beginning net position	<u>55,431</u>	<u>55,056</u>	<u>375</u>	0.7%
Ending net position	\$ 56,038	\$ 55,431	\$ 607	1.1%

Budget

The JSA conducts its activities in accordance with a budget for operating revenues, operating expenses, and capital purchases. The JSA is required to adopt a budget annually. Through monitoring and review by the JSA Board, the Agency continuously meets its responsibility for sound financial management.

Operating revenues for FY 2017 finished \$541 thousand above the amount for the prior year. Sewer charges comprise the bulk of operating revenues and are billed based on customer water consumption. These charges came in \$180 thousand more than budgeted for FY 2017. Operating expenses came in over budget for the fiscal year finishing \$131 thousand above estimate. This is primarily due to the new pension and insurance reporting requirements mandated by GASB, which were unknown, and not reasonable to estimate, during the development of the operating budget.

JSA received almost \$64 thousand in capital contributions during the fiscal year. These contributions came in the forms of grant revenue of \$5 thousand and developer non-cash contributions of \$59 thousand.

Results of Operations

Total revenues of \$8.6 million, showed an increase of \$819 thousand or 10.5% from FY 2016. The March 1, 2016 rate increase was responsible for this growth in revenue. Total expenses increased \$443 thousand or 5.8% from FY 2016.

EXHIBIT 3: Detail of Operating Expenses (Excluding Depreciation)

Operating Expenses (in thousands)	FYE 6/30/17	FYE 6/30/16	Dollar Change	Percent Change
Salaries, wages and benefits	\$ 2,426	\$ 2,305	\$ 121	5.2%
Chemicals, testing & solids disposal	426	354	72	20.3%
Utilities	808	777	31	4.0%
Material, supplies and repairs	508	475	33	6.9%
Fleet expense	92	76	16	21.1%
Professional fees	79	67	12	17.9%
Billing, collection and bad debts	189	178	11	6.2%
All other	<u>220</u>	<u>215</u>	<u>5</u>	2.3%
Total	\$ 4,748	\$ 4,447	\$ 301	6.8%

Salaries, Wages and Benefits

Salaries, wages and benefits comprise the bulk of operating expenses. These expenses increased 5.2% over FY 2016. This was made up mostly of increases in salaries, wages and overtime of \$36 thousand and in increase of normal pension costs of \$28 thousand. The JSA also recorded a \$62 thousand increase in pension and health insurance expenses over the prior year due to the new reporting requirements mandated by GASB. Employees received annual wage increases during FY 2017 and 2016.

Other Operating Expenses

Chemicals, testing and solids disposal showed a \$72 thousand increase from the prior year. Chemical usage amounts and costs vary from year to year based on a variety of factors, including economic conditions and pricing, as well as certain operational parameters which vary due to odor control requirements, treatment plant flows, and the maintenance of the bacterial inventory at the wastewater treatment plants. Solids disposal costs vary primarily based on the treated flow amounts, the efficiency of the wastewater treatment plant digesters and the ability for the City of Paducah's composting facility to efficiently handle the Paducah wastewater treatment plant's fully digested sludge inventory. In times of low composting supply material (i.e. branches, leaves, sticks, etc.) or composting facility equipment breakdown, the JSA is forced to landfill sludge at higher costs. For FY 2017, JSA experienced higher costs associated with charges from the City of Paducah for composting. In addition, JSA was forced to landfill sludge at higher costs for an extended period, due to the inability of the City of Paducah to process sludge at times.

The largest component of utilities expense is electricity costs. Electricity costs vary from year to year based on flows received and pumped. For FY 2017, JSA experienced higher electrical costs associated with treatment activities. JSA has experienced slightly higher loadings at its Paducah Wastewater Treatment Plant from certain industrial dischargers, which require more electricity to provide for adequate treatment. While this is a cost increase, JSA recoups these costs through surcharges to industrial users.

Materials, supplies and repairs are ordinary and necessary costs incurred to keep the sewer utility process, as well as JSA buildings and grounds, in good working order. This account showed a \$33 thousand increase from the prior fiscal year. Repair costs for the treatment plant and lift stations were the primary cause for the increase. Repair costs vary significantly based on the type, equipment, and location of the work.

The largest component of the material, supplies and repairs category is repairs, which include collection system point repairs, pump rebuilds, and plant equipment repairs. Contract labor is sometimes used for these repairs and is charged to this category, while internal labor for repair work is expensed to salaries and wages. Expenses are categorized using the three main components of a sewer system: pipes, pumps and motors. For FY 2017, several above-average cost activities were performed to rebuild pumps, generators, and other lift station and treatment components, which account for the increase. These activities were required to maintain the equipment in good working order, and prevent total replacement costs. Repairs were made as follows:

EXHIBIT 4: Repairs by Department (in thousands)

Department	FYE 2017	FYE 2016	Dollar Change	Percent Change
Collection System (pipes)	\$ 214	\$ 216	\$ (2)	-0.9%
Lift Stations (pipes & pumps)	69	47	22	46.8%
Treatment Plants (pipes, pumps & motors)	59	38	21	55.3%
Total	\$ 342	\$ 301	\$ 41	13.6%

Fleet expense increased \$16 thousand, or 21.1%, over the prior fiscal year. The JSA maintains a vehicle replacement program to cull the aging fleet and attempt to minimize extensive repair costs. It is important to note JSA's fleet expense costs for FY 2017 mirror FY 2015 costs.

FY 2017 professional fees were \$12 thousand more than in FY 2016. This account consists of legal and accounting fees, as well as contractual services, containing certain engineering fees and software contractual services. Contractual services were the primary cost increase for FY 2017; however, the costs for this category were \$6 thousand below budget.

Paducah Water provides billing and collection services for the JSA. Bad debt write offs finished as expected at \$56 thousand.

All other expenses totaled \$220 thousand for FY 2017 and included costs for insurance, training and safety, office expense, public education, board of directors' expense and miscellaneous expense. The budget for all other expenses was \$216 thousand.

Debt Service Coverage

Debt service coverage (DSC) ratio is an indicator of the JSA's ability to meet its debt obligations. The JSA Board strives to maintain a minimum DSC ratio of 1.30 times the required debt service payments. For purposes of this calculation, gross revenues include investment income, grant revenues and connection fees, and expenses exclude the deduction for depreciation. The JSA has continued to exceed the minimum DSC ratio set by the board. The Agency's DSC ratio was 2.46 in 2017 and 2.55 in 2016.

Relevant Current Economic Factors and Other Significant Matters

New home construction in the area has been slow which is representative of the current U.S. market. The area has experienced a surge in the construction of apartments, with several hundred units either recently constructed or in some stage of construction. This construction trend will provide for a temporary surge in connection fees for JSA.

Investment returns have continued to remain low. JSA has begun to see a slight increase in interest rates. This income will continue to fluctuate with adjustments in rates, due to the nature of JSA's investments.

The Paducah McCracken Joint Sewer Agency entered into a Consent Judgment with the Kentucky Environmental and Public Protection Cabinet and the Environmental Protection Agency in September 2007 to bring combined and sanitary sewer overflows into compliance with Federal and State guidelines. The Agency's Long Term Control Plan (LTCP), a planning document mandated by the Consent Judgment, was approved on October 10, 2016. This LTCP requires compliance within the combined sewers, sewers carrying both storm and sanitary flow, to be completed over a twenty-two year timeframe. The cost to bring the combined system into compliance, as outlined in the LTCP, is \$102 million. This amount does not take into consideration any other capital projects JSA will have to fund over the next twenty-two years. As a result, future rate increases will be necessary to achieve this undertaking. JSA implemented a revision of rates effective March 1, 2016, and July 1, 2017. In addition, JSA has built-in the ability to adjust rate by the Consumer Price Index - Urban (CPI-U) for subsequent years. The JSA strives to utilize sound business principals while meeting the needs of the community and maintaining environmental compliance with Federal, State and local regulations.

The JSA will continue to pursue alternative means of funding in the form of grants and low-interest loans to aid in the funding of the Agency's capital expenditures. The JSA has been successful in securing \$10.2 million in grants from the KIA and the United States Department of Agriculture Rural Development since FY 2005. The Agency was awarded and expended a Delta Regional Authority grant totaling \$100 thousand during FY 2013 and an Economic Development Authority Grant totaling \$315 thousand in FY 2015. These funds have been expended on projects relating to expansion of the collection system, maximization of flow at Paducah's wastewater treatment plant, the separation of flow from JSA's combined sewer system, various compliance related planning documents, and the Massac Creek Interceptor Project, thus reducing the burden of these projects on JSA ratepayers.

Requests for Additional Information

This report is intended to provide readers with a general overview of the JSA's finances and to show the JSA's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the JSA at 621 Northview Street, Paducah, KY 42001 or (270) 575-0056.

BASIC FINANCIAL STATEMENTS

PADUCAH MCCRACKEN JOINT SEWER AGENCY
STATEMENTS OF NET POSITION
JUNE 30

ASSETS

	<u>2017</u>	<u>2016</u>
Current Assets:		
Cash and cash equivalents	\$ 6,553,042	\$ 5,722,531
Investments and accrued interest	5,861,876	6,754,519
Customer accounts receivable	422,230	494,863
Grants and other receivables	33,301	29,993
Accrued unbilled revenue	651,000	650,000
Inventories and prepaid expenses	329,090	340,680
Total current assets	<u>13,850,539</u>	<u>13,992,586</u>
Noncurrent Assets:		
Utility plant and capital assets, net	65,713,831	65,443,109
Restricted assets and investments	1,169,923	1,149,796
Bond discount - net	47,010	53,039
Other noncurrent assets	761,584	761,664
Total noncurrent assets	<u>67,692,348</u>	<u>67,407,608</u>
TOTAL ASSETS	<u>81,542,887</u>	<u>81,400,194</u>

DEFERRED OUTFLOWS OF RESOURCES

Contributions subsequent to the measurement date	<u>665,651</u>	<u>503,015</u>
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LIABILITIES

Current Liabilities:		
Notes and bonds payable	1,121,899	1,073,797
Accounts payable	426,864	500,830
Salaries and benefits payable	93,899	86,523
Other current liabilities	918,932	920,198
Total current liabilities	<u>2,561,594</u>	<u>2,581,348</u>
Noncurrent Liabilities:		
Notes and bonds payable	20,513,205	21,136,109
Net pension liability	3,028,183	2,717,993
Total noncurrent liabilities	<u>23,541,388</u>	<u>23,854,102</u>
TOTAL LIABILITIES	<u>26,102,982</u>	<u>26,435,450</u>

DEFERRED INFLOWS OF RESOURCES

Difference between projected and actual earnings	<u>67,739</u>	<u>36,299</u>
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NET POSITION

Invested in capital assets, net of related debt	44,078,727	43,233,203
Restricted for debt service	1,169,923	1,149,796
Unrestricted - net assets	<u>10,789,167</u>	<u>11,048,461</u>
TOTAL NET POSITION	<u>\$ 56,037,817</u>	<u>\$ 55,431,460</u>

The notes to financial statements are an integral part of this statement.

PADUCAH MCCRACKEN JOINT SEWER AGENCY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30

	<u>2017</u>	<u>2016</u>
Operating Revenues:		
Charges for services	\$ 7,948,802	\$ 7,407,866
Operating Expenses:		
Salaries, wages and benefits	2,426,371	2,305,320
Chemicals, testing, and solids disposal	426,213	353,945
Utilities	808,386	776,503
Materials, supplies, and repairs	507,509	474,784
Fleet expense	92,238	75,715
Liability insurance	127,893	127,671
Training, safety, and dues	32,842	36,252
Professional fees	79,185	66,762
Office expense	17,625	13,442
Public education	750	750
Billing and collections	133,579	123,458
Bad debts	55,625	54,705
Board of directors expense	16,600	16,800
Miscellaneous	23,598	20,763
Depreciation	2,829,697	2,704,898
Total operating expenses	<u>7,578,111</u>	<u>7,151,768</u>
Operating income	<u>370,691</u>	<u>256,098</u>
Non-operating Revenues (Expenses):		
Investment revenue	65,629	33,760
Interest expense	(426,617)	(439,887)
Amortization	(6,029)	(6,281)
Gain (loss) on sale of assets	42,915	15,475
Tap-on and assessment fees	545,556	327,125
Other, net	(49,528)	(18,700)
Total non-operating revenues (expenses), net	<u>171,926</u>	<u>(88,508)</u>
Change in net position before capital contributions	<u>542,617</u>	<u>167,590</u>
Capital Contributions:		
Grant revenue	4,500	4,500
Contributions from developers	59,240	203,122
Total capital contributions	<u>63,740</u>	<u>207,622</u>
Change in net position	606,357	375,212
Net position, beginning	<u>55,431,460</u>	<u>55,056,248</u>
NET POSITION, ENDING	<u>\$ 56,037,817</u>	<u>\$ 55,431,460</u>

The notes to financial statements are an integral part of this statement.

PADUCAH MCCRACKEN JOINT SEWER AGENCY
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities:		
Collections from customers	\$ 7,960,749	\$ 7,273,065
Cash paid to suppliers	(2,227,597)	(2,016,531)
Cash paid to employees	(2,239,248)	(2,196,165)
	<u>3,493,904</u>	<u>3,060,369</u>
Cash Flows from Capital and Related Financing Activities:		
Grants and contributed capital	4,500	19,530
Tap-on fees and assessments	545,556	327,125
Acquisition of capital assets	(3,116,682)	(2,439,739)
Proceeds from the sale of fixed assets	61,034	15,475
Proceeds from debt issues	510,096	1,104,899
Principal payments on long-term debt	(1,084,898)	(905,898)
Interest payments on long-term debt	(471,696)	(469,423)
(Increase)/Decrease in other noncurrent assets	80	(194,900)
Other, net	(49,528)	(18,700)
	<u>(3,601,538)</u>	<u>(2,561,631)</u>
Cash Flows from Investing Activities:		
Proceeds from sales and maturities of investments	7,505,226	2,831,299
Purchases of investments	(6,583,551)	(3,694,729)
Investment earnings	16,470	31,267
	<u>938,145</u>	<u>(832,163)</u>
Net cash provided by (used in) investing activities	<u>938,145</u>	<u>(832,163)</u>
Net increase (decrease) in cash and cash equivalents	830,511	(333,425)
Cash and cash equivalents, beginning of year	<u>5,722,531</u>	<u>6,055,956</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 6,553,042</u></u>	<u><u>\$ 5,722,531</u></u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income	\$ 370,691	\$ 256,098
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,829,697	2,704,898
Changes in operating assets and liabilities:		
Accounts receivable	69,325	8,648
Accrued unbilled revenue	(1,000)	(88,000)
Inventory and prepaid expenses	11,590	(27,488)
Deferred outflows of resources	(162,636)	(314,274)
Accounts payable	26,526	(117,778)
Salaries and benefits payable	7,376	(940)
Other current liabilities	705	215,580
Net pension liability	310,190	621,361
Deferred inflows of resources	31,440	(197,736)
	<u>\$ 3,493,904</u>	<u>\$ 3,060,369</u>

The notes to financial statements are an integral part of this statement.

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016

Note A - Summary of Significant Accounting Policies:

Reporting Entity

The Paducah McCracken Joint Sewer Agency, the "Agency", was established pursuant to Chapter 76 of the Kentucky Revised Statutes. The Agency provides wastewater services to the residents of the City of Paducah and McCracken County, Kentucky. The Agency was established by merging the City of Paducah Wastewater Enterprise Fund with three sewer districts of McCracken County. Substantially all of the assets and liabilities of the separate component entities were contributed to create the Paducah McCracken Joint Sewer Agency effective July 1, 1999.

Accounting Method

The Agency maintains its books and these financial statements are presented using the "economic resources" measurement focus and the accrual basis of accounting. Accordingly, all assets and liabilities (whether current or noncurrent) are included on the Statement of Net Position. The Statement of Revenues, Expenses and Changes in Fund Net Position presents increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period incurred.

The financial statements distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with ongoing operations. The principal operating revenues of the Agency are charges for sewer service. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The significant accounting policies, as summarized below, are in conformity with generally accepted accounting principles as applicable to governmental units as prescribed by the *Governmental Accounting Standards Board* (GASB). The Agency applies Financial Accounting Standards Board (FASB) Accounting Standards Codification (Codification) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

Cash and Investments

For the purpose of the Statements of Cash Flows, "cash and cash equivalents" includes unrestricted demand and savings accounts of the Agency.

Accounts Receivable and Bad Debts

Accounts receivable are uncollateralized customer obligations due under normal trade terms requiring payment within 30 days from the invoice mailing date. Customer account balances with invoices dated over 30 days old are considered delinquent. Payments of accounts receivable are allocated to the specific invoices identified on the customer's remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

No allowance for doubtful accounts has been provided since it is believed the balance in accounts receivable is fully collectible. Overdue accounts are monitored and written off as necessary. The effect of using this method is not significantly different from results which would be obtained by using the allowance method.

(Continued)

**PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016**

Note A - Summary of Significant Accounting Policies (Continued):

Accrued Unbilled Revenue

Accrued unbilled revenue represents the portion of sewer service provided that was unbilled as of the end of the year.

Inventories

Materials and supplies are carried in an inventory account at cost and are subsequently capitalized or charged to expense when consumed utilizing the first-in, first-out (FIFO) method.

Capital Assets

Capital assets are recorded at cost. Donated assets are stated at fair value on the date donated. The Agency generally does not capitalize assets with costs less than \$1,000. The costs of normal maintenance and repairs that do not add to the asset value or materially extend useful lives are not capitalized.

When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded. Depreciation is provided by the straight-line method over the estimated useful lives of the various classes of assets as follows:

	<u>Years</u>
Utility plant	20-60
Vehicles	5- 7
General plant and office equipment	3-10

Capital Contributions

Capital contributions are derived from two main sources: 1) developers, when they construct and pay for sewer lines and then donate these additions to the Agency; and 2) other governments, in the form of grants or contributions of capital assets. Developer contributions are recorded at fair value when the property is transferred to the Agency and are depreciated over their estimated useful lives using the straight-line method.

Use of Estimates

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

Note B - Restricted Assets and Investments:

Restricted assets and investments consist of certificates of deposit and other securities, which have been set aside for the repayment of bonds and notes, for maintenance reserves as required, and for ongoing capital projects. These balances are classified as restricted assets on the statement of net assets because their use is limited by applicable bond ordinances and loan agreements.

(Continued)

**PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016**

Note B - Restricted Assets and Investments (Continued):

At June 30, these restricted funds were comprised of the following investments:

	<u>2017</u>	<u>2016</u>
Certificates of deposit - various financial institutions	\$ 642,413	\$ 639,000
U.S. Government money market funds	<u>527,510</u>	<u>510,796</u>
TOTALS	<u>\$1,169,923</u>	<u>\$1,149,796</u>

When both restricted and unrestricted resources are available for use, it is the Agency's policy to use restricted resources first, then unrestricted resources as they are needed.

Note C - Deposits and Investments With Financial Institutions:

Custodial credit risk for deposits is the risk that in the event of a bank failure, the Agency's deposits may not be returned or the Agency will not be able to recover collateral securities in the possession of an outside party. The Agency's investment policy requires all investments be made in accordance with applicable legal requirements with consideration of investment safety. Accordingly, the Agency maintains collateral agreements with its financial institutions, whereby deposits are secured with collateral valued at market value. The Board of Directors has authorized the Executive Director to utilize depository institutions located within McCracken County, which have been evaluated by the Board and/or Executive Director and Finance Director.

During the years ended June 30, 2017 and 2016, the Agency's investments include U.S. government money market funds, short term treasury obligations, demand deposits, and certificates of deposit. The bank balance of cash and investments totaled \$12,355,526 and \$12,839,239, respectively, at June 30, 2017 and 2016, with \$0 and \$0, respectively, uninsured and uncollateralized.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Generally, the Agency's investing activities are managed under the direction of the Executive Director and Finance Director. Investing is performed in accordance with investment policies adopted by the Board of Directors complying with state statutes. The state statutes authorize the Agency to invest in direct obligations of the United States government, obligations backed by the full faith and credit of the United States government, certificates of deposit or other interest bearing accounts issued by any bank or savings and loan institution provided that such investments are insured by the FDIC or guaranteed by the pledge of direct United States government obligations, bonds issued by the Commonwealth of Kentucky or one of its agencies and instrumentalities, securities issued by any state or local government of the United States rated in one of the three highest categories by a nationally recognized rating agency, certain mutual funds, commercial paper rated in the highest category by a nationally recognized rating agency, or bankers' acceptances for banks rated in one of the three highest categories by a nationally recognized rating agency.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016

Note D - Construction in Progress:

The Agency had the following projects in process at June 30:

	<u>2017</u>	<u>2016</u>
Anita Drive Pump Station Capacity Evaluation	\$ 14,061	\$ 12,085
Brentwood PS Pumps & Control Panel Upgrade	15,594	-
Chickadee Lift Station Elimination Project	11,369	11,368
Dewatering Building Roof Replacement	-	69
Harrison Street Storage Tank	344,486	36,421
Homewood Overflow Tank	-	180,870
Long Term Control Plan	-	1,023,798
Manhole Rehabilitation Contract	11,485	-
Massac Creek Phase III Study	19,500	19,500
Metal Building	23,341	-
Old Highway 60 Extension	4,250	4,250
Olivet Church Road/Rebecca Lane Extension	52,696	52,696
Perkins Creek Tank Preliminary Engineering	30,810	-
PWWTP Electrical Upgrade	4,748	-
Rehab Contract CY '15	-	315,341
Rehab Contract CY '16	-	19,189
Rehab Contract CY '17	18,863	-
Reidland Above Ground Storage Tank	295,948	23,024
Reidland/Epperson Rds Force Main Replacement Projects	14,426	-
Roofs at RWWTP & JSA Admin Building	258	-
SCADA Server Upgrade	53,688	-
Video and Cleaning Contract 2016	-	16,993
Video and Cleaning Contract 2017	16,954	-
Wexford Pump Station Valve Vault Replacement	-	4,130
Capitalized Interest	<u>11,973</u>	<u>3,413</u>
TOTALS	<u>\$ 944,450</u>	<u>\$1,723,147</u>

Construction in progress related invoices of \$178,629 and \$279,121 were included in accounts payable at June 30, 2017 and 2016, respectively.

Note E - Capital Assets:

Capital assets consists of the following at June 30:

	<u>2017</u>			
	<u>Balance as of</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance as of</u>
	<u>June 30, 2016</u>			<u>June 30, 2017</u>
Capital assets, not being depreciated:				
Land	\$ 931,096	\$ 48,540	\$ -	\$ 979,636
Construction in progress	<u>1,723,148</u>	<u>2,778,164</u>	<u>3,660,027</u>	<u>841,285</u>
 Total capital assets not being depreciated	 <u>2,654,244</u>	 <u>2,826,704</u>	 <u>3,660,027</u>	 <u>1,820,921</u>

(Continued)

PADUCAH MCCrackEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016

Note E - Capital Assets (Continued):

	2017			Balance as of June 30, 2017
	Balance as of June 30, 2016	Increases	Decreases	
Capital assets, being depreciated:				
Utility assets (pipes, pumps, plants, structures)	\$ 93,690,937	\$ 2,699,842	\$ 4,000	\$ 96,386,779
Vehicles	1,577,759	188,376	317,358	1,448,777
General plant and office furniture	<u>2,639,816</u>	<u>1,142,565</u>	<u>15,237</u>	<u>3,767,144</u>
Totals at historical cost	<u>97,908,512</u>	<u>4,030,783</u>	<u>336,595</u>	<u>101,602,700</u>
Less accumulated depreciation:				
Utility assets	32,102,162	2,458,196	3,067	34,557,291
General plant and office furniture	2,023,095	202,228	15,141	2,210,182
Vehicles	<u>994,390</u>	<u>169,273</u>	<u>300,268</u>	<u>1,463,931</u>
Total accumulated depreciation	<u>35,119,647</u>	<u>2,829,697</u>	<u>318,476</u>	<u>37,630,868</u>
Total capital assets, being depreciated, net	<u>62,788,865</u>	<u>1,201,086</u>	<u>18,119</u>	<u>63,971,832</u>
TOTAL SYSTEM CAPITAL ASSETS - NET	<u>\$ 65,443,109</u>	<u>\$ 4,027,790</u>	<u>\$ 3,678,146</u>	<u>\$ 65,792,753</u>
	2016			Balance as of June 30, 2016
	Balance as of June 30, 2015	Increases	Decreases	
Capital assets, not being depreciated:				
Land	\$ 886,057	\$ 45,039	\$ -	\$ 931,096
Construction in progress	<u>4,898,198</u>	<u>1,681,583</u>	<u>4,856,633</u>	<u>1,723,148</u>
Total capital assets not being depreciated	<u>5,784,255</u>	<u>1,726,622</u>	<u>4,856,633</u>	<u>2,654,244</u>
Capital assets, being depreciated:				
Utility assets (pipes, pumps, plants, structures)	88,675,175	5,015,762	-	93,690,937
Vehicles	1,361,384	253,209	36,834	1,577,759
General plant and office furniture	<u>2,510,965</u>	<u>128,851</u>	<u>-</u>	<u>2,639,816</u>
Totals at historical cost	<u>92,547,524</u>	<u>5,397,822</u>	<u>36,834</u>	<u>97,908,512</u>
Less accumulated depreciation:				
Utility assets	29,680,759	2,421,403	-	32,102,162
General plant and office furniture	1,860,392	162,703	-	2,023,095
Vehicles	<u>910,432</u>	<u>120,792</u>	<u>36,834</u>	<u>994,390</u>
Total accumulated depreciation	<u>32,451,583</u>	<u>2,704,898</u>	<u>36,834</u>	<u>35,119,647</u>
Total capital assets, being depreciated, net	<u>60,095,941</u>	<u>2,692,924</u>	<u>-</u>	<u>62,788,865</u>
TOTAL SYSTEM CAPITAL ASSETS - NET	<u>\$ 65,880,196</u>	<u>\$ 4,419,546</u>	<u>\$ 4,856,633</u>	<u>\$ 65,443,109</u>

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016

Note F - Notes and Bonds Payable:

Notes and bonds payable consists of the following:

	<u>2017</u>	<u>2016</u>
Notes Payable:		
Kentucky Infrastructure Authority	\$13,789,605	\$14,069,406
Bonds Payable:		
Sewer Revenue Bonds, Series 2012	4,075,500	4,140,500
Sewer Revenue Refunding Bonds, Series 2014	3,770,000	4,000,000
	21,635,105	22,209,906
Less current maturities	1,121,899	1,073,797
	<u>\$20,513,206</u>	<u>\$21,136,109</u>

Debt service requirements on notes and bonds payable at June 30, 2017, are as follows:

<u>Years Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Service Fee</u>	<u>Total</u>
2018	\$ 1,121,899	\$ 458,991	\$ 27,174	\$ 1,608,064
2019	1,137,656	438,578	25,538	1,601,772
2020	1,154,164	417,858	22,875	1,595,897
2021	1,175,426	396,716	22,183	1,594,325
2022	1,197,449	375,359	20,463	1,593,271
2023-2027	5,913,106	1,523,781	76,470	7,513,357
2028-2032	5,400,848	890,771	37,479	6,329,098
2033-2037	2,317,057	414,674	6,083	2,737,814
2038-2042	681,000	268,648	-	949,648
2043-2047	800,500	168,644	-	969,144
Thereafter	736,000	51,301	-	787,301
TOTALS	<u>\$21,635,105</u>	<u>\$5,405,321</u>	<u>\$238,265</u>	<u>\$27,279,691</u>

Notes payable are secured by capital assets and restricted funds. At June 30, 2017, the above notes are payable to Kentucky Infrastructure Authority and are payable in semi-annual installments, including interest ranging from 1.0% to 2.0%. These agreements provide capital project funding utilizing a combination of both long-term borrowing and federal stimulus grant funds from the American Recovery and Reinvestment Act.

During the year ended June 30, 2013, the Agency formally issued Sewer Revenue Bonds, Series 2012, in the amount of \$4,324,000 with the first principal payment due January 1, 2014. The interest rate on the bond is 2.75%, and the bonds require annual principal payments and semi-annual interest payments through 2051. Proceeds from the bonds, which mature January 1, 2051, were used to repay the Rural Water note.

During the year ended June 30, 2015, the Agency formally issued Sewer Revenue Refunding Bonds, Series 2014, in the amount of \$4,220,000 with the first principal payment due January 1, 2016. The interest rate on the bond is variable between 1.75% and 3.00%, and the bonds require annual principal payments and semi-annual interest payments through 2031. Proceeds from the bonds, which mature January 1, 2031, were used to repay the Series 2010 (Build America Bonds) Taxable Sewer Revenue Bonds.

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**PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2017 AND 2016**

Note F - Notes and Bonds Payable (Continued):

Notes and bonds payable activity for the year ended June 30, 2017, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Long-term liabilities:					
Bonds payable	\$ 8,140,500	\$ -	\$ 295,000	\$ 7,845,500	\$ 307,500
Notes payable	<u>14,069,406</u>	<u>510,096</u>	<u>789,897</u>	<u>13,789,605</u>	<u>814,399</u>
TOTAL LONG-TERM LIABILITIES	<u>\$ 22,209,906</u>	<u>\$510,096</u>	<u>\$1,084,897</u>	<u>\$ 21,635,105</u>	<u>\$ 1,121,899</u>

Note G - Contributed Capital:

For the years ended June 30, 2017 and 2016, the Agency accepted \$59,240 and \$144,045, respectively, of sewer line extensions and a new lift station that were placed into service during the respective years by developers in McCracken County, Kentucky.

Note H - Disclosures Regarding Statements of Cash Flows:

Non-Cash Investing and Financing

	<u>2017</u>	<u>2016</u>
Non-cash investing and financing transactions received during the years ended June 30 as follows:		
Developer contributions	\$59,240	\$203,122
Undepreciated costs of assets disposed	\$18,119	-

Note I - Risk Management:

The Agency 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. To handle the risk of loss, the Agency participates in a public entity risk pool offered to the members of the Kentucky Municipal Risk Management Association. Participating members pool their funds in order to provide self-insurance, and, when necessary, third-party insurance, against various public liability exposure.

The Agency is responsible for paying annual and supplementary contributions which are determined by the Board that governs the operation of the pool. The contributions are calculated based on actuarial evaluations, ratings plans, and other analyses of the amounts necessary for the payment of claims and losses.

In exchange, the Agency is provided with payment of all claims and losses incurred, subject to certain terms and conditions such as deductibles and coverage limits. Due to the nature of the public entity risk pool established within this policy, the Agency can receive a distribution of surplus funds in the event of excess pool assets or be assessed in the event of pool shortfalls.

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